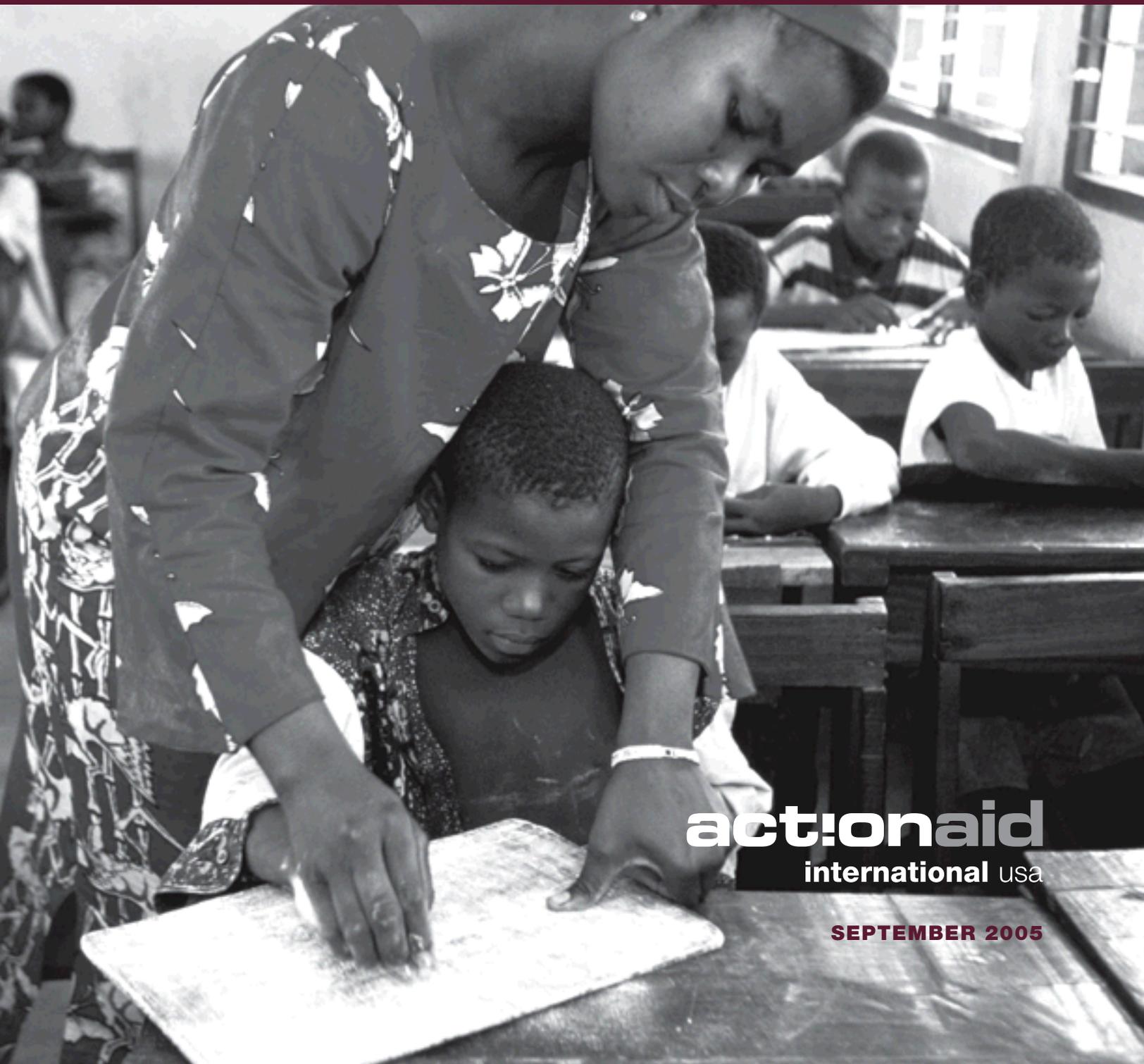


Changing Course

Alternative Approaches to Achieve the
Millenium Development Goals and Fight HIV/AIDS



act:onaid
international usa

SEPTEMBER 2005

Contents

Executive Summary	1
Part 1	
The Status Quo and Its Impacts	3
Part 2	
How and Why IMF-Led Development is Failing the Poor	21
Part 3	
Why Aren't Developing Countries Rebellious? Findings From a 5-Country Study	41
Part 4	
Another Way is Possible: Exploring Alternatives	51
Part 5	
Making Change Happen	57

All photos, except as indicated, are courtesy of ActionAid International

ACKNOWLEDGEMENTS

Author: **Rick Rowden**, Policy Analyst,
ActionAid International USA

Economics Advisor: **Prof. Fernando Cardim de Carvalho**,
Institute of Economics, Federal University of Rio de Janeiro

In Bangladesh: **Mr. Asjadul Kibria**, Economist & Journalist

In Ghana: **Mr. Kwamena Essilfie Adjaye**,
Economist, Advisor to the President

In Malawi: **Mr. Kelvin Kanswala Banda**,
Ministry of Economic Planning & Development

In Uganda: **Ms. Jane Ocaya Irama**, Economist & Consultant

In Zambia: **Mr. Caesar Cheelo**,
Economist & Lecturer at University of Zambia

Thanks also to:

**Nancy Alexander, Polly Ghazi, Romilly Greenhill,
Jeff Powell, Robin Schuldenfrei and Alex Steffler**

Acronyms

ART	Antiretroviral Treatment	LDC	Least-Developed Country
CAL	Capital Account Liberalization	LOI	Letter of Intent
CAS	Country Assistance Strategy	MDGs	Millennium Development Goals
CBI	Central Bank Independence	MTEF	Medium-Term Economic Framework
CPIA	Country Policy and Institutional Assessment	NAMA	Non-Agricultural Market Access
CRC	Convention on the Rights of the Child	NGO	Non-Governmental Organization
CSO	Civil Society Organization	OECD	Organization for Economic Cooperation and Development
DPL	Development Policy Loan	PPP	Public-Private Partnerships
DSA	Debt-Sustainability Analysis	PPI	Public-Private Partnerships in Infrastructure
EPZ	Export Processing Zone	PRGF	Poverty Reduction and Growth Facility
ESAF	Enhanced Structural Adjustment Facility	PRSC	Poverty Reduction Support Credit
GAO	Government Accounting Office	PRSP	Poverty Reduction Strategy Paper
GATS	General Agreement on Trade in Services	PSI	Policy Support Instrument
GDP	Gross Domestic Product	PSIA	Poverty and Social Impact Assessment
GFATM	Global Fund to Fight AIDS, TB & Malaria	SADC	Southern African Development Community
GNI	Gross National Income	TB	Tuberculosis
HPIC	Heavily-Indebted Poor Countries	UN	United Nations
HIV/AIDS	Human Immunodeficiency Virus/ Acquired Immunodeficiency Syndrome	UNAIDS	Joint United Nations Program on HIV/AIDS
ICESCR	International Covenant on Economic, Social and Cultural Rights	UNCTAD	United Nations Conference on Trade and Development
IDA	International Development Association	UNICEF	United Nations Children's Fund
IEO	Independent Evaluation Office (of the IMF)	USAID	United States Agency for International Development
IFIs	International Financial Institutions	VAT	Value-Added Tax
ILO	International Labor Organization	WAEMU	West African Economic Monetary Union
IMF	International Monetary Fund	WTO	World Trade Organization
IT	Inflation Targeting		

EXECUTIVE SUMMARY

In September 2005, more than 170 world leaders will assemble at the United Nations Millennium Declaration Summit in New York to assess global progress towards achieving the Millennium Development Goals (MDGs). With this report, ActionAid International USA is sending a message to the global community that the International Monetary Fund (IMF)-led consensus which has dominated economic development policy in the poor world for 25 years is not sufficient to meet the MDGs. Indeed, in many cases, the IMF-imposed macroeconomic policies used in poor countries are hindering both achievement of the Goals and an effective fight against HIV/AIDS. Based on a comprehensive analysis of existing research on the impacts of IMF-led policies, on the investment required to meet the MDGs and control HIV/AIDS, and on in-depth frontline research in five developing countries, this report argues that alternative paths forward must be urgently explored. The high level summit in New York presents an ideal opportunity to start this process.

ActionAid has criticized the MDGs for not being ambitious enough in seeking only to halve global poverty by 2015. Nevertheless, the fact that the international community has rallied behind them offers a key opportunity to assess the degree to which contemporary macroeconomic policies will enable countries to attain these goals by the target date of 2015—or not. Part 1 of this report lays out the status quo, including the dominant IMF model of economic development and the UN estimates of the costs and spending levels required over the next decade to achieve the MDGs and to fight HIV/AIDS effectively. It then contrasts these projected figures with the amount of spending currently

possible in countries that have agreed to implement IMF loan programs. Our conclusions show a yawning gap between MDG needs and spending realities under business as usual policies, raising disturbing questions for governments and the international anti-poverty movement.

Many civil society advocates working against poverty and HIV/AIDS are already concerned that macroeconomic policies enforced by the IMF block poor countries from being able to spend more on education, health and economic development. Yet there is a widespread lack of understanding as to exactly how or why this occurs. Part 2 of the report addresses this knowledge gap by exploring in depth the logic of the macroeconomic policies which drive IMF loan programs and explaining why these policies are so problematic.

Part 3 draws on in-depth interviews conducted by AAI USA during 2005 with officials from the central banks, finance, health and education ministries and HIV/AIDS agencies in Bangladesh, Ghana, Malawi, Uganda and Zambia. In these we explored why government officials willingly adopt the IMF programs and examined the extent to which there was any “policy space” within the countries for debate about, or consideration of, alternative macroeconomic policies. We found that among most officials interviewed, there was no perception of available policy space to discuss alternatives; some were not even aware that viable alternatives for macroeconomic policy existed.

AAI USA believes that understanding and advocating such alternative approaches will become essential tasks for civil society if the international community is to get



serious about tackling the spread of HIV/AIDS and lifting developing countries out of crippling poverty and disease. In Part 4 of this report we therefore contrast the limitations of the IMF's narrowly-defined "logic of available resources" with alternative economic policies that allow for much higher long-term public investments in health, education and development. It concludes by offering a brief exposition of alternative ideas, practices and policy approaches for use by civil society advocates.

We want to see discussion of such alternatives urgently pursued at local, national and international levels and offer this report as part of the process. The target for achieving the seven remaining Millennium Development Goals is only ten years away. If we are to have any hope of making the deadline, the world must start to change course now.

The Status Quo and Its Impact

“There is a desperate need for greater policy coherence in a period when many national governments, including Washington, are sensibly exhorting African governments to spend more on primary health care and education while international financial institutions largely controlled by those same Western governments have been pressing African countries to shrink their government payrolls, including teachers and health care workers.”

New York Times editorial, “Africa at the Summit,” July 3, 2005

“The macroeconomic side of scaling up [foreign aid] is often overlooked, with potential conflict between strategies to achieve the MDGs and fiscal constraints imposed by the International Monetary Fund”

Overseas Development Institute (UK)

New Aid, New Opportunities...

Lingering global poverty and a worsening HIV/AIDS crisis has led to a welcome sea change in rich countries’ willingness to increase levels of foreign aid since the turn of the new millennium. High-level attention has been given to new commitments by rich nations to help developing countries achieve the United Nations Millennium Development Goals (MDGs) by 2015.

Through the MDGs, adopted in September 2000 by 189 heads of state and government, the world’s rich and poor countries alike assumed a commitment to eradicate extreme poverty and hunger, achieve universal primary education, promote gender equality and empower women, reduce child mortality, improve maternal health, combat HIV/AIDS, malaria and other diseases, ensure environmental sustainability, and develop a global partnership for development. While the targets set by the eight MDGs apply primarily to the developing world, they also emphasize the contributions that can and should be made by wealthy developed countries through trade, assistance, debt relief, and access to essential medicines and technology transfer. Bilateral and multilateral efforts to increase funding specifically for the fight against HIV/AIDS have also added significantly to recent increases in foreign aid levels.

The US has pledged substantial increases in foreign aid and in May 2005 the European Union announced that its 25 members would give a minimum of 0.51% of their gross national incomes (GNI) in foreign aid by 2010, rising to 0.7% by 2015. A month later Japan announced aid increases of \$10bn over the next five years.

This flurry of activity was capped by the G8 Summit of June 2005, in Gleneagles, Scotland, which put aid for Africa at the heart of its agenda. The leaders of the world’s wealthiest nations confirmed a combined increase in foreign aid of \$48bn by 2010, raising their spending to an average of 0.36% of GNI within five years.

The highlight of the summit was a commitment to achieve near-universal HIV/AIDS treatment by 2010. If realized, this increase will prove vital in combating both the human suffering caused by HIV/AIDS and the further spread of the disease. The G8 also agreed to replenish the Global Fund to Fight AIDS, Tuberculosis and Malaria (GFATM), and to contribute to other initiatives combating malaria, TB, and polio although no specific financial commitments were made.

As aid levels have increased, concerns have been raised about “bottlenecks” in the disbursement of aid and the “absorptive capacity” constraints within recipient governments. The question of how much foreign aid low-income countries can accept at one time, and how quickly it can be spent effectively is now being thoroughly explored and debated.

This study, however, examines a different and less-publicized issue: the degree to which the overarching set of IMF-led macroeconomic policies used in many low-income countries fails to provide the necessary scaling-up of public expenditure projected to achieve the MDGs and fight HIV/AIDS effectively.

The Mountain to Climb: Costs of MDGs and Controlling HIV/AIDS

As far as goals for development are concerned, the MDGs are inadequate.¹ ActionAid International has been critical of the fact that, even if achieved successfully by 2015, the MDGs will only halve poverty. Likewise, rich country pledges of increased foreign aid to enable poor countries to achieve the MDGs, still fall far short of the long-term aid level of 0.7% of GNI. If they were to reach this goal in 2010, the G8 countries would need to increase their aid not by \$48 billion but by \$170 billion.

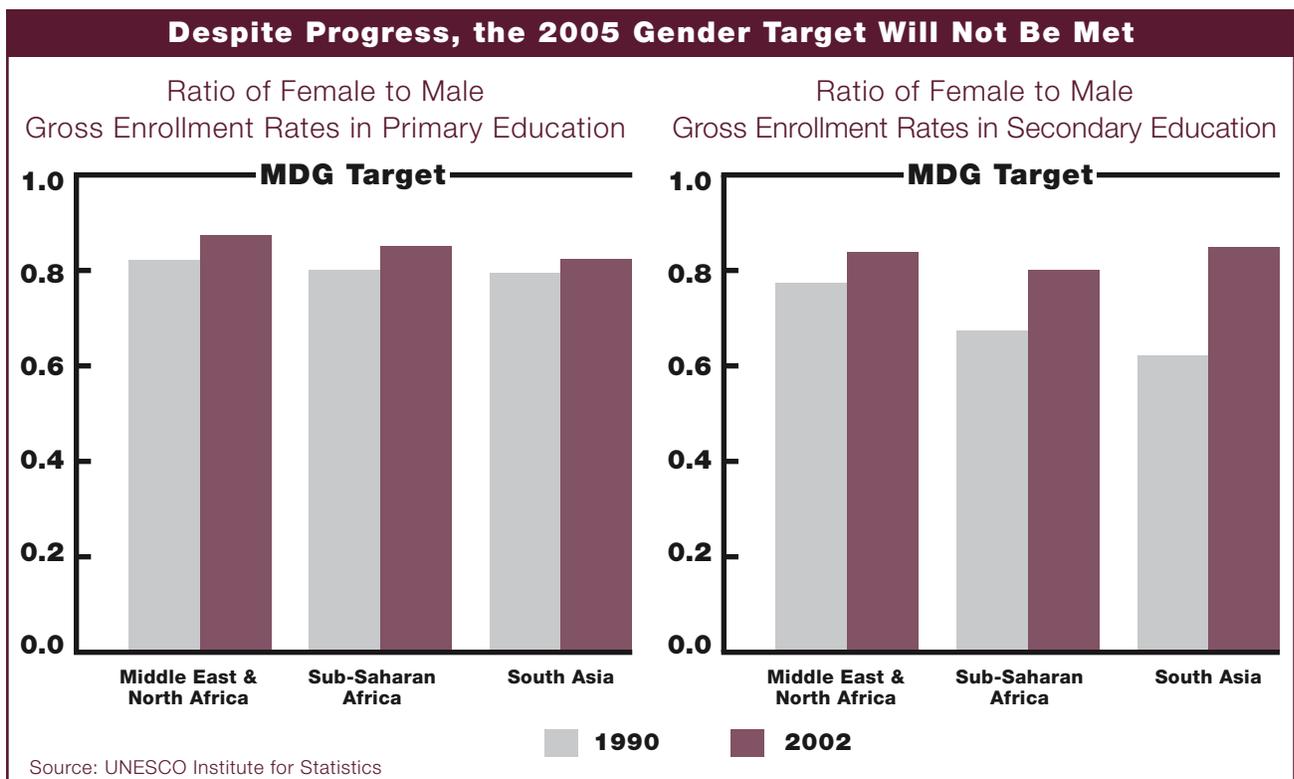
There were worrisome signals from Gleneagles that, despite all the rhetoric, the world's richest countries lack the political will to give enough to enable poor countries to achieve the MDGs. For example, the summit's official communiqué contained the strongest words yet heard from world leaders on universal education,

health and HIV/AIDS, but was weak on specific financial commitments. The G8 leaders also neglected to mention the failure of the first MDG target—to get as many girls as boys into school by 2005. Achieving gender parity in primary school today is essential for meeting other related MDGs by 2015, yet this target has been missed in over 70 countries.

MDG Funding Needs

Several authoritative estimates have been published of the funds required from rich nations to meet the world's commitments to meet the MDGs and lift billions of people out of poverty.

In spring 2002, the Monterrey Conference on Financing for Development detailed the dramatic shortfalls between what has been pledged and what is required. In the



¹ One of the most comprehensive critiques of the inadequacy of the MDGs for actual economic development is by Nancy Alexander, "The Value of Aid: A Critical Analysis of the UN Millennium Project's Approach to the MDGs." Citizens' Network on Essential Services. August 2005. available at ncalexander@igc.org



Report of the High Panel on Financing for Development (also known as the “Zedillo Report”) it set the price tag for meeting the 2015 goals at an extra \$50 billion a year over current levels of foreign aid.² The World Bank, using two different approaches, came up with estimates for implementing the Goals ranging from \$54-\$62 billion a year, and from \$35-\$76 billion a year. The UNDP Human Development Report 2003 published an estimate of about \$76 billion. Most recently, in January 2005, the UN Millennium Project report estimated the additional foreign aid flows needed to meet the MDGs at between \$48 and \$76 billion every year from 2006-2015.

HIV/AIDS Funding Needs

Despite the G8 commitments on HIV/AIDS at the Gleneagles summit, other recent events signal that financial support for controlling the epidemic may face an uncertain future. In June 2005, a UNAIDS report

projected a looming funding gap of \$18 billion for HIV/AIDS in developing nations between 2005 and 2007. The Global Fund to Fight AIDS, TB and Malaria, meanwhile, has identified funding gaps of \$700 million for 2005, \$2.9 billion for 2006 and \$3.3 billion for 2007. Unless donors come up with this money, it will be unable to continue replenishing successful country-based programs and supporting new grantees.

Also worrying is the likely failure of the World Health Organization and its collaborating partners in reaching their goal of providing three million people dying of AIDS in poor countries with antiretroviral treatment by 2005 (“3 by 5”). As of June, the WHO estimates that about one million individuals are now on ART as a result of the program. Even if completed, the “3 by 5” program by itself would reach less than half those who desperately need treatment. The WHO estimates that 6.5 million individuals worldwide need urgent anti-retroviral therapy;

² United Nations “Report of the High Level Panel on Financing for Development” (Zedillo Report) (2001). Technical Report, p.16.
<http://www.un.org/reports/financing/>

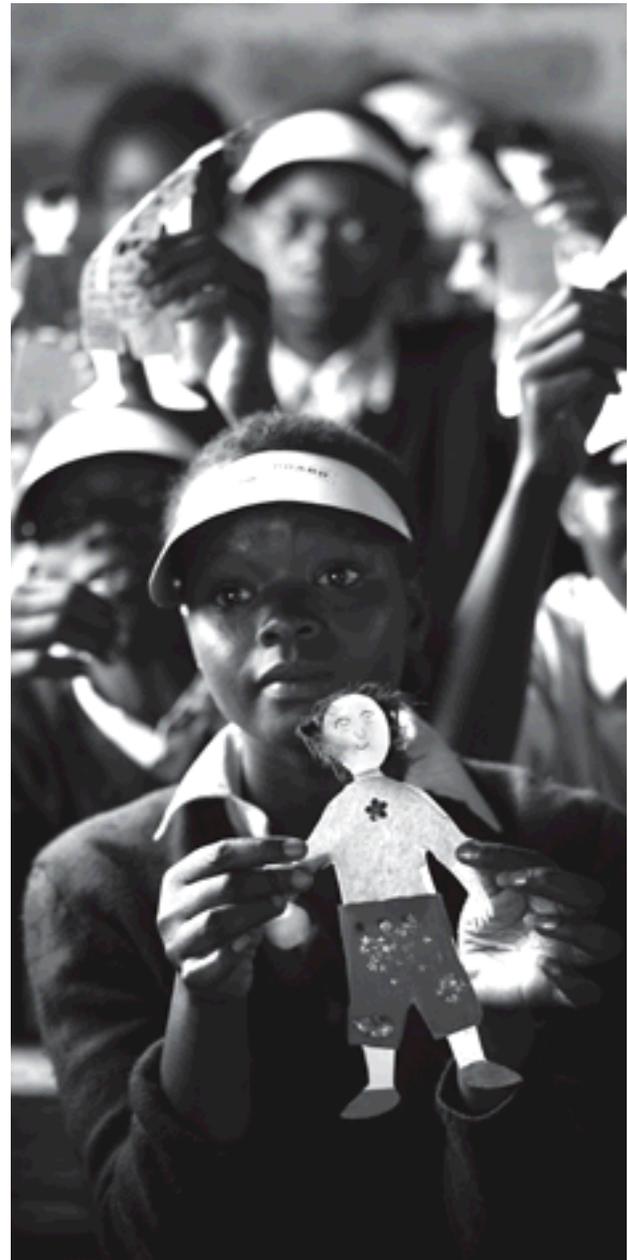
in Africa, despite the tripling of individuals on antiretroviral therapy in the past 18 months, nearly 90 percent of those who need it do not have access to ART.

In June 2005, UNAIDS released new, upwardly revised estimates that projected \$22 billion will be needed in 2008 to reverse the devastating spread of HIV/AIDS in the developing world.

These figures were painstakingly calculated using the latest available information and with input from a newly established Resource Needs Steering Committee and Technical Working Group, made up of international economists and AIDS experts from donor and developing countries, civil society, United Nations agencies and other international organizations. The revised estimates indicate funding needs of approximately \$15 billion in 2006, \$18 billion in 2007 and \$22 billion in 2008 for prevention, treatment and care, support for orphans and vulnerable children, as well as program costs (such as management of AIDS programs and building of new hospitals and clinics) and human resource costs (includes training and recruitment of new doctors and nurses).

For the first time, these estimates address the long term resources needed to improve health and social sectors in affected developing countries, through training of existing staff, recruiting and paying new staff, and provision of necessary infrastructure.

In 2004, over 100 top world health experts collaborated on an international study of the current state of the global health workforce. Called the Joint Learning Initiative on Human Resources for Health and Development, the study determined that Africa has approximately 1.0 health workers/1,000 population, whereas a minimum health worker density of 2.5/1,000 population is required to make significant progress on global health-related MDGs. Doubling the continent's health workforce by 2010 is therefore necessary to make significant progress. To recruit a health service workforce on this scale will require raising \$2 billion in 2006, rising to \$7.7 billion annually by 2010 from both African governments and the donor community. In this report we address the urgent need to create the "fiscal space" for these new



investments, which will require both reforms of existing macroeconomic policies and longer-term donor funding.

Scaling up HIV treatment presents an opportunity for countries to make lasting improvements in training health workers and establishing effective systems for providing a broad spectrum of health care. It is also critical to meeting a number of broader health and development goals. The rapid spread of HIV/AIDS and related illness and deaths are directly impeding progress in six of eight key areas addressed by the Millennium Development Goals.

Contradictory Policies Impede Progress

“The availability of additional, earmarked grant funds for health—from mechanisms such as the Global Fund—can and has led to tensions between financial ceilings set by ministries of finance aiming to maintain macroeconomic stability on one hand, and the need to expand the resource envelope in the health sector, on the other.”

“High-Level Forum on the Health Millennium Development Goals: Resources, Aid Effectiveness and Harmonization: Issues for Discussion” December 2003 World Health Organization and World Bank

As rich countries stand ready to significantly increase levels of foreign aid, there is a growing contradiction between the higher levels of public spending required to meet the MDGs or to fight HIV/AIDS effectively and the amount of spending possible under the dominant macroeconomic framework model favored by the International Monetary Fund (IMF).

ActionAid International has been critical of the donor community’s present approach to the MDGs, which presumes they can be achieved under the current IMF-led development model and without resolving the debt crisis in many low and middle-income countries. We simply do not believe this is possible, for reasons explained in Part 2 of this report. However, contrasting the MDGs’ projected costs with the spending actually possible in poor countries, provides a key opportunity for civil society advocates to question the entire basis of and rationale for the IMF-led economic development model imposed in developing countries.

How Donors Have Surrendered Power to the IMF

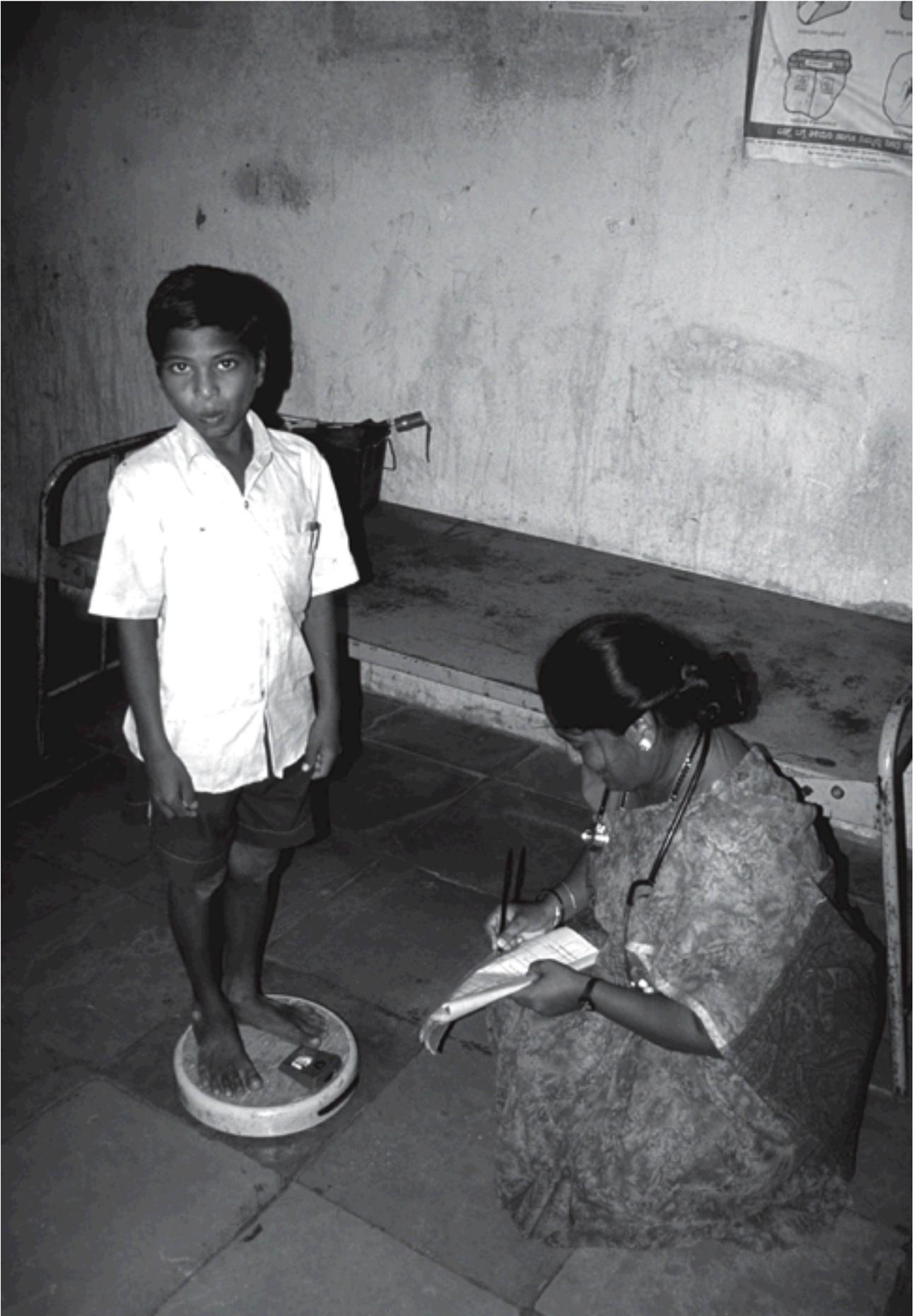
The World Bank and most other official multilateral and bilateral donors and creditors among the rich countries will not give a developing country foreign aid, loans or debt relief unless the country’s economic policies have been approved by the IMF. Known as the “signaling effect,” the IMF’s role is based on three basic functions: first, like any other creditor, the IMF has an incentive to lend its limited resources only to countries which will have the capacity to repay once the reforms upon which its lending is conditional have been implemented;

secondly, the IMF is also assumed to be in a better position than other donors and creditors to judge the economic situation of its members; third, the preeminent role played by IMF programs has also been based on the assumption that the IMF’s brand of macroeconomic stabilization policies was a priority for most low-income countries. From this perspective, it was reasonable for donors to let the IMF take the lead in designing and implementing corrective policies, and to base their lending on its assessment of the country’s compliance with program targets.

As a result of this evolution, the majority of donors now rely on the “seal of approval” signified by an IMF-supported loan program such as the Poverty Reduction and Growth Facility (PRGF) to grant financial support to low income countries. Tightening the screw even further, having a PRGF program in place is also a precondition for debt relief arrangements for highly indebted poor countries.

By deferring to the IMF, bilateral creditors have to a large extent surrendered their power to judge whether a country should benefit from debt relief. Given such a system, it is clear to poor country borrowers that failing to secure IMF agreement for a new program, or to renew a current program, would soon result in a financial catastrophe for their citizens. Not only would the country lose financial support from the IMF, it would become ineligible to virtually all other sources of assistance from multilateral and bilateral donors in the form of loans, grants, or debt relief. The IMF therefore exerts a tremendous amount of power and leverage over extremely aid dependent low-income countries. Such power imbalances can be lost when depoliticized by terms such as “development partners” and “stakeholders,” but they are very real. The implications are profound, not just for the provision of aid and debt relief but for the degree of sovereign autonomy in poor borrowing countries and the extent to which they are able to pursue alternative economic policies.

For this reason, it is critically important that advocates for HIV/AIDS, health and education spending in developing countries must be fully aware both of the contents of IMF loan agreements and of the intense pressure under which recipient governments must operate.



IMF Constraints v. MDG Needs

In recent years, most of the world's low-income countries who wish to get foreign aid, credit or debt relief have been required by the IMF and World Bank executive boards to first draft national Poverty Reduction Strategy Papers (PRSPs) to show donors how they intend to use increased support to reduce poverty. The PRSPs are submitted for endorsement by the executive boards of the IMF and World Bank.

The PRSPs identify priority areas for poverty-reduction emphasis in future health and education budgets and other pro-poor budgetary allocations within existing and available expenditures. However, they do not address the size of the national budget or consider alternative fiscal and monetary policies. Rather, the PRSPs are guided by three-year medium-term expenditure frameworks (MTEFs) whose numbers are programmed by the finance ministry and IMF. Further, the size of budget expenditures and other fiscal and monetary policies are agreed between the IMF and each country's central bank and finance ministry. The agreed macroeconomic framework is then detailed in the official Letter of Intent and Memorandum of Economic and Financial Policies posted on the IMF website. The conditions agreed are usually part of a new IMF loan or a review of an IMF loan under the Poverty Reduction and Growth Facility (PRGF).

However, overall public spending levels are not addressed in the PRSPs at all, but decided in other

agreements in the lead up to the award of a PRGF loan. Given that such loans from the IMF require borrowers to adhere to strict budget constraints the result, in country after country, is national spending well below that required to achieve the MDGs.

Squeezing Public Spending Till the Pips Squeak

Most developing country PRSPs feature a prudent fiscal policy, including a balanced budget, coupled with a commitment to generate higher public revenues through tax reform and to reallocate spending to poverty reduction programs. At the budgetary level, therefore, developing countries' proposed spending plans have a clear pro-poor bias. Many PRSPs have also been formulated with increasing participation from civil society, improving both the transparency and the effectiveness of social programs implemented as a result. The Catch 22 is that overall levels of national spending remain predetermined by IMF-imposed macroeconomic policies, about which NGOs have little say. As the IMF's Independent Evaluation Office conceded, NGOs participating in the official consultations for PRSPs have not be allowed to discuss alternative macroeconomic policies. ♦

A recent 2005 study of the economic growth policies laid out in PRSPs for 15 countries highlights the scale of this problem.⁴ While budget priorities vary, most PRSPs

Case Study: Bangladesh

Bangladesh has been suffering from a shortage of health sector funding for decades. The World Health Organization (WHO) sets optimum expenditure for the Least Developed Countries (LDCs) at US\$24 per capita per year—US\$13 per capita from government spending, the rest from foreign aid. But in Bangladesh, per capita spending on health and nutrition remains \$13-14, of which the Government's contribution is only \$6-7. In 2004, health spending as a percentage of total public expenditure dropped to 5.6% from 7.1% percent in 2002. As a result, the Government is spending little more than 1% of the GDP—a fifth of the WHO target of 5% of GDP—a sum that is pitifully inadequate to meet the most basic health needs of a growing population, let alone achieve the MDGs.³

³ Bangladesh Country Survey Findings report.

⁴ "The Macro Content of PRSPs: Assessing the Need for a More Flexible Macroeconomic Policy Framework," by Ricardo Gottschalk. Development Policy Review, 2005, 23 (4): pp. 419-442.

♦ "Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility," by Independent Evaluation Office of the International Monetary Fund. The report found: "The PRS process has

had limited impact in generating meaningful discussions, outside the narrow official circle, of alternative policy options with respect to the macroeconomic framework and macro-relevant structural reforms." For a review of civil society experiences of trying and failing to address macroeconomic policies within PRSP consultations, see: "Rethinking Participation: Lessons for Civil Society About the Limits of Participation in PRSPs" by ActionAid USA and ActionAid Uganda. April 2004.
http://www.actionaidusa.org/pdf/rethinking_participation_april04.pdf

are stuck within a low-spending/low-growth mode. The plans studied ranged from strict adherence to IMF orthodoxy at one end of the scale to the embrace of slight policy alternatives at the other. Among the former were Burkina Faso, Niger and Senegal, all of which now belong to the West African Economic Monetary Union (WAEMU), whose members have agreed to the WAEMU Convergence, Stability, Growth and Solidarity Pact. Like the Maastricht Treaty agreed by Eurozone countries, the WAEMU agreement calls for tight constraints on public expenditures. Indeed, WAEMU's constraints are even tougher than the European treaty's (a nominal fiscal balance, a ceiling of 35% for the ratio of the wage bill to total tax revenue, a debt to GDP ratio no higher than 70%, and annual inflation no higher than 3%), even though wealthy nations including Germany, France and Italy have not been able to fulfill the Maastricht criteria.

As a result, domestic flexibility to adapt fiscal policy to national circumstances and needs in poor WAEMU countries such as Niger⁵ is extremely limited. Needless to say, the scale of spending needed to achieve the MDGs simply cannot happen while complying with such criteria—yet member governments have failed to address this dilemma.

Vietnam sits at the other end of the spectrum of the 15 PRSPs studied, focusing on increased revenue rather than spending cuts to achieve fiscal balance.

It also stands apart from the other 14 countries by introducing more progressive elements in its proposed fiscal framework. These include: the adoption of instruments for mobilizing capital, including the use of preferential taxes targeted at new investment and production expansion; acknowledgment of the need to ensure a balance between capital and recurrent expenditure, and favoring tax reform that results in increased revenues from direct taxes. The latter point is

particularly important, since almost all other countries intending to undertake tax reforms emphasize the need to widen the tax base, mainly through strengthening value-added tax (VAT), while promising to alleviate the corporate sector's heavy tax burden. Clearly the objective of widening the tax base is an important one for countries where the collection system is weak and the level of tax revenues low. But some of the proposed mechanisms are clearly regressive, especially in countries where poverty is deep and widespread – a downside which few of the 15 PRSPs studied acknowledged.⁶

PRSPs and Public Health

“It is not easy within present budgetary constraints to invest more in health, especially if you have a large proportion of the budget invested in debt repayments and a macroeconomic policy focused on containing even minor inflation and setting rigid spending ceilings for the social sectors.”

Dr. Sergio Spinaci, Executive Secretary of the Coordination of Macroeconomics and Health Support Unit, World Health Organization

A key question for developing country citizens, civil society and the anti-poverty movement is this: will PRSPs mean more money for health?

A 2004 study of 21 PRSPs by the World Health Organization, “PRSPs: Their Significance for Health,” found that, despite their supposed emphasis on combating poverty, PRSP health strategies are becoming neither more nor less “pro-poor” over time.⁷ While 11 country plans examined showed health as a spending priority, five of these indicated that the slice of the spending pie available to health care will either fall over the PRSP's life or remain the same. In four of the six cases where the percentage increases, the projected rise is less than 3%.⁸

Further, the IMF's own figures suggest that PRSPs will not deliver the steep increases in health spending of the kind advocated by the WHO Commission on

⁵ Ibid.

⁶ Ibid.

⁷ “PRSPs: Their Significance for Health: second synthesis report,” World Health Organization, 2004.

⁸ Ibid.

Macroeconomics and Health or the UN Millennium Project. And while PRSPs usually reflect the goals of MDGs in their language, they tend not to include the quantifiable targets. For example, MDG 4, to “reduce child mortality” was set to be monitored in all 21 PRSPs examined in the WHO study. Yet none of the PRSPs referred to meeting the quantifiable target – a three-quarters reduction in maternal death by 2015.

The analysis of the December 2004 High-Level Forum on the Health MDGs in Abuja, Nigeria, suggested that part of the reason for not developing more robust macroeconomic frameworks within the PRSPs may be the recognition that “in practice, the macroeconomic framework that is actually implemented has to be negotiated with the IMF, since the existence of an on-track IMF program remains a prerequisite for accessing significant external aid or HIPC debt relief.”

A key criticism frequently leveled against the IMF is that fiscal and macroeconomic frameworks have been too pessimistic regarding the resources potentially available, resulting in countries implementing unnecessarily modest public expenditure plans that do not permit rapid enough progress towards the MDGs. However, the empirical evidence appears to suggest that the bias is in the other direction, with IMF programs over-estimating foreign aid and GDP growth, and consequently over-estimating both domestic and foreign resources available to finance public expenditure.

Participants of the High-Level Forum in Abuja questioned the striking uniformity of public expenditure which plateaus at roughly 25% of GDP in most countries implementing IMF-led policies. Given that countries differ in their economic growth rates, public expenditure levels and needs and ability to attract foreign aid, the Abuja meeting concluded that there was “a strong case for a

more open debate on the macroeconomic framework”⁹ imposed in these countries.

There is no question that the high degree of budget austerity in many PRGFs is directly at odds with the spending increases needed to achieve the MDGs and fight HIV/AIDS. Not a single country in the industrialized world spends less than 5% of GDP on government-financed health services. Yet rarely does developing countries’ spending on health reach that level, despite the much greater need; indeed, in most cases, it is less than half that proportion, only 0.9% in India, for example and 2% in China 2%. Similarly, rarely do industrialized countries spend less than 4.5% of GDP on publicly financed education. Only a small proportion of developing countries allocate as much.¹⁰

The conclusion is simple. Significant increases in health and education spending are not possible under the current macroeconomic framework as designed by the IMF. To achieve the MDGs and bring the benefits to hundreds of millions of people will take more expansionary fiscal and monetary policies than are currently permitted.

The IMF Line on Aid and Social Spending

Advocates of significant increases in public expenditures for HIV/AIDS, health and education must understand the IMF’s position on increasing foreign aid and social spending in order to argue for change.

The IMF’s rhetoric on this point can be tricky. When the IMF says it is in favor of increased social spending, this is technically true. But the “increases” they allow for are nowhere near the levels projected to fight HIV/AIDS effectively or achieve the other MDGs. Permitted “increases” in public expenditures are gauged carefully

⁹ “MDG-Oriented Sector and Poverty Reduction Strategies: Lessons from Experience in Health” December 2004 High-Level Forum on the Health MDGs in Abuja, Nigeria. World Bank and World Health Organization.

¹⁰ “The Millennium Development Goals: Targeting Basic Services for the Poor or Ensuring Universal Access?” by Santosh Mehrotra, Human Development Report Office, United Nations Development Program. Presentation at the Meeting of Experts on International Social Policy on the UNDP Human Development Report 2003: Millennium Development Goals: A compact Among Nations to End Human Poverty.

to stay within the confines of the IMF's own disputed definition of "macroeconomic stability"—i.e. inflation in the low single digits. (See box below).

IMF policy statements are also generally supportive of increased aid, stating that additional inflows should be accommodated by adjusting a loan program's fiscal and financing targets: "if they can be effectively absorbed and utilized without endangering macroeconomic stability." However, the Abuja High-Level Forum warned that "the IMF may unintentionally restrain future aid commitments by producing fiscal frameworks that assume only modest growth in aid levels. Countries may not push for additional aid flows, nor will donors offer such aid, if the macro-economic projections on which the expenditure program is based do not show a clear need for additional aid."¹¹

The IMF Line on HIV/AIDS

The IMF has made recent attempts to engage the HIV/AIDS advocacy community, including the international health agencies, academia and civil society. These attempts have included participation in international meetings, hosting open dialogues with civil society and the health community and a 2005 policy discussion paper directed at civil society titled, "Understanding Fiscal Space." The discussion paper assured readers that the IMF would support increased spending on HIV/AIDS, as long as it occurred within the boundaries of what the

IMF believes to be "macroeconomic stability". However the paper neglects to describe exactly how much more spending the IMF is willing to tolerate. Likewise, the paper fails to address the crucial contradiction between the much higher levels of spending projected to be needed to meet the MDGs and the spending levels currently possible under PRGFs.

In not even mentioning the existence of alternative macroeconomic possibilities, "Understanding Fiscal Space" offers civil society advocates a less than a comprehensive analysis for HIV/AIDS, health and education spending.

Instead of informing borrowing governments that a range of more expansionary fiscal and monetary policies exist, and doing everything in their power to help poor countries utilize such policies to maximize public spending on HIV/AIDS and other people-centered programs, the IMF remains silent. What it says to the governments is, "So sorry, you have what you have; now live and die within your meager means."

This twisted logic translates into IMF programs where health budgets in impoverished countries are allocated four or five dollars per person per year, compared with US spending of more than \$5,000 a year per citizen.

The IMF and World Bank definition of "Macroeconomic Stability"

There is no unique threshold between stability and instability for each macroeconomic variable. Rather, there is a continuum of combinations of levels of key macroeconomic variables, including growth, inflation, fiscal deficit, current account deficit, and international reserves, that together can indicate macroeconomic instability or stability. However, the IMF and World Bank have their own criteria among these variables as to what constitutes "stability" and "instability". According to the IMF and World Bank, "macroeconomic stability" includes: "current account and fiscal balances consistent with low and declining debt levels, inflation in the low single digits, and rising per capita GDP".¹² Conversely, their definition of a country in a state of macroeconomic instability includes: "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".¹³

¹¹ "MDG-Oriented Sector and Poverty Reduction Strategies: Lessons from Experience in Health" December 2004. High-Level Forum on the Health MDGs in Abuja, Nigeria. World Bank and World Health Organization.

¹² "PRSP Source Book" Chapter 12 "Macroeconomic Issues" by Brian Ames, Ward Brown, Shanta Devarajan, and Alejandro Izquierdo. The World Bank and IMF. December 2004.

¹³ Ibid.

Case Study: How IMF policies create the conditions for exposing women and children to HIV/AIDS

A study was recently published in the Journal of Health, Population and Nutrition on the potential impact of IMF and World Bank adjustment policies on the vulnerability of women and children to HIV/AIDS in sub-Saharan Africa. Using five different pathways of causation, the authors connected changes at the macro level (e.g. removal of food subsidies) with effects at the meso (e.g. higher food prices) and micro levels (e.g. exposure of women and children to commercial sex). They found evidence to suggest that adjustment policies may inadvertently produce conditions facilitating the exposure of women and children to HIV/AIDS.¹⁴

A Flawed World View

The over-riding reason the IMF is such a barrier to implementing the Millennium Development Goals embraced by the international community is that it sticks rigidly to its world view of economic policy making and public spending constraints, and refuses even to consider alternatives.

As the Box, “Crowding Out or Crowding In?” explains below, most development policy of the last 25 years has been confined to the IMF’s narrow “logic of availability of resources”, in which a country only has to spend whatever it can raise in tax revenues and from foreign aid. This perspective, however, is not shared by industrialized countries, who regularly engage in strategic deficit spending during economic slow-downs and recessions.

The IMF insists that all forms of deficit spending are always harmful and wrong, and is particularly concerned with the interest poor countries must pay on servicing their deficits. By taking this stand, the Fund neglects any distinction between wasteful or productive spending and their consequences. For example, charging up one’s credit card on lavish parties and expensive vacations is one kind of debt, but taking out student loans for a university education or buying a home with a 30-year mortgage is quite a different kind because of the consequences: the former is debt for short-term consumption and will indeed be a burden to pay over time with no benefits, while the latter is a long-term productive investment that will not only pay for itself but provide exponential economic benefits over the long run. This is just one example of how the IMF’s logic has trapped poor countries into a destructive cycle of low spending over the last 25 years.

¹⁴ “Structural Adjustment and HIV/AIDS: Potential Impact of Adjustment Policies on Vulnerability of Women and Children to HIV/AIDS in Sub-Saharan Africa,” by Roberto De Vogli and Gretchen L., Journal of Health, Population and Nutrition. June 2005;23(2):105-120. Centre for Health and Population Research ISSN 1606-0997. http://www.icddrb.org/images/jhpn2302_potential-impact.pdf. Complex research designs are needed to further

investigate this relationship. A shift in emphasis from an individual approach to a socioeconomic approach in the study of HIV infection among women and children in the developing world is suggested. Given the potential for IMF structural adjustment policies to exacerbate the AIDS pandemic among women and children, a careful examination of the effects of these policies on maternal and child welfare is urgently needed.

“Crowding Out” or “Crowding In”? 2 Ways of Looking at the World; 2 Ways to Achieve the MDGs

by Fernando Cardim de Carvalho, Institute of Economics, Federal University of Rio de Janeiro

Put very simply, there are two fundamentally different ways of looking at the world of economic policy making and increasing government spending—the IMF’s view, as articulated in its policy paper directed at civil society titled, “Understanding Fiscal Space,” and the traditional Keynesian view used in the successfully-industrialized countries.

The IMF note is coming from an accountant point of view and offers some common sense observations, such as reminders about how recurring expenditures will have to be financed every time the expenditure is made, or about how expenditures financed by foreign aid may demand some corresponding internal expenditure so you have to worry how this domestic part will be financed, and so on. However, these points are just the obvious, and not very enlightening about how to get public expenditure levels from where we are today to the much higher levels on HIV/AIDS, health and education needed to achieve the MDGs.

The important questions about “fiscal space” are, of course, what is it and how large it is? There are two ways to understand the expression. The first is the public accountant perspective, which asks whether the expenditure generates future revenues or, if this is not case, if it will be possible to find other sources of finance, such as raising taxes or cutting other expenditures or finding other sources of revenue (like charging fees for the use of public goods), etc. This is a microeconomic view. It takes the government as an entity whose expenditures are constrained by its current sources of revenue so that to spend more money on something (building schools, for instance) requires either cutting a corresponding amount of spending on something else or to raise the additional revenue by raising taxes. Of course, if other revenues have to be found, and everything else remaining the same, others elsewhere in the economy will have to cut their own expenditures to accommodate any increase in government spending. This is called the “crowding out” effect in economics.

In contrast to this view there is the Keynesian view, that relies on the existence of an “income multiplier” that changes the adjustment process profoundly, as all of the rich countries have long understood. Instead of seeing government expenditure as crowding out private spending, it suggests the opposite: government spending

creates new income, by inducing increased production so that in fact it does not cause private spending to fall but actually to rise. The people who sell goods to the government spend their income on other goods, in a second round of spending, creating income for other sectors of the economy, and so on. This is the “crowding in” effect, suggested by Nicholas Kaldor, a British Keynesian economist that was an advisor to Labor governments.

Thus, a true measure of “fiscal space” is not merely a budgetary question, but a macroeconomic question: can the increase in government demand lead to an increase in output and thus in real incomes? The answer to this question may be different for industrialized and developing countries. It is the economic “output gap” that matters (the difference between current and potential level of economic output). If there is idle capacity and unemployment in the economy, government spending can stimulate an increase in economic output. Out of these newly created incomes, new taxes will be collected without need to raise tax rates, so that fiscal deficits may be avoided. Industrial economies and even middle income economies usually have a potential output that is routinely greater than actual output, so that fiscal spending may increase without creating macroeconomic problems (see the US experience since the 90s). The macroeconomic fiscal space in the US is obvious. If there will be a budget deficit or not depends, in the case a sophisticated economy such as the US, of many factors, but the “real” impact on the economy is positive without a doubt.

In very poor economies, the degree of the output gap will vary, but if output could be raised significantly, fiscal space would actually be endogenous. If potential output is too low, domestic policies may not do much in the short term, although if governments spends on the creation of human and physical capital (will increase future productive capacity) they may help to increase potential economic output in the future. But this is a very different world view than the IMF’s zero-sum notion of government spending “crowding out”—with any increase in spending in one area causing budget cuts elsewhere in order to keep a limited budget balanced. The IMF’s paper directed at HIV/AIDS, health and education advocates, “Understanding Fiscal Space”, does not even begin to address the important questions about such major alternatives.

Business as Usual Economics

The spending constraints in today's IMF-imposed plans and policies are the result of tight fiscal and monetary policies that have characterized the last 25 years of neoliberal free market and free trade reforms, known collectively as "The Washington Consensus" (see box below). Many of the original IMF stabilization loans and debt rescheduling programs of the 1980s included Washington Consensus-type policy reforms as loan conditions attached to Structural Adjustment Programs. These continue today as Poverty Reduction and Growth Facilities (PRGFs) and Policy Support Instruments (PSIs) from the IMF and as Poverty Reduction Support Credits (PRSCs) and Development Policy Loans (DPLs) from the World Bank.

Since the 1970's, the IMF's approach to designing its lending programs and policy advice has been based on the "financial programming" model. This model has been adapted from earlier IMF loan programs (ESAFs) into PRSPs, PRGFs and the HIPC debt relief processes without much alteration.¹⁵ It is used by the IMF to

derive monetary and fiscal programs to achieve desired macroeconomic targets in borrowing poor countries.

The typical IMF program connects balance of payments constraints, the government fiscal deficit, and central bank policy in order to attempt to reduce indebtedness to a sustainable level, primarily by keeping economic growth in line with likely available foreign resources from export taxes, donor aid and foreign investment inflows. Increasingly, reducing inflation into "the low single-digits" has become a central focus. Therefore, two key central assumptions of these programs are that: a) inflation rates above 10 percent per year are bad for economic growth and reducing inflation below that level will not reduce economic growth; and b) reducing government spending is good for the economy, because higher government spending crowds out private investment.

Under the standard financial programming methods implemented by the IMF, target ceilings are set for the central bank to limit monetary and credit expansion and floors are established to maintain a certain level of net international currency reserves. The main targets

The 10 Steps of "The Washington Consensus"

- 1 **Fiscal Discipline:** budget deficits of no more than 2 percent of GDP
- 2 **Public Expenditure Priorities:** redirecting public expenditures towards poverty-reduction priority areas of the budget, especially towards primary health and education, and infrastructure
- 3 **Tax Reform:** broadening the tax base, cut marginal tax rates, improve tax administration
- 4 **Financial Liberalization:** reforms towards market-determined interest rates, abolition of preferential interest rates for privileged borrowers and achievement of a moderately positive real interest rate
- 5 **Exchange Rates:** a unified exchange rate (for trading) set at a level sufficiently competitive to induce a rapid growth in non-traditional exports, and managed so as to assure exporters that competitiveness will be maintained in the future
- 6 **Trade Liberalization:** Changing quantitative trade restrictions with tariffs, and then progressively lowering these tariffs until a uniform low tariff in the range of 10 percent (or at most around 20 percent) is achieved
- 7 **Foreign Direct Investment:** abolish restrictions on entry of foreign firms; establishing "national treatment" for foreign investors, i.e. no beneficial subsidies or taxes or other support for domestic firms
- 8 **Privatization:** state enterprises should be privatized
- 9 **Deregulation:** abolish regulations on entry of new firms or competition laws that favor domestic firms; ensure that any remaining regulations are "justified" by safety, environmental, or financial oversight needs
- 10 **Property Rights:** legal reforms to secure property rights without excessive costs and to regularize the informal sector

¹⁵ "Few Changes Evident in Design of New Lending Program for Poor Countries." Report to the Chairman, Committee on Foreign Relations, U.S. Senate. United States General Accounting Office. May 2001. GAO-01- 81.

are net domestic assets ceilings – sometimes called domestic credit ceilings – which directly limit the amount of credit that the central bank can create, and net international reserve floors, which require monetary and fiscal policy to operate so as to preserve a minimum level of international reserves. If either target is threatened – that is, if international reserves are too low or if net domestic assets are too high – then the IMF criteria call for tightening monetary policy, usually by raising interest rates or reducing monetary expansion.¹⁶ The original motivation for these restrictions was to ensure the ability of program countries to reduce their foreign debt and remain solvent, while protecting the IMF's ability to be repaid. Recently, other goals, including reducing inflation and “creating room for private investment,” have been emphasized.

In addition to the 10 standard economic policy reforms in the Washington Consensus, other reforms have become standardized features of IMF lending in recent years:

Central Bank Independence (CBI): The idea is to detach the central bank from the rest of national government so that it is free of domestic politics as much as possible. Therefore, even when in times when there is a strong political demand for increased deficit spending, CBI allows unelected central bank officials to remain insulated from such pressures and maintain the strict budget discipline necessary for achieving monetary policy goals and maintaining central bank “policy credibility” among foreign investors and bond holders. Critics, however, argue that this undermines democratic accountability and surrenders the use of long-term fiscal policy tools in order to achieve short-term monetary policy goals.

Inflation Targeting (IT): IT commits central banks to a formal target to reduce inflation rates by a certain degree over a set period of time. Many countries have now adopted ‘inflation targeting’ as their chief macroeconomic policy, setting both monetary and fiscal policies to maintain price inflation rates within a target range often as low as 3-5 per cent per year. According to this perspective, inflation is caused by excessive aggregate demand and by expectations about its future rate. By publicly announcing an inflation target, monetary authorities hope to control such expectations. Monetary policy is regarded as the main instrument to control inflation and interest rates as the main tool of monetary policy.¹⁷ IT regimes involve a range of supporting institutions and an elaborate institutional framework dedicated to achieving the central bank's main policy objective. The IMF's PRGF loans generally nudge many borrowers in this direction. Zambia, for example, offers an excellent case of what the IMF calls, “IT-lite”.¹⁸ Even when central banks do not exclusively adopt a formal IT regime, most still tend to focus on getting inflation down to the neglect of economic output and employment.¹⁹ This happens because global investors evaluate central banks primarily on their ability to control inflation, not on their ability to maintain output stability or stimulate economic growth.²⁰

Capital Account Liberalization (CAL): This is driven by the supposedly numerous benefits associated with deregulated restrictions on the free flow of international investment and private capital in and out of economies. In the wake of the disastrous financial crises and rapid outflows of capital in East Asia in the late 1990s, however, the IMF's Internal Evaluation Office (IEO) recently concluded in a report on the Fund's approach

¹⁶ Epstein and Heintz explain how it works: The main targets are net domestic assets ceilings (NDA) – sometimes called domestic credit ceilings—which directly limit the amount of credit that the Bank of Ghana can create, and net international reserve floors (NIR), which require monetary and fiscal policy to operate so to preserve a minimum level of international reserves. If either target is threatened—that is, if international reserves are too low or if net domestic assets are too high—then the policy calls for tightening monetary policy, usually raising interest rates or reducing monetary expansion. It is important to note that even if both targets are met, programming does not call for expansionary monetary policy. There is no other target (e.g. economic growth, employment creation, or poverty reduction) that would require an expansionary monetary policy. The bias of financial programming is always on the side of hitting the contractionary constraints. See: “Monetary Policy and

Financial Sector Reform For Employment Creation and Poverty Reduction in Ghana,” by Gerald Epstein, Political Economy Research Institute and James Heintz, University of Massachusetts, Amherst. August 11, 2005 Draft.

¹⁷ “MDG-Based PRSPs Need More Ambitious Economic Policies,” by Terry McKinley. Policy Discussion Paper, United Nations Development Program. 2005.

¹⁸ Stone, M.R. “Inflation Targeting Lite,” IMF Working Paper. WP/03/12. 2003.

¹⁹ Ibid.

²⁰ Arestis, Philip and Malcolm Sawyer. “Inflation Targeting: A Critical Appraisal.” Working Paper #388, Levy Economics Institute of Bard College, September 2003.

to CAL that: "The lack of a formal IMF position on capital account liberalization gave individual staff members freedom to use their own professional and intellectual judgment in dealing with specific country issues... [However] there continues to be some uneasiness with the lack of a clear position by the institution."²¹

"Debt-Sustainability" Analyses (DSAs): This new analytical tool is designed to foster the notion that 100 percent debt cancellation is not necessary, and that some level of debt-servicing is "sustainable". However it is not based on how much debt cancellation a country may need to achieve the MDGs or fight HIV/AIDS effectively.

The first version of the debt cancellation initiative (HIPC), from 1996-1999, failed to assist countries in achieving its arbitrary debt-sustainability threshold of 150%-debt-to-exports ratio, while its successor the Enhanced HIPC initiative, launched in 1999, has failed to assist countries in achieving its arbitrary debt-sustainability threshold of 250%-debt-to-exports ratio. This failure is measured by the fact that most of the 38 HIPC countries continue to pile on new debts from new foreign aid and lending. In light of this problem, the IMF and World Bank have abandoned the earlier arbitrary debt-sustainability thresholds and have proposed a new debt-sustainability analysis (DSA) tool by which the two institutions determine on a case-by-case basis how much of a debt servicing burden a country can handle.

While this may seem like a reasonable improvement in the assessments, this new analysis is also not a needs-based one which calculates how much debt cancellation a country may need to achieve the MDGs or fight HIV/AIDS effectively. Worse, the new calculus

used by the World Bank for determining a country's debt-sustainability threshold is now based on how much more new lending the Bank would like to move through borrowing countries. While this balance between servicing old debts and servicing the future debts-to-be may be carefully calculated in the new DSAs, the new tools are also heavily steeped in the World Bank's annual report card on countries' policies.²²

Report Card Rewards

The World Bank's report card evaluates borrowers on how quickly they have spent their earlier loans and are ready to receive more; a governance factor on financial transparency; and how well they have implemented the economic policy reforms favored by the Bank and IMF (Country Policy and Institutional Assessment CPIA). The higher the grade on this report card, the more likely the borrower will get access to the highest-case lending scenario over the next 3-year period in the Country Assistance Strategy (CAS).

In practice, this creates an incentive for borrowers to get a good grade on the report card in order to access higher amounts of new lending. In turn, higher CPIA scores can lead to larger amounts of new World Bank lending, lower debt-sustainability thresholds and more debt cancellation. They win all around. Conversely, those who lag in adopting IMF and World Bank policies won't be likely candidates for big new lending increases, and consequently will not need as much debt relief, will get higher debt-sustainability thresholds, and thus less debt cancellation.

Furthermore, the CPIA score and new lending volume the Bank gives a country appears to have little link with resolving the drain on public expenditures caused by

²¹ Press Release No. 05/02 May 25, 2005 International Monetary Fund. Washington, D.C. 20431 USA. "IMF's Independent Evaluation Office Announces Release of Report on the IMF's Approach to Capital Account Liberalization" <http://www.imf.org/External/NP/ieo/2005/pr/eng/pr0502.html>

²² For more information on the World Bank's annual report card assessing the degree to which borrowers satisfactorily implemented IMF and World Bank programs, see several analyses on the Country Policy and Institutional Assessment (CPIA) done by Nancy Alexander of Citizens Network on Essential Services at www.servicesforall.org; See also, "The World Bank policy scorecard: The new conditionality?" by Jeff Powell. Bretton Woods Project Update. November/December 2004. Update 43. [http://brettonwoodsproject.org/article.shtml?cmd\[126\]=x-126-84455](http://brettonwoodsproject.org/article.shtml?cmd[126]=x-126-84455)

the debt crisis. For example, Zambia spends a quarter of its yearly national budget on debt, Ethiopia spends about \$6 per capita on debt-servicing and \$2.5 per capita on education, and in Honduras, Mozambique, Nicaragua, Niger and Uganda, debt repayments have been absorbing more budget resources than health and education combined.²³

World Bank figures for 1999 show that \$128 million was being transferred daily from the 62 most impoverished countries to wealthy countries, and that for every dollar countries receive in grant aid, they were repaying \$13 on old debts.²⁴ This highlights the absurdity of what the UN Millennium Project called, “a pointless and debilitating churning of resources,” with rich countries delivering large amounts of new foreign aid just to watch it flow back from poor countries in the form of debt servicing.

Business as Usual Politics

The IMF is not a development organization and has little to do with fighting HIV/AIDS in the world’s poorest countries. As an international creditor institution, it has a primary fiduciary responsibility to its shareholders to ensure their loans are repaid on a timely basis. As the head of an international creditor cartel, it alone signals the creditworthiness of dozens of countries around the world, and works to ensure that other official multilateral and bilateral creditors are repaid on a timely basis.

The IMF’s major political role is to instill discipline in its borrowers to ensure that their short-term macroeconomic policies generate maximum foreign exchange with which to repay creditors, and to keep borrowers on track with their short-term repayment schedules. If this means insisting that borrowers take the necessary steps to scale-up exports or curtail domestic spending, then repayment for creditors is given priority over public expenditure needs. The notion of discipline is particularly important, as US Treasury and IMF officials

fear “slippage” on the part of borrowing countries. If you give them an inch in additional deficit spending, they will take a mile, the argument runs, therefore it is better to insist on very tight fiscal and monetary policies as borrowing countries cannot be entrusted to manage more moderate policies.²⁵ Another example of strict IMF discipline in action is suspension of countries’ loan or debt-relief programs for failure to satisfactorily implement reforms such as privatizations, budget cuts, or trade liberalizations. The IMF acts this way because its mandate has little to do with addressing long-term development issues, such as the need to scale-up the fight against HIV/AIDS or achieve the MDGs.

The IMF has long since strayed far from its original narrow mandate of temporarily assisting countries with their balance of payments problems and its monumental role as the head of the international donor and creditor cartel has enabled its influence to grow exponentially. That few object to this illegitimate power grab is a reflection of the political prerogatives of the most powerful shareholders on the IMF’s executive board.

Another reflection of political prerogatives is the selectivity with which the World Bank is willing to challenge the IMF on fiscal and monetary policy. It is ironic that while the World Bank has proclaimed its support for the MDGs and fighting HIV/AIDS, it has been leading a little-known charge against overly-tight IMF fiscal constraints so that it can create additional “fiscal space” to make way for its planned huge increase in infrastructure lending over the next several years.²⁶

It is remarkable that while the Bank regularly goes along with the IMF’s demands for tight fiscal constraints when it comes to social spending, it is willing to confront the IMF when more space is needed for big new World Bank lending in infrastructure.

Given that much of this infrastructure lending is designed to be financed in large part by private sector

²³ Kapoor, Sony and Meenoo Kapoor. “Financing Development Towards the MDGs: What Needs to be Done? An Issues Paper and Call to Action,” Heinrich Böll Foundation North America. July 2005.

²⁴ Ibid.

²⁵ US Treasury and IMF officials have expressed concerns that undisciplined developing country officials will allow inflation or deficit spending to “slip” out of control, and that if allowed moderate levels of inflation, countries will

push this further into irresponsible hyperinflation. However, Dornbusch and Fischer (1993) found that an inflation rate in the moderate range of 15-30 percent does not usually accelerate to extreme levels. Similarly, Bruno and Easterly (1998) found that the threshold inflation rate of 40 percent at which the probability of the inflation rate accelerating significantly. See: Chowdhury, Anis. “Poverty Reduction and the ‘Stabilisation Trap’—The Role of Monetary Policy,” draft available at a.chowdhury@uws.edu.au

participation, the public subsidies and risk guarantees offered to private foreign investors have put great pressure on governments' fiscal balances. Much of the early rhetoric about public-private partnerships in infrastructure (PPPI) was that the private sector would step in and finance the initial major infrastructure improvements as part of the privatization process. However, between 1984 and 2003 the private sector has only put up 22 percent of the \$790 billion in infrastructure investments.²⁷ This substantial failure of the World Bank's privatization agenda to successfully lure in the international private sector has increasingly shifted the long-term financial risks onto public guarantees and governments' already stretched fiscal balances - yet the World Bank seeks to increase its infrastructure lending even farther over the next few years.

What will this increased infrastructure spending mean for governments taking on even larger public subsidies and risk guarantees in order to lure in an ever-doubting private sector? What will these additional subsidies and risk guarantees mean for the anti-poverty movement's advocacy efforts to squeeze out any additional "fiscal space" that might exist?

In 2004, the IMF agreed to work with the World Bank in exploring options for accommodating increased public investment in infrastructure into fiscal targets, while safeguarding macroeconomic stability and debt sustainability. The two institutions also discussed criteria under which the operations of commercially run public enterprises could be excluded from fiscal indicators and targets and reviewed a range of issues related to the fiscal implications of PPPs. However, the IMF warned the World Bank and its future big-infrastructure borrowers: "in deciding overall spending allocations, governments face important trade-offs between public infrastructure spending and other public spending (e.g., in health and education)."²⁸

The IMF's warning will prove especially potent if countries take on even further public subsidies offers and risk guarantees to lure private investors into PPPs. Likewise, if external shocks or other economic crises occur, health and education budgets will be the first to suffer in such over-extended countries. The point is not that making "fiscal space" for infrastructure is a bad idea, but that if the World Bank is willing to argue with the IMF for space for infrastructure spending, then why won't it argue for more fiscal space for health, education and HIV/AIDS spending?

Another reflection of political prerogatives in the current macroeconomic model is the strong push for liberalization of the services markets in developing countries. Proceeding hand-in-hand with the ongoing General Agreement on Trade in Services (GATS) negotiations within the WTO, the IMF and World Bank have been pushing forcefully for liberalization of services sectors in their lending conditions. Many loan programs call for trade barriers to be reduced, for far-reaching domestic regulatory and legal reforms and sometimes even for constitutional amendments to be introduced, in order to allow foreign private investors entry into domestic services markets. This liberalization is breaking apart the subsidization of prices for essential services and utilities and rising prices are undermining poor people's access to such basic life-giving services. This trend is continuing despite a track record on privatization of services which has not revealed benefits the poor.

One Rule for India, Another for Zambia

Political reality often trumps the application of neoliberal ideology by the IMF and World Bank. An interesting example of this selectivity is the differing degrees to which the two institutions tolerate policy behavior by India when compared to other borrowers. India has a deficit of about 9% of GDP, continues to maintain

²⁶ Speech by Danny Leipziger, Director of PREM, World Bank. "PREM Week 2005: Session 03 - What's Old and What's New in Development Policy," April 19, 2005.

²⁷ Estache, Antonio. "PPI partnerships vs. PPI divorces in LDCs," World Bank and ECARES (University Libre de Bruxelles). October 2004. pp.8-9. Available at: aestache@worldbank.org

²⁸ International Monetary Fund. "Public Investment and Fiscal Policy—Lessons from the Pilot Country Studies," Prepared by the Fiscal Affairs Department. April 1, 2005.



relatively high trade tariffs, regulates foreign investors, maintains profitable state-owned companies rather than privatizing, and commits a host of other violations of the Washington Consensus and yet it is rewarded with massive new World Bank infrastructure lending and other new loans. Contrast this with poor and aid-dependent Zambia, where the IMF cut off the country's debt cancellation and PRGF programs because it had exceeded its agreed upon wage bill ceiling of 8% of GDP.

Is this policy tolerance because India is an important borrower for the World Bank, capable of absorbing large amounts of new lending with an excellent ability to repay and Zambia is not? Or is it the case that, because India is wealthy enough to borrow elsewhere on private international capital markets, India does not need the World Bank as much as the Bank may need India? None of this is the case with Zambia, which must comply with the IMF to get World Bank and other loans and aid. The fact that the IMF and World Bank impose harsher discipline on some borrowers than others, may also be a reflection of geopolitical realities: India has political power in a strategic region; Zambia is a small country in an ignored continent.

Recent studies have exposed how outside political interests exert pressure and influence on IMF and World Bank programs and loan conditions. Based on an analysis of 249 cases, Erica Gould explained in *International Organization* that the IMF regularly relies on external financing to supplement its loans to countries. As a result, these supplementary financiers, both private and official, are able to exercise leverage over the Fund and the design of its conditionality programs.²⁹

Another key study examined the question "who runs the IFIs?", unearthing strong patterns of influence from the United States and the European Union. As the votes cast by the IMF and World Bank executive board shareholders are not made public, the authors scrutinized the pattern of lending of both institutions as a function of their institutional mission and of the commercial and financial interests of their main shareholders. They found that both institutions are quick to respond to the borrowing needs of their members, particularly during a balance of payments crisis. That aside, however, the lending pattern of both was influenced by the commercial and financial interests of the US and, to a lesser extent, of the European Union. Japan played a smaller role, largely confined to decisions concerning Asia.³⁰

²⁹ "Money Talks: Supplementary Financiers and International Monetary Fund Conditionality," by Erica R. Gould, Department of Politics, University of Virginia. *International Organization*, Summer 2003.

³⁰ "Who Runs the IFIs?" by Riccardo Faini, University of Rome, Tor Vergata of CEPR (London) and Enzo Grilli of Johns Hopkins University-SAIS, Washington D.C. www.dagliano.unimi.it Centro Studi Luca D'Agliano, Development Studies Working Papers, N. 191. October 2004.

How and Why IMF-led Development is Failing the Poor

On the eve of the 2005 UN Millennium Summit, there are vital questions that world leaders and global civil society must ask and answer regarding the effectiveness of the dominant macroeconomic model and its appropriateness for achieving the MDGs or effectively scaling-up the fight against HIV/AIDS. The IMF-led model was largely intended to address developing countries' hyperinflation and balance of payments and foreign debt crisis 25 years ago. Steep cuts in public expenditure were a key feature of the IMF loan programs in the 1980s. Today most countries have long since "stabilized" their economies and significantly reduced inflation. What they desperately need is to head full speed in the opposite direction and scale-up public spending to help their impoverished citizens achieve a better quality of life. ActionAid International is concerned that the current macroeconomic framework supported by the World Bank and the IMF will simply not allow this new course to happen; that they will not allow borrowing countries to increase public expenditures to the levels necessary to achieve the MDGs and effectively fight HIV/AIDS.

During the past quarter century, the major criticisms of the impacts of status quo policies have been that they failed to promote higher economic growth rates and have worsened inequality in poor countries; that tight fiscal and monetary policies have led to reduced

government spending resulting in lay-offs, salary freezes, cuts in basic service provision and higher prices for remaining public services; that higher interest rates have made commercial loans inaccessible for domestic companies, leading to bankruptcies and further lay-offs; that currency devaluation has led to increased costs of imports and lower consumption; that increased export-oriented agricultural production has led to more arable land being used for export crops (meaning less for local food production) and an increased reliance on volatile international commodity prices; and that the removal of price controls has led to rapid price rises for basic goods. It is a long and serious list of accusations which we investigate fully in the following pages.

IMF Failure to Deliver Economic Growth: The Evidence

The current framework's policies have failed to deliver on the two major reasons used to justify their application: that they would increase economic growth and reduce poverty.

The best conventional indicator that economists have to measure national economic development is per capita economic growth rates, and over 20 years of neoliberal reforms, per capita economic growth rates have been markedly lower than during the previous 20

years. For example, a 2001 study by the Washington DC-based Center for Economic and Policy Research suggested the recent 20-year era of globalization has brought substantially less progress than was achieved in the previous twenty years. This paper looked at the major economic and social indicators for all countries for which data were available, and compared the recent 20-year period under the structural adjustment policy reforms (1980-2000) with the previous 20-year period (1960-1980). These indicators included: the growth of income per person, life expectancy, mortality among infants, children, and adults, literacy, and education. For economic growth and almost all of the other indicators, the last 20 years have shown a very clear decline in progress as compared with the previous two decades. Among the findings: the fall in economic growth rates was most pronounced and across the board for all groups or countries; progress in life expectancy was also reduced for 4 out of the 5 groups of countries; progress in reducing infant mortality was also considerably slower during the period under neoliberal reforms (1980-2000) than over the previous two decades; and progress in education also slowed during the later period.³¹

Regarding the last 5 years, Latin America is representative of the continuing slow growth and lingering poverty among countries that have adopted the IMF and World Bank policies. Although growth rates for some commodity producers in Latin America and elsewhere have been increased in 2005, largely because of China's increasing consumption, however, for the first 5 years of the current decade, 2000-2004, per capita GDP growth was about 0.2 percent annually, or about 1 percent for the whole 5-years period. This low growth rate continued the long period of economic failure: for the prior 20 years, 1980-1999, the Latin America region grew by only 11 percent (in per capita terms) over the

whole period. By comparison, for the two decades from 1960-1979, Latin America experienced per capita GDP growth of 80 percent.³²

According to the United Nations Economic Commission for Latin America and the Caribbean, the percentage of households in poverty in Latin America—with poverty defined as insufficient income to meet basic needs—grew from 34.7 percent to 35.3 percent during the last 20 years, meaning that despite the population growth, roughly the same proportion of people is impoverished today as 20 years ago, only now there are more of them.

The economist Paul Krugman summed up the general situation in his *New York Times* column, reporting that the Latin American countries that had made the biggest commitment to implementing the macroeconomic and other structural reforms favored by the IMF and World Bank were now failures ranging from “disappointing” in Mexico to “catastrophic” in Argentina.³³

Krugman contrasted this track record with the evident successful economic development of East Asian economies and parts of India and China, but neglected to spell out exactly why the difference in the outcomes. In fact, while East Asia traditionally had higher domestic savings rates and lower levels of economic inequality, parts of East Asia may well have developed so successfully because of the fact that these countries mostly resisted and never fully adopted the IFI's structural adjustment policy reforms to the same degree as Latin American and African nations. Instead, these East Asian economies largely maintained high levels of trade protection and state-directed subsidy support for key domestic industries, engaged in deficit spending and maintained relatively lower interest rates for domestic commercial loans, fully supported public infrastructure

³¹ “The Scorecard on Globalization 1980-2000: Twenty Years of Diminished Progress,” by Center for Economic and Policy Research. 2001. www.cepr.net; This report was then corroborated by World Bank economist, William Easterly, who published a 2001 analysis with similar conclusions to the CEPR report, calling it “puzzling” that poverty-reduction was indeed more successful in the prior two decades than in the last two under World Bank and IMF policy influence, and that per capita income growth rates had been much higher in the earlier period, too. See: “The Lost Decades: Developing Countries’ Stagnation in Spite of Policy Reform, 1980-1998,” by William Easterly. The World Bank. February 2001. www.worldbank.org/research/growth/pdffiles/lostpercent20decades_joeg.pdf

³² “Another Lost Decade? Latin America’s Growth Failure Continues into the 21st Century,” by Mark Weisbrot and David Rosnick. Center for Economic and Policy Research. November 13, 2003. www.cepr.net

³³ “The Good News,” by Paul Krugman. The New York Times. November 29, 2003.

and public health and education services, maintained price controls for basic commodities, and heavily regulated foreign investment to make sure it provided positive spin-offs for domestic industries. In many ways, these economies in East Asia mimicked what the industrialized countries of Japan, Europe and the US had themselves done during the last couple of hundred years of their own successful industrialization.³⁴

In 2003, the United Nations Development Program's annual Human Development Report harshly admonished the IFIs by calling for a broader policy view of how best to lift the least developed nations out of extreme poverty rather than the "Washington consensus of the World Bank and International Monetary Fund."³⁵ The 2003 annual UNDP report said the IFI's current policy approach, which is based on a total reliance on market forces and increased trade to achieve development, will not succeed. Mark Malloch-Brown, then-administrator of the UNDP, said many countries in Africa and Latin America that had been previously held up as examples of how to kick-start development were today among the stragglers in the global economy. "The poster children of the 1990s are among those who didn't do terribly well." Malloch-Brown called for a "guerrilla assault" on the neoliberal policies and for a reaffirmation of the role of the state in development policy: "Market reforms are not enough. You can't just liberalize; you need an interventionist strategy."³⁶

There is an increasing acknowledgement that insufficient national health budgets and education budgets have been the consequences of strict IMF budget austerity. "The IMF and the World Bank should no longer set these kind of ceilings," Malloch-Brown said.³⁷

In a direct rebuke to the neoliberal policy approach that insists high economic growth rates must come first, and only then can increases for public health and education budgets be afforded later, Jeffrey Sachs, former IMF advisor and current special adviser to Kofi Annan on the UN Millennium Development Goals (MDGs), said, "Poor countries cannot afford to wait until they are wealthy before they invest in their people."³⁸

This gap between what the IMF has committed to (to reduce poverty, help achieve the MDGs) and the low-spending/low-inflation fiscal and monetary policies it promotes reflects a problem with the IMF's analysis of challenges faced by low-income countries. It also presents a problem for civil society and the national and international HIV/AIDS, health and education advocacy networks.

Even though the crises of hyperinflations of the late 1970s and early 1980s has long since abated, the IMF still often perceives the problem in terms of stabilizing countries and getting their deflationary macroeconomic policies correct in order to create the right environment for pro-poor growth. Yet, many years of relatively lower economic growth rates and considerably lower levels of inflation have not yet persuaded the IMF to reconsider its concepts about the need for macroeconomic stabilization, or to reconsider its disputed definition of "macroeconomic stability" (see below) in borrowing countries. Some countries in Africa for example have long been stabilized, but in a state of stagnation and low growth or locked-in to a dependence on factors that they have no control over, such as the world market prices of their raw commodity exports.

³⁴ "Kicking Away the Ladder: Development Strategy in Historical Perspective," by Ha-Joon Chang. Anthem Press, 2002.

³⁵ "Human Development Report 2003: Millennium Development Goals: A compact among nations to end human poverty." United Nations Development Programme. 2003. www.undp.org/hdr2003

³⁶ "The lost decade: They were promised a brighter future, but in the 1990s the world's poor fell further behind." by Larry Elliott, economics editor. The Guardian (UK). Wednesday July 9, 2003.

³⁷ "Boom Bubble of 1990s Leaves 50 Nations Poorer -UN," by Evelyn Leopold. Reuters. July 8, 2003.

³⁸ "The lost decade: They were promised a brighter future, but in the 1990s the world's poor fell further behind." by Larry Elliott, economics editor. The Guardian (UK). Wednesday July 9, 2003. See also the conclusions by Sachs and others in their 2001 WHO Commission on Macroeconomics and Health. http://www.who.int/gb/EB_WHA/PDF/WHA55/ea555.pdf

Financial Programming: A Flawed Model

The IMF has long used its “financial programming” model to determine the various components of its policy advice for loan programs. According to an analysis of the “financial programming” model by former World Bank economist William Easterly, the IMF’s financial programming uses a set of “identities” and extremely simple models (at best, a set of assumptions about the structure of the economy) to establish a set of targets that the IMF will monitor and the borrowing government will have to meet in order to receive the next installments of IMF loans, or qualify for HIPC debt relief or other donor support. Easterly’s analysis found that all of the identities contain large statistical discrepancies, which weakens the case for them as a “consistency check.”³⁹ In at least the literal applications of the framework, financial programming does not do well in forecasting or explaining the target variables, even when some components of the identity are known with certainty. “These results suggest that IMF staff have to rely on macroeconomic theory and empirics that come from outside the financial programming framework in designing stabilization packages.”⁴⁰

In particular, financial programming is based on a neoliberal free-market approach to macroeconomic policy that assumes that output growth (economic growth rate, employment rate, higher public spending) is not affected by monetary policy. Therefore, financial programming assumes that restrictive monetary policies will reduce inflation, without any long-run negative impacts on economic growth. However, important

evidence and reasonable theory suggests that excessive restrictions on monetary policies and credit and high interest rates do have negative impacts on economic growth (see below).⁴¹

On top of these, many other “structural” goals are often included targets or even as performance requirements, including capital account liberalization. For example, in one of our cases examined, for Ghana these goals and targets are embedded in their PRSP and HIPC debt-relief conditions, so that implicitly, “poverty reduction” is supposedly part of the overall framework. But the key question for HIV/AIDS, health and education advocates about monetary policy is this: do these “stabilization” goals contribute to Ghana’s ability to reduce poverty and generate more employment, or do these “stabilization procedures” in fact interfere with these developmental objectives?

Because the macroeconomic model is based on the (questionable) notion that restrictive monetary policies will reduce inflation, without any long-run negative impacts on economic growth, IMF loan programs over the years have sought to subordinate the use of fiscal policy (strategic budgeting) as a main tool for economic policy making in favor of using monetary policy to achieve macroeconomic stability as the guiding set of tools for driving national economic policy. This shift is of profound importance for democracy, democratic process and civil society input on crucial decisions affecting the shape of the political economy. By removing fiscal policy as a tool for the government to plan economic policy, governments are surrendering many variables to the dictates of the financial sector.

³⁹ Easterly, William. “An Identity Crisis? Examining IMF Financial Programming.” New York University Development Research Institute. No. 6. February 2004.

⁴⁰ Ibid.

⁴¹ “Monetary Policy and Financial Sector Reform For Employment Creation and Poverty Reduction in Ghana,” by Gerald Epstein, Political Economy Research Institute and James Heintz, University of Massachusetts, Amherst. August 2005 Draft. For a detailed critique of the many problems with financial programming that economists have highlighted, see Easterly, William. 2002. “An Identity Crisis? Testing IMF Financial Programming”. Center for Global Development. Working Paper No. 2. August 2002. Easterly identifies these

problems: 1) It is based on identities that, in practice, often have large and variable measurement errors (“errors and omissions”), thereby rendering precise targets problematic; 2) Their policy prescriptions are based on the assumption of constant or even one-for-one economic relationships—for example a stable velocity of money or a constant relationship between domestic credit and the money supply – relationships which turn out to be highly unstable and often not one-for-one; 3) They often leave out other important channels of monetary policy besides changes in the money supply, channels such as credit and asset prices; and 4) There are important variables that are assumed to be exogenous to monetary variables, which are, to the contrary, often affected by monetary policy.

Unrealistic Growth Expectations

As the IMF model has sought to diminish the use of fiscal policy as a key policy tool for governments in economic policy making, and to subordinate fiscal policy to monetary policy, the IMF's main argument has long been that cutting spending now is OK because having the "correct" tight fiscal and monetary policy indicators would ultimately lead to higher and more stable long-term economic growth rates, from which public expenditures could later be increased. To bolster enthusiasm for this prognosis, the IMF has regularly projected unjustifiable and over-ambitious future growth rates in its PRGF programs, and in the PRSP documents upon which the PRGFs are supposedly based.

It is standard procedure in the IMF to be overoptimistic about the future under their loan conditions. One IMF staff paper explained, "As in all Fund-supported programs, macroeconomic projections were predicated on the success of the programs, including the restoration of [investor] confidence."⁴²

For example, a 2005 analysis of 15 PRSPs showed that for almost all countries the future economic growth targets were set above the average growth of the 1990s. In some cases, the targets were close to the peaks of the economic growth trends observed in the 1990s, which differ considerably from the average trend.⁴³

Why does projecting over-high rates of growth matter? For most countries under PRGFs, GDP growth is highly influenced by external factors such as drops in the world prices for their commodity exports or unpredictable

natural disasters. If IMF planners do not take such prospects into account, failure to reach projected growth rate targets as a result of such uncontrollable outside factors could force governments to make public expenditure cuts to balance the budget.⁴⁴ Therefore the IMF's overoptimistic future growth projections have exceedingly dangerous implications for social spending and poverty reduction in developing nations.

Ricardo Gottschalk, author of the 15-country analysis of PRSPs, raises two important questions for HIV/AIDS, health and education advocates to keep in mind when assessing PRSPs: First, if volatility in trade is bad for economic growth and poverty reduction, to what extent are the PRSP documents designing alternative macroeconomic policies to deal with this crucial issue, and to address growth and poverty reduction directly? Second, what macroeconomic conditions were countries facing at the start of the PRSP process, and are these conditions appropriate to address the challenges of macroeconomic volatility, growth and poverty reduction? An additional task is to scrutinize the differences between the PRSP "wish list" for spending priorities and the low base-case spending scenario on which the IMF's PRGF loan program is actually based.

Short-Term Fixation

A major problem with the IMF's current macroeconomic framework is its overly focused on short-term and medium-term economic variables to the near-neglect of long-term economic planning. This is especially problematic for other aid donors who are seeking to tackle HIV/AIDS and achieve MDGs through medium to

⁴² "IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment," by Timothy Lane, Atish Ghosh, Javier Hamann, Steven Phillips, Marianne Schulze-Ghattas, and Tsidi Tsikata. International Monetary Fund. Occasional Paper 178. Washington DC. 1999. p45.

⁴³ "The Macro Content of PRSPs: Assessing the Need for a More Flexible Macroeconomic Policy Framework," by Ricardo Gottschalk. Development Policy Review, 2005, 23 (4): 419-442. An analysis of 15 PRSP from a economic growth perspective.

⁴⁴ Ibid.

long-term planning. The incentives of the IMF and those of other donors are increasingly different. In terms of financing, whereas the PRGF support involves short-term lending, most other donors have now moved on to providing assistance exclusively in the form of long-term concessional loans or grants. As a result of this, the IMF is primarily concerned by the short to medium-term macroeconomic situation of its borrowing countries, since this will determine their ability to repay in the near future. Other donors tend to pay more attention to the long-term impact of their assistance, whose determinants include many elements besides short-term macroeconomic stability.

Undermining Economic and Social Rights

All five case study countries analyzed in this report have already either ratified, acceded or succeeded to two major United Nations treaties on economic and social rights: the International Covenant on Economic, Social and Cultural Rights (ICESCR) and the Convention on the Rights of the Child (CRC). However, there are striking contradictions between the spending needed by these governments' to meet their commitments and obligations to their own citizens under these treaties and the tight fiscal constraints they are obliged to under their IMF programs.

Gorik Ooms and Rachel Hammonds of Medicins Sans Frontieres (MSF) articulated this stark contradiction in a recent article in the International Journal of Health and Human Rights, in which they contrasted PRSP goals and PRGF spending constraints against specific rights and obligations of the states parties to the ICESCR and CRC. The minimum budget required to finance adequate levels of health in poor countries was estimated by the World Health Organisation (WHO) Commission on

Macroeconomics and Health to be US\$ 35 per person per year in 2001. These were based on the costs of interventions required to realize a minimum right to health, as defined by the Committee on Economic, Social and Cultural Rights. Yet, as Ooms and Hammonds pointed out, many PRSPs are based on the assumption that health spending will be much lower, for some countries below US\$ 10 per person per year, thus imposing public health choices incompatible with the minimum right to health. Since PRSPs have an impact on both national resources and international assistance dedicated to health care, their acceptability from a human rights point of view is questionable.⁴⁵

Deficit Reduction Damage

Huge financing gaps stand between poor countries and the achievement of the MDGs. It follows that in addition to striving for an acceptable degree of macroeconomic stability, countries should be seeking to optimize spending on poverty reduction wherever possible. If the IMF were actively fulfilling its claim to help countries achieve the MDGs, its key role should be designing financial frameworks with countries that seek to optimize and maximize public spending on the MDGs. Unfortunately the evidence is that instead the IMF is programming further deflation and deficit reduction programs, even in the face of unprecedented needs for scaling-up spending for fighting HIV/AIDS effectively.

The IMF's demands for deficit reductions have long been blamed for consequent reductions in social spending, particularly during the early IMF stabilization loans in the 1980s, when public expenditures for social services were reduced dramatically. This bias persists 20 years on, despite rising poverty in several regions, notably sub Saharan Africa.

⁴⁵ "World Bank Policies and the Obligation of its Members to Respect, Protect and Fulfill the Right to Health," Hammonds, Rachel and Gorik Ooms. Health and Human Rights: An International Journal. Vol. 8 No. 1. 2004.

⁴⁶ Jha, Raghendra. "Macroeconomics of Fiscal Policy in Developing Countries" April 2001. Paper provided by Australian National University, Economics RSPAS in its series Departmental Working Papers with number 2001-05. See: Tanzi, V. "Fiscal Deficit Measurement: Basic Issues" in M. Blejer and A. Cheasty (eds.) How to Measure the Fiscal Deficit, IMF, Washington, DC, 1993. pp. 13-21. For a further elaboration of this point see Hermes, N. and R. Lensink, "Fiscal Policy and Private Investment in Less Developed Countries" paper for the WIDER project on New Fiscal Policies for Growth and Poverty

Reduction, 2000; and Gemmill, N., "Fiscal Policy in a Growth Framework" paper for the WIDER project on New Fiscal Policies for Growth and Poverty Reduction, 2000.

⁴⁷ "Is PRGF Maximizing Finance for Poverty Reduction?" Eurodad. May 2003. Other studies of early PRGFs denote a similar trend. For example, "staff appear to have behaved rather passively under this [fiscal policy] heading", failing in most cases to come up with alternative fiscal scenarios to be discussed with

For several of the 5 countries analyzed in this study, for example, strict budget deficit reduction goals were a key component of their PRGFs. Most IMF programs claim to seek to mobilize additional fiscal resources to finance increases in public investment and social spending, but that, however, can happen only within the existing macroeconomic framework goals of reducing deficit spending. The important implication is that any additional increases in social spending are likely to be minimal.

Budget Deficit Levels, Actual and Projected
(as a percent of GDP)

	2003	2004	2005	2006	2007	2008
Bangladesh	3.4	3.2	4.2	4.2	4.1	3.9
Ghana	8.2	5.4	3.1	2.4	2.2	1.9
Malawi	11.6	7.1	4.1	1.3	2.1	1.8
Uganda	11.3	11.3	9.7	9.2	—	8.0
Zambia	5.0	—	1.0	—	—	—

Source: Various IMF and World Bank country documents

The conventional measure of the “fiscal deficit” is the difference between total government expenditure and current government revenue, and while being clear as an accounting concept, it is not above controversy as an economic entity. The IMF’s narrow “logic of availability of resources” leaves governments, as opposed to private businesses, having to treat all public investments as a short-term expense in the year in which it occurs rather than as long-term depreciating assets over time. As explained in the Box: “Crowding Out or Crowding In?” the major problem with the IMF’s approach to the conventional measure of the deficit is that it fails to recognize that different tax and expenditure categories have different types of effects on aggregate demand. For example, an excess of expenditure on the infrastructure creates productive capacity and will have a different impact than an excess of expenditure due to consumption subsidies.⁴⁶

EURODAD’s examination of 12 PRGFs in 2003 found that that overall deficits were scheduled (permitted) to increase in only three countries over the next three years, and that apart from these three cases where the rationale for a temporary increase in budget deficits was clearly laid out, alternative fiscal policies were not discussed in the other 9 PRGF arrangements reviewed.⁴⁷

Amartya Sen defined the IMF’s obsession with deficit reduction in IMF loans by calling their approach “anti-deficit radicalism”. He distinguished between the more traditional notions of financial conservatism and the more recent anti-deficit radicalism of the last couple of decades under neoliberalism.⁴⁸ While financial conservatism tends to demand that deficit reduction takes place eventually, this is not to be confused with the IMF’s perceived “necessity of eliminating budget deficits altogether within a few years no matter what the social cost of this might be.”⁴⁹

A major argument of the IMF has long been that high budget deficits cause higher inflation rates. However, there are many studies of the economics literature on this point that challenge the IMF claim.⁵⁰

The major concern with excessive deficit reduction policies is that countries could be spending much more on public expenditures if they were not using scarce revenues to pay down the level of the deficit. Oxfam International attempted to express the seriousness of these trade-offs and sacrifices by doing a survey of 20 PRGFs and showing what could have happened differently had countries channeled deficit reduction monies into more health or education spending instead. In some cases the projections would have doubled or tripled those budgets.⁵¹

national authorities. These findings are also supported by Caroline Robb’s review of early experiences of Poverty and Social Impact Assessments (PSIAs). See “Poverty and Social Impact Analysis - Linking Macroeconomic Policies to Poverty Outcomes: Summary of Early Experiences”, Caroline Robb, IMF, February 2003. Page 35. Available at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=16248.0>

⁴⁸ Sen, Amartya. “Human Development and Financial Conservatism,” World Development. Vol. 26, No. 4, pp. 733-742, 1998.

⁴⁹ Ibid.

⁵⁰ For an international study that finds that deficits do not in general cause inflation, see: de Haan, J. and Zelhurst, D., “The impact of government deficits on money growth in developing countries,” Journal of International Money and Finance. No. 9, pp.455-469.

⁵¹ Oxfam International. “The IMF and the Millennium Goals: Failing to deliver for low income countries.” September 2003. Briefing Paper No. 54.

For the limited number of countries whose fiscal deficits remain at highly unsustainable levels, this continued lack of flexibility in setting and/or changing fiscal targets is more understandable. However, as the Bank and the IMF have noted themselves “many developing countries are presently in a state of macroeconomic stability”.⁵²

HIV/AIDS, health and education advocates should also take note of the sacrifices made to comply with this level of macroeconomic stability, and the very significant negative toll on the ability of countries to fight HIV/AIDS and to achieve the MDGs. Even in some of the so-called “star performers” like Uganda and Tanzania, praised for their ability to prioritize poverty reducing spending, the use of very stringent budget procedures has increased the volatility of public expenditures and led to under-funding of social and infrastructure programs.⁵³ More widely, a number of studies have shown how running an overly tight fiscal policy negatively impacts on the poor by reducing recurrent expenditures, forcing governments to raise revenues in harmful ways (e.g. high user fees or petroleum taxes), or more generally by harming the quality of budgetary management.⁵⁴

**Public Health Spending Per Capita
Has Fallen in Some Regions**
(Current US Dollars, Weighted by Population)

REGION	1997	1998	1999	2000	2001
East Asia and Pacific	15	15	16	17	19
Europe and Central Asia	100	90	77	84	89
Latin America and the Caribbean	131	132	120	125	122
Middle East and North Africa	59	61	61	66	69
South Asia	4	5	5	5	5
Sub-Saharan Africa	17	15	13	13	12
High-Income Countries	1,596	1,609	1,694	1,714	1,763
World	274	274	284	285	294

Source: WHO 2004

⁵² “Is PRGF Maximizing Finance for Poverty Reduction?” Eurodad. May 2003.

⁵³ Are Cash Budgets a Cure for Excess Fiscal Deficits (and at what costs)?, David Stasavage and Dambisa Moyo, Oxford, May 1999. Working Papers Series from Centre for the Study of African Economies, University of Oxford.

⁵⁴ “The Political Economy of Fiscal Policy in Low-Income countries,” by Tony Addison, in Eurodad Annual Conference report, 2000, cited in “Is PRGF Maximizing Finance for Poverty Reduction?” Eurodad. May 2003.

Re-Slicing the Same Pie to Boost Health and Education Spending

The good news, however, is that although developing countries have suffered a long-term declining trend in per capita health care spending, recent years have seen marked increases in social spending on health and education. This is largely due to a recomposition of the existing budgets; taking money from something else in the budget and putting it into health and education budgets. Budget recomposition has been championed by the World Bank in recent years as a way to increase social spending while not violating the IMF program constraints on overall national spending, which have remained tight to comply with the macroeconomic framework. But this rearranging the “slices of the pie” is not the same thing as increasing the size of the pie.

However, while these recent increases in social spending in some countries are welcome, they are not large enough to allow countries to fight HIV/AIDS effectively or meet other MDGs. Nor do they come close to social sector spending levels in rich countries. According to the United Nations, high-income countries spend an average of 27 per cent of GDP on the social sectors, compared with 19 and 15 per cent respectively in upper-middle- and lower-middle-income countries and 12 per cent in low-income countries.⁵⁵ Overall, rich countries devote an average of two and a half times more of their national wealth to the health, education and welfare of their citizens than do poor countries.⁵⁶

The 2004 Joint Learning Initiative on Human Resources for Health and Development found that in order to fight HIV/AIDS effectively, the countries of sub-Saharan Africa will need to nearly triple the sizes of their current health workforces.⁵⁷ However, these types of increases to the wage bill and other expenditures ceilings are totally out of the realm of possibility under the current macroeconomic framework, as the JIL report clearly recognized:

⁵⁵ “The allocation of government expenditures in the world, 1990-2001.” Kelly, P., and V. Saiz-Omeñaca. Unpublished paper. November 2004. Cited in “The Inequality Predicament Report on the World Social Situation 2005” by Department of Economic and Social Affairs (DESA), United Nations, 2005. A/60/117/Rev.1 ST/ESA/299.

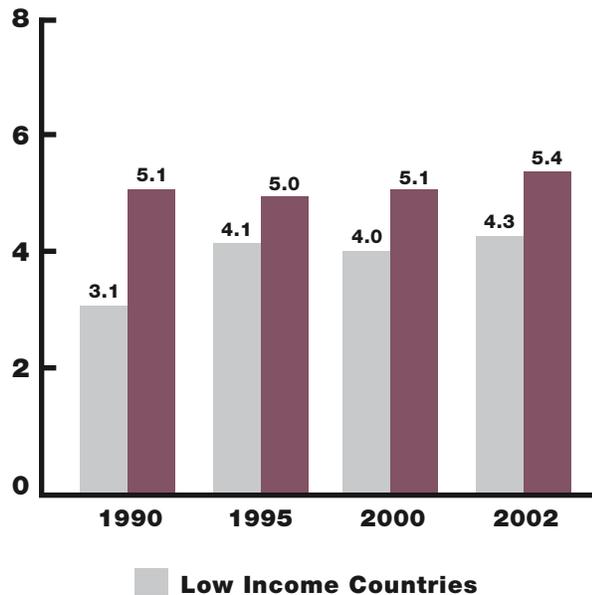
⁵⁶ Ibid.

⁵⁷ “The Joint-Learning Initiative Strategy Report: Human Resources for Health Overcoming the Crisis,” Chapter 4, “Global Responsibilities”, Harvard University Press, January 2005

Low-Income Countries Have Been Increasing Their Spending on Education and Health

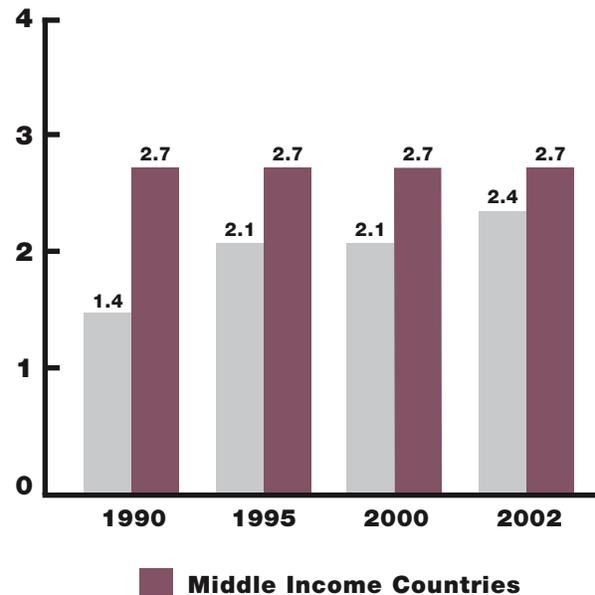
Government Spending on Education

Percent of GDP



Government Spending on Health

Percent of GDP



Source: IMF Data

Note: Unweighted averages based on corresponding available data from 1990-2002

“Legitimately concerned about fiscal discipline, public sector reforms clamped down on public expenditures in the social sectors—salaries were capped, hiring was frozen, and education and training were neglected. Prolonged application of these policies resulted in severe erosion of the human infrastructure for health, from which many countries are only now emerging. Yet public budgets remain hard pressed with public expenditure ceilings and with employment and wage caps still in place. A review of eight low-income African countries found that bans on recruitment and staffing had been only partially lifted in half of them. In Rwanda the wage bill is still considered beyond affordability, necessitating new staff cuts in the midst of worker shortages. Without lifting macroeconomic ceilings, workforce expansion, salary improvements, and incentive payments will be impossible, no matter what the volume of funds pledged by donors.”⁵⁸

Inflation Reduction Damage

A fundamental part of the IMF’s economic orthodoxy has been that a low level of inflation (near to zero, certainly under 5%) is a prerequisite for growth and macroeconomic stability. Many IMF loan programs over the years have had inflation reduction as a key overriding goal.

The important questions revolve around the most appropriate level for inflation in developing economies and the speed with which inflation reduction targets are set to be achieved.

In April 2005 ActionAid International used country documents available on the IMF’s external website to survey 63 current IMF arrangements with developing countries. Of the 63 arrangements examined, 45 had

Inflation Rates

(Annual Average Price Changes)

	1999	2000	2001	2002	2003	2004	2005*	2006*
Bangladesh	5.0	2.0	2.0	3.0	4.4	5.8	6.5	6.0
Ghana	14.0	27.0	35.0	23.0	26.7	10.8	6.0	5.0
Malawi	42.0	26.0	27.0	15.0	11.0	12.7	11.4	8.0
Uganda	0.0	4.0	6.0	-4.0	10.1	5.5	4.9	4.0
Zambia	21.0	30.0	24.0	20.0	20.0	17.5	15.0	----

Source: Various IMF and World Bank country documents; * = projections

either already achieved or were targeting inflation rates at 5 percent per year or below. Among the 5 countries in this study, 2 of our cases have already achieved relatively low inflation rates while the other 3 have recently been attempting to lower inflation from relatively higher rates.

In the 2003 Eurodad survey of 12 PRGFs, the majority of countries had inflation programmed to decline and then level off at a rate under 5 percent per year. The average level of inflation among all 12 PRGFs over the medium term was 4.1 percent.⁵⁹

The Oxfam International study of 20 PRGFs found that although most poor countries had already sustained low inflation over a number of years, the IMF was still pushing them towards even further inflation rate reductions: 19 out of the 20 IMF programs had inflation targets at the end of less than 10%; 16 out of the 20 had inflation targets of less than 5%.⁶⁰

The IMF's main argument for inflation reduction is that high inflation hurts economic growth rates, and this in turn hurts prospects for poverty reduction. There is no doubt that high inflation can be harmful to the poor, by raising prices, eroding real wages and inhibiting growth. In Malawi for example, where the inflation rate has been about 20%, reducing inflation is clearly a priority. However, a considerable amount of research has

explored the question as to how much inflation hurts the poor. Research by Anis Chowdhury turns conventional orthodoxy on its head:

“The poor have very limited financial assets; they are largely net financial debtors. Thus inflation can benefit the poor by reducing the real value of their financial debt. Meanwhile, the IMF’s cure for inflation—raising interest rates, can actually harm the poor because this increases the servicing costs of their current debts.....The poor fare worse when unemployment rises and persists, especially when there is no adequate safety net or social security system. At the same time, the real value of their household debt rises with falling inflation rates. Hence the poor have more reason to be averse to unemployment and less averse to inflation than the elite in society.”⁶¹

The poor lack a voice and representation in the closed door proceedings between their central bank and finance ministry officials and the IMF when agreeing on the proper weights for weighing inflation and unemployment in the “social welfare function” equation.

The IMF and others have argued that inflation makes income distribution less equal and/or hurts the welfare of the poor in developing countries. More research needs to be done in this area because, as Gerald Epstein points out, much of the current research has been asking the

⁵⁹ “Is PRGF Maximizing Finance for Poverty Reduction?” Eurodad. May 2003.

⁶⁰ “The IMF and the Millennium Goals: Failing to deliver for low income countries.” Oxfam International Briefing Paper No. 54. September 2003.

⁶¹ Chowdhury, Anis. “Poverty Reduction and the ‘Stabilisation Trap’—The Role of Monetary Policy,” University of Western Sydney draft available at a.chowdhury@uws.edu.au

⁶² Barro, Robert. “Inflation and Growth,” *Review of Federal Reserve Bank of St. Louis*. Vol. 78, 1996. pp. 153-69.

⁶³ Bruno, M. “Does Inflation Really Lower Growth?”, *Finance & Development*. Vol. 32, no. 3. September 1995. pp. 35-38.

⁶⁴ Bruno, M. and Easterly, W. “Inflation and Growth: In Search of a Stable Relationship,” *Review of Federal Reserve Bank of St. Louis*. Vol. 78, no. 3. May/June 1996. pp139-46.

⁶⁵ Chang, Ha-Joon and Ilene Grabel. “Reclaiming Development: An Alternative Economic Policy Manual,” Zed Books, New York, 2004.

⁶⁶ Ibid.

⁶⁷ “A Response to ActionAid International and Other Organizations,” by Thomas C. Dawson, Director External Relations Department, IMF September 30, 2004. This response was in reaction to a briefing by ActionAid USA and Coauthors, titled “Blocking Progress”. For this policy briefing, the full IMF response, and the point-by-point rebuttal to the IMF critique, see: http://www.actionaidusa.org/blocking_progress.php

wrong question: the issue is not the impact of inflation on the poor, per se, but rather, the impact of a tight monetary policy designed to reduce the rate of inflation and to keep it low, compared with the impact of other alternative monetary policies designed to generate more employment, or more rapid economic growth.

The question of what levels of inflation are acceptable remains an open debate among economists. However, regarding the IMF's main argument for inflation reduction that high inflation hurts economic growth, several studies contradict the IMF claim. For example, a leading expert who is considered tough on inflation, Robert Barro, has found that levels of inflation rates 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.⁶² A major 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 obvious negative impacts for long-term economic growth rates.⁶³ 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.⁶⁴

Indeed, many developing countries have made impressive increases in economic growth rates despite rates of inflation up to 20%, including Latin American economies in the 1950s and 1960s.⁶⁵ Japan and South Korea enjoyed high rates of economic growth in the 1960s and 1970s while also experiencing inflation rates of about 20%.⁶⁶ 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.

“The policy brief by [ActionAid & Coauthors] claims that the IMF undermines the fight against HIV/AIDS by insisting that keeping inflation low is more important than public spending to fight HIV/AIDS. However, this claim is wrong...There is no evidence that attempts to systematically target high inflation rates above a few percentage points will work: they will not create more growth or more room to spend on HIV/AIDS.”

*International Monetary Fund*⁶⁷

“Historically, all possible combinations have occurred: inflation with and without [economic] development, no inflation with and without [economic] development.”

Milton Friedman

“While some will interpret this as a license for big spending, huge deficits and hyperinflation, we simply point out that there is no strong evidence in support of the argument that very low inflation is either pro-growth or pro-poor.”

*United Nations Development Program*⁶⁸

Most of the recent economics literature on the relationship between inflation and economic growth has consistently found that growth falls sharply during high inflation crises of over 40 percent per year, then recovers rapidly and strongly after inflation falls. But, in stark contrast to IMF opinion, there is no clear link that economic growth rates are negatively impacted by rates of inflation under 20-40 percent per year.⁶⁹ The literature suggests that moderate levels of inflation may even help to sustain economic growth—especially when there is significant under-used capacity, such as high unemployment or underemployment (as in many developing countries). So the jury is still out on the impact of “moderate” inflation on economic growth.

⁶⁸ “Can the MDGs Foster a New Partnership for Pro-Poor Policies?” Vandemoortele, Jan. UNDP Asia-Pacific Regional Programme on Macroeconomics and Poverty Reduction. 2004. See also: “Is Low Inflation an Important Condition for High Growth?” by Walter Stanners. *Cambridge Journal of Economics*. Vol.17, no. 1, 1993. pp79-107. Stanners analyzes available postwar data in a number of ways to conclude that “Factual evidence for the seemingly universal belief that low price inflation is necessary for high GNP growth is curiously lacking, maybe even felt to be unnecessary.”

⁶⁹ Chowdhury and Siregar review the recent literature on this point in “Indonesia’s Monetary Policy Dilemma: Constraints of Inflation Targeting” Project INS/99/002—Policy Support for Sustainable Social Economic Recovery.

United Nations Support Facility for Indonesian Recovery (UNSFIR) Working Paper: 02/11 by Anis Chowdhury and Hermanto Siregar, both of UNSFIR Jakarta, November 2002. They cite: Barro, R. (1996), “Inflation and growth”, *Federal Reserve Bank of St. Louis Review*, 78:153–69. See also: Bruno, M. and Easterly, W. (1998), “Inflation crises and long-run growth”, *Journal of Monetary Economics*, 41: 3–26; Fischer, S. (1993), “The role of macroeconomic factors in economic growth”, *Journal of Monetary Economics*, 32: 485–512; The Bruno-Easterly investigation confirms the observations of Dornbusch (1993), Dornbusch and Reynoso (1989), Levine and Renelt (1992) and Levine and Zervos (1993) that the inflation–economic growth relationship is influenced by countries with extreme values (either very high or very low inflation). Thus, Bruno and Easterly (1998) examined only cases of discrete high inflation (40 per cent and above) crises.

What is clear about the inflation-growth relationship, however, is that there can also be significant economic costs associated with tight monetary policies that seek to drive inflation into very low levels. The economics literature is mostly concerned about inflation when it gets too high. However, HIV/AIDS, education and health care advocates should know that there are also problems when inflation is driven too low in a tight monetary policy of the central bank.

The 2001 US General Accounting Office (GAO) report on IMF loans cautioned as much along these lines: “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.”⁷⁰ According to IMF and World Bank documents shared with the GAO, there is a “substantial gray area” between those policies that may be considered too austere and those that cause macroeconomic instability. Presumably, one goal of including the macroeconomic framework within the national poverty reduction dialogue would be to explore this gray area to establish an effective mix of policies consistent with the medium-term goals of the country, yet this has not occurred.⁷¹

The economics literature indicates a consensus that bringing inflation down from very high levels to below 40-20 percent per year is beneficial for economic growth. However, there is another body of research which asks a different set of questions: how low should inflation be brought down, and how quickly? The answers to these questions are particularly important for HIV/AIDS, health and education advocacy groups concerned with low-income countries and IMF loan programs that usually push countries to get inflation very low (5 percent a year or lower) as quickly as possible.

The Sacrifice Ratio: Making Poor People Pay

The main way the IMF advises countries to reduce inflation is to raise interest rates—doing so is deliberately designed to have a dampening effect on economic output (spending, employment and economic growth). When governments raise interest rates, the idea is to reduce the amount of buying, spending and hiring going on in the economy, and basically bring on an economic recession: this is how inflation is brought down. Of course, inducing recessions has a high cost for society. For decades economists have long referred to the equation that calculates how much is gained by lower inflation vs. how much is lost through sacrificed economic output as the “sacrifice ratio”.[□] Debates in the economics literature about how to best calculate the ratio have included efforts such as “Okun’s Law” and “Howitt’s Rule”.[▲] But the IMF doesn’t talk about it, ever.

Inflation and “sacrifice ratio” expert, Peter Howitt of Brown University, explained that “Getting inflation down from 40 percent to 10 percent is not so bad,” because the benefits to growth are believed to still outweigh the sacrifice in lost output at this level. However, Howitt said, “Its getting inflation further from 10 percent down to 5 percent that really hurts.”⁷² Despite the huge costs in sacrificed higher spending, higher employment and higher economic growth rates, Howitt noted that the economics literature suggests there are no clear additional long-term benefits to economic growth rates associated with driving inflation from 10 percent lower to 5 percent.⁷³

The exact costs of the sacrifice ratio can depend on exactly how a country goes about bringing down inflation. For example, if it is achieved primarily through

⁷⁰ “Few Changes Evident in Design of New Lending Program for Poor Countries.” Report to the Chairman, Committee on Foreign Relations, U.S. Senate. United States General Accounting Office GAO. May 2001.

⁷¹ Ibid.

[□] “The Costs and Benefits of Price Stability: An Assessment of Howitt’s Rule,” Thornton, Daniel L. Federal Reserve of St. Louis Review. March/April 1996; See also: Ball, Lawrence. “What Determines the Sacrifice Ratio?” and Cecchetti, Stephen G. “What Determines the Sacrifice Ratio? Comment,” in Mankiw, Gregory N., ed., “Monetary Policy,” University of Chicago Press, 1994.

[▲] “The Costs of Inflation and Disinflation,” Dowd, Kevin. The CATO Journal. Vol. 14 No. 2, Fall 1994. Dowd provides an overview of the literature on calculating the sacrifice ratio: Recent work by William Scarth (1990) and Fortin (1990) suggest quite high sacrifice ratios. Howitt (1990) estimated a sacrifice ratio of 4.7 on the basis of Canadian experience in the recession of the early 80s. Cozier and Wilkinson (1991) suggested that Howitt’s estimate of the sacrifice ratio was as high as it was because he failed to control for other relevant variables, and they came up with a considerably lower sacrifice ratio of around 2 percent. Most studies report sacrifice ratios in the region of 2-4 percent. See: *Fighting Inflation: Are the Costs of Getting to Zero too High?* Scarth, W. in York, R.C., ed. “Taking Aim: The Debate on Zero Inflation,” 1990. pp.81-103; “Can the Costs of an Anti-inflation Policy be Reduced?” Fortin, P. in York R. C., ed. *Taking Aim: The Debate on Zero Inflation*, 1990. pp.135-72.

reductions in public expenditure, the costs can be harsher in terms of the sacrifice ratio. Most IMF programs provide for a mixture of expenditure cuts and revenue increases to meet the targets. According to a leading inflation policy expert, Lawrence Ball of Johns Hopkins University, many of the IMF's deflationary PRGFs involve sacrifice ratios to some extent.⁷⁴

Sacrificing Action on MDGs and HIV/AIDS

The key thing to understand about the “sacrifice ratio” is that it means IMF programs are literally moving countries in the exact opposite direction from increasing the levels of economic output they will need to be generating to achieve the MDGs or to fight HIV/AIDS effectively. Rather than adopting macroeconomic frameworks that maximize economic output and raise social spending, the IMF is enforcing the opposite approach and unnecessarily constraining the level of economic output simply in order to reduce the inflation rate to levels which are not justified by the economics literature.

Nevertheless, the World Bank, USAID, DFID and most other bilateral and multilateral creditors and donors will still only offer help to poor countries if the IMF has first said the country is satisfactorily complying with its tight

fiscal and monetary framework—a framework that will constrain spending to degrees that prevent countries from fighting HIV/AIDS effectively or achieving the MDGs. This makes donors' witting or unwitting accomplices to blocking the fight against HIV/AIDS and the effort to achieve the MDGs.

Inflation Targeting: Tightening the Screw Further

As if unjustified policy positions on low inflation and exacting huge economic sacrifices in their macroeconomic frameworks was not already bad enough, the IMF has since the 1990s, been taking its inflation reduction effort to even new lengths in its tacit support for countries adopting full-fledged, formal “Inflation-Targeting (IT)” regimes.

“Inflation targeting” goes beyond the common PRGF inflation reduction targets and is a particular example of the neoliberal approach to central banking. Neoliberal central banks attempt to: keep inflation at a very low level; reduce central bank support for government fiscal deficits; help manage the country's integration into world trade and financial markets; and dramatically reduce the influence of democratic social and political forces on central bank policy. The major claims made by advocates

Case Study: Ghana

Regarding the PRGF for Ghana, one of the main lessons learned from a recent in-depth study of Ghana's monetary policy by the Political Economy Research Institute (PERI), is that interest rate increases can have stagflationary costs, and that increases in GDP growth appear to have minimal impacts on inflation. Hence, it is not clear that the IMF program which seeks to control inflation by raising interest rates and moderating economic growth in order to contain inflation is a sensible strategy, especially in light of the significant costs in terms of forgone income and employment in a poor country such as Ghana (sacrifice ratio).⁷⁵

⁷² Interview with Prof. Peter Howitt, Dept. of Economics, Brown University.

⁷³ *Ibid.*

⁷⁴ Interview with Prof. Lawrence Ball, Dept. of Economics, Johns Hopkins Univ.

⁷⁵ “Monetary Policy and Financial Sector Reform For Employment Creation and Poverty Reduction in Ghana,” by Gerald Epstein, Political Economy Research Institute and James Heintz, University of Massachusetts, Amherst. August 2005 Draft.

of inflation targeting are that it will: enhance the credibility of monetary policy; reduce the sacrifice ratio associated with contractionary monetary policy; and help to attract foreign investment. The evidence on these claims is mainly in the negative. It is true that countries that formally adopt IT often achieve lower inflation rates, but they do not do so at any lower cost than other countries, in terms of forgone output. That is, inflation targeting does not appear to increase the credibility of central bank policy and therefore, does not appear to reduce the sacrifice ratio.⁷⁶ Central banks that reduce inflation do so the old-fashioned way: by raising interest rates, causing recessions or slower growth, and by throwing people out of work. Moreover, there is no evidence that countries adopting IT manage to attract more useable foreign investment.⁷⁷

Regarding the PRGF for Zambia and its monetary policies, the recent announcement by the 14 members of the Southern African Development Community (SADC) about its new intention to achieve single-digit inflation will likely accelerate Zambia's intention's to adopt an IT regime. South African finance ministry spokesperson Logan Wort said: "There is now a single objective which will filter through to the economic policies of member countries," and that single-digit inflation was one of several areas of an envisaged macroeconomic convergence for the region.⁷⁸

Central Bank Independence: A Critique

The IMF has been favoring countries adopting a policy of central bank independence since the 1990s, based on the assumption that unelected and detached central

banks will not come under popular political pressure for increased deficit spending. However, such logic has further disconnected policymakers from accountability to citizens as it removes fiscal policy as tool for policy makers, and diminishes the maneuverability of government officials to respond to external shocks and recessions with countercyclical policies as needed. Subsequently, the IMF's promotion of inflation-targeting (IT) regimes further accelerates this disconnect.

CBI also furthers the general neoliberal trend of financial sector control of the key sources of accumulation and has increased this sector's influence over state policies above and beyond their limited resources. Unlike the government, the financial sector has not proven to use this influence to channel investments towards key poverty-reducing or other priority areas. In an analysis of Zambia's macroeconomic policies, Alfredo Saad-Filho described a situation common to many developing countries, namely the financial sector's "disproportionate leverage over economic policies and outcomes" and its socially harmful actions in "draining public funds and social resources, but failing to channel them to priority and welfare-enhancing economic sectors."⁷⁹

Such policies make it difficult for donors to implement pro-poor economic development strategies in countries which desperately need them. Worse, the shift to indirect monetary policy instruments will increase further the degree of financial system control of social resources. The result is that the Zambian financial system, and those of other countries, are only partially fulfilling their essential function of making resources available for production and funding socially desirable investment projects.

⁷⁶ See Bernanke et al, 1999 and Epstein, 2000 for detailed surveys of the literature. Cited in "Alternatives to Inflation Targeting Monetary Policy For Stable and Egalitarian Growth: A Brief Research Summary" by Gerald Epstein Professor of Economics and Co-Director, Political Economy Research Institute (PERI) University of Massachusetts, Amherst. June, 2005.

⁷⁷ "Alternatives to Inflation Targeting Monetary Policy For Stable and Egalitarian Growth: A Brief Research Summary" by Gerald Epstein Professor of Economics and Co-Director, Political Economy Research Institute (PERI) University of Massachusetts, Amherst. June, 2005.

⁷⁸ "SADC Wants to Achieve Single-Digit Inflation," Business Day - Johannesburg, South Africa August 5, 2005
<http://www.businessday.co.za/articles/topstories.aspx?ID=BD4A77348>

⁷⁹ "Monetary and Exchange Rate Policy" (Zambia). Saad-Filho, Alfredo. SOAS University of London. Draft Chp 8. Available at as59@soas.ac.uk

Capital Account Liberalization: A Critique

The trend towards liberalization of countries' traditional regulations governing the entry and exit of domestic and international private capital has led to increased instability and frequency of financial crises, especially in developing countries.⁸⁰

In addition, countries that have undertaken capital account liberalization have to a large extent lost autonomy over their exchange rate and monetary policies, which in turn has severely limited their capacity to implement countercyclical macroeconomic policies to protect their citizens during external shocks or economic recessions.⁸¹

In particular, the liberalization of international capital flows has made countries more vulnerable to capital flight. The flow of capital into a country following liberalization tends to lead to real exchange rate appreciation, which is often linked to higher real interest rates. Higher interest rates,

in turn, often attract additional capital flows. The resulting credit expansion can trigger a consumption and import boom or a speculative asset price bubble. The damaging "mousetrap" created by capital account liberalization policies is explained in detail in the box below.

A May 2005 report by the IMF's own Independent Evaluation Office (IEO) concluded that the institution's "cheerleading" on capital account liberalization in the early 90s was unbalanced and inconsistent. While IMF management, staff and executive board were "aware of the risks of premature capital account liberalization", such awareness "remained at the conceptual level" and did not lead to operational advice on preconditions, pace and sequencing of parallel reforms "until later in the 1990s". Moreover, when advice was given, it was inconsistent. Careful sequencing of policy reforms needed prior to capital account liberalization was "mentioned in some countries but not in others"; advice on managing capital inflows "differed across countries and time"; and on the use of capital controls "a range of views were expressed".⁸²



⁸⁰ "Bank insolvencies: cross country experience," Caprio, G., and D. Klingebiel. World Bank Policy Research Working Paper, No. 1620. Washington, D.C.: World Bank, 1996.

⁸¹ "Developing countries' anti-cyclical policies in a globalized world," Ocampo, José Antonio in "Development Economics and Structuralist Macroeconomics: Essays in Honour of Lance Taylor," by Amitava Dutt and Jaime Ros, eds. Cheltenham, Edward Elgar, 2002.

⁸² "Evaluation of IMF and capital account liberalization," by Bretton Woods Project. June 13, 2005. www.brettonwoodsproject.org

The Mousetrap: Keeping economies indefinitely “in the short-term”⁸³

by Fernando Cardim de Carvalho, Institute of Economics, Federal University of Rio de Janeiro

The IMF's general approach of encouraging financial liberalization has ended up placing many low-income and middle-income countries into positions of constantly reacting to short-term fluctuations in foreign investors' confidence in their national economic policies. This situation has made long-term national economic planning, and public expenditure investments in long-term productive assets, extremely difficult.

Emerging market economies with open capital and current accounts are always subject to sudden reassessments of risks and prospective gains that may lead to reversals of capital flows and balance of payments crises. To follow the IMF's strategy, these countries have to be prepared to react in such a way as to regain the investors' good will, by raising interest rates [their profits on bonds, lending, etc] to the extent necessary to lull the investors' disquietudes. The recurrence of episodes of interest rate increases tends to strengthen bearish sentiments as to future interest rates, keeping them higher than otherwise. In this context, investments in real capital assets [longer-term productive investments] are penalized and trend growth rates reduced. Economies appealing to frequent increases in interest rates can exhibit positive growth in calmer periods, but output is more likely to grow by reduction of idle capacity since investments are likely to be reduced. The resulting picture is a sequence of stop and go episodes along a declining long-term trend.

It is important to note that this is not a temporary shortcoming of this kind of strategy. Vulnerability to sudden capital outflows is an intrinsic element of a financially integrated world as devised by the IMF. This is a permanent situation and so are the risks associated with it. As former Deputy Managing Director of the IMF, Michel Camdessus, clearly explained:

“Further, countries that successfully attract large capital inflows must also bear in mind that their continued access to international capital is far from automatic, and the conditions attached to that access is not guaranteed. The decisive factor here is market perception: whether the country's policies are deemed basically sound and its economic future, promising.”*

Besides this potential mousetrap that keeps economies indefinitely in the “short-term”, adhering to the IMF's strategy also means important losses of degrees of freedom [policy space] in what respects growth policies. The IMF's Candessus readily admitted the striking loss of domestic policy space: “the globalization of the world's financial markets has sharply reduced the scope for governments to depart from traditional policy discipline.” Any policy that can be construed as interventionist, be it industrial policy or commercial policy, or whatever, will be branded as populist and will generate suspicion in the financial community. Again, in the absence of any capital controls and restrictions, financial investors will be able to veto these policies by withdrawing their placements from the country, causing balance of payments crises and forcing a retreat by the deviating government to the ranks of the well-behaved. This is precisely what the IMF means by being “disciplined by the market”, one of the hallmarks of financial globalization.

⁸³ “The Changing Role and Strategies of the IMF and Perspectives for the Emerging Countries,” by Fernando Cardim de Carvalho. *Brazilian Journal of Political Economy*, vol. 20., no. 1 (77), January-March, 2000. p.15. *Camdessus, M. “The IMF and the challenges of globalization: The Fund's evolving approach to its constant mission; the case of Mexico.” International Monetary Fund, 1995.

The Devastating Impacts of Rapid Trade Liberalization

Trade liberalization is the driving force of economic globalization, pursued relentlessly by rich nations and international financial institutions at the expense of the poor world.

When trade protection is liberalized too much or too quickly, imports climb steeply as new products flood in and local producers are priced out by cheaper, better-marketed goods. Exports also tend to grow, but by less, restricted by relatively low demand for typical developing country exports – such as raw materials. As a result, local producers sell less than before trade was liberalized and short term gains to consumers are wiped out in the long term as incomes fall and unemployment rises. This has been the story of sub-Saharan Africa and other regions over the past 20 years.

The rich countries that dominate the IFIs and negotiations at the World Trade Organization (WTO) continue to argue that rapid trade liberalization policies will improve the plight of the poor in developing countries. They claim, for example, that lowering developing countries' barriers to trade in manufactured goods, as proposed in the WTO's ongoing non-agricultural market access (NAMA) negotiations, would translate into poverty reduction by boosting economic growth, prices and employment opportunities. In fact, there is now substantial evidence to back up NGOs' longstanding claims that rapid liberalization policies actually cause a net loss for low and middle income countries.⁸⁴

UNCTAD recently concluded from a study of the relationship between trade liberalization and poverty in the world's poorest countries that: "the incidence of poverty increased unambiguously in those economies that adopted the most open trade regimes."⁸⁵

Loss of Jobs and Revenue: Trade Liberalization's Double Whammy

The most frequently cited pro-poor effect of the liberalization of imports is to bring benefits to poor people in developing countries by reducing the price of the imported goods they consume. But such benefits must be weighed against the reality that a high percentage of poor people, particularly women, produce goods for the domestic market. Sudden exposure to competition from floods of cheaper imports can prove disastrous for their jobs and incomes.

Another supposed benefit of trade liberalization is its impact on employment opportunities; it is supposed to create more jobs than the old ones, that are lost. However employment opportunities in any given country depend on the strength and performance of its economy and many developing countries have seen their domestic manufacturing capacity simply wither away when faced with the enormous market power of multinational companies.⁸⁶ Millions of workers have lost their livelihoods as a result. In Chile, for example, net employment in manufacturing fell by about 8 percent following trade liberalization, while Senegal lost one-third of all manufacturing jobs. Other examples of devastating "de-industrialization" following trade liberalization include:

- Zambia, where employment in formal-sector manufacturing fell by 40 per cent in just five years following trade liberalization.⁸⁷
- Ghana, where employment in manufacturing fell from 78,700 in 1987 to 28,000 in 1993 following trade liberalization.⁸⁸

⁸⁴ "Trade Policy at the Crossroads—The Recent Experience of Developing Countries," Shafaeddin, M. Palgrave Macmillan, New York, 2005; Stein, H., "Deindustrialisation, Adjustment the World Bank and the IMF in Africa", *World Development*, vol. 20, no. 1. 1992.

⁸⁵ "The Least Developed Countries Report 2004: Linking International Trade with Poverty Reduction," UNCTAD, United Nations, New York and Geneva. 2004.

⁸⁶ MNCs often get massive production, export and marketing subsidies from the rich-country governments that enable them to sell goods at much lower prices than local producers in developing countries.

⁸⁷ "Poverty, Inequality and Growth in Zambia during the 1990s," Neil McCulloch, Bob Baulch, Milasoa Cherel-Robson. IDS Working Paper 114, Institute of Development Studies, University of Sussex, 2000; See also: "The economics of failure: The real cost of 'free' trade for poor countries," Christian Aid. June 2005.

⁸⁸ *Learning from the Asian Tigers*, Sanjaya Lall. London: Macmillan, 1997; See also: "The economics of failure: The real cost of 'free' trade for poor countries," Christian Aid. June 2005.

- Malawi, where textile production fell by more than half between 1990 and 1996. Many firms manufacturing consumer goods like soap and cooking oils went out of business, and the poultry industry collapsed in the face of cheap imports.⁸⁹

Trade liberalization does create new jobs, but job losses have typically occurred at a faster rate than job creation. In addition, the new jobs are rarely similar to the ones lost, making it difficult for many citizens to regain formal employment. The evidence suggests that in many developing countries trade liberalization has favored skilled labor over unskilled. This is a significant problem in the battle against poverty. As the World Bank itself admits, the sale of unskilled labor is the single most important source of income for poor people.⁹⁰ Without new jobs for the unskilled, trade liberalization can hardly claim to be pro-poor.

Moreover, many of the new jobs created after trade liberalization are located in so-called Export Processing Zones (EPZs)—special port areas detached from the rest of the country in which there are no trade barriers or labor laws. Due to their disconnected nature, these zones do not produce the traditional beneficial spin-off effects of foreign investment, such as paying taxes to the host government, transfers of technology to local firms, or requirements to purchase needed goods and services from domestic companies. While all of the rich countries traditionally insisted upon such benefits from foreign investors, the IMF tells poor countries they may not do so.⁹¹

The Loss of Tax Revenue

For the purposes of this study, the most important damage done by rapid trade liberalization has been

the loss of essential tax revenues needed for social programs. International trade taxes still make up a large proportion of public revenue in many developing countries—27% of total government revenue across sub-Saharan Africa, for example and 37% in South Asia, the region most dependent on tariff revenues.⁹²

This compares with a mere 0.8 percent for high income OECD countries.

In 2005, Christian Aid commissioned economic modeling which concluded that trade liberalization had cost 22 African countries more than US\$170 billion in lost GDP since the 1980's.⁹³ Their findings also confirmed that imports tend to rise faster than exports following trade liberalization and that this results in quantifiable losses in income for some of the poorest countries in the world.⁹⁴ The UNCTAD Least Developed Countries Report for 2004 noted, equally damningly, that: “even where LDCs have increased their overall export growth rate, as many did in the 1990s, better export performance rarely translated into sustained or substantial poverty reduction.”

A recent IMF staff research paper acknowledged the scale of this problem, observing: “With the public finances of many developing and emerging market countries still heavily dependent on trade tax revenues, further trade liberalization may be stymied unless they are able to develop alternative sources of revenue.” The report went on to investigate to what degree 125 countries had been able to make up revenue lost through trade liberalization from other sources between 1975-1990, and found “troubling” answers. While high income countries had recovered revenues with ease, middle income countries had recovered only about 35–55 cents for each dollar of trade tax revenue lost and low income countries had recovered essentially none.⁹⁵

⁸⁹ UNCTAD Least Developed Countries Report, 2004.

⁹⁰ “PRSP Sourcebook”, Chapter 13, World Bank, Washington DC. 2004.

⁹¹ “Kicking Away the Ladder: Development Strategy in Historical Perspective,” by Ha-Joon Chang. Anthem Press, 2002.

⁹² “Trick or Treat? Development Opportunities and Challenges in the WTO Negotiations on Industrial Tariffs,” Fernandez de Córdoba, S., et al. Draft May 10, 2004, forthcoming in “The World Economy”.

⁹³ Using data from “Estimating Demand Side Effects of Trade Liberalization on GDP of Developing Countries,” Egor Kraev. May 2005. Available on request from cmelamed@christian-aid.org; See also: “The economics of failure: The real cost of ‘free’ trade for poor countries,” Christian Aid. June 2005.

⁹⁴ “The economics of failure: The real cost of ‘free’ trade for poor countries,” Christian Aid. June 2005.

⁹⁵ “Tax Revenue and (or?) Trade Liberalization,” Thomas Baunsgaard and Michael Keen. International Monetary Fund Staff Research Paper. Draft. September 20, 2004.

What Trade Liberalization Has Cost Uganda⁹⁶

Uganda began to liberalize trade in 1991. In 2000, its GDP was nearly US\$6 billion. If the country had not liberalized, our model suggests that its GDP in 2000 would have been over US\$735 million higher than it was—more than what Uganda spent on health and education combined that year. Adding the loss every year from 1986 to 2001 (the last year for which we have data), gives a total loss of almost US \$5 billion, or eight per cent of Uganda's GDP over that period. In 2000, Uganda lost US\$32 for every one of its 23.3 million people, thanks to trade liberalization. In the same year, the country received aid worth just US \$35 per person. Over the ten years since trade was liberalized, Uganda has lost US\$204 per person—compared with a per capita GDP in 2000 of US\$253. It's as if everyone in Uganda stopped working for ten months.⁹⁶

No Sign of Nirvana

Neoliberal theory and IMF officials have long promised that the newly-unemployed rural small farmers will be “freed up” by trade liberalization to look for new opportunities on more efficient and higher-value agricultural exports farms or in urban manufacturing sectors. However, the 2005 Christian Aid study concluded that among 32 countries studied, while exports generally did increase, most countries simply exported more of the same goods. Worse, the 2004 UNCTAD annual report on LDCs found that many least-developed countries lost market share following trade liberalization, as their exports failed to compete in international markets.⁹⁷

It is clear that rapid or premature trade liberalization is not achieving the dynamic, diversified or pro-poor pattern of development that the IMF has long promised. On the contrary, such trade liberalization has locked Africa and other countries into greater dependence on a few agricultural products whose prices have been declining on world markets for decades. In such a context, national economic plans for industrial development will remain severely hampered.

IMF In Denial

This exploration of the problems with the current macroeconomic framework has underscored the contradiction between the amount of increased public expenditures that are projected to be needed to fight HIV/AIDS and meet the MDGs and how this level of spending is not possible under the IMF's current macroeconomic framework.

These lessons are not new. Through the late 1990s, it was increasingly noted that the economies that grew the most remarkably were ones who did not follow the IMF macroeconomic framework. Like the “4 Tigers” of Korea, Taiwan, Hong Kong and Singapore a generation before them,⁹⁸ in the 1990s China, India and Vietnam have taken unorthodox approaches, liberalizing some aspects of their markets, integrating in certain ways, but also retaining the prerogative to disconnect, to limit capital and other flows, and to maintain a degree of government involvement in the economy (industrial policy) and overall stability that was well outside of the Washington Consensus prescriptions.⁹⁹ China has had an average economic growth rate since 1980 of around 9 percent, a stupendous performance, India has managed to engineer its own smaller-scale miracle by doubling its growth rate

⁹⁶ “The economics of failure: The real cost of ‘free’ trade for poor countries,” Christian Aid. June 2005.

⁹⁷ Ibid.

⁹⁸ “Governing the market : economic theory and the role of government in East Asian industrialization,” Wade, Robert. Princeton: Princeton University Press, 1990.

⁹⁹ “Light within the ASEAN gloom? The Vietnamese Economy since the first Asian Economic Crisis (1997) and in the light of the 2001 downturn,” Fforde, A. Paper presented at the Vietnam update 2001 Governance in Vietnam: the Role of Organizations. National University of Singapore. Cited in “Poverty Reduction Strategy Papers: a new convergence,” David Craig and Doug Porter. *World Development*, Vol. 30, No. 12. December 2002.

since 1980. The success of these large countries is of momentous consequence, since most poor people live (or used to live) in Asia.

In recent years, as the report card on the failure of the current macroeconomic framework came due, the IMF and World Bank have scrambled for ways to deflect criticism of their own policies and shift blame

on borrowing countries, whom they accused of not implementing the policies correctly.¹⁰⁰ The IFIs have tried to extend the jury time and suggest that the final verdict is still out on their policies. In so doing to they added to the standard structural adjustment policy mix and augmented the original Washington Consensus with a raft of additional domestic policy and institutional and governance reforms (*See the Box: The Augmented Washington Consensus*”).

The Augmented Washington Consensus

The World Bank and the IMF have augmented the original Washington Consensus with several additional layers of policy reforms, focusing heavily on institutional and governance areas. The idea behind this approach is that, while the original policy prescriptions had the right fix on the problem, their implementation and effectiveness have been undercut by weaknesses in other, unforeseen domains. The remedy is to fix these other problems in addition to implementing the original agenda. Hence, if trade liberalization did not produce the expected boost to economic activity, it must be because labor markets were not sufficiently flexible, the fiscal system was not robust enough, and the educational system not good enough. If privatization did not work and proved unpopular, it must be because the appropriate regulatory system had not been put in place. If financial liberalization led to financial crises, it must be because the prudential regulation and corporate governance systems were too weak. If tight fiscal policies did not produce macroeconomic stability, it must be because they were not perceived as credible, and hence credibility-enhancing institutions (such as central bank independence and fiscal responsibility legislation) were required. If the poor did not receive much of the benefits and ended up feeling more insecure, it must be because targeted anti-poverty programs and social safety nets had not been put in place. And let's not forget corruption, which has the potential to blunt the effectiveness of any and all of these reforms if not tackled aggressively.

This sort of logic has been employed both to explain why the reforms of the 1980s and 1990s have produced such weak effects and to shape the policy agenda of the day. The result has been called variably the Washington Consensus-plus agenda, the second-generation list of reforms, and the Augmented Washington Consensus. The new items on the list are heavily institutional in nature. Unlike the elements of the old list, which for the most part could be implemented (in principle) with the stroke of a pen (e.g. trade liberalization, tight fiscal policy, price deregulation), these new reforms require extensive administrative and human resources. The Augmented Washington Consensus is problematic from a number of different perspectives. For one thing, there is an almost-tautological relationship between the enlarged list and economic development. The new “consensus” reflects what a rich country already looks like. If a developing country can acquire, say, Denmark's institutions, it is already rich and need not worry about development. The list of institutional reforms describe not what countries need to do in order to develop—the list certainly does not correspond to what today's advanced countries did during their early development—but where they are likely to end up once they develop.”

*By Prof. Dani Rodrik, Harvard University*¹⁰¹

¹⁰⁰ “Adjustment Lending Retrospective: Final Report,” by the Operations Policy and Country Services (OPCS), World Bank. June 15, 2001.

¹⁰¹ “Rethinking Growth Policies in the Developing World,” Rodrik, Dani. October 2004. Draft of the Luca d’Agliano Lecture in Development Economics to be delivered on October 8, 2004, in Torino, Italy; See also Chapter 3 of “Kicking Away the Ladder: Development Strategy in Historical Perspective,” by Ha-Joon Chang. Anthem Press, 2002.

Why Aren't Developing Countries Rebelling?

Findings From Our Five Country Study

"The globalization of the world's financial markets has sharply reduced the scope for governments to depart from traditional policy discipline."

*Michel Camdessus,
former Deputy Managing Director of the IMF*¹⁰²

Negotiating with the IMF: One Hand Tied Behind Their Backs

The current international trade and financial systems we have described significantly limit developing countries' room for independent action if they want to qualify for foreign aid, loans or debt relief. Global competitive pressures also tend to restrict a country's policy choices and often have an adverse affect on social development, since decisions or actions required to advance social policies and social equality are usually perceived as unnecessary costs. Put simply, social development policies are often mistakenly considered to be in conflict with the preservation of a country's international competitiveness.¹⁰³

The desire of developing countries to attract foreign investment and expand exports has frequently led to

a "race to the bottom" in which labor protection and environmental standards are ignored or compromised to make the countries more competitive in the international market. As this suggests, external competitive pressures have restricted the ability of some countries to pursue certain aspects of social policy and have therefore undermined the progress of social development.¹⁰⁴

In the new international context, countries which are integrated into the world financial system have also lost a tremendous amount of domestic political autonomy, or "policy space" within with to freely choose their macroeconomic policies (discussed below). Deepak Nayyar has noted, "Many low-income countries in particular are constrained in using an autonomous management of domestic demand to maintain levels of output and employment. Expansionary fiscal and monetary policies – large government deficits to stimulate aggregate demand or low interest rates to encourage domestic investment – can no longer be used because of an overwhelming fear that such measures could lead to speculative capital flight and a run on the national currency. The problem exists everywhere. But it is far more acute in developing countries."¹⁰⁵

¹⁰²"The IMF and the challenges of globalization: The Fund's evolving approach to its constant mission; the case of Mexico," by Camdessus, Michel. International Monetary Fund, 1995.

¹⁰³"The Inequality Predicament Report on the World Social Situation 2005" by Department of Economic and Social Affairs (DESA), United Nations, 2005. A/60/117/Rev.1 ST/ESA/299.

¹⁰⁴*Ibid.*

¹⁰⁵"Why is Macroeconomics Different in Developing Countries?" Deepak Nayyar. Initiative for Policy Dialogue Working Paper. Task Force on Macroeconomic Policy. Jun 02, 2003.

Poverty Concerns Over-Ruled

Many finance ministers from the world's poorest and most heavily-indebted countries do not share the IMF's concern with keeping inflation to very low levels. Indeed, high inflation rates have not been an apparent problem for many of their countries in recent years. 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. For example, in a formal declaration from an April 2002 meeting, finance ministers of the heavily-indebted poor countries (HIPC) stated their desire to see more "flexible growth-oriented macroeconomic frameworks," than in the current IMF programs, and stated there is a need "to think more closely about ways to increase growth and employment rather than further reducing inflation."¹⁰⁶ But the IMF's concerns have consistently overruled such concerns to such an extent that few finance, health or education ministers attempt to challenge the underlying assumptions of IMF programs anymore. "It's not like they are losing the fight over the issue of budget ceilings and low public spending with the IMF; it's more like they are not even fighting," said Joanne Carter, Legislative Director of US-based RESULTS Educational Fund, and a leading expert on diseases associated with poverty in developing countries.

This despondency on the part of development country governments, particularly the health and education ministries, is regularly reinforced when the IMF tells countries to scale-back and tone-down their poverty-reducing spending priorities and spending scenarios in their PRSPs. Not only did the United Nation's Millennium Project research find that the IMF program design has paid almost no systematic attention to the MDGs when considering a country's budget or macroeconomic framework, but in the vast number of frameworks

approved by the IMF since the adoption of the MDGs, "there has been almost no discussion about whether the plans are consistent with achieving them":

"In its country-level advisory work, the UN Millennium Project has found that multilateral and bilateral institutions have not encouraged countries to take the Millennium Development Goals seriously as operational objectives. Many low-income countries have already designed plans to scale-up their sector strategies, but due to budget constraints could not implement them. In other cases, countries are advised to not even consider such scaled-up plans."¹⁰⁷

The reality of these many crippling constraints is clearly reflected in the findings of our five country study.

ActionAid International's Five Country Study

During the summer of 2005, ActionAid International USA commissioned local economists to conduct interviews with officials from the central banks, finance ministries, health and education ministries and HIV/AIDS agencies in Bangladesh, Ghana, Malawi, Uganda and Zambia. The main purpose of the interviews was to explore two issues: why governments appeared willing to adopt the IMF macroeconomic framework, and to examine the extent to which there was any "policy space" within the case countries for debates or consideration of alternative macroeconomic policies among officials. Because of the very sensitive political nature of many questions and the difficulty this posed, especially for central bank and finance ministry officials, respondents were given the opportunity to answer the questions anonymously. One difficulty in interpreting responses was the ability to clearly distinguish between official ministry positions and individuals' personal opinions.

¹⁰⁶"Implementing HIPC II; Declaration of the 6th HIPC Ministerial Meeting," London, 5 March 2002. Available at: http://www.dri.org.uk/pdfs/Min_Meeting_March02.pdf ; See also: "Economic Development for Africa: From Adjustment to Poverty Reduction; What Is New?" UNCTAD. Geneva and New York, 2002.

¹⁰⁷"Investing in Development A Practical Plan to Achieve the Millennium Development Goals," UN Millennium Project. January 2005, Chapter 3, p. 36.

Among the 5 countries studied, three (Ghana, Malawi and Zambia) seem to be illustrative of a very important subset of cases, the ones whose recent experiences with high inflation has left people very scared. Our surveys indicated officials in these three countries were very sensitive to the fact that they are still in the transition process toward the IMF's definition of macroeconomic stability (inflation in the low single-digits), and this view affects the choice of macroeconomic policies. It is understandable that if inflation has been high recently, that government officials would be so strongly in sync with the deflationary IMF programs. Because of this, Ghana, Malawi and Zambia represent the dream situation for the IMF because they are situations in which "ownership" works in the sense the IMF wants: when local governments take on the IMF's programs as their own. However, among our cases studied, Bangladesh and Uganda, both of which have had relatively low inflation for several years, are perhaps more representative of low-income countries generally.

Locked Into False Logic?

Apart from Bangladesh, most interviews with central bank and finance ministry officials seemed to reflect an unwillingness to consider more expansionary fiscal and monetary policies, and most were firmly rooted within the IMF's "logic of availability", as discussed above. Based on interview responses, the officials interviewed in Ghana seem to be basically happy (including in the spending ministries) with their policies. They think within the framework of PRGFs and PRSPs, which are prepared under the "logic of availability" (See Box "Crowding Out or Crowding In?"). From this logic, the only question to ask is how to use a given amount of resources freed by the partial debt cancellation they will get. However, civil society advocates for the MDGs, which are based on the countervailing "logic of needs,"

should see these opposing worldviews as an opportunity for further discussion and debate with their governments about the pursuit of the MDGs. Despite the timidity of the MDGs themselves, at least the process follows for introducing the logic of needs and contrasting it against the logic availability. For example, civil society groups and parliamentarians in Ghana can see that it doesn't matter that Ghana is spending somewhat more on social spending under the IMF's direction if it is still at levels much lower than what is projected to be necessary to achieve the MDGs or fight HIV/AIDS effectively.

Most surveys with central bank and finance ministry officials exhibited a dedicated belief to the "logic of availability" and did not acknowledge the possibility of more expansionary fiscal and monetary policies. One striking feature across most interviews was a wholesale inability of officials to distinguish between "higher spending" and "high spending"—or, in other words, the only fathomable possibilities are "low" and "lower" levels of public expenditures. Apart from Bangladesh, where officials did not agree that inflation needed to be driven down as low as the IMF wants, again most respondents did not believe that inflation could reasonably stay in the moderate ranges; most agreed with the IMF that inflation should be driven from moderate levels down into the low single digits, despite the lack of evidence of economic benefits of doing so and the "sacrifice ratio" costs of doing so. This suggests the donors' fears of "slippage" has been thoroughly accepted by borrowers, and the possibilities of allowing more moderate levels of inflation (and thus avoiding the harmful costs of the sacrifice ratio) are not even considered from the outset in most countries examined.

That Ghana was in sync with the cash-only "logic of availability" upon which the IMF policy is based was

articulated well by a Ghanaian finance ministry official: “Like every banker, the IMF sets conditionalities—but these have been targets for macroeconomic stability which this government also subscribes to: and in respect of the PRGF, the prescribed spending on social services has been consistent with government policy. To repeat, the constraint on budget size is revenue, our financial resources. We can’t spend what we don’t have.”¹⁰⁸

Similarly, the surveys in Malawi concluded, “As far as the IMF is concerned, there are no two ways about it: There is either an increase or a decrease in expenditures. Maybe we have been ‘brainwashed’ to think in similar ways. We tend to think that there is nothing like higher spending. Malawi can increase spending so long as resources are there, and one of the main reasons for low expenditures in education, health and HIV/AIDS is because the government does not have enough resources and donor aid inflows have generally been low in recent years.”¹⁰⁹ Regarding inflation rates and negotiating with the IMF, Malawian officials explained they are so busy arguing with IMF about how low inflation must go, that in this context, “How can we argue for allowing a higher level inflation?”¹¹⁰ The striking feature was that in most cases examined, even the idea of the existence of other more expansionary fiscal and monetary policy frameworks is not at all acknowledged, let alone actively considered. In most country surveys, such possibilities seemed completely out of the question.

In stark contrast to orthodox positions of Ghana, Malawi and others was the tone of the responses by officials in Bangladesh. When asked if there was a general agreement with the IMF’s definition of “macroeconomic stability,” that includes that inflation must be kept “in the low single digits” (at 5 percent a year or below), the finance ministry staff responses were summarized as:

“No. Finance doesn’t entirely agree with the IMF definition of macroeconomic stability by keeping inflation very low. The economy of Bangladesh is now in a transition and it can be termed as a take-off stage of economic development. In a take-off stage or transition in the economy, ‘macroeconomic stability’ defined by the IMF is something beyond reality in many cases. As Bangladesh has initiated series of reforms, it is presumable that the economy has to go through some corrections which may destabilize the economic indicators. But, the more important thing is to achieve growth. To achieve certain level of growth, as projected in the country’s PRSP, inflation will spur time to time as growth is inherently inflationary. Containing the inflation by applying monetary instruments is difficult in Bangladesh as the nature of inflation is not very sensitive to monetary policy and factors of inflation are also not always purely economic. In Bangladesh, there is no doubt that inflation hurts the poor and limited-income people. At the same time, higher inflation has positive impact on growth as it pushed up aggregate demand.”

The central bank staff responses were summarized as:

“No, the central bank does not fully agree with the IMF’s definition of ‘macroeconomic stability’ that includes inflation must be kept in the low single digits. In fact, Bangladesh Bank tries to make its own assessment analyzing the macroeconomic trends. But, in Bangladesh, inflation is politically sensitive and inflation above 6 or 7 per cent is quite disturbing for the Government. So, the central bank also tries to apply its instruments to keep inflation at a moderate level, around 6 per cent in general. Again, it is matter of situation demand and Bangladesh Bank doesn’t blindly adopt contractionary monetary policy, although the IMF generally advises it. During the post-flood period in 2004, the central bank adopted an expansionary monetary policy providing more credit for post-flood rehabilitation and agricultural production. In the post flood period, inflation triggered as high as 7.92 per cent at one stage along with food inflation above 10

¹⁰⁸Ghana Survey Findings report.

¹⁰⁹Malawi Survey Findings report.

¹¹⁰Ibid.

per cent. Later, the central bank adopted a “cautious but accommodative” monetary policy stance. Moreover, the factors of inflation as reflected in the consumer price index (CPI) through price hikes of essential products and services, are not always within the control of the central bank. The money supply is not the prime factor always.”

When asked if it would consider adopting a looser monetary policy that allowed for both higher inflation and higher spending, higher employment and higher economic growth, the Bangladesh finance ministry official responded, “Yes, Finance believes that inflation may go higher to some extent for the time being. The present level of inflation (6%+) is in fact moderate and does not necessarily cause serious damage to economy. Again, Finance is not in a rigid position on spending and adopts a looser monetary policy from time to time.” And the central bank official responded similarly, “The Central Bank prefers a ‘cautious accommodative’ stance as well as expansionary policy when necessary that has helped to maintain a relatively low inflation rate even in the face of adverse external and domestic shocks.”

Lack of Independence

Many of the officials interviewed reflected the reality of global competitive pressures described above that restrict a country’s policy choices regarding decisions or actions required to advance social policies and social equality.

These restrictions were made clear, for example, by the finance ministry official in Ghana who explained: “The Government and the IMF come to agreements on the key fiscal and monetary targets, and once agreed, it is the responsibility of the Government of Ghana to draw up the budget in a way that ensures the targets are met.” In Malawi, the health ministry official explained, “In

recent years, the Government’s budgetary consultative process has broadened to include the civil society, the private sector, bilateral donors and indeed the IMF and World Bank. Therefore, many players in this process are fully aware of the Government’s sovereign limits and also understand the IMF/World Bank’s mandate in this process. Participation in this process leads to the preparation of the Green Paper otherwise known as the (MTEF), a document which spells out Government’s economic intentions over the medium term.”

However, while the drafting of the national and sector budgets is a process that may indeed be more participatory and transparent, “key fiscal and monetary targets” which are decided by the country’s negotiations with IMF are not. While many NGOs have become involved in budget-tracking work that monitors the disbursements of the sector budgets from the line ministries to local government levels, most NGOs and civil society groups have no involvement in the government-IMF negotiations that set “the key fiscal and monetary targets”. Nevertheless, this report has underscored that it is precisely these negotiations which must be made more transparent, participatory and accountable to HIV/AIDS, health and education advocates, including public discussions and debates about the key fiscal and monetary targets and possible alternatives.

One question in our report about IMF-borrower negotiations was to ask officials how citizens could know where the line exists between the sovereign autonomy of their governments and the external decisions of IMF. Every report found that citizens cannot know this, although officials from different ministries had different responses. Several respondents, such as Malawi’s health ministry, expressed a similar concern that citizens should

be able to know this, as it would show that in many cases governments do make their own decisions.

Responses about the IMF's influence on the size of the national budgets were mixed. Some countries' officials, such as the Bangladesh finance ministry, felt the IMF had little influence on the outcome of the budget size, but in Malawi officials felt that the IMF's influence was strong. However, across the interviews there were mixed perceptions on this question, possibly because of varying understanding among respondents about how particular fiscal and monetary targets impact the final budget size.

Regarding internal negotiations between the finance ministries and the spending ministries, one strikingly strong conclusion from the interviews was that the HIV/AIDS, health and education ministries were not involved in determining the size of their respective sector budgets. In most cases, these ministries submitted initial budget requests to their finance ministries, but in the end had little say or negotiating room on the final size of their sector budgets. This seems to underscore that the determinants of fiscal and monetary policies agreed to by the finance ministry and central banks with the IMF are where these crucial decisions are made.

For example, the health ministry official in Malawi said, "The health ministry is involved, but it is given a ceiling from the beginning of the process. How the ceiling is arrived at is not known. The ministry tries to live within its ceiling; it massages its needs to fall within the ceiling." A common concern raised by the health and education ministries was also exemplified by the Malawi health official: "There is an absence of physical feel for what is happening in the health sector on the part of decision-makers. For this reason I would propose that graphic presentations on diseases and programs should be included in budget hearings. This might make the decision-makers more willing to give the health ministry bigger budget appropriations."

In Bangladesh, the education ministry official explained:

"Both the Education Ministry and Primary Education have limited authorities on involvement in the process of negotiating the size of education budget, as the budget formation process is very much Finance-centric. The government has, however, initiated mid-term budgetary framework (MTBF) for four ministries including Education with effect from 2005-06. Thus Education has been given more authority for resource allocation and utilization and preparing its own budget up to FY08. There is, however, a budget ceiling and Ministry has not allowed exceeding the ceiling. On receiving the budget circular from the Finance Division, the Education ministry prepares the estimates or projections for three years of the MTBF following the directions contained in the circular. The estimates have to be forwarded to Finance Division and Planning Commission and reviewed by these two wings and the budget will be finalized in a joint meeting between Finance, Planning and Education. Thus, the real authority is still in the hand of Finance."

Wasted Resources, Lost Opportunities

Several countries pointed to budget constraints as the main reason why more teachers, nurses and doctors could not be hired. In some countries, they were using all available trained professionals and demand was such that they resorted to hiring para professionals (less than fully trained and much cheaper). In several cases, however, officials expressed concerns about the "brain drain" phenomenon, in which wages and working conditions were demoralizing and leading professionals to find better paying work in the private sector (with NGOs) or abroad. However the wage bill constraint was commonly cited. For example, the Malawi health ministry official explained, "A major outcome of the expenditure restrictions on the wage bill for the health sector has been the loss of well qualified health personnel and failure to attract new ones."

The Bangladesh education ministry official said: "There are trained and qualified people available to work as professional teachers in Bangladesh, but the wage bill for the public education system is too low to be able to hire them." This official added, "Although Government has revised the pay structure upwardly after seven years, it decided to implement the increment in three phases following an IMF prescription. There are also loopholes in fixing educational qualifications for primary teachers." The HIV/AIDS unit in the Bangladesh health ministry suggested the IMF had at first advised the government not to increase the public pay structure, and then later asked it to implement only the lowest increment, and over time in three phases. As the Government has acted accordingly, "there is a widespread belief that IMF is against the pay hike on the plea that it would spur inflation."

The Government did announce a new pay scale for public employees in Bangladesh, raising salaries by 53 per cent on an average for all public servants of 20 grades. The new scale will be implemented in three phases with retrospective effect from January 1, 2005. But the latest pay hike failed to offset real income eaten up by inflation in last seven years as the hike is still 8 to 10 per cent away from the level required to compensate the public servants for erosion in real value of the money they will draw. Real earnings of the government officials and employees lost more than 40 per cent of their value due to inflation since the last pay scale enforced partly in 1997.

The Bangladesh finance ministry official also said the ceiling has also imposed a cap on the spending of the government and hampered capacity to receive external assistance. As a reflection of the IMF's policy on a budget deficit ceiling, an IMF delegation visiting

Dhaka in the first week of April 2005 discouraged the government from giving the new pay scale increase for public servants. A major section of beneficiaries from the government-planned higher pay structure would be the teachers' community that, in turn, might contribute to the expansion and improvement in quality of education in the country and to better future economic growth.¹¹¹

In addition to the IMF, the World Bank had also warned that immediate implementation of the new pay scale for public servants, as recommended by the national Pay Commission, would jeopardize fiscal discipline and macroeconomic stability in Bangladesh. In a letter dated March 10, 2005, the World Bank's country director Christine Wallich, said, "The costs of implementing substantial increases in public servants' pay and allowances, reportedly recommended by the Pay Commission, could cost around 1.7 percent of the GDP and would risk the government's hard-won fiscal prudence." In maintaining the lender-prescribed fiscal discipline, the Government has more often than not cut down the annual expenditure especially in development sectors. It was also found that politically-sensitive governments sometimes though make higher allocations, they later backtrack from such spending showing various pleas, in keeping with the lenders' prescription to maintain fiscal discipline.

Most countries' officials mentioned that there was a shortage of teachers and health professionals in rural areas and that it was difficult to get professionals out into these areas, so while some countries' urban centers may have excess professionals, it is still a problem to induce these staff to work in rural areas at current pay rates.

Stifled Debate: No Policy Space to Debate IMF v MDG Trade-offs

“...While the new policy direction has successfully uprooted the previous regime it has failed to establish a flourishing alternative. More worrying still, in terms of future prospects, has been the loss of policy autonomy, at both the microeconomic and macroeconomic levels, and the narrowing of the room for policy maneuver.”

Rubens Ricupero, Secretary General of UNCTAD

“The broader the sway of market discipline, the narrower will be the space for democratic governance... International economic rules must incorporate ‘opt-out’ or exit clauses [that] allow democracies to reassert their priorities when these priorities clash with obligations to international economic institutions. These must be viewed not as ‘derogations’ or violations of the rules, but as a generic part of sustainable international economic arrangements.”¹¹²

Dani Rodrik, Harvard University

“There is a growing concern that, over the last quarter of a century, the “policy space” available for the developing countries has shrunk so much so that their ability to achieve economic development is being threatened.”

Prof. Ha-Joon Chang, Faculty of Economics, University of Cambridge

An important question at the center of this five-country study is understanding of the trade-offs that policy makers must consider between meeting tight fiscal and monetary policy targets in their PRGF loan conditions and the otherwise higher spending scenarios that could be envisioned using a number of combinations of alternative macroeconomic policies. There are important trade-offs in macroeconomics, particularly in the sphere of macroeconomic policies, which must be recognized. These trade-offs are at present everywhere. However, the relative importance of such trade-offs depends on the contexts, and Nayyar explained a crucial distinction between how the trade-offs play out in rich and poor countries: “The trade-off between inflation and unemployment is much more important in the industrialized economies than it is in the developing countries (some of which may already be operating at close to full economic capacity); The trade-off between short-term macroeconomic management and long-term objectives is much more important in the developing countries than it is in the industrialized countries (because the developing countries still have important long-term objectives, i.e. significant poverty reduction and industrialization yet to be achieved!).¹¹³

The Need for More “Policy Space”

“Harm can also be done when countries do not have the space to design and implement economic policies that are in their best interests...It is apparent that many countries have managed to generate significant economic growth and poverty reduction without the kind of deep and comprehensive structural reform that has been the buzzword of development institutions during the last quarter century. That is the good news. The bad news is that there seems to be very little that is generalizable across countries—except for some vague notions of respect for incentives, markets, outward orientation, macro stability, and so on. The hard part of development is figuring out the actual policy content of these general principles in a country’s own specific setting. And that task cannot be undertaken without room for policy autonomy and experimentation.”

From: “If Rich Governments Really Cared About Development,” by Nancy Birdsall, President of the Center for Global Development in Washington D.C., Dani Rodrik, Professor of International Political Economy at Harvard University’s John F. Kennedy School of Government, and Arvind Subramanian, Division Chief in the Research Department of the International Monetary Fund.

¹¹²“Four Simple Principles for Democratic Governance of Globalization,” by Dani Rodrik. Harvard University, May 2001.

¹¹³“Why is Macroeconomics Different in Developing Countries?” Deepak Nayyar. Initiative for Policy Dialogue Working Paper. Task Force on Macroeconomic Policy. Jun 02, 2003.

Policy Space in Historical Perspective

By Prof. Ha-Joon Chang, * Faculty of Economics, University of Cambridge

Long-range historical records suggest that “policy space” has an enormous influence on a country’s ability to achieve economic development. When they were colonies or subject to unequal treaties, the developing countries experienced extremely slow economic growth (and we are not even taking into account the issues of political legitimacy, cultural/racial domination, and social inequity associated with colonialism and imperialism). When they were allowed quite large policy space between the 1950s and the 1970s, their growth accelerated beyond expectation. Once the policy space started shrinking from the 1980s [under IMF and World Bank loan programs and through various trade negotiations], their average growth rate fell to half of what it was in the “bad old days” of import substitution in the previous period. Historical comparison shows that the policy space available for today’s developing countries is in fact not the smallest by historical standard. However, policy space for developing countries has been constantly shrinking over the last quarter of a century and it is at the risk of shrinking even further, to the point of making the use of any meaningful policy for economic development impossible.

Among our 5 sets of interviews, those with officials in Bangladesh may be the most interesting case of the set. It was very interesting to see both the finance ministry and the central bank officials willing to discuss at length the relationship between fiscal and monetary policies on the one hand, and of the inflation/welfare trade-off on the other, as if they were sandwiched between the IMF’s demands for more fiscal rigor and their own “spending” ministries demands for more money.

In Ghana, officials felt that any “gray area” that may exist between policies considered too tight and those considered too expansionary won’t be explored in Ghana until after inflation is first brought down to a sustainable single-digit level. This was a typical response of the finance and central bank officials, suggesting little room in the short-term for exploring trade-offs. In contrast, the Malawi finance official was aware of trade-offs and the concerned about the “sacrifice ratio” cost associated with the IMF program’s deflationary approach: “The inflation limit should depend on the growth of the economy and the country’s level of development. While low single digits are said to be optimal for industrialized countries, it is not necessarily the same for developing

countries. There seems to be an appropriate level of 8% for developing countries. However, given that there is often a trade-off for growth in the short run when you seek for lower inflation, this has to be carefully balanced out.” Largely, however, the health, education and HIV/AIDS officials were not aware that any such trade-offs existed, but some said they would like alternatives to be considered if this would translate into higher social spending.

Again, because three of our 5 case countries have recently been suffering high inflation, this sampling of responses may not be representative of views from officials in most developing countries who have already had much lower inflation for many years. In Ghana, inflation seems to be still reasonably high at about 16%, “so it is unlikely that there is much political space within government for discussions of more expansionary fiscal and monetary policies that would show a different attitude” to the problem we are studying. On the other extreme seems to be Bangladesh, whose responses to our survey expressed the most openness to consideration of alternatives. In this sense, of the 5 countries studied, Ghana and Bangladesh are the

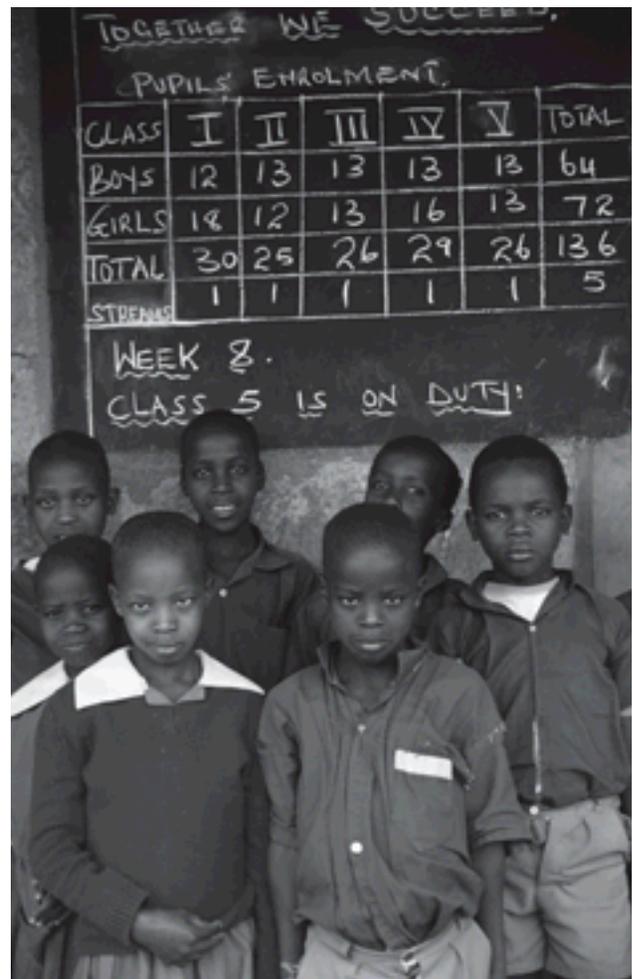
* “Policy Space in Historical Perspective– with special reference to Trade and Industrial Policies” Ha-Joon Chang, Faculty of Economics, University of Cambridge. Second draft: July 2005. A paper presented at the Queen Elizabeth House 50th Anniversary Conference, “The Development Threats and Promises”, Queen Elizabeth House, University of Oxford, 4-5 July, 2005. http://www.networkideas.org/featart/sep2005/Policy_Space.pdf

extreme cases, the first with relatively greater enthusiasm and “ownership” of the IMF’s programs and an inability to perceive a need for alternative policies; and the other with the more explicit willingness to consider the need for alternative macroeconomic policies.

The Malawi health ministry official expressed a concern about a lack of trade-offs being considered: “While giving prominence to growth sectors may have some merit in Government policy priority given the history of economic stagnation over the years, there is also a missing link in this framework. The emphasis ignores the importance of a healthy and literate workforce in increasing productivity in the economy, stressing that an illiterate and sick nation is less productive.”

In Malawi, most officials interviewed expressed interest in consideration of alternatives, but felt constrained by short-term issues such as the huge external and domestic debt obligations, and alternatives for achieving longer-term goals are secondary compared with the short-term commitment to reduce and clear off this debt. Malawi, Uganda and Zambia could be seen as middle cases, in which there is a common split between central bank and finance officials expressing more IMF-type fiscal and monetary rigor while the spending ministries (health, education and HIV/AIDS) expressed a greater openness towards considering alternative macroeconomic policies that would allow for increased expenditures. Of course, all the replies are colored by a background conflict between “the logic of availability of resources” versus the logic of needs for fighting HIV/AIDS effectively or achieving the MDGs.

In summary, the interviews found that most government officials willingly adopt the IMF programs because they believe the policies are appropriate for achieving macroeconomic stability as the IMF defines it, or because either a) they do not believe they have a choice of adopting alternative macroeconomic policies, or b) a general lack of awareness of the existence of alternative policies options. The interviews suggest that there is



an interest in exploring alternative monetary policies, particularly by the spending ministries if such alternatives could achieve higher sector budgets. However, where such interest was expressed, it was dampened by a general perception that there is not sufficient “policy space” within the countries for debates or consideration of alternative macroeconomic policies among officials or in public. This may well be because, apart from Bangladeshi officials, most interviewed seemed to not consider or be aware of alternative macroeconomic policies outside of the limitations of the IMF’s narrow “logic of available resources”, that has characterized the last 25 years of dominant development policy. Few officials were aware of other sets of alternative economic policies that can allow for much higher long-term public investments in health, education and development.

Another Way Is Possible: Exploring Alternatives

There is growing recognition that improved understanding of the current macroeconomic policies and the existence of better alternatives is fast becoming an essential advocacy tool for civil society anti-poverty organizations. ActionAid International has supported national budget-tracking exercises undertaken by civil society organizations in many developing countries and is exploring how to step up this work and expand it into broader efforts at economic literacy training. We strongly encourage other nongovernmental organizations

to substantially scale up both budget-tracking work and economic literacy training for civil society advocates.

There are many variations on existing macroeconomic policies as well as full-fledged alternative macroeconomic models to be considered by civil society as we strive to significantly increase public expenditure for HIV/AIDS, health and education goals. A small sample of these are explored below.

REAL TARGETING

Alternatives to Inflation Targeting Monetary Policy for Stable and Egalitarian Growth

*Gerald Epstein, Professor of Economics and Co-Director, Political Economy Research Institute (PERI)
University of Massachusetts, Amherst, USA*

Professor Epstein suggests that any macroeconomic policy framework which attempts to tackle the ills of poverty, high unemployment and slow economic growth in developing countries must develop a feasible and efficient framework for conducting monetary policy that is oriented to these variables, while at the same time keeping inflation in check. He proposes a “real targeting” framework whereby central banks choose a real target appropriate for their country – normally either reducing poverty levels, employment growth, investment, or real economic growth – and then choose a set of monetary policy instruments to achieve that target.

The key advantage of this approach is that it places front and center the economic variables that have the most immediate and clearest association with social welfare. The central bank would be forced to identify a social welfare target and if it fails to reach it, to explain publicly both why it failed and how it will improve in the next period. New monetary policy tools required would generally include asset allocation strategies to encourage banks to lend more to high employment generating uses, and capital control techniques to manage balance of payments problems.

“Real targeting” lends itself naturally to a more democratic, transparent and accountable central bank policy that serves the genuine needs of the majority of a country’s citizens, rather than the minority that typically benefits from the IMF combination of slower growth, low inflation, and high real interest rates. It is also much more conducive to tailoring monetary policy to the specific needs of different countries. For example, if a country has a particular problem with generating good jobs for women, or more jobs in a particular region, then the real targeting approach can devise specific targets and instruments to achieve those objectives.

To learn more, visit: <http://www.umass.edu/peri>

Basing Economic Policy Around Meeting the MDGs

*Terry McKinley, Economist, United Nations Development Program (UNDP)*¹¹⁴

UNDP has been exploring the implications for economic policies of basing the Poverty Reduction Strategy Papers (PRSPs) of developing countries on what is needed to achieve the 2015 Millennium Development Goals (MDGs). Its key objective is to open up the dialogue on the policy content of PRSPs and promote greater policy choices for national policymakers. For example, UNDP officials are arguing for an increased emphasis on raising domestic revenue and financing extensive public investment programs essential to raising a country's productivity.

UNDP's approach counters the view that a large influx of foreign aid will necessarily appreciate a country's exchange rate and make its exports less competitive (so-called "Dutch Disease"). If countries lack the "absorptive capacity" to effectively disburse development assistance, UNDP argues that resources should be directed, early on, towards developing such public sector capacity. The agency also contends that monetary policies should be targeted to "real" variables, such as economic growth, not just inflation, and that the public sector should provide support to specialized institutions, such as rural banks and development banks, which can promote long-term investment and provide equitable access for poor people to financial services. The UNDP also warns that privatization programs strongly supported by donor nations, have failed to provide equitable and affordable access to essential public services.

To learn more, visit: www.undp.org/poverty/propoor.htm and www.asiapropoor.net

International Working Group on Gender and Macroeconomics

Program on Knowledge Networking and Capacity Building on Gender, Macroeconomics and International Economics

GEM-IWG is an international network of economists that was formed in 1994 for the purpose of promoting research, teaching, policy making and advocacy on gender-equitable approaches to macroeconomics, international economics and globalization. The 2005 Program on Knowledge Networking and Capacity Building on Gender, Macroeconomics and International Economics, which was inaugurated in the summer of 2003, has two objectives: first, to engage with fellow economists in order to enhance capacity building in research, teaching, policy making and advocacy in this area; second, to strengthen the intellectual links among practitioners in networks working on similar issues.

Women and men experience poverty differently. Taking gender inequalities into consideration in the design of economic modeling for alternative macroeconomic policies can significantly improve current understanding of the mechanisms through which macroeconomic policies affect poverty. Mariza Fontana, Department of Economics, University of Sussex (UK) and Yana van der Meulen Rodgers, Department of Women's and Gender Studies, Rutgers University (USA) have compiled an overview of the current approaches to gender modeling and offer further suggestions for research in "Gender Dimensions in the Analysis of Macro-Poverty Linkages," Development Policy Review. May 2005. Vol. 23, no. 3. pp 333-349.

To learn more, see: www.genserandmacro.org/

¹¹⁴"MDG-Based PRSPs Need More Ambitious Economic Policies," Terry McKinley. Policy Discussion Paper. United Nations Development Programme. 2005.

“REAL ECONOMY” OBJECTIVES OVER FINANCIAL OBJECTIVES

Colin Bradford, Professor of Economics and School of International Service, American University, Washington DC, USA

In order to prioritize economic growth, job creation and poverty reduction, countries must increase their macroeconomic room for maneuver. Professor Bradford argues that there are four key, reinforcing steps to making this happen – new policy tools, selective and pragmatic use of capital controls and exchange rate intervention, fiscal policy-based stabilization, and strategic frameworks.

Additional policy instruments enable a greater number of policy goals to be addressed, while selective capital controls, intermediate exchange rate regimes, and some monetary policy autonomy create the policy space to mix and match interventions to changing national circumstances.

Prioritizing real economy goals, he argues, also requires a larger strategic framework focused on accelerated, human-centered development and embracing institutions, behaviors and governance. Mobilizing societies in this way creates a more favorable context for macroeconomic policy to drive growth, employment creation and poverty reduction. The examples of the East Asian success stories provide the evidence for this conclusion.

To learn more, see: “Prioritizing Economic Growth: Enhancing Macroeconomic Policy Choice,” by Colin I. Bradford, Jr. G-24 Discussion Paper No. 37. April 2005.

Public Investment and Employment Generation

*UNDP and International Labor Organization (ILO)
Joint Program*

The UNDP-ILO Joint Program, when linked to the UNDP’s policy studies on pro-poor growth, the ILO’s Decent Work program, and the MDGs, has the potential to shift the policy debate in favor of bolder initiatives for poverty reduction. The Program proposes that without policies to redistribute income, the probable rates of growth in sub-Saharan countries are unlikely to generate rates of poverty-reducing employment that will achieve the MDGs. The principle policy instrument available to governments to achieve redistribution and poverty-reducing employment growth is public investment. To achieve poverty targets through decent work, governments should a) put less emphasis on short term macroeconomic stability, and b) give primary emphasis to medium and long term public investment.

Such policies would have a major beneficial impact on the world’s poorest region, sub-Saharan Africa, which has suffered a drastic fall in public investment, with major knock-on effects on employment and poverty levels, for the past 20 years.

To learn more, see: “Investment for Poverty Reducing Employment in Africa: Review of case studies and an analytical framework,” by Carlos Oya and John Weeks. Report to the UNDP and ILO. May 2004.



TRIP WIRES & SPEED BUMPS

Managing Financial Risks and Reducing Financial Crises in Developing Countries

Ilene Grabel, Associate Professor of International Finance at the Graduate School of International Studies, University of Denver

Based on an analysis of the shortcomings of conventional Early Warning Systems (EWS) favored by the international academic financial community, Professor Grabel proposes an alternative “trip wire & speed bump” regime. Trip wires are indicators of vulnerability that can illuminate specific risks facing developing countries. The most significant include: large-scale currency depreciations; sudden withdrawal of capital by domestic and foreign investors; debt distress, and the contagion effects of financial crises originating in other countries or in specific sectors of its own economy. To soften the impact of such shocks, Professor Grabel argues that trip wires must be linked to specific “speed bumps”—that is, targeted and gradual changes in policies and regulations that change behaviors.

A trip wire-speed bump regime is not intended to prevent all financial instability and crises in developing countries. Indeed, such a goal is fanciful. But insofar as developing countries remain highly vulnerable to financial instability, such a regime provides avenues for policymakers to reduce the risks to which their economies are exposed and curtail the destabilizing effects of unpredictable changes in international private capital flows. While investors and the IMF have registered concerns about such an approach, Professor Grabel argues that obstacles confronting the trip wires and speed bumps approach are not insurmountable.

To learn more, see: “Trip Wires and Speed Bumps: Managing Financial Risks and Reducing the Potential for Financial Crises in Developing Countries,” By Ilene Grabel in Buirra, Ariel, ed. “The IMF and World Bank at Sixty,” G-24 Research Program. London: Anthem Press, 2005.

NATIONAL DEVELOPMENT BANKS

Policies to Support the Productive Economy

New Rules for Global Finance

Increasing broad-based growth and productivity rates and reducing poverty call for the development of a financial sector capable of supporting the needs of the productive economy. The market has an important role to play in determining the pattern and allocation of investment. However, as noted in a growing body of literature, the market alone cannot ensure such pattern and allocation that are optimal to secure and maintain a desired profile of production. Over reliance on the market can also lead to undesirable levels of credit concentration. It can hamper credit whose collective or social rate of return (such as innovative activities, small farm owners, small and medium enterprises) is higher than the rate of return that could motivate individual market participants. The question then is not whether but how state intervention should be implemented.

As New Rules reports, the state can choose from a range of institutional frameworks to influence patterns of investment. It can: a) provide credit itself; b) regulate the private/commercial share of credit; and c) establish development finance institutions. A menu of policy instruments includes: a) directed and subsidized credit; b) partial subsidies on credit insurance premiums or partial guarantee funds; c) differential and preferential interest rates; d) ceilings and other measures aimed at

affecting the deposit-credit ratio; e) state-directed equity investments; and f) the establishment of state-backed development finance institutions.

Many of these policy instruments were used by today's developed countries at earlier stages of their development process, and in some cases are still used today. One example is the German reconstruction credit bank. Another is the US Community Reinvestment Act, whereby banks, thrifts and other lenders are required to make capital available in low and moderate-income neighborhoods. The East Asian countries achieved sustained rates of growth and development over long periods of time using similar policies. Today, however, developing countries have been required to dismantle many of these same instruments in the name of financial liberalization.

New Rules for Global Finance recommends that governments should use policy instruments to ensure the availability of long-term credit, on affordable terms, to support the productive economy. Establishing domestic and public development finance institutions should be supported by international financial institutions, donors, and when feasible, the private sector, including through the provision of technical assistance and equity investment.

To learn more, visit: New Rules for Global Finance www.new-rules.org



Capital Management Techniques in Developing Countries

Gerald Epstein, Professor of Economics and Co-Director of the Political Economy Research Institute (PERI) at the University of Massachusetts, Amherst.

Ilene Grabel, Associate Professor of International Finance at the Graduate School of International Studies, University of Denver. K.S. Jomo, Professor of Economics, University of Malaya.

Capital management techniques refer to two complementary (and often overlapping) types of financial policies: those that govern international private capital flows and those that enforce prudent management of domestic financial institutions.

Policymakers can use capital management techniques to achieve critical macroeconomic objectives. These included the prevention of maturity and locational mismatch; attraction of favored forms of foreign investment; reduction in financial fragility, currency risk, and speculative pressures on the economy; insulation from the contagion effects of financial crises; and enhancement of autonomous economic and social policy. Key lessons described by the authors from different countries' experiences include:

1) Capital management techniques can enhance overall financial and currency stability, buttress the autonomy of

macro and microeconomic policy, and bias investment toward the long-term; 2) The efficacy of capital management techniques is highest in the presence of strong macroeconomic fundamentals, though management techniques can also improve fundamentals; 3) The nimble, dynamic application of capital management techniques is an important component of policy success; 4) Controls over international capital flows and prudent domestic financial regulation often function as complementary and beneficial policy tools; 5) State and administrative capacity play important roles in the success of capital management techniques; 6) macroeconomic benefits of capital management techniques probably outweigh their microeconomic costs; 7) capital management techniques work best when consistent with a national development vision; and 8) There is no single type of capital management technique that works best for all developing countries. "Indeed" the authors conclude "our cases, demonstrate a rather large array of effective techniques."¹¹⁵

Even the IMF and international business community have begun to recognize the achievements of capital management techniques, and the potential for some developing countries (such as China, India, Malaysia, Chile, Singapore) to lead discussions on their feasibility and efficacy.

To learn more, visit: <http://umass.edu/peri>

¹¹⁵"Capital Management Techniques In Developing Countries: An Assessment of Experiences from the 1990's and Lessons For the Future," Epstein, Gerald, Ilene Grabel and Jomo, KS. April 2003. Number 56 Working Paper Series. <http://www.umass.edu/peri/> The paper presents seven case studies of the diverse capital management techniques employed in Chile, Colombia, Taiwan Province of China, India, China, Singapore and Malaysia during the 1990s

Making Change Happen

Why NGOs Must Start Lobbying for Macroeconomic Change

While much attention has been given to civil society organizations participating in their governments' consultations for drafting Poverty Reduction Strategy Papers (PRSPs), crucial macroeconomic policies discussed in this report are not usually discussed or debated within PRSP consultations.

Instead, these policies are usually decided behind closed doors between officials from central banks and finance ministries when they meet with a visiting IMF mission in what are called "Article IV Consultations". These are the critical talks that civil society should be paying attention to. Citizens' organizations should work with their parliamentarians and domestic media to insist

on opportunities to lobby and advocate for alternative macroeconomic policies in advance of IMF mission visits and to demand greater transparency in the consultation proceedings.

While civil society groups have long endeavored to address their concerns about paltry budgets to health and education ministries, they must now go farther and seek to engage their finance ministries and central banks about the determinants of their country's macroeconomic framework and the details of IMF loan conditions, and to begin to advocate for alternatives through domestic sensitization, education and advocacy at the local, national and international levels.

ActionAid International is working with civil society groups in many developing countries to make this happen. We offer the following case studies as inspiring examples of the kind of approaches we are advocating.

ISODEC: GHANAIAN CIVIL SOCIETY LEADS THE WAY...

ISODEC, a leading economic advocacy organization in Ghana, has developed an effective modeling project entitled The Distributive Effects of Economic Modeling (DEEP). Its work is driven by the realization that government macroeconomic policies have the biggest impact on the poor who often lack the power or means to contain any negative shocks resulting from such policies.

Its objective with DEEP is to overcome the lack of transparency in economic policymaking in Ghana by building a series of publicly available tools to enable informed discussion on policy options and tradeoffs with the Government of Ghana. The model will also be used to assess impacts of government policies and external shocks on different population groups and sectors of the economy.

In May 2002 an informal advisory committee for the project—DEEP Technical Support Group (TSG)—was created with representatives of the Bank of Ghana, National Development Planning Commission, Ministry of Finance, Institute for Economic Affairs, the Center for Economic Policy Analysis (CEPA) and Institute for Statistical, Social and Economic Research (ISSER). Interactions with the TSG members have been an important source of both economic data sets and insight into the tools that could be useful to these institutions. The developing DEEP model has since been presented at two international conferences in the US and UK to representatives of civil society and academia.

When completed, DEEP will be used as a user-friendly tool for dialogue between the government, civil society and general public, encouraging wide participation in the formulation of economic policies and processes.

To learn more, visit: www.isodec.org.gh

Economic Literacy Tools to Download

Just Associates, Washington DC, USA

Just Associates was founded in 2002 by a global network of advocates, popular educators and scholars from 14 countries with the goal of strengthening and diversifying citizen voices, leaders, and organizations, and promoting equitable, democratic solutions to poverty, inequality, and injustice. Members of the network share a long history of involvement in grassroots development, community empowerment, and citizen education and advocacy. Their work builds on this collective track record and on the network's unique capacity to combine on-the-ground change experience with learning and action innovations.

Effective economic literacy is not just about the ins and outs of concrete policies, it must also equip citizens to probe and think critically about the core ideas, ideology and political agendas behind policy. What's more, recent experience shows that economic literacy must also help citizens trace the connections between their local economic situation and realities of injustice to national and global economic policy dynamics in order to enable them to strategize about organize to create sufficient pressure for change.

Just Associates believes that, in this way, economic education efforts become a political project in themselves, linking learning about the global economy and it's intersection with national politics and policy directly to the planning of actions and long-term strategies that build collective power to promote greater worker-citizen participation, transparency, public debate and alternatives in the arena of economic policy at local, national and global levels. Integrating education and action requires some clarity about the long-term vision of democratic governance tapping into the double role of workers and citizens. In this way, it's not just economic literacy, it's political education tied to organizing.

To learn more, visit: www.justassociates.org

Reclaiming Development: An Alternative Economic Policy Manual

By Ha-Joon Chang and Ilene Grabel

“There is no alternative” to neoliberal economics, Americanization and globalization remains the driving assumption within the international development policy establishment. In an easy to read manual for civil society advocates, Ha-Joon Chang and Ilene Grabel explain the main assertions behind this dominant school of thought. They combine data, a devastating economic logic, and an analysis of the historical experiences of leading Western and East Asian economies to question the validity of the dominant neo-liberal development model. They then set out practical sets of policy alternatives in the key areas: trade and industrial policy; privatization; intellectual property rights; external borrowing; investment; financial regulation; exchange rates, monetary policy, government revenue and expenditure. The most useful proposals that have emerged around the world are combined with innovative measures of their own, in an empowering and accessible book.

To learn more, visit: www.zedbooks.com/uk/

GET CONNECTED: www.ifivatchnet.org

IFIwatchnet is a groundbreaking initiative in international NGO networking, currently in its second year of operation. It connects organizations worldwide which are monitoring international financial institutions (IFIs) such as the World Bank, IMF, and regional development banks.

Formed in response to a call by civil society groups to maximize the effectiveness of their communications and networking efforts, it is rapidly developing into a key tool for increasing collaboration between IFI-watching groups at national, regional and international levels. With nearly 60 organizations from 27 countries in every region of the world, it has huge potential to increase the ability of civil society to make global governance institutions accountable to the people they serve.

IFIwatchnet does not undertake monitoring or campaigning work itself, but supports the work of its participants. It aims to pool independent information about IFIs from a broad range of civil society sources and make it easier for people to find what they need. It does this by providing a range of web-based information sharing-tools including an IFIwatchers events calendar, a database of documents and newsletters collection, a place to submit documents, a search engine and a shared area for discussion, strategizing and sharing sensitive documents.

To learn more, visit: www.ifivatchnet.org



INTERNATIONAL PARLIAMENTARIANS PETITION

Getting Your Parliaments to Scrutinize IMF and World Bank Loans

The 60th anniversary of the creation of the IMF and World Bank in 2004 was an appropriate time to improve the democratic accountability of these organizations to national parliaments. The International Parliamentarians' Petition (IPP) for Democratic Oversight of the IMF and World Bank is a practical way of encouraging parliaments to be fully involved in the development and scrutiny of IMF and World Bank policies.

The IPP was launched at the World Bank and IMF Spring Meetings in Washington, in April, 2004. Eight parliamentarians from Southern and Northern countries presented 1,000 signatures of members from 50 parliaments around the world to Bank and Fund representatives.

Civil society organizations concerned with IMF and World Bank policies in their countries should encourage their parliamentarians to sign the IPP by sending them the petition, a parliamentary briefing, and the standard letter (or your own.) Civil society groups can endorse the petition and return it to the IPP International Coordinator.

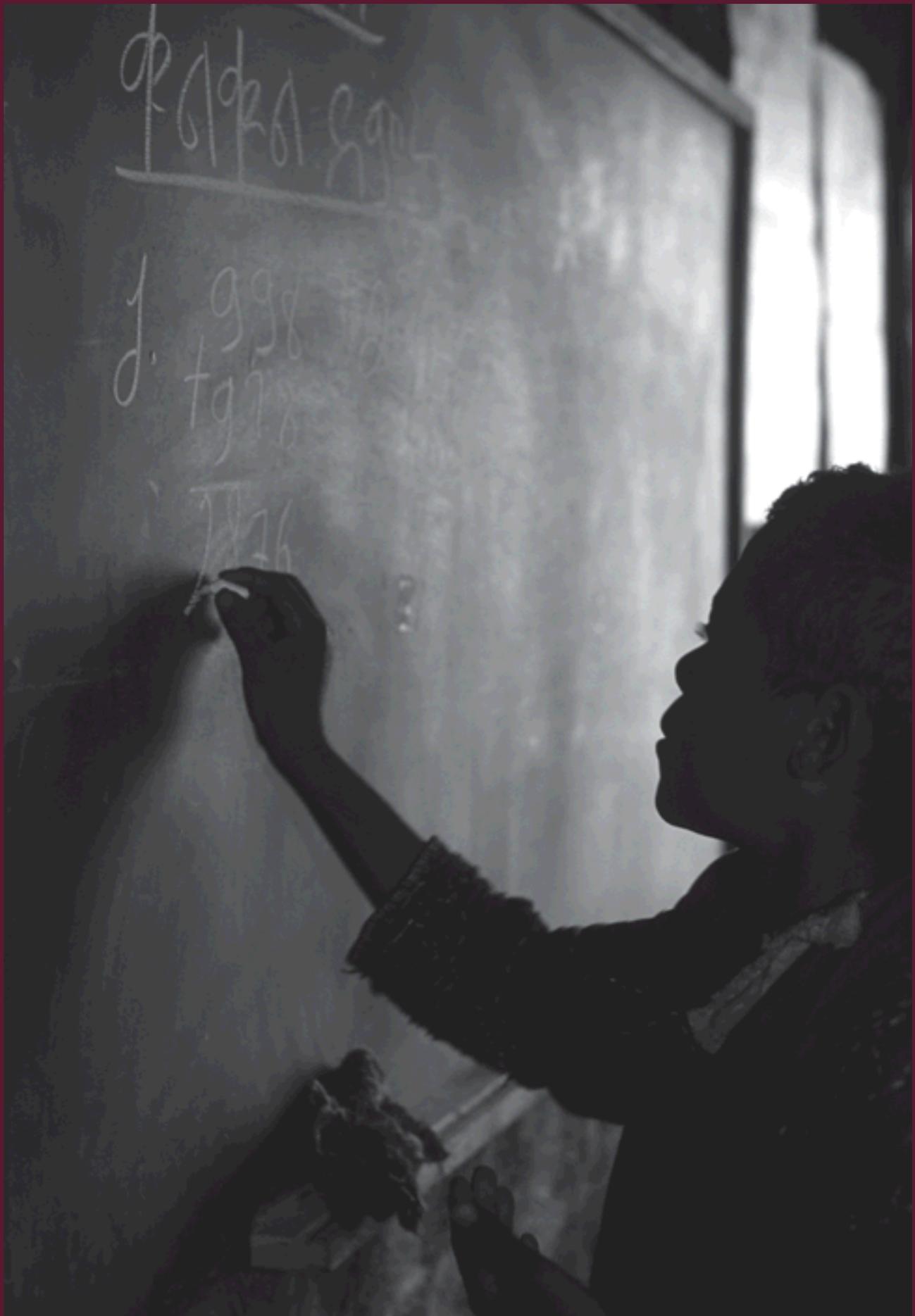
To learn more, visit: **www.ippinfo.org**

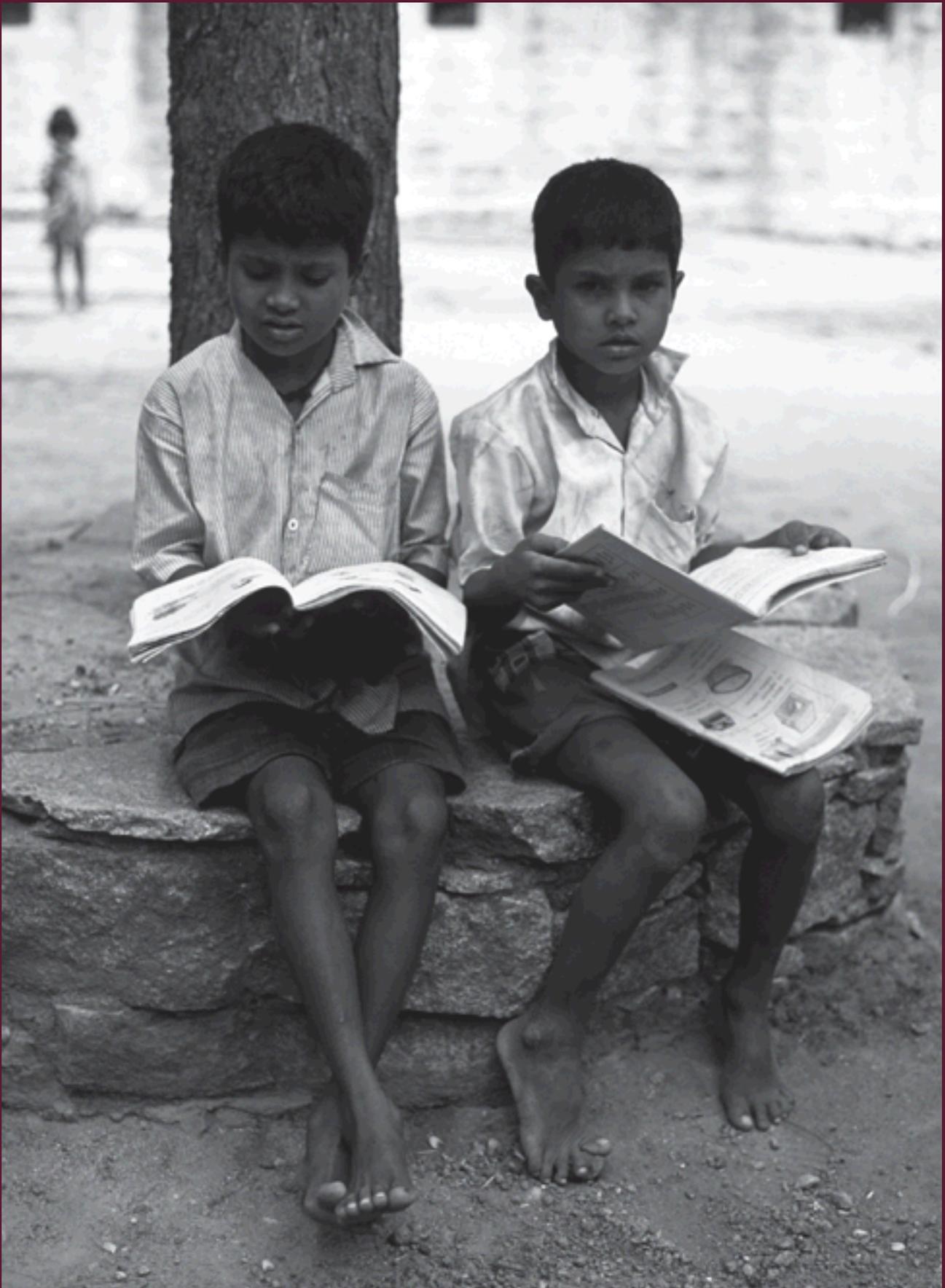
ActionAid International USA

1112 16th Street NW
Suite 540
Washington, DC 20036

202.835.1240 | Phone
202.835.1244 | Fax

www.actionaidusa.org





act:onaid
international usa