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MUTUAL ACCOUNTABILITY AND GREATER POLICY COHERENCE FOR DEVELOPMENT EFFECTIVENESS

AN ISSUES PAPER

May 2003

PREFACE

This Issues Paper has been prepared for the Conference of African Ministers of Finance, Planning and Economic Development, scheduled to take place in Addis Ababa, on 1 June 2003, preceded by a meeting of the Committee of Experts from 29 – 30 May.

The purpose of the paper is to serve as background for the discussions at experts as well as ministerial level, and is intended to inform the Ministers in their preparation of a Ministerial Policy Statement to be issued at the end of the Conference.

The paper covers three topics:

- Mutual Accountability, Policy Coherence and Development Effectiveness;
- Making the IMF Work Better for Africa; and
- The Macroeconomic Implications of HIV/AIDS.

The paper reflects the outcomes of major recent international meetings, among them the 8th HIPC Ministerial meeting held in Kigali on 29 April, the Spring Meetings of the World Bank and IMF held in Washington from 12 – 13 April, the Special High Level Dialogue of ECOSOC with the Bretton Woods Institutions and the WTO held in New York on 21 March, and the OECD/DAC High Level Forum held in Paris on 24 April.

PART I

TOWARDS MUTUAL ACCOUNTABILITY AND GREATER POLICY COHERENCE FOR DEVELOPMENT EFFECTIVENESS

Background

At their meeting on 3 November 2002, the New Partnership for Africa's Development (NEPAD) Heads of State and Government Implementation Committee (HSGIC) requested that: "In the spirit of mutual responsibility and accountability that is embedded in NEPAD, the HSGIC underscored the need for mutual review of development partners in terms of their commitment to Africa. The Economic Commission for Africa (ECA) and Organization for Economic Cooperation and Development (OECD) should urgently conclude work on the institutional framework for this review".

In the past few months, the ECA and the OECD Secretariat have been working together towards that end. A document based on this work entitled "Towards an Institutional Mechanism for Mutual Review of Development Effectiveness Between Africa and its Partners", was presented by ECA to the Sixth Summit of the NEPAD HSGIC on 9 March 2003.

Part I of this Issues Paper will discuss mutual accountability and policy coherence as they relate to the reviews of development effectiveness by Africa and its partners. Specifically, it will:

(i) Present the case for reviews of development effectiveness;
(ii) Discuss the commitments to be monitored on both sides of the partnership;
(iii) Highlight the key areas of policy coherence of crucial importance to Africa; and
(iv) Discuss the review process and the related indicators and data sources.

Particular relevance are the Millennium Development Goals (MDGs), which provide internationally agreed benchmarks for development outcomes that lend themselves to monitoring, and the Monterrey Consensus, with focus on financing development and on mutuality of commitments by African countries and their development partners for meeting shared development outcomes. As pointed out in the Secretary-General's address to the Economic and Social Council Special High-Level Meeting with the Bretton Woods Institutions and the World Trade Organization (WTO), 14 April 2003, the unity of purpose embodied in the development objectives and policy guidelines in the Monterrey Consensus sets the framework for coherence, that is, consistent and sustainable outcomes based on mutually supportive policies and actions by all actors and institutions.

The Case for Development Effectiveness Reviews

If the pace of Africa's development is to be accelerated, it is imperative that the relationship between Africa and its partners be within the context of interdependence and cooperation, and based on shared responsibility for development effectiveness and outcomes. It is also necessary that the commitments on all sides be monitored within an interactive and constructive relationship between developed and developing countries. This requires a functioning process of accountability that can enhance the credibility of commitments undertaken by Africa and its partners, strengthen a results focus, create space for dialogue and exchange towards constructive partnerships, and facilitate the sharing of exchange of good practice as well as the promotion of innovations. The reviews of development effectiveness proposed by ECA are envisaged to achieve this.

Critical here, are the commitments by African countries and their development partners. In the context of NEPAD, African leaders have committed to implementing sound economic policies, tackling corruption, putting in place measures for good governance, investing in their people, adopting the MDGs as the common reference point for development programming, and establishing an investment climate to attract private capital. Similarly, through the Monterrey Consensus and other initiatives such as the G8 Africa Action Plan, Africa's development partners have committed to intensifying efforts for enhanced Official Development Assistance (ODA) quality and quantity, including its composition, allocation, and predictability. Mutual reviews of development effectiveness would entail a systematic, open and constructive dialogue, informed by the application of performance indicators with respect to reviewing the commitments made by those on both sides of the partnership.

African Commitments and Related Indicators

The African Peer Review Mechanism (APRM) approved by the Heads of State and Government of the NEPAD Implementation Committee envisages a number of key indicators, spanning democracy and political governance, economic governance and management, corporate governance, and socio-economic development. The key indicators that form the basis of the country peer reviews under this mechanism and could also inform the mutual reviews of development effectiveness are highlighted below.

Democracy and Political Governance – Level of ratification and accession to relevant African and international instruments for conflict prevention, management, and resolution; independence and effectiveness of Electoral Commissions to ensure free and fair elections; effectiveness of institutions and processes for the implementation, oversight, and public awareness of human rights principles and country obligations to them; the overall state of civil and political rights; the existence and effectiveness of independent and transparent judiciary and parliamentary oversight committees; constitutional provision for fighting corruption and the effectiveness of institutions implementing the mandate, and institutions protecting and promoting the rights of women and children.

Economic Governance and Management **–** In addition to standard indicators of prudent macroeconomic management (deficit to GDP ration and its sustainability, revenue to GDP, inflation rate, debt to GDP and its sustainability, level of unemployment, share of deficit financed by the Central Bank, etc), the focus will be on the transparency and accountability of the budget planning and execution process, autonomy and effectiveness of the national auditing body; autonomy of the Central Bank; effectiveness and enforcement of competition regulation; and enactment and enforcement of effective anti-corruption and anti-money laundering laws.

Corporate Governance **–** Effectiveness of the regulation of the accounting and auditing professions; effectiveness of the legal framework and enabling commercial environment; effectiveness of protection of property rights and creditors' rights; timeliness and effectiveness of resolving corporate disputes; effective ness of private sector regulation; results of assessments of corporate integrity; level of compliance with reporting and disclosure requirements covering capital markets, state owned enterprises and agencies, banking, insurance, and financial sectors.

Socio-Economic Development **–** Level of food security; progress towards meeting the MDGs; progress towards meeting the WSSD goals; the human development index; the incidence of poverty and inequality; trends in social indicators including prevalence of HIV/AIDS and other communicable diseases; proportion of girls attending school; disparities between urban and rural access to educational services; proportion of budget and GDP allocated to the social sectors.

Partner Commitments and related Indicators

Three aspects of partner commitment and action are critical to Africa's quest to meet the MDGs. These include aid quality, aid quantity, and policy coherence.

Aid quantity - As demonstrated by the Monterrey Consensus, and ODA commitments by members of the G8 and OECD's Development Assistance Committee (DAC), including the United States government's new Millennium Challenge Account (MCA), the advent of NEPAD and the renewed focus on Africa's development is timely. More partner countries are setting specific timeframes for meeting the UN aid target of 0.7 per cent of GDP, and most others are stepping up their ODA efforts. The record of partners on efforts towards meeting the UN target and the Monterrey and G8 commitments and the extent to which levels of aid flows are harnessed towards enabling Africa to meet the MDGs should feature as important components in mutual reviews of development effectiveness.

Aid quality - Partners have reaffirmed in major development forums their commitment to improving the quality of aid, and are moving to align their aid around country led national development strategies. But the country evidence shows that while there are some promising examples, general progress in this area has been slow. In practice, partners have tended to lack comprehensive approach to development and are slow in aligning their aid modalities and practices to national priorities, thus continuing the undermining of national systems and processes for development. Complex and multiple aid-related procedures and requirements have imposed heavy transaction costs on recipient countries. In the "Rome Declaration", issued on 25 February 2003, bilateral and multilateral donor agency heads have undertaken to be guided by agreed new sets of good practices to correct these problems, which have been elaborated in conjunction with a panel of developing countries, including six from Africa. The commitments and indicators to be monitored in terms of the Rome Declaration and the DAC Reference Document on the Harmonization of Donor Practices will include the following critical areas.

Progress towards reduction of transaction costs through greater harmonization of donor practices as measured by reduction in the number of donor missions and/or increasing the number of joint missions; progress in sharing country analytic work programmes and products of donor agencies, and more systematic preparation of such products in ways that strengthen partner capacity; the extent to which donors are working jointly (joint sector support, budget support, evaluations, and delegated cooperation); and the extent to which donors use common reporting formats.

Progress towards greater alignment of donor policies with African countries' nationally owned development programmes and their PRSPs based on these programmes.

The predictability of support as measured by the proportion of donors working within medium term expenditure frameworks of recipient countries (includes budget support, sector support, and project support), and proportion of aid resources included/reported through such frameworks, the timing of the disbursement of promised aid funds as agreed; and the progress towards untying of aid.

Support for national capacity development strategies in Africa as illustrated by policies and practices in the use and remuneration of local professionals in donor African field offices vis-à-vis support for capacity building in the public service (relative use, for example, of project implementation units and associated salary and other incentives in relation to local salary structures). The extent to which donor support is focused on national owned medium term capacity building efforts.

Key Policy Coherence Issues for Africa

Coherence is critical to ensuring that all policies impacting on African development prospects are positively correlated and therefore do not conflict or nullify each other. Lack of coherence results in reduced development effectiveness (failure to achieve objectives), inefficiency (waste of resources), loss of policy credibility, and inability to sustain development progress. Ensuring policy coherence is therefore a key pillar in meeting mutual responsibilities towards development effectiveness.

Policy coherence is required both on the side of the African countries and on the side of the development partners. As an example, it may not be possible to increase the proportion of GDP spent on investing in people if there is a sudden change in policy to increase defense spending, or if revenues from extractive industries are not fully transparent and applied through the budget to fund national development strategies. African countries must therefore aim to ensure that there are no offsetting policies and practices towards the goal of creating a robust environment for meeting the MDGs.

The policies of Africa's development partners raise fundamental and pressing issues. Key in this regard are partner commitments to ensure that all policies impacting on African development, including those in the areas of ODA, trade and market access, agriculture, intellectual property, migration, competition, corporate governance, investment, and debt, are coherent with the MDGs.

For instance, abolishing OECD agricultural subsidies would provide developing countries with potential export revenues worth three times their current ODA receipts. The World Bank has estimated that the annual welfare gains from eliminating barriers to merchandized trade range from US$ 250 billion to US$ 620 billion. Up to half of these gains would accrue to developing countries. In terms of poverty reduction, this could lift over 300 million people out of poverty by 2015.

Tariff escalation in the international trade regime makes it difficult for African countries to diversify their economies towards high value added processed goods. Tariff peaks – rates above 15 per cent -- are often concentrated in products that are of export interest to developing countries. Two sectors that matter most from a developing country export perspective are textiles and agriculture. Tariff barriers in textile still remain high while high tariffs for agricultural commodities and continued subsidization of agriculture in many OECD countries have detrimental effects on agricultural exports from Africa and elsewhere.

The success of the Doha Development round of multilateral trade negotiations is crucial for Africa. However, given the current state of these crucial talks, action by OECD countries to front-load the benefits of trade liberalization for the poorest countries by providing immediate duty-free and quota-free market access is important.[1]

The Review Process, Indicators and Data Sources

Responding to the request by the NEPAD Heads of State and Government Implementation Committee, the recent High Level Meeting of the DAC agreed to carry forward the joint work towards establishing mutual reviews of development effectiveness. The precise modalities will be finalized through further discussions, with final recommendations to the NEPAD HSGIC and the DAC/OECD by the end of 2003. At this stage, the concept is for a mutual review process conducted biennially, based on reports produced by the ECA in conjunction with the OECD Secretariat.

The reviews will contribute to a common effort to raise decisively Africa's growth and development performance, so that it can meet the MDGs, which is at present not in prospect for all but a few African countries. The work will be presented to an ODA Forum, comprising the Ministers in attendance at the ECA Conference of African Ministers of Finance and Ministers of Planning and Economic Development, held concurrently with the ADB Annual Meetings. It will also be discussed at the ECA/OECD Ministerial Consultation (the Big Table) where several African Finance Ministers meet with OECD Ministers of Development Cooperation and as well as Heads of bilateral and multilateral agencies, who can take key findings and recommendations through to the DAC/OECD.

The outcomes of these discussions will contribute to the development of common African positions on ODA reform, governance of multilateral institutions, and other related issues such as debt, market access, and agricultural subsidies. Such positions can be taken to relevant international fora – such as the World Bank/IMF meetings and the meetings of the WTO. A report from each ODA Forum, along with recommendations, will be sent to NEPAD.

Regarding indicators and data sources, understandably, the indicators must satisfy the criteria of being acceptable to both African countries and their development partners, and must be supported by sufficient and reliable data sources. Strengthening the information and statistical database for assessing and monitoring development outcomes is therefore critical.

Data and information would need to be gathered from existing and future processes, frameworks, and institutional mandates. Data would include country reports from the APRM; the annual global report of the Secretary-General on the MDGs; country MDG reports; the annual ECA *Economic Report on Africa*; the annual ADB *African Development Report* and joint ADB/OECD *African Economic Outlook*; the PRSPs; the World Bank *Country Policy and Institutional Assessment*; African country reports on ODA; and DAC/OECD reports on ODA levels and allocations.

[1] A growing number of OECD countries and the EU have announced action on this front.

The reviews will also draw on information generated through the work of the ECA-sponsored African Learning Group on PRSPs, the Strategic Partnership with Africa (SPA), and from good practices and ongoing innovative approaches to monitor partner commitments and actions at the country level, including in Ghana, Mozambique, Rwanda and Tanzania. In some of these countries, these innovations include the involvement of independent monitoring groups, the drawing up of codes of conduct for multi-donor group lending, and broadening the use of Consultative Group meetings and other existing instruments as donor coordination mechanisms. By drawing on the lessons of experience from these innovations, the development effectiveness review will promote the replication of good practices in an increasing number of countries, and strengthen ownership through the strategic build-up of local capacity over the medium term. The DAC's new Working Party on Aid Effectiveness and Donor Practices will provide a forum, involving developing countries, in which this process can be reinforced.

One key priority is developing indicators for monitoring policy coherence that capture issues of policy concern to Africa. Potential indicators could include trends in changes in agricultural subsidies, effective tariff rates, and debt stock and reductions. However, much of the data may be global, and disaggregating it by country or region will be a challenge.

Bearing this in mind, it is nevertheless encouraging that work on assessing developments and monitoring changes in such policies as trade, debt, and agriculture subsidies is underway in a number of organizations. For example, the UN Millennium Project over time may come up with guidelines on monitoring progress on the MD Goal 8. At the request of the Development Committee, the Bretton Woods Institutions are also setting up a monitoring and reporting framework for tracking implementation of policies, including those on the trade agenda, by consolidating indictors compiled by the World Bank, Fund, UNCTAD, and WTO. OECD Ministers, in 2002 Policy Statement, pledged greater attention to policy coherence and the OECD Secretariat is working to strengthen the policy coherence dimension in a range of relevant subject areas, including agriculture, fisheries and intellectual property. DAC is also preparing a synthesis report on policy coherence based on the donor peer reviews carried out in 2001 and 2003. Centre for Global Development, a new Washington think-tank, has also recently produced, on a first-run work in progress basis, a Commitment to Development index (CDI) to rank rich nations on the extent to which their aid, trade, immigration, investment policies help or hurt poor countries. The reviews of development effectiveness will draw upon this emerging work in analyzing trends towards policy coherence and assessing the impact of such developments on Africa.

Issues for Consideration

- What is the evidence at country level on progress by donors in aligning their aid modalities and practices to nationally owned development strategies and in harmonizing procedures to reduce the transaction cost of aid?

- How can the principle of African ownership and a credible peer review mechanism be reconciled with the obligations to track progress under a partnership based on mutually agreed outcomes?

- What are the implications of the reviews of development effectiveness for institutional and statistical capacity building in Africa?

- How can African countries address the coherence of their development cooperation policies with their national macrœconomic, sectoral, trade, and financial policies? How can they ensure overall domestic policy coherence between the Finance and Planning ministries, Trade, Agriculture, and other economic ministries?

- What are the possible impacts of agriculture subsidies in Europe and US on agriculture, trade and poverty reduction in Africa? How can Africa ensure that enhanced market access for exports is accompanied by the development of domestic capacities to take advantage of such access? What types of indicators might best capture the issues of concern to Africa on policy coherence?

- There is shared understanding that progress in addressing the related issues on policy coherence must occur in the context of multilateral negotiations including the WTO, and the EU. What measures are needed to strengthen the WTO negotiating capacity of African countries? What steps can be taken to build and strengthen constituencies in donor countries for greater policy coherence?

PART II

Making the International Monetary Fund (IMF) work better for Africa

The IMF is in the process of evaluating its instruments, policies and procedures towards low-income countries in order to better serve this important group of member States. As this process unfolds, it is imperative that Africans themselves engage in the debate and provide constructive suggestions as to how the IMF can better serve Africa.

While there are clearly different opinions as to what role the IMF should play in low-income countries there is a clear consensus in Africa that in addition to its core objectives, the IMF has a vital role to play in helping achieve the Millennium Development Goals, including halving the proportion of people living in absolute poverty by 2015.[1]

At the country level, the IMF plays a pivotal role in support of the Poverty Reduction Strategy process and the development of realistic and effective policy options in African countries. The IMF is a key player in promoting sound economic policies and therefore has a vital role to play in delivering high levels of growth with stability and poverty reduction in Africa. At the global level, the IMF is uniquely placed to play an important role in mobilizing resources for development.

Some critics of the IMF have advocated that it withdraws from operations in low-income countries.[2] Within Africa, this is seen in authoritative quarters as being counter-productive to Africa's quest for deeper integration into the global economy.[3] Indeed, for a region that suffers so much from negative investor perceptions of risk, the IMF's signaling role remains of vital importance.

Yet, much more needs to be done if the IMF, -as the custodian of the international financial system- is to live up to its potential to promote the prosperity of African countries. The challenge is for the IMF to develop new functions and policies to ensure it remains effective and better able to respond to the special circumstances that African countries face.

The special circumstances of Africa include, weak capacity for policy analysis and implementation, the high degree of dependence on primary commodity exports, extreme vulnerability to natural disasters, the large number of small land-locked countries, the relatively large number of post-conflict countries, the large number of countries with unsustainable levels of external debt and the fact that at current trends Africa is the only region where absolute poverty will have increased by 2015.

To deal effectively with the special circumstances of Africa the IMF will need to make progress in the following areas.

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[1] The core function of the IMF is "To promote international monetary cooperation through a permanent institution which provides machinery for consultation and collaboration in international monetary matters". Article 1, section (i) of the IMF's Articles of Agreement.

[2] Meltzer, Alan (2000) "Report of the International Financial Institutions Advisory Committee", US Congress, Washington DC

[3] See Statement by Trevor Manuel, Minister of Finance of South Africa quoted by Brian Kahn (2000) in "Debates over IMF Reform in South Africa" Studies on International Financial Architecture.

- Streamlining conditionality;
- Reinforcing long-term external debt sustainability;
- Alignment of the PRSP approach and the PRGF;
- Renewing efforts to mobilize additional resources for development.

1. Streamlining conditionality

IMF support to low-income African countries is increasingly focused on supporting the development and implementation of Poverty Reduction Strategy Papers (PRSPs) that are consistent with achieving the MDGs at the country level. The IMF provides support for the PRSPs through its concessional facility: the Poverty Reduction and Growth Facility (PRGF); and through debt relief: the enhanced Heavily Indebted Poor Countries (HIPC) initiative. In 2001, the IMF committed new PRGF resources of $2.7 billion -- a record high. IMF projections indicate that new commitments in 2002 could reach $2 billion.[4] Of the 77 countries worldwide (40 African) that are eligible for the PRGF, 28 have produced interim-PRSPs (26 African), another 21 have produced full-PRSPs (20 African)[5] and 38 have arrangements under the PRGF.

The PRSP process has the potential to enhance country ownership of development programmes, focus attention on poverty reduction and encourage broad-based participation in the design and monitoring of these programmes yet several challenges remain.

One of the biggest challenges is how to reconcile the need for more country ownership of adjustment and reform programmes with the need for conditions on IMF loans. Critics charge that IMF conditions are too numerous or too intrusive and hence undermine country ownership. [6]

In recent years, the international community has proposed a number of ways to do a better job of reconciling country ownership and conditionality -- notably, encouraging countries to design "homegrown" programmes, developing a menu of policy options for countries to choose from, and investing time and effort in selling the programme to various domestic constituencies in the country. The poverty reduction strategy papers (PRSPs) used as a basis since 1999 for IMF lending to poor countries, reflects this new direction.[7]

In addition to encouraging "homegrown" programmes, three other proposals have been made to change the IMF's approach to conditionality and help increase ownership. [8] The first approach **---reducing or streamlining structural conditions---** has resonated with African policy makers. The reason is that there is a strong belief that fewer conditions can actually deliver better outcomes. While the number of conditions in programmes relating to macroeconomic performance has been relatively stable over time, the number of structural conditions has increased substantially, going from an average of 3 in the late 1980s to 15 in the late 1990s.

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[4] Annual Report 2002, International Monetary Fund, pp46

[5] as of April 2003

[6] IMF, 2001a Streamlining IMF Structural Conditionality: Review of Initial Experience http://www.imf.org/external/np/pdr/cond/2001/eng/review.htm

[7] Mohsin Khan and Sunil Sharma" Reconciling Conditionality and Country Ownership" Finance and Development Volume 39 Number 2 (2002)

[8] The discussion draws heavily on Mohsin S. Khan and Sunil Sharma, 2001 "IMF Conditionality and Country Ownership of Programs" IMF Working Paper 01/142 (Washington)

The IMF has recognized this trend and made efforts to reduce and streamline structural conditionality. In 2000, IMF management issued to staff an Interim Guidance Note on Streamlining Structural Conditionality, stating that IMF conditionality should cover structural reforms that are critical to achieving the programme's macroeconomic objectives and that lie within the IMF's core areas of responsibility. [9]

The second approach – **floating tranche conditionality** -- has also garnered considerable interest in Africa. The floating tranche approach builds on the idea that flexibility should be introduced in the timing of structural measures.

Under the floating tranche approach, the availability of a loan disbursement would not be tied directly to any specific date; instead, the disbursement would become available upon completion of certain agreed structural reforms. This approach gives the country flexibility in the timing of implementation. Furthermore, it allows the de-linking of disbursements associated with the implementation of one part of the programme (say privatization) from another part of the programme (say enactment of anticorruption legislation).

The third approach is **outcomes based conditionality**. This approach would involve the IMF's disbursing loans based on results, rather than on policy measures expected to lead eventually to attainment of the programme's objectives. This would mean setting performance criteria on the achievement of targets for the policy objectives by selected dates. The policy objectives would be negotiated with the IMF. But the policy content of the programme would be left largely up to the country.

In principle, there are two major benefits to this approach. First, countries would be responsible for designing policies to achieve desired goals. This approach would enhance ownership by requiring that the government and the IMF agree only on the objectives of the programme and not necessarily on the mechanisms that link these objectives to specific policies. Second, funds would be disbursed only when certain goals are attained. IMF resources would be safeguarded because disbursement would depend on the country's achieving the desired results. If policies failed to have the envisaged outcomes, the country and the IMF would be forced to rethink the economic strategy.

Despite the efforts – described above – by the IMF and others to rethink conditionality, there remain deep concerns in Africa as to whether these efforts mark a real change in the way the Fund operates. For instance, since streamlining is about ensuring that conditionality is focused on the most critical policy areas and with both the World Bank and the Fund cutting back most heavily in the gray areas of second-order benchmarks, or non-binding conditionality, African governments may well find themselves with less flexibility rather than more. That is, there will be fewer conditions but they will be more rigidly applied.

The extent of cross-conditionality between the World Bank and the Fund is also of major concern. Several observers have noted that there has long been a *de facto* cross conditionality from Fund to Bank adjustment programmes. However, under the arrangements between the Bank and Fund concerning their PRGF and PRSC programmes some critics claim that the degree of cross-conditionality has been increased at the level of broad performance, although the Boards of both institutions state that cross-conditionality

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[9] IMF 2001 "Strengthening Country Ownership of Fund-Supported Programs" http://www.imf/org/external/np/pdr/cond/2001/eng/strength/120501.htm

should not be applied to policy specifics within either programme, with each institution separately accountable for its lending decisions.

2. Reinforcing long-term external debt sustainability

The IMF also provides support for PRSPs via the debt relief process -- the enhanced Heavily Indebted Poor Countries (HIPC) initiative. Seven African countries have reached completion point under this initiative -- most recently Burkina Faso and Mauritania in 2002, Mali and Benin in 2003.[10] Fourteen African countries have reached decision point. Ten African countries are yet to be considered - almost all of these are in conflict or emerging from conflict.[11] Two African countries, Kenya and Angola are considered to have potentially sustainable debt levels after receiving relief provided under traditional mechanisms.

Of major concern to African countries is that the enhanced HIPC initiative is not delivering long-term debt sustainability to the HIPCs.[12] Of the seven African countries that have so far reached their completion points under the initiative, four (Benin, Burkina Faso, Mauritania and Uganda) are clearly unsustainable for varying periods of time, even if all creditors contribute relief as projected. Two of the remaining three (Mozambique and Tanzania) have been analyzed by the countries themselves to be unsustainable because creditors are unlikely to provide relief as anticipated. Several reasons have been put forward for the inability of the enhanced HIPC initiative to ensure long-term debt sustainability.[13]

Lack of Comparable Relief

The Declaration of the 8th HIPC Ministerial Meeting held in Kigali on 29 April 2003 noted that broad and equitable participation of all creditors is essential to the successful implementation of the HIPC Initiative, and to reducing debt to sustainable levels. The HIPC Ministers also acknowledged the serious issues of HIPC-to-HIPC debt relief and creditor litigation.

There are 49 non-Paris Club official bilateral creditors and their share of debt relief to the 26 decision point countries amounts to US$2.9 billion (2001 NPV terms). Of these, 12 creditors have agreed to deliver full debt relief under the HIPC framework amounting to US$402 million. Libya agreed to participate in the HIPC Initiative in September 2002. A further 14 countries have delivered or agreed to deliver relief on some, but not all, claims on HIPCs representing US$1.9 billion. Finally, 23 countries have not yet agreed to deliver any HIPC relief (representing US$ 580 million).

For non-Paris Club official bilateral creditors, overall commitments have been made to provide relief for about 59 per cent of the total costs applicable to these creditors. In most cases the same creditors have also not provided debt relief under traditional mechanisms (generally 67 per cent NPV reduction on eligible debt), which is required in addition to the

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[10] As at April 9, 2003

[11] Burundi, Comoros, Democratic Republic of Congo, Republic of Congo, Cote d'Ivoire, Liberia, Somalia, Sudan and Togo

[12] Other concerns not discussed here include the slow progress African countries are making towards HIPC completion point.

[13] *What's wrong with HIPC* in Strategies for Financing Development" Issue 15, 1st Quarter 2003. See also study conducted by the World Bank Operations Evaluation Department jointly with the Commonwealth Secretariat.

HIPC relief for reducing HIPCs' debt to sustainable levels. For example, Uganda, the first of the six completion point countries that are supposed to receive all HIPC relief unconditionally from all creditors, has not yet received all such relief. Some of Uganda's creditors have yet to sign HIPC debt-relief agreements, while others have signed agreements that fall short of providing the prescribed NPV reduction. Under-delivery of debt relief (traditional relief as well as original and enhanced HIPC relief) adds US$ 323 million in NPV terms to Uganda's outstanding stock of debt as of end-June 2001, equivalent to 48 per cent of exports.[14]

Increasing the participation of non-Paris Club official bilateral and commercial creditors remains a challenge for the successful implementation of the HIPC Initiative. HIPC ministers noted that moral suasion remains the principal means available to facilitate participation by reluctant creditors because the Bank's and the Fund's decision on the HIPC Initiative are not legally binding on other creditors, the Paris Club's Agreed Minutes create no obligations on the part of non-Paris Club creditors, and the provision of HIPC relief by official creditors is not dependent on the participation of private/commercial creditors.

The fact that not all creditors are providing relief as expected requires that each debt sustainability analysis should analyze the effects on debt sustainability of potential shortfalls of relief from bilateral creditors and of lawsuits by creditors, and recommend steps to overcome them. In addition, donors need to get more involved in assuring the provision of comparable relief by non-Paris Club creditors through solutions tailored to the payment capacity of each creditor, with a particular focus on HIPC-to-HIPC debts, and legal capacity building measures to forestall lawsuits or to assist HIPCs in winning them.

High Levels of New Borrowing

New borrowing that exceeds projected levels has undermined several countries' sustainability. Insofar as this will fund spending needs for poverty reduction, it can often be a positive development. This requires that debt sustainability analysis should include more realistic new borrowing projections, with sensitivity analysis designed to show exactly the amounts/grant elements of finance each country can afford to borrow. This would allow more careful justification of when unsustainable present value ratios need to be ignored in order to allow more borrowing for poverty spending, provided that liquidity ratios remain sustainable.

Failure to Free Fiscal Resources for Poverty Reduction Spending

The IMF approach to debt relief focuses on policies required to stabilize the ratio of external debt to exports. However, fiscal liquidity freed by external debt relief is being offset by excessive domestic debt service. As a result, debt sustainability analysis needs to analyze domestic and total (external + domestic) debt sustainability with a view to identifying ways to relieve heavy domestic debt burdens outside the HIPC framework.

Indeed, by ignoring the role of domestic debt, sustainability analyses may underestimate the magnitude of the fiscal effort that poor countries will have to make in the

[14] "Highly Indebted Poor Countries Initiative – Progress in Implementation," September 23, 2002, SM/02/264 Revision 1, http://222.imf.org/external/hp/hipc, and http://www.worldbank.org/hipc.

post-HIPC era. Such large fiscal adjustments may result in a reduction of funds available to implement the anti-poverty programmes. In addition, very large reduction in primary expenditures may result in political instability and reform backtracking.

The debt service/revenue ratio should be used as the key ratio for judging the delivery of external debt relief and domestic/total debt sustainability. PRGFs need to conduct systematic analysis of domestic debt burdens, and pay more attention to designing measures to relieve them without using HIPC funds directly for this purpose.

Illusory Debt Relief

Debt sustainability is being undermined by the fact that some creditors are providing relief later than projected, or not at all if they insist on tying relief to imports of their goods, or spending it on projects implemented by NGOs. As a result, debt sustainability analysis should project relief according to the timing of its actual delivery, and to whether it is real or illusory.

Unrealistic Macroeconomic Projections

Many debt sustainability analyses still contain overoptimistic macroeconomic projections. The international community needs to implement some of the multiple technical solutions that have already been designed to overcome macroeconomic shortfalls, notably contingency financing through 'floating' additional tranches of the Bretton Woods Institutions programmes, much more rapid additional budget support, and other protection measures such as insurance.

No Market-based schemes to reduce commodity price volatility

Countries that are in danger of slipping back into debt unsustainability tend to depend heavily on primary commodity exports, which make them quite vulnerable to external shocks. Lower than expected level of exports drives these countries back into debt and calls for a major rethinking of how the IMF can help these countries withstand such shocks. Previous attempts to stabilize commodity prices and smooth the impact of commodity shocks have not been successful. Yet this area is too important to be ignored. The IMF has the technical capacity to develop market-based approaches to hedging risk and price volatility.

3. Alignment of the PRSP Approach and the PRGF

The IMF has recognized that for the PRGF to be effective it must be closely aligned with the PRSP approach.[15] Alignment is double-sided. It refers both to a country's own processes (for example aligning the PRSP cycle with the national budget cycle) as well as to congruence between donor procedures and a country's own processes (e.g. aligning the timing and different phases of donor programs with the budget/PRSP cycle). Alignment also refers to the fact that policies supported by donors need to be derived directly from the PRSP. For the IMF an important dimension of this is macroeconomic alignment, in the sense that the macroeconomic framework of the PRSP, of the national budget and of PRGF-supported programs should be congruent.

[15] Aligning the Poverty Reduction and Growth Facility (PRGF) and the Poverty Reduction Strategy Paper (PRSP) Approach: Issues and Options, March 1, 2003. International Monetary Fund.

Of particular concern to African countries is overly optimistic projections in PRSPs and associated PRGF-supported programs. Unrealistic assumptions regarding growth, budget revenues and exports is a major reason why Fund programs are disrupted. Faced with changed circumstances countries are often forced to adjust by radically reducing expenditures - including those on health and education, incurring unsustainable levels of new debt and/or resorting to inflationary financing.

The IMF has responded to this shortcoming by requiring that a more rigorous analysis of growth prospects be an integral part of PRGF-supported programs. The Fund has also launched a new research agenda on the sources and constraints to economic growth to better inform the analysis of a country's growth prospects. In addition, Fund staff are being called on to engage early and actively in the PRSP process in discussing the underlying macroeconomic assumptions.

Another key macroeconomic alignment issue is the need for multiple macroeconomic scenarios to provide more realistic projections underpinning the PRSPs and greater fiscal flexibility. The Fund has proposed that one could be the baseline (or feasible) scenario. The other could be the more ambitious scenario for making faster progress towards the MDGs. The ambitious scenario would provide a basis for discussions with development partners on mobilizing the additional resources required for progress towards the MDGs.

While multiple scenarios have been used on a case-by-case basis in a few countries it is not clear how effective it has been in providing countries with "fiscal space" for maneuver. Indeed, from Rwanda's 2002 PRGF negotiations it is clear that the IMF remains committed to the more conservative baseline scenario which is feasible rather than the more ambitious scenarios to reach the MDGs.

To provide greater fiscal flexibility the IMF should analyze the linkages, trade-offs and policy choices required to attain the ambitious scenario. Evaluating downside risks – commodity price volatility, natural disasters and aid shortfall -- to the various scenarios through formal sensitivity analysis should be a standard feature of IMF discussions with member states.

Accommodating higher aid inflows is another critical macroeconomic alignment issue. This is especially important for post-conflict countries and countries tackling the HIV/AIDS pandemic. Positive externalities that accrue from exceptional financing in these circumstances are increasingly being recognized by the Fund on a case-by-case basis. More generally, African countries recognize that larger aid inflows can have implications for fiscal sustainability, external debt sustainability and a country's competitiveness. Therefore, the macroeconomic impact of significant increases in aid-financed development spending needs to be analyzed and reflected in the design of annual budgets and associated PRGF-supported programmes.

4. Mobilizing additional resources for development

Even the best efforts of the poorest countries will not be sufficient to achieve the MDGs, without additional support from the international community. Concerted efforts have to be taken in areas of trade, private sector development and scaling up official development assistance. The Fund continues to play a major role in each of these areas, advocating for a successful Doha round of trade talks and supporting the establishment of Investor Advisory Councils.

A report prepared by Ernest Zedillo, former President of Mexico, estimates that if we are to succeed in achieving the MDGs, an extra $50 billion in aid flows will be required each year until 2015. The Zedillo Report made a number of proposals for innovative mechanisms to raise development assistance, for example through allocations of Special Drawing Rights (SDRs).

Special drawing rights (SDRs) are assets created by the IMF in 1969 to supplement the traditional reserve assets of its members (such as gold reserves). Allocated to IMF members in proportion to each member's quota in the Fund, SDRs can be exchanged for foreign currency to settle financial obligations between and among member countries and the IMF.

David Lipton, the U.S. Treasury's Under Secretary for International Affairs in the Clinton Administration, proposed an issuance of SDRs in order to create a trust fund to combat financial crises. SDRs would be issued to all members of the IMF, and countries participating in the trust fund would pool their SDRs for use in times of crisis. A similar arrangement could be used to provide additional resources for the MDGs perhaps even in tandem with the creation of the financial crisis trust fund.

Issuing SDRs has been proposed since they were created, and often the argument against them has centered on the risk of inflation due to increased demand. The risk would be minimal. The last time SDRs were issued (1979-1981) about one-quarter of them showed up as increased global demand. Therefore, even a large SDR allocation on the order of $300 billion (as suggested by Lipton) would likely only increase the current $30 trillion of global demand by 0.25 per cent. This option is worth exploring.

The UK proposal for an International Financing Facility (IFF) to raise $50 billion annually to meet the MDGS has commanded wide interest. The founding principle of the IFF is long-term, but conditional funding for the guaranteed to the poorest countries by the richest countries. The Facility would be built on long-term donor commitments to provide regular annual payments to the facility. On the basis of these, it would leverage up immediate resources by issuing bonds in the international capital markets, thus frontloading aid in the period of urgent need. Leveraging funds in this way has long been a part of financing development through the World Bank and other regional development banks, but the IFF is structured to meet the limited and specific task of raising the critical mass of financing required meeting the MDGs. The IMF has an important role to play in supporting the IFF and other innovative means of raising finances for development.

Issues for discussion include:

- Are the recent attempts by the IMF to streamline its conditionality making any difference to African governments?
- How successful has the PRSP process been, in shifting away from the traditional form of conditionality towards greater ownership?
- Which proposal for moving away from strict conditionality is most appropriate for African countries?

- The IMF is increasingly flexible on the fiscal side, but how helpful will it be if all PRGFs recorded discussion of policy choices and compared two or three fiscal scenarios?
- Some creditors, mostly commercial, do not want to participate in HIPC and instead have pursued litigation. Should a new institution be established to manage a legal technical assistance facility to help HIPCs discourage or deal with creditor litigation?
- How can the IMF best provide technical assistance to work out negotiated solutions for HIPC-to-HIPC debt (e.g. Uganda debt owed to Tanzania)?
- What role can the IMF play in smoothing commodity price shocks?

PART III

Macroeconomic Implications of HIV/AIDS

1. Background

According to the latest UNAIDS figures, an estimated 20 million people have died since the start of the HIV/AIDS epidemic on the African continent. A further 29.4 million are presently living with the virus and most of them will die within the next ten years. This means that some 50 million people will have died from HIV-related illnesses, including AIDS, before the end of the present decade.

HIV/AIDS impacts most heavily on the most productive sectors of African economies, namely prime-aged adults. Thus, the virus is depriving these economies of scarce skills, children of their parents and a continent of a generation in the prime of their working lives. In Southern Africa, less than half of today's 15-year olds, in some countries less than a third, can expect to live out a normal adult lifespan, reaching age 60. In Botswana, for example, figures from United Nations Population Funds (UNFPA) indicates that life expectancy has dropped from 65 years (1990-1995) to 56.3 years in 1995-2000 to 39.7 in 2000–2005; without AIDS 2000 – 2005 life expectancy would have reached 68.1 years.

Considering the gravity of the HIV/AIDS epidemic and the devastating human resource losses it entails, understanding its implications for economic policy, planning and outcomes demands our immediate attention. Unfortunately, there are many uncertainties in existing models and projections for what HIV/AIDS will do to economic development, but it is imperative that we begin to grapple with the probable impacts without delay.

The work being initiated by the Commission on HIV/AIDS and Governance in Africa (CHGA) convened by the Secretary-General of the United Nations, and to be chaired by the Executive Secretary of the Economic Commission for Africa, will be concerned with these issues. In addition, the Commission will build upon existing research to deepen understanding of the multidimensional development impact of the HIV/AIDS pandemic in Africa. Based on this, it will seek to define a rigorous foundation for responding strategically to the sectoral, human resource, as well as capacity and governance challenges posed by HIV/AIDS.

2. Macroeconomic Implications

The HIV/AIDS epidemic will affect African economies in a number of different ways: at aggregate, household and fiscal levels.

Aggregate impacts

Earlier studies of the macroeconomic impacts of HIV/AIDS on African economies indicated that the pandemic would probably reduce the growth rate of Gross Domestic Product (GDP) by between 0.4 and 1.5 per cent. The view that the size of this reduction would be well within the range of variation that could be caused by poor economic management or fiscal policy, has led to some complacency among policy-makers in dealing with HIV/AIDS. However, as the epidemic has progressed, it is becoming clear that longer-term macroeconomic implications of the pandemic could be quite dramatic. A recent analysis of the Kenyan economy, for example, has indicated that HIV/AIDS could leave the Kenyan economy one-sixth smaller than it would be without a high HIV prevalence by the year 2015. Similarly, a study in South Africa has indicated that by the year 2020, the level of GDP could be lowered by 17 per cent due to HIV/AIDS; while the level of per capita GDP could be lower by 7 per cent.

This focus on headline figures of overall growth, however, conceals a number of important impacts, some of which must be considered systemic. For instance, the demographics of the continent are being systematically changed by the epidemic, most obviously in respect of adult mortality, which has doubled in most countries (WHO 2002), and a reversal of trends in under-5 mortality caused by increasing levels of HIV transmission from mother to child. One of the most important consequences is a change in the age pyramid of the population, with a narrowing of the distribution in the working age population, and consequent problem with respect to age dependency, with larger numbers of youthful and elderly dependents.

As a result, the age structure of the population and labour forces is also changing in many African countries. This is happening at a time when the overall workforce is also contracting a process that might well be related. The International Labour Organization (ILO) estimates that the workforce will contract by up to 20 per cent in the Southern African Development Community (SADC) subregion by 2015. These deaths occur to workers in their most productive years. Thus, those with important economic and social roles, both men and women, are prevented from providing their full contribution to development. The effects are, of course, not confined to a simple calculus of labour losses, but have much deeper implications for the structure of families, the survival of communities and the continent's rising number of orphans.

It is reasonable to expect that reductions in labour supply, due to declining life expectancy, would also adversely affect output; an impact that will be compounded by reduction in productive efficiency associated with increased incidences of ill health and shortages of critical skills. Moreover, such decline in economic activity will take place against a background of rising social service expenditure, both private and public, and is also likely to reduce savings rates as well as to increase poverty.

Household Level Impacts

The above discussions refer largely to broad macroeconomic impacts at the level of aggregation. However, not all households will be affected by HIV/AIDS in the same way, most obviously depending on whether or not household has a member who is HIV positive. The impact on households with HIV will be as follows: (a) loss of income, if a breadwinner stops work due to sickness or death (this is a permanent impact); (b) loss of income if a breadwinner has to stop work to look after a sick family member (this is temporary or transient impact); (c) additional expenditure on health care and eventually funeral costs (a transient impact).

AIDS death brings with it loss of productive resources through the sale of livestock to pay for sickness, mourning and funeral expenses, as well as sharp decline in crop production. Sickness also contributes to the scarcity of labour because of both the incapacity of workers and the time others have to devote to looking after them. In addition, the scale of the number of people dying in sectors like agricultural, is threatening to undermine the transmission of vital intergenerational knowledge in some communities. According to recent Food and

Agriculture Organization (FAO) statistics, 7 million agricultural workers in Africa have already been lost to AIDS and at least 16 million more could die before 2020.

The net effect of the impacts of these deaths is that such households rarely recover even their initial level of living, since their capacity is reduced through the loss of productive family members through death, and through the sales of any productive assets they once possessed. As a result, a true process of immiseration quickly sets in. It is therefore reasonable to expect that HIV/AIDS will bring about increase in the proportion of households that are poor.

Fiscal (government level) Impacts

The literature on the impact of HIV/AIDS on African governments' fiscal policy suggests there will be direct effects on some of the key areas of government spending, most obviously the health budget. There will also be a range of indirect effects arising from the aggregate economic impacts, and the increase in poverty noted earlier. These can be expected to reduce the ability of governments to raise tax revenues (since these depend on the size of the economy), while increasing the demands on government expenditure, including poverty alleviation measures. Moreover, HIV/AIDS will distort development spending on other areas, since it will be necessary to use resources in a 'defensive' way.

3. The Economic Challenge of HIV/AIDS

Predicated on the outcomes sketched above, it is reasonable to hypothesise that the pandemic may pose one of the greatest current challenges to sustained economic development in Africa. As such, understanding its implications for economic policy, planning and outcomes demands our immediate attention. Specifically, we need to understand the deeper implications of the pandemic for the continual survival of African economies. It is already the case that public services in the most affected countries are facing widespread attrition of staff. The same is happening with directly productive activities, such as agriculture and industry, where losses of personnel are taking place at an accelerating rate due to HIV/AIDS.

The following examples will perhaps suffice to illustrate the impact and challenges posed by HIV/AIDS to industry on the African continent. In Zimbabwe, the cost of AIDS to the national railways in 1997 was found to be equivalent to 20 per cent of company profits; in Zambia, the costs to a petroleum company for AIDS-related medical and funeral expenses in the early 1990s exceeded their meagre profits of US$24,500; in South Africa it was estimated that the total costs of employee benefits due to AIDS would rise from 7 per cent of salaries in 1995 to 19 per cent by 2005; in Kenya, a study of six firms projected that the AIDS-related loss in profit would increase from 6 per cent to 14 per cent between 1994 and 2005; in Côte d'Ivoire, a survey of three firms found average annual costs per employee due to HIV/AIDS representing between 0.8-3.2 per cent of the wage bill in 1997; in Botswana, projections indicate that the impact of HIV/AIDS on five surveyed firms could increase by seven-fold between 1996 and 2004 to reach 5 per cent of their total wage bill.

A question arises as to what the implications of these losses will be for the continual functioning of African economies. Moreover:

- What are the implications of the sustained process of HIV-led immiseration on the continual functioning of Africa's development capacity?

- What mechanisms need to be devised to mitigate the impacts of HIV and AIDS on national economies?

- What are the costs (social and economic) associated with the types of response envisaged?

- What are the impacts (social and economic) associated with the types of response envisaged?

- How sustainable will these various types of responses be?

- What are the emerging policy implications for future policy formulation?

These questions take on even more pressing form when one considers them alongside the wider impact of HIV/AIDS on other societal sectors. Take the case of the educational sector; World Bank projection of primary school age population and the projected teacher mortality in four African countries - Zimbabwe, Zambia, Kenya and Uganda - leads to the tentative conclusion that, 'the change in the number of teachers needed is greater than the changes in the availability of teachers'. Notwithstanding the Bank's warning that, 'the demand and supply analysis used … is meant to be indicative and should be used cautiously', the question arises as to what the educational sector can do both to fulfil its own demands for replacement teachers, administrators and so on, as well as meet the specific needs of the other sectors.

4. The Challenge Ahead

Although, the overall impact of AIDS on the macroeconomy is small at first, it does increase significantly over time. Unfortunately, HIV prevalence continues to rise in most African countries, indicating that most of the likely impacts lie in the future. However, the time-lag between increasing HIV rates and increased AIDS deaths also provides us with a time-window in which to implement policies to mitigate the impact. The ability of African governments to devise these policies will be largely dependent on two factors: first, their understanding of the long-term macroeconomic challenges posed by the pandemic and second, their ability to marshal adequate and sustained resources to mitigate these challenges now.

Some of the key steps that need to be taken include examining the following questions:

- What are the impacts of HIV/AIDS for national budgeting strategies?

- How will the necessary resources for Ministries of Health be mobilized?

- How would scaled-up HIV/AIDS programmes be accounted for in the formulation of national poverty reduction strategies?

- Are there any tensions between the need to respond to HIV/AIDS in the health and social service sectors, and the broader budgetary challenges facing Ministries of Finance?

- What are the human resources and capacity needs required to mitigate the impacts of HIV/AIDS on national economies?

- What is the distribution of the epidemic in terms of its impact on skills and experience?

- Will sector-specific planning be sufficient to replenish human resource losses, or is there a need for national strategic human resource plans?