Executive Summary

Controversy surrounds IMF-supported programs in low-income countries and one of the most contentious questions is whether the IMF forces governments to take policy measures that hurt the health of populations. Critics argue that IMF programs have unduly constrained health spending, at a time when more donor money is available and the health sector needs are very great, because the IMF is too pessimistic about how much aid will materialize or because it takes too conservative a view about what policies are needed to sustain sufficient macroeconomic stability. Critics also maintain that ceilings on government wage bills in IMF programs have unnecessarily disrupted much-needed expansions of the health workforce. The IMF response to such criticisms is that governments are responsible for choices on expenditure priorities and that the Fund does not set targets for spending or wages in particular sectors.

Health outcomes and economic policies are linked in complex ways, involving many policy issues beyond the IMF's competence or mandate

To investigate these issues, the Center for Global Development convened a Working Group on IMF Programs and Health Spending. The Group was charged with two broad goals: (i) to establish the facts about what actually happened on these key issues; and (ii) to make practical recommendations for improvements where warranted. The Group's work focused on the interaction between macroeconomic, especially fiscal, policies in recent IMF programs and government health spending in aid-dependent countries; it did not address other health sector or economic policies except where relevant to this mandate. Working Group members, serving in individual and voluntary capacities, included experts in macroeconomic and health sector analysis and policy implementation.

The Working Group drew upon a range of background papers on different aspects of IMF programs, including detailed case studies for Mozambique, Rwanda, and Zambia.

IMF Influences on Health Spending: Indirect But Potentially Significant

Health outcomes and economic policies are linked in complex ways, involving many policy issues beyond the IMF's competence or mandate. Governments make the key decisions on what share of their resources to spend on health and on the policies that will determine how effectively those resources are used. Their decisions may not match the political rhetoric given to the importance of health, especially for the poor. For example, the share of total government spending devoted to health has not increased as much as promised in some earlier political statements. Within the health sector, there is considerable scope for improvements in planning, budget allocation and implementation to

ensure resources reach frontline service providers and for improving incentives to ensure effective service delivery, including access for the poor. Higher spending on health is a critical part of the solution, as most health systems are funded at levels well below what is judged as necessary to deliver a basic package of health interventions, but the right policy setting is also needed to ensure that more money translates into better health. These are issues on which the IMF should have little to say given its expertise and mandate as a macroeconomic risk advisor; in particular, it cannot say how much additional resources health systems can use effectively.

However, the content of IMF programs can have important indirect effects on the health sector, through the size of overall public spending and other influences (e.g., on the growth rate, which in turn influences future spending capacity). Furthermore, the nature of many health interventions makes them especially sensitive to fiscal decisions. In countries with weak budgetary processes, the burden of short-term expenditure cuts can fall disproportionately on health spending, causing disruptions in the availability of resources. Because of the imperative of ensuring continuity in services and drug supply for HIV/AIDS, tuberculosis and other major diseases, any temporary interruptions in funding can have very serious consequences for health outcomes. Moreover, the nature of much health spending—including the large share spent on wages and the complexity of training and recruitment—increases the importance of forward-looking budgetary planning. Therefore, IMF-supported fiscal policies in particular can have an important influence on the health sector.

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In this context, the IMF has two main functions: (i) advising countries on the macroeconomic consequences and feasibility of policies (e.g., on the path of the fiscal deficit and public spending); and (ii) providing signals to the broader international community, including donors, on whether a country's proposed strategy is macroeconomically sustainable.

In assessing how well the IMF has carried out these functions, it is important to recognize that we often know little about some critical economic relationships that have a major influence on macroeconomic policy choices. For example, it is difficult to determine, in advance, how public spending (in the health sector and elsewhere) will affect future economic capacity. Also, how private investment might respond to lower fiscal deficits is not straightforward. So humility is required when pronouncing on the appropriate macro framework unless country-specific evidence on such relationships is available. In practice, policy choices must inevitably be made under considerable uncertainty and need to take account of the implied costs of different types of potential mistakes. For example, risks to macroeconomic stability have to be weighed against foregone opportunities for additional public spending.

Even if all these empirical questions could be answered, many policy issues—especially those involving the health sector—would continue to involve fundamental social choices that should be left to national political processes. The IMF's job is to help countries explore the consequences of various feasible policy options to clarify the tradeoffs involved. So a key question posed by the Working Group was whether the IMF has unduly constrained the range of feasible policy options that should be left to domestic political

processes. Our conclusion is that, in several important ways, the IMF has often been too restrictive by ruling out potentially viable policy options without sufficient consideration.

What Has Happened to Government Health Spending? Moderate Increases But Still Well Short of Supporting an Effective Basic Health System

Government health spending in low-income countries has risen moderately, both as a share of GDP and as a share of total government spending, since the late 1990s. Viewed from a longer perspective, these increases have only managed to restore previous shares. However, the data is weak and does not capture most off-budget spending. In dollar terms, average public spending per head on health for the group of countries eligible for the IMF Poverty Reduction and Growth Facility (PRGF) has also increased moderately, rising from $10 in 1998 to $15 in 2005 (at market exchange rates). Most countries, though, still spend much less than the levels estimated as the minimum necessary for effective delivery of a basic public health system (e.g., around $40 per person, when updated to current prices, according to groups such as the WHO Commission on Macroeconomics and Health).

Comparing countries that have had extensive involvement with IMF programs during 1998–2005 with those that have not indicates that, outside of Africa, broad trends in government health spending are similar for the program and non-program groups. For sub-Saharan Africa, the average increase in health spending as a share of GDP was larger for the group of program countries. However, not much can be inferred from these relatively small differences. For example, since an IMF arrangement was a pre-requisite for HIPC debt relief and part of the resources from such relief was supposed to support higher health spending, much bigger increases in health spending might have been expected in countries with IMF programs. An earlier study that tried to control for such factors concluded that the presence of an IMF program tends to maintain or slightly increase health spending, but the effects appear to be small and short-lived.

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Fiscal Content of IMF Programs: Too Little Exploration of More Ambitious But Still Feasible Spending Options, Despite Some Recent Evidence of Flexibility

The evidence suggests that IMF-supported fiscal programs have often been too conservative or risk-averse. In particular, the IMF has not done enough to explore more expansionary, but still feasible, options for higher public spending.

The problem is more complex than suggested by accusations that the IMF pursues a “one size fits all” approach. Cross-country evidence indicates considerable variation in the size of targeted changes in fiscal deficits and public spending. Moreover, on average, recent fiscal programs incorporate moderately higher expenditures and deficits, reflecting better macroeconomic starting conditions.

Nevertheless, a recent study of IMF programs in Africa by the IMF Independent Evaluation Office and the detailed case studies undertaken for the Working Group both found that the IMF has tended to favor additional domestic debt reduction or external reserves increases over additional spending. While the IMF is right to take account of the level of reserves and domestic macroeconomic conditions when designing the fiscal response to additional aid, the degree to which these factors influenced the fiscal strategy seems too conservative and sometimes led to too stringent fiscal programs. A wider range of fiscal paths is often now possible, especially following debt relief, but there was little discussion—at least in publicly available IMF documents—of the rationale underlying the specific path chosen for the fiscal deficit and overall government spending. More ambitious but still potentially feasible fiscal options for higher spending were usually not explored. In Rwanda, for example, an earlier donor-sponsored effort to explore alternative expenditure options, although technically flawed, was a missed opportunity to broaden the debate over fiscal strategy. The case studies show that the IMF has often adapted its programs significantly to changing circumstances at the time of program reviews (i.e., in the middle of programs), but this is not the same as taking the lead in exploring alternative scenarios.

More ambitious but still potentially feasible fiscal options for higher spending were usually not explored

Three factors may account for the reluctance to explore a broader range of options. First, information on the sector-level costs and consequences of higher spending scenarios necessary to make reasonable macroeconomic assessments is often lacking, especially for the health sector. Filling these information gaps goes well beyond IMF expertise and requires better inputs on sector-level issues, drawing on the inputs of country-level stakeholders and bilateral and multilateral partners. If key information is lacking, the IMF should be humble in its macroeconomic pronouncements. But the Fund often responded to the uncertainty by implicitly "assuming the worst" concerning the potential for higher public spending—for example, about the severity of any constraints on the capacity to absorb more aid, the likely permanence of additional aid, the impact of higher public spending on long-term output, and the speed with which a strategy based on paying down domestic debt might "crowd-in" private investment. Second, the IMF Board and management have given insufficient guidance to IMF staff on what exactly they are meant to do in this area. Third, tensions between different roles of the IMF weakened incentives to open up the debate to include a broader range of options and stakeholders. For example, negotiations over short-term macroeconomic conditionality may be easier to conclude if kept within a narrow circle and may involve information that the government wishes to keep confidential.

The Working Group also investigated how IMF programs respond when aid is higher or lower than expected. Many programs required that, in the short term, higher-than-projected aid be saved whereas expenditures were to be cut if aid fell short of projections. The balancing of risks implied by such an approach is not justified if the costs of under- or over-shooting targets are no longer asymmetric. If there is a reasonable cushion of reserves and the costs of disrupting medium-term expenditure plans are high, the appropriate policy response would be to smooth expenditure fluctuations. A change in program

design to allow greater short-term flexibility could be especially important for the health sector, which tends to suffer disproportionately from short-term expenditure cuts. The case studies suggest that the IMF is already moving, albeit gradually, in this direction.

The IMF and Aid Projections: Unclear Expectations Create a Risk of Confused Signals

The lack of clarity about what is expected with regard to aid risks sending confused signals to donors and recipient governments

With a few recent exceptions, there was little exploration of the macroeconomic consequences of scenarios for scaling up aid. In some earlier programs in the countries for which case studies were prepared, aid projections were oriented around goals of reducing aid dependency (e.g., Mozambique) or avoiding borrowing even on concessional terms (Rwanda) without strong macroeconomic arguments in favor of the approach taken. In these cases, the IMF programs did eventually adapt when substantially higher aid was forthcoming, but it is not possible to say whether the initial negative signals discouraged any aid.

In-depth analysis of alternative scenarios for "scaling up" aid have been undertaken in a few countries in the last couple of years, and some more are in the pipeline, suggesting some signs of a gradual change in approach. However, expectations of IMF staff in this area are still not clear, and much seems to depend on the initiative of individual mission chiefs. The Working Group was told that it is now the policy of the IMF African Department to undertake such an analysis whenever it is requested by the authorities and sufficient information on sector-level costs is available. At the time of writing this report, however, that revised approach had not yet been reflected in any general policy statement by the IMF.

The lack of clarity about what is expected with regard to aid has two consequences. First, the IMF has not done as much as it could to help countries (and donors) explore the macroeconomic consequences of higher aid. Second, it risks sending confused signals to donors and recipient governments. For example, if only conservative scenarios are presented, does this mean that the IMF thinks more resources cannot usefully be absorbed from a macroeconomic perspective? Or does it mean that the IMF thinks more resources will not be forthcoming, regardless of whether they could be well-utilized?

In practice, projections of aid to Africa in IMF programs remain conservative—reflecting skepticism by IMF staff, which may be justified, on donors' resolve to deliver on their commitments to double aid by 2010. Of the 27 IMF programs and reviews in sub-Saharan Africa that were completed in the 18 months after the Gleneagles Summit, baseline projections in only two were consistent with the Gleneagles commitments.

Targets for Inflation

Most recent IMF programs with low-income countries have targeted inflation at very low levels (i.e., 5 percent or lower), largely reflecting low starting levels of inflation or membership of currency unions. Empirical evidence does not

justify pushing inflation to these levels in low-income countries. The IMF should not be unduly risk-averse by ruling out additional aid-financed government spending options just because they may put some upward pressure on prices. It should explore more macroeconomic scenarios to allow a better assessment of the costs and benefits of more fiscal space, including the potential supply side benefits of additional spending on spare capacity utilization, investment and future output growth.

The targets for inflation that guide monetary policy should take account of country-specific circumstances that are likely to influence the path of prices, including the consequences of any adverse supply shocks. However, an across-the-board relaxation of monetary policy associated with an adoption of higher inflation targets would be unlikely to yield higher growth, because expectations of higher inflation would adapt quickly.

A shift toward greater emphasis on providing inputs into a broader policy dialogue would require important changes in the IMF way of doing business

IMF Program Negotiations: Too Narrow a Circle Weakens Political Support

The narrow circle of national participants discussing IMF programs had two adverse consequences. First, an overly narrow debate aggravated the lack of integration between discussions about sector-level policies (specifically, choices on the level and composition of expenditures and what was needed to improve their effectiveness) and the overall macroeconomic framework. Second, it weakened political support for key policy choices. In the case studies, it was striking how some decisions affecting the health sector were incorrectly attributed, including by some government officials, to the IMF program. This "blame the IMF" attribution of policy choices is unhealthy because it undermines what should be a robust domestic debate about priorities.

The IMF alone cannot broaden the dialogue (which ultimately depends on the government) but could do much more to provide additional evidence, discuss the rationale for its policy proposals, and encourage more analysis and discussion of various options. A shift toward greater emphasis on providing inputs into a broader policy dialogue would require important changes in the IMF way of doing business, including downplaying the Fund's role as a negotiator of short-term conditionality.

Ceilings on the wage bill have been useful as a temporary device when a loss of control over payrolls threatened macroeconomic stability, but such situations will probably be rare

Wage Bill Ceilings Have Been Overused and Should be Restricted to Very Specific Circumstances

Conditionality related to the wage bill was included in almost half of recent IMF programs with low-income countries. For example, 17 out of the 42 countries with PRGF-supported programs during 2003–2005 included some form of ceiling on the wage bill; all were in Africa or the Central America/Caribbean region. Such ceilings have been especially common in Africa. Our conclusion is that such ceilings have been overused. They have been useful as a temporary device when a loss of control over payrolls threatened macroeconomic stability (e.g., Zambia 2003–2004), but such situations will probably be rare. In practice, they have been used in many other situations, including efforts to influence

long-term resource allocation choices (i.e., the share of government spending going to wages) that the IMF is not well-suited to pronounce upon and that should not be addressed by short-term macroeconomic conditionality.

Wage-related conditionality in IMF programs has always used ceilings on the overall wage bill and not sector-specific constraints on hiring or wages in health (or education). Indeed, programs with ceilings on the overall government wage bill usually included some mechanism that attempted to protect expansions of employment and pay in priority sectors, often by trying to build such projections into the baseline ceiling. In practice, however, there was usually no way to enforce such protection or even to monitor what actually happened. Consequently, if space under the ceilings was used up by unanticipated hiring in sectors with more political influence, employment in health could still be constrained.

Although IMF involvement in wage bill issues should be scaled back, governments will still face huge long-term challenges in their efforts to address their large health workforce needs within likely resource availability

Although IMF involvement in wage bill issues should be scaled back, governments will still face huge long-term challenges in their efforts to address their large health workforce needs within likely resource availability. Evidence from the case studies suggests that countries often have no clear strategy to match incentives to the most urgent needs for the supply and distribution of skilled staff. In some cases where long-term human resource plans have been developed (e.g., Zambia), the targeted staff increases are large but have not been integrated with medium-term expenditure planning. Consequently, they provide only limited guidance to priority-setting in annual budget discussions.

Strengthened National Budgetary and Planning Processes are Needed to Reduce the Disconnect Between Fiscal and Health Sector Policies

Fixing the striking disconnect between overall fiscal and budgetary policies and health sector issues will require actions by many stakeholders, not just the IMF

While the main focus of the Working Group has been on identifying changes in the IMF approach that can improve the framework for choices on health spending, it is important to recognize that the IMF role—for good or ill—is always going to be an indirect and secondary one. Some critical changes can only be made by national governments, and supported by donors. In this regard, our investigation has highlighted a striking disconnect between overall fiscal and budgetary policies and health sector issues. Fixing this disconnect will require actions by many stakeholders, not just the IMF, since it involves many different aspects. First, as noted, a huge analytical and information gap exists: macro-policy decisions are often made with very little understanding of the likely costs and effects of potential choices for health spending; similarly, discussions on longer-term health policy are often not guided by a clear idea of what the overall budget constraints might be. Second, national planning and budgeting capacities—including those of ministries of health—are not strong enough to make meaningful choices on tradeoffs. Addressing these analytical and capacity gaps will usually require additional external technical support. At the international level, the issue is usually discussed in terms of stronger IMF-World Bank collaboration, but it is much broader than that because the relevant external expertise often lies with other multilateral institutions or bilateral

donors. Strengthened frameworks are needed for identifying who does what and by when to help governments, with feedback on accountability. Third, donors have contributed to the segmentation of budgetary processes. Keeping important donor-financed activities outside of the normal budget process tends to weaken national priority setting and creates longer-term fiscal problems if donor priorities do not align well with national priorities.

Expenditure Protection Mechanisms—Potentially Useful During Periods of Budgetary Stringency But Need to be Focused and Reflect Domestic Priorities

The Working Group looked at possible mechanisms to protect spending on health, as the health sector has often been particularly vulnerable to budget cuts. While strengthening budgetary and governance processes is the "first best approach" to ensuring that budgetary priorities properly reflect social choices, current budgetary systems are flawed. So, mechanisms that protect (i.e., give special priority to) some categories of spending can be a useful device while overall processes are being strengthened. The evidence on what works best is limited, but the Working Group found three guiding principles on these expenditure protection mechanisms: (i) designation of spending categories to be protected should reflect priorities of domestic constituencies, not donors; (ii) priority categories should be well-focused and not overly broad; and (iii) such mechanisms need to be integrated with macroeconomic strategies for smoothing aggregate public spending, which requires flexibility in related IMF conditionality.

The worst of all worlds would be for the IMF to pretend that it can continue to play its current major role in these countries without adapting its way of doing business to the new challenges they face

Six Recommendations for the IMF

The IMF needs to adapt its approach in low-income countries to its expected role and be crystal clear about what that role is. Our recommendations assume that the IMF will remain an important macroeconomic policy and risk advisor in these countries. In this case, some significant changes in its way of working are needed. To implement the six specific recommended changes summarized below and discussed in more detail in the main report will require action by the IMF Board and management. Clearly, an alternative division of labor among international institutions, involving a much-reduced role for the IMF, is also possible. In this case, the Board should make clear that the IMF role in post-stabilization low-income countries will be much more limited, and scale back its involvement and policy pronouncements accordingly. But the worst of all worlds would be for the IMF to pretend that it can continue to play its current major role in these countries without adapting its way of doing business to the new challenges they face.

1. The IMF should help countries explore a broader range of feasible options for the fiscal deficit and public spending. This requires less emphasis on negotiating short-term program conditionality and a greater focus on helping countries strengthen their understanding of the consequences of different options.

2. The IMF Board and Management should adopt and make public clearer guidelines on what is expected of IMF staff in analyzing the consequences of alternative aid paths and on what should drive IMF signals about aid levels.
3. While it is not the IMF's job to decide what aid levels should be, it should do more to promote fuller and more timely information about expectations for aid in its programs
4. Wage bill ceilings should be dropped from IMF programs except in cases where a loss of budgetary control over payrolls threatens macroeconomic stability.
5. IMF programs should give greater emphasis to short-term expenditure smoothing, especially when macroeconomic instability is no longer a significant threat.
6. The IMF should be more transparent and pro-active in discussing the rationale for its policy advice and the assumptions underlying its programs.

The Group's main recommendations are directed at the IMF, but our investigation also suggests a number of important messages for other stakeholders, including national governments, donors, and civil society.

Lessons for other stakeholders

Many of the lessons for other stakeholders focus on the need to build better connections between the health sector and overall budgetary processes in order to make sure health interests are a more effective part of the equation in making fiscal choices.

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1. National priority-setting processes need to be sharpened. In particular, the capacity of ministries of health to undertake budgetary planning should be strengthened, with external technical support, to enable them to produce concrete operational plans that will make a good case for additional budgetary resources. The capacity of ministries of finance to analyze alternative options should be increased. The role of parliaments in the priority-setting process also needs to be enhanced.
2. Development partners should avoid adding to the fragmentation of budgetary processes and the national dialogue over policy priorities. They should improve the predictability of their aid and make longer-term commitments in order to promote more effective planning and implementation of health spending.
3. Bilateral donors, the World Bank, and other multilateral institutions should be more pro-active in providing timely sector-specific analysis as inputs to macro assessments of scaling up. In the health sector, they should be more pro-active in giving empirically-based advice on how to translate increased resources into more effective interventions. This should include more concrete advice on how to reform wage structures and incentive systems for countries' health sectors.
4. Civil society organizations involved in budgetary and health advocacy issues should give greater attention to monitoring and influencing the setting and implementation of annual budgets.