

Macroeconomic Literacy Training

by
Health Gap, ActionAid, Partners in Health
and Physicians for Human Rights

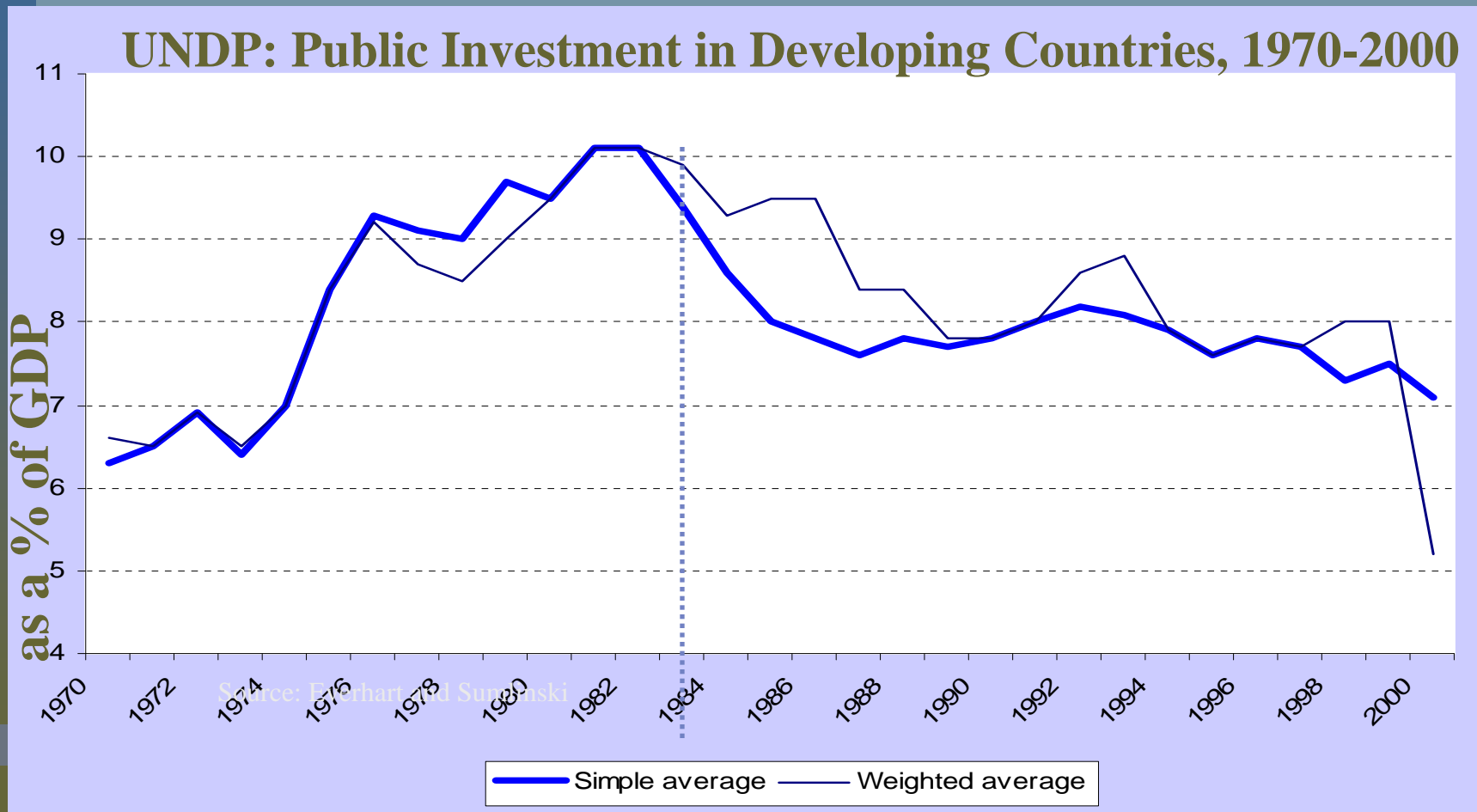
Budget constraints stemming from IMF fiscal and monetary policies

by
Rick Rowden

March 12-13, 2009 Cambridge, MA



Public investment spending has been declining since the 1980s



Main Problem with IMF Policies



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- The macroeconomic framework is designed to achieve, and then maintain, “stabilization”



Main Problem with IMF Policies

- The macroeconomic framework is designed to achieve, and then maintain, “stabilization”
- The macroeconomic framework is not designed to enable a major “scaling up” of public spending to meet the MDGs or fight HIV/AIDS

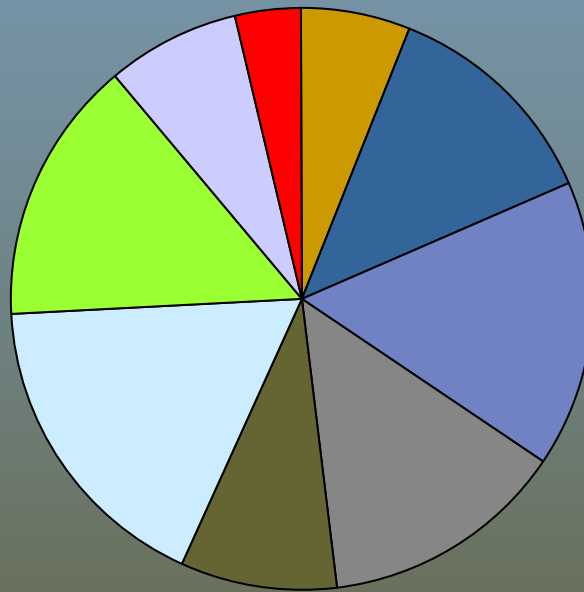


Main Policy Changes Needed

- Health advocates will have to get the IMF's dominant macroeconomic framework changed to enable more expansionary fiscal and monetary policies

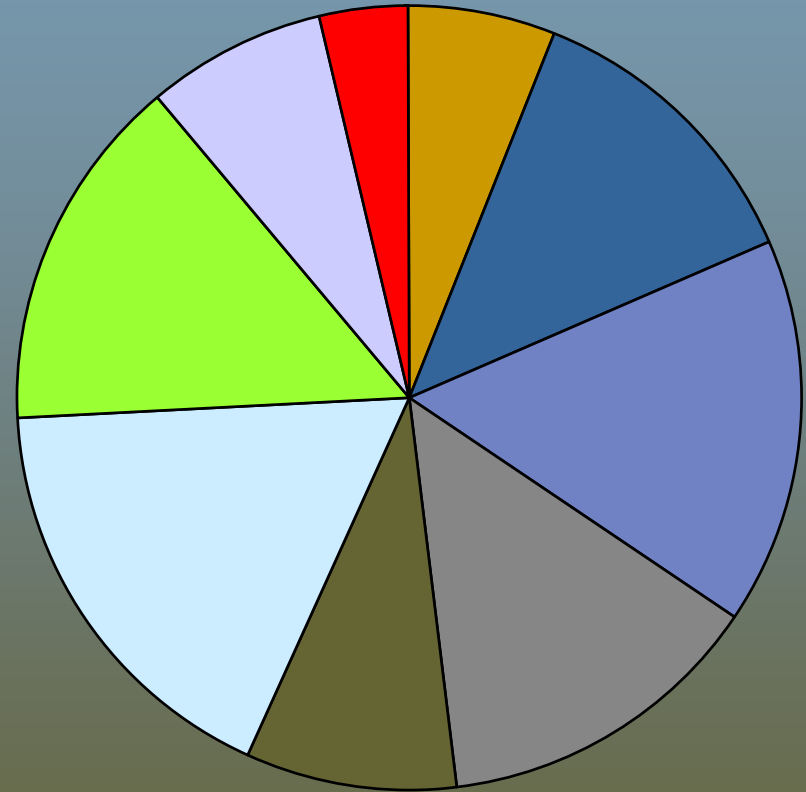
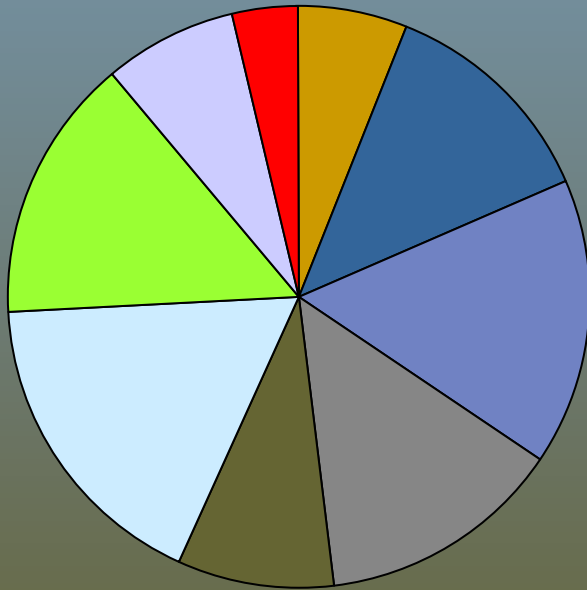


National Budget



National Budget

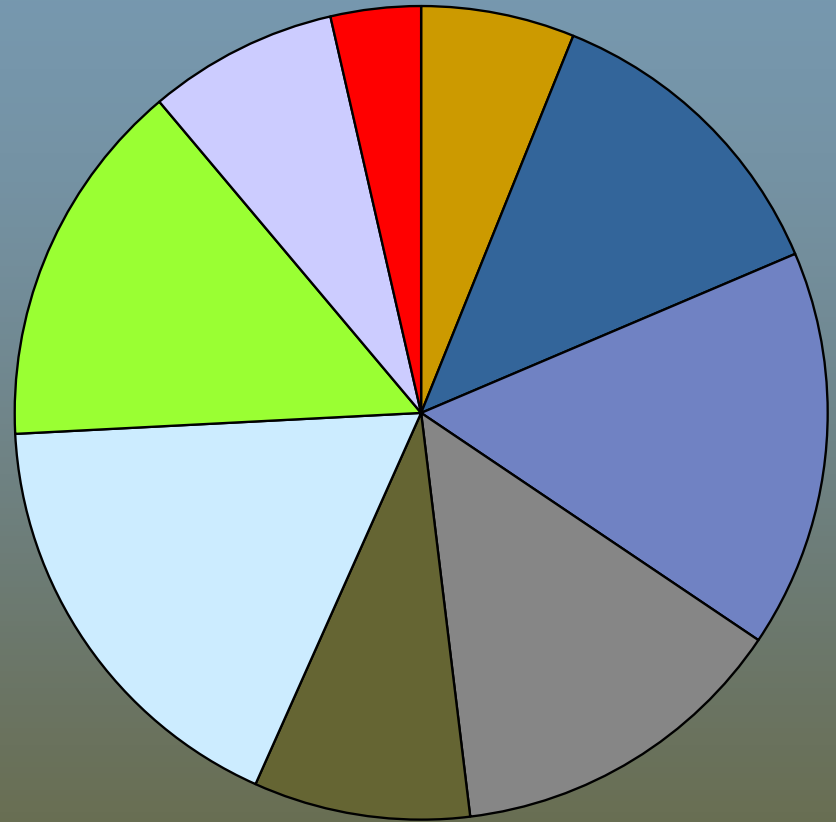
National Budget



National Budget

IMF Fiscal Policy

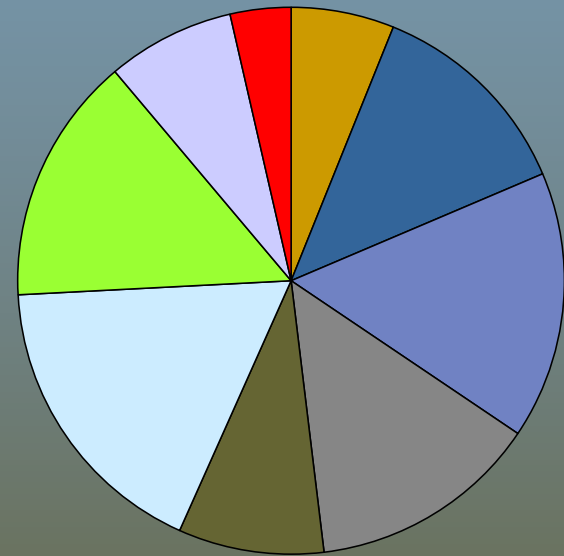
- deficit-reduction targets



National Budget

IMF Fiscal Policy

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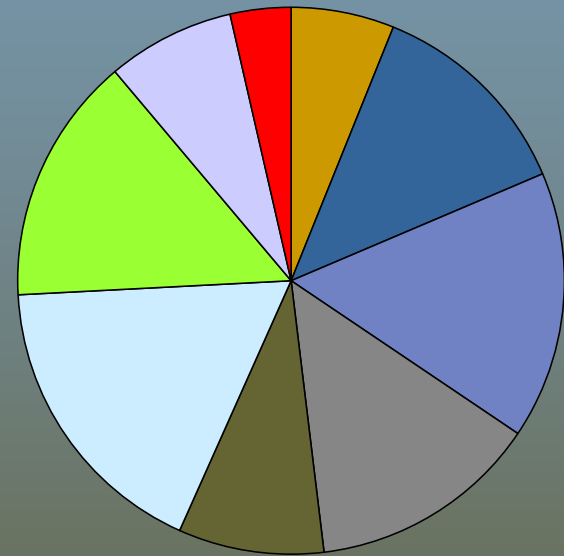
National Budget

IMF Fiscal Policy

- deficit-reduction targets ✓

IMF Monetary Policy

- inflation-reduction targets ✓



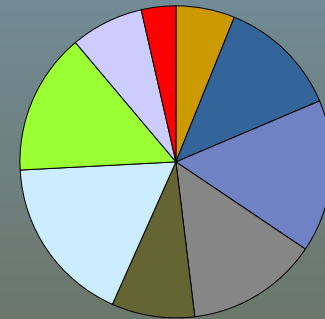
National Budget

IMF Fiscal Policy

- deficit-reduction targets ✓

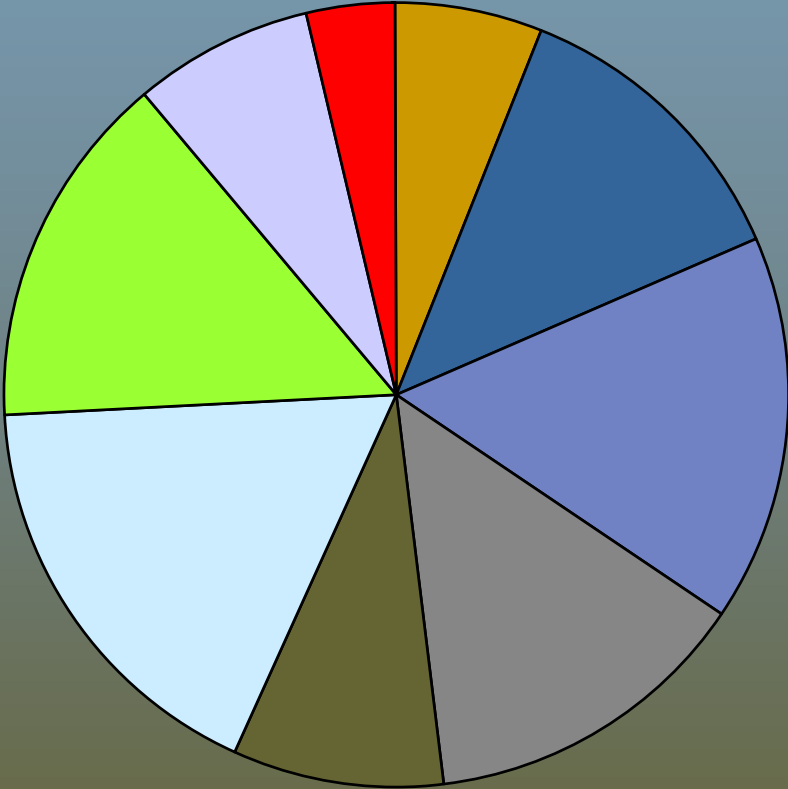
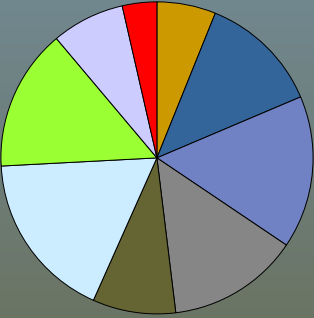
IMF Monetary Policy

- inflation-reduction targets ✓



National Budget

National Budget



Deficit-Reduction



Deficit-Reduction

- Traditional “fiscal conservatism” vs. the IMF’s “anti-deficit radicalism”



Deficit-Reduction

- Traditional “fiscal conservatism” vs. the IMF’s “anti-deficit radicalism”
- IMF seeks to keep budget deficits below 3 percent of GDP
- In some cases, IMF has demanded balanced budgets or even budget surpluses



NIR/NDA Ratio

- NIR - Net International Reserves
- NDA – Net Domestic Assets (credit)
- To constrain “fiscal space” and limit the ability of the government to engage in more deficit spending, often the IMF will:
 - raise the “floor” requirement of the NIR level
 - lower the “ceiling” or limit on available credit
 - or both



NIR/NDA Ratio – Quantitative Conditions in IMF Loan for Kenya

	June 2005	June 2006	June 2007	June 2008	Sep 2008	Dec 2008	Mar 2009	June 2009
Net Domestic Assets (NDA) In Billions of Kenyan Shillings								
Domestic Credit	466.3	521.7	607.1	712.8	693.6	767.6	820.6	864.4
Avail for Govt	112.3	117.9	157.2	132.7	158.2	185.7	172.6	171.9
Avil for Rest of Economy	354.0	403.8	450.0	580.1	535.4	581.9	647.9	692.5
Net International Reserves (NIR)								
BOK Net Foreign Assets in Millions of US \$	1,212	2,159	2,357	2,896	3,067	3,078	3,089	3,192

Kenya must lower the ceiling on available credit (NDA) while raising slightly the required floor for international currency reserves (NIR), thereby squeezing away possibilities for greater “fiscal space” which have could have enabled a greater scaling-up of spending for HIV/AIDS or TB and investment in health systems.



From: “The IMF and the Millennium Goals - Failing to deliver for low income countries” Oxfam International (2003)

Country	Fiscal Deficit Targets over 3-year IMF Program	Reduction % GDP	What this could buy for one year
Cameroon	-0.7 to 0.7	-1.4	Could have doubled health expenditure
Ghana	-9.7 to -5.7	-4.0	Could have doubled primary healthcare expenditure each year of the 3-year program
Mauritania	-4.4 to -1.6	-2.8	Could have almost doubled health expenditure in any one program year
Rwanda	-9.9 to -8.0	-1.9	Could double the health and education budget in each of three program years
Senegal	-4.0 to -3.5	-0.5	Could have doubled the total education and health expenditure in one year or doubled the health budget in each year of the three year program

Deficit-Reduction

- The IMF's main logic for demanding such restrictive deficit-reduction policies is: “debt unsustainability”
(not being able to afford to service the interest on the debt)



Deficit-Reduction

But the underlying questions we must ask

- “Why are interest rates so high?”
- “Why are the terms for government borrowing so unfavorable?”



Deficit-Reduction

But the underlying questions we must ask

- “Why are interest rates so high?”
- “Why are the terms for government borrowing so unfavorable?”
- What are other arrangements besides “market-based interest rates” that could enable governments to engage in more deficit financing at affordable and sustainable rates?



Alternatives

- More expansionary fiscal policy, including strategic deficit spending on public investment as a percent of GDP, supported by a more expansionary monetary policy.
- Donors, IFIs, banks and governments should work to develop alternative mechanisms to provide the government with more affordable and sustainable deficit financing



Alternatives

- Lower-interest credit over longer terms will help government increase public spending and investment
- More affordable credit will also allow micro, small and medium-size companies to expand production and employment



Inflation-Reduction



Inflation-Reduction

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Inflation-Reduction

- Monetarism believes that inflation must be very low at all times and that this should be the main goal of macroeconomic policy
- The IMF seeks to keep annual inflation rates below 5 percent



**macroeconomic
stability**

**macroeconomic
instability**

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20

inflation rate



Inflation-Reduction

- The main way the IMF seeks to lower inflation is by raising interest rates (which has a cost)



Inflation-Reduction

- The main way the IMF seeks to lower inflation is by raising interest rates (which has a cost)
- The central bank's main policy goal is to get inflation down and keep it down below 5 percent, and uses one instrument – higher interest rates



Inflation-Reduction

- The cost of too much inflation-reduction
 - less public spending



Inflation-Reduction

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 - less commercial borrowing



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Inflation-Reduction

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 - less commercial borrowing
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 - less public expenditure



The Sacrifice Ratio

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- The “sacrifice ratio” is a measure used by economists to weigh the trade-offs between inflation reduction & lost or foregone GDP growth or employment
- Okun’s Law
- Howitt’ Rule
- Health advocates need to ask, “What is the IMF sacrificing?”



“The IMF, World Bank and Ugandan Finance Ministry have decided that protecting against inflation is more important than [protecting] peoples' lives”

Francis Omaswa, former Uganda Health Ministry
Interview, October 2001



Review of Inflation Literature

Some empirical studies on 'kinks' in the relationship between inflation and growth

IMF Papers	Outside Papers	Estimated Inflation Thresholds
	Fisher (1993)	15-30 %
	Bruno and Easterly (1998)	40%
	Burdekin, <i>et al</i> (2000)	3% for developing and 8% for rich countries
	Gylfason and Herbertsson (2001)	10-20%
	Pollin and Zhu (2005)	15-18%
	Bruno (1995)	20%
	Barro (1996)	Finds that a 10% increase in the annual inflation rate is associated on impact with a decline in GDP's annual growth rate of only 0.24%.
Sarel (1996)		8%
Khan and Senhadji (2001)		11-12% for developing & 1-3 % for rich countries
Ghosh and Phillips (1998)		Finds that the inflation-growth relationship is convex, so that the decline in growth associated with an increase of 10-20% inflation is (1998) much larger than that associated with moving from 40 to 50% inflation.



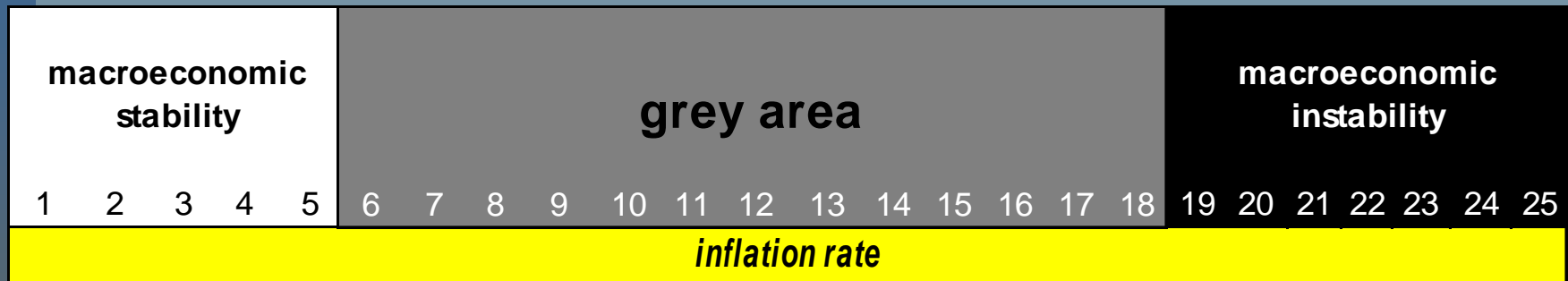
**macroeconomic
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1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20

inflation rate





Policy Space

Poor countries need to have "enough space to craft their own economic policy" and "adequate room for policy autonomy and experimentation."

--- Nancy Birdsall, Dani Rodrik, and Arvind Subramanian,
"How to Help Poor Countries," *Foreign Affairs*, 2005



Alternatives

- There are alternatives to central bank's only targeting low inflation
- Central banks can be ordered to target other goals, such as increased employment, higher GDP growth, or higher expenditure on health care by certain amounts
- Policies on reserve requirements at banks can create incentives for lending to priority social sectors in the economy



Alternatives

- There are alternatives to financial liberalization and capital account liberalization (CAL)
- Taxation on financial flows
 - to favor actual FDI and dissuade PI
- Trip Wires & Speed Bumps
 - gradual and temporary capital controls

