Understanding the macroeconomic effects of scaling up ODA funding for HIV and AIDS

A learning resource and CD-Rom of materials

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The attached CD-Rom of materials contains:

- Workshop Materials
- Key Publications for Further Reading
- A Collection of Papers from the Brasilia Conference on 'Gearing Macroeconomic Policies to Reserve the HIV/AIDS Epidemic
- A List of Websites for Relevant Organizations and Information
- A Summary of Academic Studies and other Key publications
- Fast Facts
- Glossary of Key Terms

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WHO DEVELOPED THIS LEARNING RESOURCE?

This learning resource has been developed by The Joint Programme on Strengthening National Capacities for Integrating AIDS in Poverty Reduction Strategy Processes (Joint PRSP Programme) under the guidance of UNDP. The Joint PRSP Programme is an initiative established by UNDP, the World Bank, and UNAIDS Secretariat in 2005, to strengthen the capacity of countries to better integrate HIV and AIDS priorities into national planning efforts, particularly into Poverty Reduction Strategy Papers (PRSPs). UNDP is the lead agency with overall management responsibility for this initiative as part of the response to recommendations made by the Global Task Team on Improving AIDS Coordination Among Multilateral Institutions and International Donors to make financial and technical assistance available for countries to integrate AIDS in the PRSP. The goal of the Joint PRSP Programme is to enable countries to take advantage of the PRSP processes, at whatever stage, whether planning, implementation, or evaluation, to strengthen national HIV and AIDS prevention and control initiatives, by facilitating the integration of these issues into national domestic policy formulation and execution processes. The Joint PRSP Programme members will use this learning resource to improve understanding on this issue at all levels, to influence the policy debate and to share this information with others.

WHAT IS THE BACKGROUND TO THIS LEARNING RESOURCE?

This learning resource builds on the findings of a Joint PRSP Programme and the Brasilia conference on 'Gearing Macroeconomic Policies to Reserve the HIV/AIDS Epidemic', sponsored by UNDP Bureau for Development Policy and co-hosted by UNDP HIV Group and the International Poverty Centre, in Brasilia, in December 2007. This conference brought together a pool of specialized experts and practitioners drawn from national governments, civil society and the international development organizations, to deliberate on the effects of large-scale inflows of ODA funding on macroeconomic stability. Further evidence has been drawn from a recent Joint PRSP Programme study of three country members on the micro/ macro implications of scaling up MDG levels of AIDS expenditure1.

WHAT IS THE PURPOSE OF THIS LEARNING RESOURCE?

The purpose of this learning resource is to overcome existing concerns that scaling up ODA funding for AIDS financing to Millennium Development Goal levels could affect the economic performance of recipient countries. The countries which are most likely to be affected by these specific concerns are existing country members of the Joint PRSP Programme. It is hoped that this learning resource will serve as a source of concise information on this issue for the Joint PRSP Programme, policy-makers, finance authorities, donors and others involved in AIDS financing. In addition the learning resource includes a workshop facilitation guide (see Annex I) and supporting materials (see attached CD-Rom) to support the Joint PRSP programme, academic institutions, and other key audiences to explore and internalize these issues during a workshop setting. The CD-Rom includes the workshop facilitation guide, two workshop schedules, three PowerPoint presentations and speaking notes, and a pre- and post-workshop self-assessment questionnaire). It also includes papers from the above mentioned Brasilia conference, Joint PRSP newsletters, a summary guide of academic studies and other relevant publications, and additional references for internet resources and organizations to contact.

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1. 'Addressing the Macro-Micro Economic implications of Financing MDG Levels of HIV and AIDS Expenditure' – included on the attached CD-Rom

WHO IS THIS PUBLICATION FOR?

Outside of the Joint PRSP programme itself, the primary audience for this publication is national policy-makers and authorities responsible for (or dealing with) issues related to HIV and AIDS financing and staff of international donor agencies and NGOs working on specialized HIV and AIDS financing programmes. The secondary audience includes other readers interested in current debates on the macroeconomics of HIV and AIDS financing. Individuals who would find this publication useful include those working for:

- national governments (particularly individuals engaged in national level planning and budget management e.g., staff from NACs, Ministries of Finance, federal reserve banks, President's offices,)
- multilateral agencies
- international financial institutions (e.g., IMF, World Bank and regional development banks)
- other donors (GFATM, Bilateral donors, Foundations etc)
- academic institutions
- civil society organizations (including international and national NGOs, FBOs, networks)
- businesses
- other development professionals

Readers who are not economists should note that there is a glossary of key terms in Annex II. It is suggested that readers with very limited time read the executive summary, which summarizes the overall issues and messages, and Fast Facts (annex III), which summarizes section 2 of the learning resource on elements of an alternative policy response that will allow for the scaling up of ODA funding for HIV and AIDS.

WHAT ARE THE OBJECTIVES OF THIS PUBLICATION?

- to provide concise information about existing concerns on the effect of scaling up ODA funding for HIV and AIDS on the economic performance of a recipient country, explore existing policy responses to these concerns
  and share elements of an alternative policy response
- to provide resources to support a half day or two day 'workshop' to understand these concerns, the current policy responses and elements of a possible alternative policy response to scaling up ODA funding for HIV and AIDS (see Annex I: Workshop Facilitation Guide, and workshop materials included on the attached CD-Rom)
- to provide a CD-Rom of additional publications, references, key print-ready sections of this publication, and the above mentioned workshop resources (see inside the front cover of this publication for the attached CD-Rom and a full list of CD-Rom content)

Note on text: Unless specified otherwise, the symbol '$' refers to US dollars

This publication is a Joint PRSP Programme product of collaboration with many talented colleagues who have given generously of their time and expertise. We would like to thank John Serieux and his team (University of Manitoba) for sustaining the enthusiasm and commitment in preparing the technical draft of this resource guide, Nicky Davies for her expert handling of the language for non-economists, editing and content structuring, and Jeff Hoover for his willingness and ability to work on the initial editing.

Sincere thanks to all the colleagues who have contributed to and supported this publication since its conceptualization at the Brasilia conference, co-sponsored by the HIV and Poverty Groups in the Bureau for Development Policy in November 2006 including Durjoy Nari Shongho (Bangladesh), Joseph Annan, Rene Bonnel, Ibrahim Coulibaly, Nadia Fuleihan, Caty Fall, Degol Hailu, Bengi'i Issa, Alberic Kacou, Terry McKinley, Hala Mouneimne, Patrick Osewe, Nadia Rasheed, Fidele Sarassoro, Paola Solda, Pauline Tamesis, Bob Verbruggen, Caitlin Wiesen, Alan Whiteside.

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The dramatic increase in global funding for AIDS has enabled important strides to be made in some areas, with three million people now on antiretroviral therapy and the incidence of HIV infection falling in several countries. Yet despite the progress made so far, 7 out of 10 people with HIV in need of antiretroviral therapy in low- and middle-income countries still do not have access to it, and around 2.5 million people become newly infected with HIV each year. While increasing resource commitments is important for matching expectations of planned expenditures, the ability to spend better will go a long way to meet the prevention and treatment needs in most countries.

With global ODA holding at peak levels, there have been serious concerns over the past few years that even when substantial funds have been made available, many recipient countries have been holding back spending on HIV. In many instances this is a consequence of overly restrictive macroeconomic policies, set by national financial and monetary institutions together with international finance organizations, and based on fears that substantial increases in aid can lead to macroeconomic instability. In other cases national authorities responsible for the HIV response have been cautious about rapidly scaling up the response due to the unpredictability of external funding in the longer term.

Concerned about the lack of consensus among researchers and practitioners alike, between real and perceived threats to the macroeconomy, UNDP has been supporting efforts to address knowledge gaps in the global debate and help inform national decision-making on HIV resource allocations. This learning resource has been developed to explain the issues of ODA funding for AIDS and explore alternative policy responses. It sets out in plain terms elements of an integrated policy response that would allow for the full use of aid for HIV without undermining the long term macroeconomic stability of the recipient country. Many of the issues explored in this learning resource will continue to be critical as the global dynamics of funding the HIV response evolves, and some donors move towards supporting the national HIV response through direct budget support, sector wide approaches and health system strengthening.

The learning resource also brings into focus the importance of the Poverty Reduction Strategy Paper (PRSP) in ensuring that macroeconomic policies are compatible with scaling up the national HIV response. It is our hope that this publication will be useful to country teams in facilitating dialogue between HIV and macroeconomic policy-makers towards a common agenda on scaling up the HIV response. The learning resource has also been written for a broader readership including governments, international finance institutions, multilateral organizations, donor agencies, as well as non-governmental organizations in promoting an expanded and more effective HIV response.

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ACRONYMS AND ABBREVIATIONS

AIDS	Acquired Immune Deficiency Syndrome
ART	Antiretroviral Therapy or Treatment
ARV	Antiretroviral
BOP	Balance Of Payments
DFID	UK Department for International Development
FBO	Faith Based Organization
GDP	Gross Domestic Product
GFATM	Global Fund to fight AIDS, TB and Malaria
HIV	Human Immunodeficiency Virus
IBRD	International Bank for Reconstruction and Development
IDA	International Development Assistance
IMF	International Monetary Fund
MDGs	Millennium Development Goals
NAC	National AIDS Commission or National AIDS Council
NGO	Non-Governmental Organization
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PEPFAR	US President's Emergency Plan for AIDS Relief
PLHA	People Living with HIV and AIDS
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
TB	Tuberculosis
UN	United Nations
UNAIDS	Joint United Nations Programme on HIV/AIDS
UNDP	United Nations Development Programme
USAID	US Agency for International Development
WB	World Bank
WHO	World Health Organization

EXECUTIVE SUMMARY

The AIDS pandemic is undeniably one of the world's most devastating human disasters in recent history. Observers and policy makers may have different opinions as to the most appropriate and effective strategies and policies to respond to the epidemic, but nearly all agree that far greater amounts of money needs allocating at regional, national and local levels. Comprehensive, effective HIV and AIDS prevention, care and treatment programmes and strategies are costly to design, implement and sustain, especially for high prevalence developing nations. The countries most in need however, are among the poorest which means they are less able to provide adequate financial resources themselves. Consequently, Overseas Development Assistance (ODA) plays a vital role.

Contrary to some existing concerns, ODA funding and AIDS-directed ODA funding can make economies more productive overall. Effective HIV and AIDS prevention, care and treatment helps people living with HIV, their families and caregivers to be remain healthy and productive, and reduces uncertainty and fears about the future. This allows both individuals and firms to invest with more confidence. In addition, if ODA funding for HIV and AIDS initiatives are well integrated into larger development initiatives, they will have significant spillover effects that benefit the economy, for example, expanded efforts to treat and care for people living with HIV might involve the construction and upgrading of many health facilities, the training of personnel and the purchase of equipment.

Government, public health and development stakeholders, from both the donor and recipient sides, therefore recognize that ODA funding will continue to constitute the vast majority of AIDS financing. However, the possibility of scaling up of ODA funding to finance AIDS responses to halt or reverse the spread of HIV/AIDS (Millennium Development Goal #6) causes concern that ODA funding may have a significant economic cost. Government, public health and development stakeholders, from both the donor and recipient sides, typically express these concerns in an interlinked way as:

> 'Massive volatile influxes of external funding destabilize recipient countries' economies and essentially retard their ability to grow at appropriate, sustainable rates'

In particular, some economists argue that rapidly scaling up ODA funding to address the AIDS pandemic can cause inflation and appreciation of the real exchange rate (some of the 'Dutch Disease' effects). As Chowdhury (2006) explains, "If such effects occur, they could impair a country's international competitiveness and endanger its growth prospects." In addition, even though there has been an increase in ODA funding available for scaling up AIDS responses, recipient countries are reluctant to plan for scaling up programmes to use this money, as their previous experience shows that this exposes them to other problems associated with ODA funding disbursements not matching commitments.

Section 1 of this learning resource explores some current policy responses to these concerns. These policy responses assume that sound macroeconomic policies are required for economic growth. To the extent that ODA funding is associated with short-term changes in macroeconomic variables, policy makers and financial authorities responsible for maintaining the goal of macroeconomic stability pay close attention to the effect of ODA absorption and spending on these measures. Currently, the desire to protect or achieve macroeconomic stability (including protection from the 'Dutch Disease' effects) affects decisions concerning the extent to which ODA funding is fully absorbed and spent. Section 1 of this learning resource explains these existing concerns related to macroeconomic stability, Dutch Disease and the effects of aid volatility. Some current policy responses to address these concerns are then discussed in detail. Section 2 presents elements of a policy response that show how well planned and coordinated use of ODA funding combined with efforts to protect against aid volatility can allow for the full use of scaled up ODA funding for HIV and AIDS without destabilising the long-term growth potential of the recipient country economy. This approach would address macroeconomic instability at its source while monitoring macroeconomic measures so corrective interventions can be used if there is incomplete adjustment of the economy.

The key issues addressed in this publication include:

- to gain the full potential benefit of scaling up ODA funding for HIV and AIDS (both for the economy and AIDS mitigation) recipient governments could consider the following four elements of a policy response:
    - allowing the economy to make the adjustment,
    - enhancing the economy's capacity to adjust to the scaling up of ODA funding,
    - addressing volatility issues,
    - applying macroeconomic measures for incomplete adjustment.
- to achieve this, better coordination of HIV and AIDS planning, costing, budget allocation and disbursement is needed. Therefore, recipient governments could consider:
    - improving interagency-relations and coordination between those prioritising and costing HIV and AIDS programmes (usually led by NAC) and those responsible for budget allocation and disbursements (the Ministry of Finance and central bank),
    - improving interagency-relations and collaboration to prepare for consultations on the PRSP, MDGs and other national planning frameworks, to allow for the scaling up ODA funding for HIV and AIDS to MDG levels.
- to support countries receiving ODA funding to follow the approach suggested policy response, intermediary institutions could consider:
    - accepting short-to-medium term volatility of key macroeconomic indicators as a normal part of a process of adjustment for an economy facing a challenge (such as an influx of ODA foreign exchange).

- to help protect against the potential damaging effect of aid, and aid volatility on the economic performance of recipient countries, donors could consider:
  - providing long-term funding commitments, minimizing gaps between commitments and disbursements, and following agreed disbursement schedules,
  - encouraging investment in health systems strengthening (e.g., training health professionals, building health care facilities) that will otherwise limit recipient countries' capacity to absorb ODA funding and divert resources from other needs,
  - adhering to the principles of the Paris Declaration of Aid Effectiveness, strengthening commitment and action, building on the progress already made.

A well-developed and implemented scaling up of ODA funding considers longer-term macroeconomic implications and seeks to mitigate their impact from the start. Embracing the scaling up of ODA funding for HIV and AIDS, and anticipating and averting any negative macroeconomic impact can play a vital role in the collective efforts to halt and reverse the spread of HIV by 2015.

SECTION 1

UNDERSTANDING SOME CONCERNS AND THE CURRENT RESPONSES TO THE APPARENT CONFLICT BETWEEN SCALING UP ODA FOR HIV AND AIDS FINANCING AND THE ECONOMIC PERFORMANCE OF A COUNTRY

1.1 WHY IS SCALING UP OF ODA FUNDING FOR HIV AND AIDS IMPORTANT?

THE AIDS PANDEMIC

AIDS is the fourth leading cause of death worldwide for people between the ages of 15 and 59 for several years. According to the most recent data from the Joint UN Programme on HIV/AIDS (UNAIDS), 2008 Report on the Global AIDS Epidemic (UNAIDS 2008), an estimated 2 million people died due to AIDS in 2007 alone. This report also estimated that some 33 million people worldwide are living with HIV, with perhaps 2.7 million new infections occurring in 2007. These figures clearly point to an ongoing humanitarian crisis.

THE IMPACT OF HIV AND AIDS ON THE ECONOMY

AIDS can affect the national (macro) economy through various channels. Various studies have investigated these effects in different parts of the world (see A summary of academic studies and other relevant publications, on the attached CD-Rom). However, determining the precise extent of the effect of AIDS on the macroeconomic performance is not straightforward. Many of the most affected countries are also facing droughts, war and civil strife, and other challenges. It is therefore unlikely that AIDS is solely responsible for any particular change in an economic measure (such as a fall in income). In addition, calculating the contribution of AIDS to changes in economic measures is difficult because of the poor quality of HIV and AIDS data in many countries. Nevertheless, we can understand certain specific impacts from the way in which HIV and AIDS affects families and the paid workforce – families affected by HIV and AIDS can be impoverished through loss of household savings.

Sickness and death as a result of AIDS means a loss of economically productive labour as the age group most affected includes people in the most productive years of their life (between 15 and 49 years). However, because most moderate and high-incidence countries have a significant reserve of unemployed labour, the performance of the economy will not be constrained by the size of the labour force per se, rather the supply of skilled labour. Skilled and educated workers are critical in the production of many goods and services in all economies, and most countries with moderate or high infection rates only have a limited supply of skilled workers even before the effects of AIDS are taken into account. The sickness and death of some of skilled workers limit the supply of that type of labour; often faster than new workers can be trained. Even when new workers are trained, invaluable experience accumulated over many years is lost. Consequently, these countries may find it difficult to expand production and, therefore, income, because of the shortages. The loss of labour in general, and the loss of skilled labour in particular, can have further long-term effects as future production requires investment. Companies that face high insurance and other costs due to the frequent illness of their employees may be discouraged from investing. Additionally, if there is uncertainty about the availability of skilled labour, firms may be further discouraged from investing. The net result is that investment levels fall and future output growth is lowered, with the potential of negative growth.

THE RELATIONSHIP BETWEEN HIV AND AIDS AND THE MILLENNIUM DEVELOPMENT GOALS

The Millennium Development Goals (MDGs) are a set of eight development goals adopted by the UN General Assembly in 2000. All of these goals have clearly defined global targets to be achieved by the year 2015. MDG # 6 commits the global community to halt or begin to reverse the spread of HIV/AIDS, and incidence of malaria and other major diseases by 2015. Clearly, a lack of progress in stemming the increased incidence of HIV means a failure to meet that target. The AIDS pandemic jeopardizes the achievement of the MDGs in two ways; directly as an integral part of one of the MDGs (i.e., MDG #6), and indirectly by endangering the achievement of other MDGs through its effect on economic and health outcomes. For example, the AIDS pandemic has a serious impact, albeit indirectly, on MDG #1 which commits the world community to reducing poverty and hunger, and MDG #4 which commits the world community to reducing child mortality by two-thirds by 2015, particularly for high and moderate prevalence countries.

Success in halting or reversing the spread of HIV requires reducing new incidences of HIV and, for HIV-positive individuals, reducing or halting progression to an AIDS diagnosis. As recent UNAIDS figures indicate, insufficient progress has been made toward achieving those markers of success in most of the world. New infections continue at a relatively high rate in many countries, and far less than half of those in need have access to potentially life-saving antiretroviral treatment (ART). The Millennium Development Report (2007) stated, "if current trends continue, the number of people with advanced HIV infection in need of therapy will rise faster than treatment services can be scaled up." As noted previously, large-scale prevention and treatment programmes for HIV and AIDS are costly endeavours. While resource-constrained countries are increasingly providing domestic resources to address HIV and AIDS (i.e., through government revenues, domestic borrowing, and gifts from domestic charities), scaling up of aid for HIV and AIDS will play an important part in achieving the MDGs in general, and effectively addressing the AIDS pandemic in particular.

ODA FUNDS FOR HIV AND AIDS RELATIVE TO OTHER AID CATEGORIES

Also sometimes known as 'foreign aid' or simply 'aid', Overseas Development Assistance (ODA) refers to funds provided by wealthy country governments, UN member states or international financial institutions to governments and other institutions in the developing world. ODA funding can be in the form of grants (transfers of funds with no expectations of repayment), loans or debt relief. For a loan to be defined as ODA, it must be 'concessional', meaning it has lower interest rates and/or longer repayment periods and more flexible repayment structures compared with commercial loans provided at market rates. Box 1 includes definitions for ODA provided by UNDP and the Organisation for Economic Co-operation and Development (OECD).

ODA funding can be provided bilaterally, multilaterally or from private sources such as Foundations. Bilateral ODA

nvolves a direct transfer of external funds to a developing country government or institution through a specialized government aid agency such as the United States Agency for International Development (USAID). Multilateral aid is provided by institutions such as the European Union, World Bank, the International Monetary Fund (IMF), Global Fund to fight AIDS, TB and Malaria (GFATM), regional development banks and UN agencies. Most, but not all of the ODA funding provided by multilateral institutions comes originally from the contributions of wealthy countries, particularly the G8 (Canada, France, Germany, Italy, Japan, Russian Federation, United Kingdom, and the United States). For the World Bank, however, most of ODA funding comes from borrowing; with contributions from donors are only being important for World Bank International Development Assistance (IDA) (see Box 2).

BOX 1. WHAT IS ODA?

The OECD Glossary of Statistical Terms defines ODA as "Flows of official financing administered with the promotion of the economic development and welfare of developing countries as the main objective, and which are concessional in character with a grant element of at least 25 percent (using a fixed 10 percent rate of discount). By convention, ODA flows comprise contributions of donor government agencies, at all levels, to developing countries ("bilateral ODA") and to multilateral institutions. ODA receipts comprise disbursements by bilateral donors and multilateral institutions. Lending by export credit agencies—with the pure purpose of export promotion—is excluded."

According to the UNDP Human Development Report 2007/8 "ODA receipts are total net ODA flows from DAC countries as well as Taiwan Province of China, Czech Republic, Hungary, Iceland, Israel, Republic of Korea, Kuwait, Poland, Saudi Arabia, Slovakia, Turkey, United Arab Emirates and other small donors, including Estonia, Latvia, Lithuania and Slovenia, and concessional lending from multilateral organizations. A negative value indicates that repayments of ODA loans exceed the amount of ODA received."

BOX 2. THE WORLD BANK

According to the World Bank website, the World Bank is "made up of two unique development institutions owned by 185 member countries - the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA).

IDA is one of the largest sources of assistance for the world's 78 poorest countries, 39 of which are in Africa. It is the single largest source of donor funds for basic social services in the poorest countries. IDA lends money (known as credits) on concessional terms. This means that IDA credits have no interest charge and repayments are stretched over 35 to 40 years, including a 10-year grace period. IDA also provides grants to countries at risk of debt distress. While the IBRD raises most of its funds on the world's financial markets, IDA is funded largely by contributions from the governments of its richer member countries. Additional funds come from IBRD's income and from borrowers' repayments of earlier IDA credits. Donors get together every three years to replenish IDA funds. Donor contributions account for 60% of the SDR 27.3 billion (US$41.6 billion) in the IDA15 replenishment, which finances projects over the three-year period ending June 30, 2011. 45 countries contributed to the 15th replenishment of IDA. The largest pledges to IDA15 were made by the United Kingdom, the United States, Japan, Germany, France, Canada, Italy and Spain. The IDA15 replenishment raised funds for poor countries for the three-year period between July 2008 and June 2011. These are critical years for countries trying to achieve the UN Millennium Development Goals since it takes time for projects to be completed and yield measurable results."

Financing the HIV response to the extent needed to bring MDG #6 within reach will require large sums for both prevention and treatment resources. Current funding levels for HIV and AIDS have risen substantially over the past decade, both in terms of the level of funding and the rate of increase; although with great year-on-year variability at the country level (see Box 3). According to UNAIDS, "by the end of 2007, AIDS funding was expected to stand at just under $10 billion – an almost forty fold increase since 1996, when the figure was $260 million. The increase has been largely due to a series of new funding initiatives and mechanisms, notably the Global Fund for AIDS, tuberculosis and malaria, the World Bank's Global AIDS Programme and the US President's Emergency Plan for AIDS Relief (PEPFAR). Domestic spending on AIDS in low and middle-income countries has also risen to now stand at around one third of all money going into the global AIDS response."

BOX 3. LEVELS OF ODA FUNDING FOR HIV AND AIDS

As summarised in Walters (2007), "the estimated worldwide costs of treating and containing [the AIDS] pandemic in low and middle income countries are provided in UNAIDS (2006). These are estimated to be US$14.9 billion in 2006, US$18.1 in 2007 and US $22.1 billion in 2008 (UNAIDS, 2006, p.224). The funding requirements under different categories of treatment and prevention are shown below.

AIDS Funding Requirements for low-and middle-income countries				
US$ Billions	2006	2007	2008	2006 - 2008
Prevention	8.4	10.0	11.4	29.8
Care and Treatment	3.0	4.0	5.3	12.3
Support for Orphans & Vulnerable Children	1.6	2.1	2.7	6.4
Programme costs	1.5	1.4	1.8	4.6
Human Resources	0.4	0.6	0.9	1.9
Total	14.9	18.1	22.1	55.1

Source: Table 10.1 p.225 UNAIDS (2006)

Despite the rapid rise in commitments and disbursements in recent years, these funding requirements are still considerably larger than the present level of commitments, estimated to be US$8.9 billion in 2006 and US$10 billion in 2007 (UNAIDS, 2006,p.224). However, Lewis (2005, Figure2, p.7)) provides evidence of recent, sharp increased in commitments and disbursements to sub-Saharan African countries with the highest levels of infection. External funding increased in most of these countries, sometimes by extremely large amounts in proportionate terms; for example, in Zambia between 2002-2004, the increase was nearly 700 per cent. However, it is worth observing that although there was a steady increase both for sub-Saharan Africa as a whole and for the sub-sample of most infected countries, there is still considerable year-on-year variability; the total for Kenya, for example, falls from over US$100 million in 2000 to just US$24 million in 2001, then rises by 2003 to US$110 million and falls to US$87 million, before rising again to US$119 million in 2005."

Box 4 gives some examples from Africa showing that although ODA funding for AIDS is set to rise, it is still a relatively small proportion of overall aid disbursed. As Walters (2007) points out, this is significant when considering the concerns related to the impact of an increase in external funding from scaling up ODA funding on the economic performance of a country (to be discussed in section 2), as ODA funding for AIDS constitutes a relatively small portion of overall ODA funding. However, as discussed next and in more detail in section 2.1, it is not just how much external funding is provided through ODA, but how well the use of ODA funding is planned, which will influence the positive or negative impact it has on the economic performance of a country.

BOX 4. ODA FUNDING FOR HIV AND AIDS AS A PROPORTION OF OVERALL ODA FUNDING – EXAMPLES FROM AFRICA

As Walters (2007) states, "the table below demonstrates that aid commitments to tackle HIV/AIDS are a relatively small proportion of the overall level of aid disbursed to the most infected countries. As commitments are usually lower than Organisation for Economic Co-operation and Development (OECD) subsequent disbursements, the proportions shown in the table are likely to be upper bounds. Even for those countries that are now in receipt of considerable ODA directed at HIV/AIDS, this is in the context of very large aid inflows for other purposes. In the case of Uganda, for example, although aid commitments for HIV/AIDS were almost US$170 million, this represented only 14 per cent of aid disbursements in 2004. This is consistent with the earlier observation of Lewis (2005, p.8) that, over the 2002-2004 period, the flows associated with HIV/AIDS relief were, in most cases, a relatively modest proportion of the projected overall increases, representing between 5 and 35 per cent."

Aid commitments for HIV/AIDS as a percentage of overall Aid Disbursements (US$millions)

Year:2004	(1) Aid for HIV/AIDS	(2) Overall Aid	(1) as % of (2)
Botswana	20.76	47	44
Central African Republic	5.08	110	5
Cote d'Ivoire	12.33	160	8
Gabon	3.16	40	8
Kenya	86.52	664	13
Lesotho	6.19	106	6
Malawi	21.51	501	4
Mozambique	82.2	1246	7
Namibia	57.33	173	33
South Africa	148.28	628	24
Swaziland	1.1	22	5
Tanzania	93.27	1761	5
Uganda	169.22	1198	14
Zambia	62.42	1125	6
Zimbabwe	55.2	187	30

Source: OECD DAC database (2007) and author's calculations

THE POTENTIAL BENEFIT OF ODA FUNDING FOR HIV AND AIDS

Comprehensive, effective HIV and AIDS prevention, care and treatment programmes and strategies require significant levels of resources to design, implement and sustain, especially if universal access is to be achieved in high prevalence countries. ODA funding for HIV and AIDS can be used to improve the quality of life for people living with HIV, reduce the vulnerability and risk of individuals to HIV infection, support the provision of treatment and quality care to limit periods of sickness, and care for those that are dying and support those that are bereaved. In terms of the economic prospects for a country, the reduction in HIV incidence and the provision of treatment and quality care of people living with HIV means that HIV can start to be seen as a chronic, manageable disease. This allows individuals (and firms) to invest with more confidence and make long-term plans. In addition, if HIV and AIDS initiatives are well integrated into larger development initiatives, they can also have significant spillover effects in many other areas. For example, expanded efforts to provide care and treatment for people living with HIV might involve the construction and upgrading of many health facilities, the training of personnel and the purchase of equipment. The following are some of the spillover effects that can be achieved by using ODA funding for HIV judiciously:

- more and better health facilities, and trained personnel for HIV prevention and AIDS treatment and care, can assist in the prevention and treatment of malaria and tuberculosis (TB) which will benefit individuals, households and national economy as a whole,
- HIV prevention initiatives in the community and workplace can be integrated with activities preventing other diseases, and initiatives to overcome HIV vulnerability and risk have broader benefits for the individual and economy as a whole (e.g., ensuring that children orphaned by AIDS are supported to completed their education),
- the construction of facilities and other health system–related infrastructure increases demand for labour, and the development of infrastructure (such as road access to facilities) can boost many other types of economic activity.

However, the degree to which these benefits are realised and the spillover effects are felt is very country specific and depends largely on how well ODA funding is linked to high quality national planning frameworks (see Box 5 below). The wealth of potentially beneficial outcomes from the scaling up of ODA funding for an improved AIDS response is extremely important not only for the well-being of individuals directly affected, but for public health and the national economy overall. A well-developed, coordinated and implemented scaling up of ODA funding takes macro-economic concerns (see section 2) into account and seeks to mitigate their impact. Taking this approach not only allows for the maximum use of the aid to address the AIDS pandemic, but also to boost rather than dampen, the economy of the nation in certain cases.

BOX 5. INSTITUTIONAL CAPACITY AND HEALTH SYSTEM STRENGTHENING

According to Compernolle (2006), "With regards to scaling up the AIDS response, the capacity of the health sector and strength of the health system is fundamental. Initially, it was hoped that expanding the health sector response to AIDS, especially the provision of ART, would strengthen the overall health systems, by attracting financial resources, improving capacity of health care workers and investments in health infrastructure, such as laboratories. However, increasingly concerns are being voiced about the way in which AIDS programmes risk undermining the health systems rather than strengthening them by creating parallel structures, placing a heavy burden on the scarce resources available in the health sector, without taking a longer term and sector wide approach to AIDS. There has even been talk about a health-system-tax on aid earmarked for AIDS. At least what is required is coordination or integration of the health sector component of the national AIDS Strategy with the Health Sector Strategy.

1.2 SOME EXISTING CONCERNS ABOUT THE EFFECT OF SCALING UP ODA FUNDS FOR HIV AND AIDS ON THE ECONOMIC PERFORMANCE OF A COUNTRY

WHAT ARE THE MAIN CONCERNS?

There are a number of inter-related concerns about the impact of the scaling up of ODA funding to MDG levels on the economic performance of recipient countries. A review of the literature shows these concerns commonly expressed as:

> 'Massive volatile influxes of external funding destabilize recipient countries' economies and essentially retard their ability to grow at appropriate, sustainable rates'

Government, public health and development stakeholders, from both the donor and recipient sides, share these concerns to some extent. Their concerns are that increased ODA funding poses potential threats to a recipient nations' macroeconomic stability, and in particular, the potential for a scaling up of ODA funding to cause a 'Dutch Disease' effect, and increasing negative affect of volatility of external funding.

Large influxes of external funding HIV and AIDS are unlikely to have a destabilizing effect on an economy on its own. Walters (2007) points out that it is, "important to recognize that although funding for HIV/AIDS is likely to rise further both absolutely and proportionately, the context is an overall scaling up of aid into countries, which are, for the most part, already in receipt of considerable amounts of aid. This does not mean that extra spending for HIV/AIDS will have no macroeconomic effects. However, for many of the highly infected countries, it does suggest that "HIV/AIDS funding alone is unlikely to derail overall macroeconomic policy" (Lewis, 2005, p.8, italics added). It follows that for the most infected countries, the appropriate way to assess the impact of the extra HIV/AIDS spending is in the context of the large increase in aid associated with targeting all the MDGs."

Viewing the scaling up of ODA funding for the MDGs as a whole is also important as making progress on MDG#6 which directly concerns HIV and AIDS will have an impact on other MDGs and vice versa (see section 1.1). Therefore the following information reflects of the effects of scaling up of ODA funding to MDG levels for all MDGs, with specific information regarding ODA funding for HIV included where relevant. The following questions reflect the three main existing concerns, which are then explored in more detail below:

1. What is meant by macroeconomic stability and how does this affect the scaling up of ODA funding?
2. What is meant by Dutch Disease and could scaling up ODA funding cause this effect?
3. What is meant by volatility of external funding and how does this affect the scaling up of ODA funding?

1. What is meant by macroeconomic stability and how does this affect the scaling up of ODA funding?

Macroeconomic instability is generally said to occur when one or more of a small number of important economic variables move outside the range that is thought to be compatible with the satisfactory performance of the economy. (The use of the phrase 'thought to be compatible' is important because it suggests a significant degree of subjectivity in the determination of what indicates instability – discussed below). In that regard, the measures of greatest interest are:

a. low (single digit) inflation
b. fiscal surpluses or small deficits
c. balance of payments surpluses or small deficits
d. stable (or depreciating) exchange rates
e. substantial and stable or increasing foreign exchange reserves

Macroeconomic stability is often seen as a requirement for economic growth. Since, in the short-term, ODA funding can cause these macroeconomic measures to change, financial authorities who monitor macroeconomic stability pay close attention to the effect of ODA absorption and spending on these measures. Currently, the desire to protect or achieve macroeconomic stability as defined above, affects decisions concerning the extent to which ODA funding is fully absorbed and spent. To be able to explore elements of an integrated policy response in section 2, it is important to understand some of the economic measures affected by ODA and factors that contribute to movements in macroeconomic stability. A review of elements of an integrated policy response described in section 2 shows how well planned use of ODA, building in short-to-medium term volatility of these key macroeconomic measures as a normal part of a process of macroeconomic adjustment, alongside protection from aid volatility can allow for a scaling up of ODA funding without 'destabilising economies'.

a. Why is low (single digit) inflation seen to be so important?

Inflation results from the fact that supply (of goods and services) is falling behind demand and/or the banking system is producing money faster than the economy needs it. During periods of high inflation, prices are not good indicators of long-term value, so it makes sense to hold on to cash. A high rate of inflation can be viewed as both an outcome and a cause of poor economic performance

High inflation is usually volatile, which means that the actual level changes from year to year. Most economists agree that a rate of inflation above 40 percent is a definite indicator of instability that can damage economic growth. However, there is no clear consensus regarding rates below that level. Many studies (see Figure 1) have attempted to determine the rate of inflation at which economic performance definitively turns from good to bad, and the resulting estimates have ranged from 3 percent to 40 percent (although most are suggestive of an inflation rate below 25 percent). Even within those studies, it is not always clear whether it is high inflation that causes slower growth, or vice versa. Moreover, lower-income countries with under-utilised capacity often show greater tolerance for inflation and may have better economic outcomes at higher rates of inflation than high-income countries. The current preference for single digit inflation rates in PRSP and PRGF programmes is just that – a preference that tends to ignore country particularities. There is no compelling evidence that inflation rates in the 10–20 percent range have significant negative effects, or necessarily signal major imbalances, in resource-constrained countries (see figure 1). Indeed, the cost of trying to keep inflation below those levels (using monetary policy) may be higher than any cost associated with those levels of inflation.

An increase in ODA funding receipts usually causes an increase in inflation, at least in the short term. This occurs for two main reasons: (i) there is more money being injected into the economy, in the form of funding for new projects, and (ii) as new projects and programmes are implemented, they may increase the demand for certain goods and services ahead of supply, thereby causing certain prices to rise. This initial rise in inflation can be viewed as the normal functioning of the economy, with the higher prices encouraging a shift in resources to where they are most needed (resulting in an increased supply), and an overall increase in resource use.

The inflation response can be viewed as an indication of economic adjustment rather than instability if:

- a spike in inflation (even a relatively large one) due to scaling up ODA funding is quickly followed by a return to the moderate range without direct action by the central bank; and
- the increase in the average rate of inflation due to the scaling up of ODA funding still leaves it within the moderate range.

FIGURE 1. AN OVERVIEW OF KEY STUDIES ON INFLATION THRESHOLDS

Researchers	Inflation threshold (percent)	Countries in the sample	Period
Fischer (1993)	15	80	1960–89
Barro (1996)	10–20	117	1960–90
Sarel (1996)	8	87	1970–90
Bruno and Easterly (1998)	40	97	1961–92
Ghosh and Phillips (1998)	>5	145	1960–96
Kochar and Coorey (1999)	5	84	1981–95
Khan and Senhadji (2001)	7–11	140	1960–98
Burdekin, Denzou, Keil, Sitthiyot, and Willett (2000)	3	51	1967–92
Gylfason and Herbertsson (2001)	10–20	170	1960–92
Sepehri and Moshiri, 2004	5–15	92	1960–96
Pollin and Zhu, 2006	15–18	80	1961–2000
Rousseau and Watchel, 2002	13–25	84	1960–95

Potentially dangerous imbalances can occur from higher levels of inflation, however. Imbalances reflecting macroeconomic instability tend to occur when:

- the increase in inflation is very large (for example from 8 to 35 percent) in a year and that high level persists or worsens over time; or
- the year-on-year (average) rate of inflation shifts from a low or moderate range to high (for example from single digits to the 20s or 30s).

b. Why are fiscal surpluses or small deficits seen to be so important?

A small fiscal deficit shows that a government is not spending more than it is receiving in revenues. If ODA funding come mostly in the form of grants, it has no significant effect on the fiscal deficit. The fiscal deficit, in this case, should not be a source of concern and any widening of the deficit cannot be attributed to ODA funding.

If spending in excess of revenues is funded by borrowing then the source of borrowed funds determines the effect on the economy. There are three potential sources of borrowing:

- funds from abroad meaning that the country is accumulating foreign debt. This may be sustainable for long periods by some countries but not resource–constrained countries,
- funds from domestic banks, persons and other institutions (except for the central bank) meaning the government is using up resources that would normally have been used for private investment projects and as working capital by firms,
- funds from the central bank essentially meaning that new money is created to fund the deficit. The result could be higher inflation because the amount of money in the economy is increasing faster than the amount of goods and services. Zimbabwe in the period from 2002 to 2007 is a good example of high inflation induced by too much government borrowing from the Zimbabwean Central Bank.

ODA funding affects the fiscal deficit directly only if it comes in the form of borrowed funds. In that case, whether it signals worrisome debt accumulation or not depends on the country, and should be considered on a country-by-country basis.

c. Why are balance of payments surpluses or small deficits seen to be so important?

Since resource-constrained countries (particularly those defined as low-income) often approach international financial institutions for loans to address their balance of payments (BOP) problems, loan arrangements between these countries and the international financial institutions include policy measures designed to keep BOP deficits to a minimum. In this way, BOP deficits become a measure of macroeconomic instability. There are two types of deficits. An *overall balance of payments deficit* means that foreign exchange payments exceed foreign exchange receipts, and that difference must be made up by dipping into the country's foreign exchange reserves or seeking exceptional financing from the IMF. Scaling up of ODA funding for AIDS should result in a surplus (as it is extra foreign exchange) so this should not be a concern. On the other-hand, the *current account deficit* means that more is spent on imports, debt payments and expatriated profits than received from sale of exports, money sent home, and grants. In this case, ODA loans will increase a current account deficit while ODA grants will lessen the current account deficit.

Instability is suggested only if the country's debt levels are rising quickly or if the flows are unstable (volatile). If the level of debt and/or the rate at which it is increasing is not sustainable, then this will necessarily be reviewed by the international financial institutions and recipient government.

d. Why are stable (or depreciating) exchange rates seen to be so important?

The real exchange rate is the (average) cost of foreign goods in terms of domestic goods (or vice versa). ODA funding can affect the real exchange rate in two ways. ODA funding can cause inflation meaning that the cost of domestic goods increases compared to foreign goods. This makes foreign goods more attractive. ODA funding also reduces the cost of foreign goods because the increase in availability of foreign currency means the value of foreign currency decreases. Therefore, one unit of domestic currency can buy more foreign exchange or goods.

A substantial real exchange rate appreciation makes imports much cheaper and exports can earn less in terms of domestic goods. While this can benefit industries that require imports, it can negatively affect exporting industries. Industries that produce goods that compete with imports are also likely to be negatively affected. For most developing economies, both of these sectors are important and disruption can mean less goods being produced, less income and less employment. If this is a short-term phenomenon, it is merely part of normal economic adjustment. However, if this effect is long term it can, at a theoretical level at least, lead to 'Dutch Disease' (see below)

e. Why are substantial and stable or increasing foreign exchange reserves seen to be so important?

As an overall measure of an economy's health, macroeconomic stability is the result of deliberate government interventions to achieve desired macroeconomic target measures. Therefore, reserves of foreign exchange are important as they can be used (through government intervention) to reduce the impact of fluctuations in the price level, rates of inflation and of economic growth on the economy.

2. What is meant by Dutch Disease and could scaling up ODA funding cause this effect?

Understanding Dutch Disease is easier using the context in which it was originally defined. The connection with scaling up ODA funding then becomes clear. As originally defined, Dutch Disease occurs when a country suddenly becomes a large producer of a highly valued natural resource, such as oil, gold, diamonds etc. This resource brings in a large amount of foreign currency, which causes one of the following two outcomes: (i) the resource's price drops relative to the price of domestic currency, or (ii) the domestic currency becomes more expensive, which represents a nominal exchange rate appreciation. The new wealth also increases the demand for goods and services in the economy, which tends to generate inflation, including wage inflation. As noted previously, the combination of cheaper foreign currency and higher domestic inflation amounts to a real exchange rate appreciation because the average price of domestic goods increases faster than the average price of foreign goods. Exports of the highly valued resource are not significantly affected because of its high value. However, other exports are strongly, and negatively, affected because exportable goods become more expensive to produce, in domestic dollar terms. Moreover, exports have a lower price in domestic dollar terms because foreign currency can now buy less domestic currency. Thus, all other exports besides that resource may become non-viable (low price, high cost). Import-competing industries are also negatively affected because imports are now much cheaper; that occurs because the foreign currency used to buy them is now much cheaper in domestic currency terms. Meanwhile, domestic industries that produce competing goods must pay a higher price for domestic labour and other goods, a requirement that reduces their ability to compete. The net result is deindustrialization. All export and import-competing sectors of the economy, except the one that produces the high-valued natural resource, are severely affected or even disappear.

At a theoretical level at least, scaling up ODA funding can produce the same effect as such a natural resource windfall as ODA funding results in a country gaining a large and sudden influx of foreign currency, the apparent cause of the outcomes described above. As noted previously, an increase in ODA funding can cause the real exchange rate to appreciate, the outcome of a fall in the price of foreign currency combined with higher inflation. If this effect is long term, and particularly if it involves a rise in domestic wages, Dutch Disease is possible. Both export and import-competing sectors could be negatively affected, thereby leading to the deindustrialization discussed above.

BOX 6. A SUMMARY OF THE AID AND THE 'DUTCH DISEASE' EFFECT

The Conference of African Ministers of Finance (2006) summarised the relationship between aid and Dutch Disease as follows, "A major policy challenge for recipient governments faced with an increase in aid flows is the likelihood of Dutch Disease effects. Aid inflows absorbed into the economy, result in an increase in domestic demand for both tradable and non-tradable goods. In the tradable sectors, an increased demand results in higher imports from international market. In the non-tradable sectors, an increased demand may not be directly met owing to various domestic supply constraints, resulting in an increase in prices in the non-tradable sector. The rise in prices in the non-tradable sector relative to prices in the tradable sector causes an appreciation of the real exchange rate. A higher real exchange rate consequently harms the international competitiveness of a country's tradable goods sector."

If the Dutch Disease scenario were likely, it would mean that countries would become unable to produce significant amounts of exportable goods, and there might also be very real adjustment costs. For example, cash crop producing farmers who are unable to maintain their livelihood may not easily transform themselves into construction or service sector workers. Therefore, such an economy might have large pockets of increasing despair and poverty even as other areas, as well as the broader economy, appear to be doing well.

Despite its prominence in development literature, there are few documented case of aid-induced Dutch Disease. Some researchers have found cross-country evidence suggesting that very large increases in aid lead to slower growth of export sectors, but no single-country study has been able to demonstrate a link between large increases in aid inflows and a contraction in tradable goods producing sectors. While the scarcity of evidence does not disprove the hypothesis, it does suggest that this concern is overemphasised.

While there are many documented cases of resource windfall-related Dutch Disease, for example, in Iran, Nigeria and Venezuela from 1965–85, there have not, so far, been documented cases of aid-induced Dutch Disease. The reason for this may lie in the fact that there are two crucial factors driving Dutch Disease: substantial rises in exchange rates, and wage inflation. Some aspects of ODA funding tend to protect against both of these phenomena. For example:

- ODA funding is often directed at projects that have high import content, this is particularly the case for ODA funding for HIV where portions of ODA is spent on importing condoms, and antiretroviral drugs (Hailu 2006). So while ODA funding leads to an increase in the supply of foreign currency, it also leads to increased demand for foreign currency to pay for these essential imported goods. Although the reduction in drug prices means that this should not be overstated (see Box 8), for many countries it is unlikely that there will be significant changes in the exchange rate despite high inflows of foreign currency.

- ODA funding is usually directed at increasing productive capacity through infrastructure development, training of new professional personnel, and the like. If well planned, (see box 8) this prevents price from increasing because supply is increased with demand.
- ODA funding tend to be better distributed geographically (across regions) and sectorally (across sectors) than the proceeds of resource windfalls. The bottlenecks that often generate large price increases are therefore less severe for ODA.

Box 7 shares McKinley's (2006) view on the likelihood of ODA funding causing 'Dutch Disease' and Box 8 shares Walters's (2007) and Compernolle's (2006) perspectives on whether ODA funding for HIV is any different from other aid in this respect.

BOX 7. IS SCALING UP ODA LIKELY TO CAUSE DUTCH DISEASE?

Terry McKinley (2006) states, "Models that assess the threat of a 'Dutch Disease' often assume that economies are on their 'production possibility frontier'- namely, fully utilizing all available productive resources. The corollary is that the expansion of public-sector spending inevitably 'crowds-out' private spending. The reality, in contrast, is that many economies experience widespread unemployment and underemployment (Nkusu 2004). Once the unrealistic assumption of full employment is relaxed, the immediate likelihood of a 'Dutch Disease' diminishes. Nevertheless, even if productive resources are not fully utilized, underdeveloped economies are plagued by many specific supply bottlenecks, e.g., lack of infrastructure or skilled personnel. These problems suggest that governments should focus ODA on removing these bottlenecks, which impede the responsiveness of aggregate supply. Public investment can play a central role in this effort."

BOX 8. IS SCALING UP ODA FUNDING FOR HIV AND AIDS ANY DIFFERENT FROM OTHER ODA?

According to B. Walters (2007), large increases in aid commitment, along with a large increase in government expenditures, are urgently required to address the emerging humanitarian crisis in sub-Saharan Africa. Walters argued that the effects of Dutch disease are overemphasized and that aid directed at HIV and AIDS is likely to have positive short and long-term effects on production in the recipient countries. Aid directed at combating the immediate impact of HIV and AIDS would help to increase the productivity of the workers in the short run. Moreover, the positive impacts of aid on health, education and intergenerational transfer of knowledge would help the economies in the long run. The author contended that high levels of inflation are more likely when governments resist spending the increased aid than when they actually do spend it.

According to Compernolle (2006), "nevertheless, a cautious approach might be particularly important in the face of increased aid flows for AIDS, as the response to AIDS is different to other, more traditional areas of aid expenditure. These differences might increase the risk of Dutch Disease-like macroeconomic instability:

- with a reduction in prices for antiretroviral treatments, the import component of AIDS programmes has been reduced;
- moreover, there is a limit to what the domestic economy can absorb of imports without experiencing demand-effects (e.g. in transport industry, health care workers required to handle the imported goods);
- as the response to AIDS is being scaled up, AIDS programmes increasingly draw on scarce domestic goods and services, in a health system with limited spare capacity, which has an effect on prices;
- though multisectoral, AIDS programmes are biased towards the social sectors as education and health rather than "productive" sectors such as infrastructure. Though it can certainly be argued that investments in education and health also impact on the productive capacity of an economy, this happens indirectly and in the longer run."

It seems that the potential for Dutch Disease to result from a scaling up ODA funding for AIDS, or other MDGs, may have been overemphasised, but that ODA funding must be used judiciously to avoid supply bottlenecks and increase productivity in the long term. As Bevan argues (Bevan 2006) beyond the short run, when conventional demand-side Dutch Disease effects are present, the relationship between enhanced aid flows and real exchange rates, output growth, and welfare is less straightforward than simple models of aid suggest. His study of Uganda concludes that aid used for public infrastructure that generates a productivity bias in favour of non-tradable production delivers the largest aggregate return, with the real exchange rate appreciation reduced or reversed and export performance enhanced, but it does so at the cost of a deterioration in the income distribution.

3. What is meant by volatility of external funding and how does this affect the scaling up of ODA funding?

Although volatility of external funding is the least discussed of the potential negative effects of ODA funding, it is the most likely to occur. This is because some of the reasons for the volatility of ODA funding is caused by intermediary institutions (including donors and international financial institutions) that determine the allocation of ODA funding, and the policies it uses. These causal factors include the multitude and lack of coordination of donors, the preference for short- over long-term commitments, and the increasing emphasis on rewarding short-term economic (and related) performance which allows more aid in good economic years and less in bad years.

Three main types of volatility can be identified in the distribution of ODA funding:

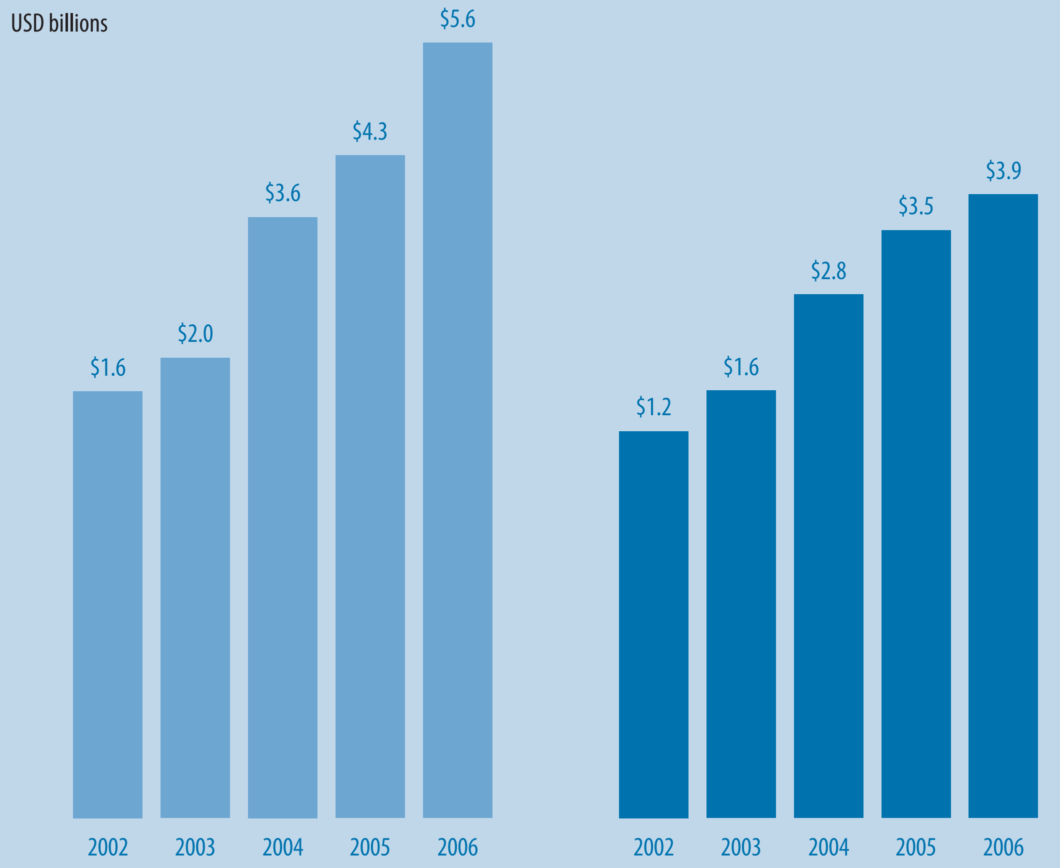
a. the difference between commitments (promises) and disbursements (actual delivery);
b. the year-to-year variability in amounts disbursed (to a country or a cause); and
c. pro-cyclical ODA (i.e., more aid in good years and less in bad years).

Each of these negative effects is discussed below.

a. The difference between commitments and disbursements

Donor governments and agencies pledge certain amounts of development assistance to certain countries as ODA funding commitments. Months (or sometimes years) later, these governments or agencies dispense resources to the intended recipient or intermediary institution as ODA funding disbursements. ODA funding commitments and disbursements are rarely the same. In general, disbursements are less than commitments, although on occasion they are larger (see Box 9). Regardless, this discordance creates problems for implementing institutions and recipient governments. Planning is made difficult because commitments may be adjusted, or cancelled, with little warning. Consequently, the credibility and effectiveness of the recipient government's actions are affected negatively.

BOX 9. TRENDS IN DONOR GOVERNMENT ASSISTANCE FOR AIDS 2002-2006



Source: UNAIDS (2006)

b. The year-to-year variability in amounts disbursed

The amount of development assistance disbursed from one year to the next (whether to countries or to causes) can change dramatically (upward or downward). This is more problematic for governments that use a cash budget approach to spending because it results in a stop-start-stop funding for many important initiatives that harms their effectiveness. Alternatively, governments can make use of the banking system, so that volatility may be transferred to the rest of the economy in terms of the availability of credit. For example, if the government borrows locally to make up for drops in disbursements, then less credit is available for the private sector and consequently lending rates may rise as well. If governments use bank deposits to save surplus disbursements, then there is more credit and lower lending rates. The net effect is higher volatility of credit and lending rates. At low levels of ODA funding, relative to government spending, this may not be of great concern. As ODA funding is scaled up, however, these effects are increasingly apparent and increasingly disruptive either in terms of economic activity or to the effectiveness of project and programme implementation (see Box 10).

BOX 10. IMPACT OF VOLATILITY EXTERNAL RESOURCES (OR 'AID SHOCKS') ON HEALTH SECTOR HUMAN RESOURCES INVESTMENT: MALAWI CASE STUDY

According to Compernolle, P. (2006), "health care staffing in Malawi are low even by African standards, with 2 physicians for 100,000 people, compared to 22 physicians for the same population in the AFRO region. The reasons for the lack of staff are insufficient training and staffing, AIDS-related attrition, and increasing numbers of staff moving out of the public sector (due to low pay, working conditions). Increased aid for AIDS through the GFATM and other pooled donors enabled the Government of Malawi to scale-up antiretroviral treatment. However, given the limited capacity of the health sector, this also risks diverting scarce resources, such as health care staff, from elsewhere in the health sector. Therefore, in 2004, the government of Malawi launched a programme to deliver an Essential Health Package, which includes AIDS treatment and care, as part of a sector-wide approach. Within this a six-year, US$ 272 million, Emergency Human Resources Plan has been funded to a large extent by the Government of Malawi, GFATM and DFID. This plan will be used to expand training capacity by 50% on average, address re-allocation with 'hardship incentives' and increase salaries of 11 key health cadres by 52% (taxed) in order to reduce the push factor into other jobs and overseas. The Ministry of Health will address non-financial factors that determine retention and performance such as promotion policies, gender issues and quality of housing. Though the salary increases were actually a forwarding of planned pay reforms for the Malawi government as a whole, the Ministry of Finance (as well as other civil servants and the IMF) has now accepted the resulting salary differential for the health sector. Because the salary increases are currently only affordable with external funding, leaving the government of Malawi very vulnerable to aid shocks, DFID has committed itself to giving two years notice of plans to reduce its contribution to the salary support. Nevertheless, even if support would be withdrawn with two years notice, it would still force the Government of Malawi to make some difficult expenditure choices as the commitment to increased salaries is difficult to exit from, thus inevitably crowding out other health priorities."

Note: AFRO refers to the World Health Organization (WHO) Regional Office for Africa

THE PRO-CYCLICAL ODA (I.E., MORE AID IN GOOD YEARS, LESS IN BAD YEARS)

Economic activity is typically cyclical in all countries. There may be high output growth for a few years, followed by a few consecutive years of low output growth (or even negative growth) and then the cycle begins again. Ideally development assistance could help to reduce this cyclical pattern by providing ODA funding anti-cyclically by providing more ODA funding in bad years and less in good years. Typically, however, ODA funding has been pro-cyclical by providing less ODA in bad years and more ODA in good years. Consequently ODA funding tends to make this cyclical pattern worse.

Emphasis in recent years on rewarding good economic performance among recipient countries (using measures used to define macroeconomic stability discussed previously) is likely to have increased this tendency. It is also important to point out that the pro-cyclical nature of ODA funding is less important when ODA is small, relative to the size of the economy, but that it becomes increasingly important when ODA funding is scaled up.

1.3 WHAT ARE SOME CURRENT RESPONSES TO CONCERNS ABOUT THE EFFECT OF SCALING UP ODA FUNDING FOR HIV AND AIDS ON THE ECONOMIC PERFORMANCE OF A COUNTRY?

As noted previously, a dominant concern of many recipient governments (donors and intermediary institutions) with respect to the scaling up of ODA funding has been maintaining macroeconomic stability and avoiding the possibility of Dutch Disease. The result has been an intense focus on ensuring the following conditions:

- low (single digit) inflation,
- fiscal surpluses or small deficits,
- balance of payments surpluses or small deficits,
- stable (or depreciating) exchange rates,
- substantial and stable or increasing foreign exchange reserves.

A scaling up of ODA funding to MDG levels implies a large inflow of currency into an economy over a very short period. It is unlikely that this would leave the economy unaffected. Typically, in an effort to forestall negative impacts, macroeconomic managers (central bank governors, finance ministers and officials in similar positions) have tried to ensure that the above-mentioned conditions are met by strictly managing ODA funding inflows. As a result, the two most common policy responses (or approaches) are 'full hoarding of ODA' or 'partial hoarding of ODA'.

Overall, there are three policy responses available to countries receiving aid:

- full hoarding of ODA;
- partial hoarding of ODA; or
- full absorption and spending of ODA.

To understand these policy responses it is best to first review the sequence of steps that funds must navigate before reaching the targeted project or programme. In its simplest form, ODA funding is disbursed by a donor agency or country arrives in the form of a cheque, in foreign currency, made out to the government or other implementing agency of the recipient country. This cheque is deposited by the government at the central bank and becomes part of the central bank's pool of foreign exchange reserves. For its part, the central bank increases the government's local currency deposits (at the central bank) by the equivalent of the foreign currency deposited. This is referred to as the counterpart. To spend the funds locally, the government either writes cheques (in local currency) on the central bank or transfers the funds from the central bank to another local bank and writes cheques on the account at that bank. At the same time, the central bank makes the foreign currency it has received available to anyone who desires, through local banks. This currency is used to purchase foreign goods and services (imports) in exchange for domestic currency.

1. Full hoarding of ODA (or 'not absorbing and not spending ODA')

The full hoarding of development assistance means that this process is not completed. The foreign currency is deposited at the central bank and the government's local currency account at the central bank is credited. However, no cheques are written by the government on the new amounts at the central bank, and the central bank does not make the foreign currency available to any domestic actors. Therefore, the main noticeable effect of the receipt of ODA funding is an increase in the central bank's foreign currency reserves. However, it is important to note that if the ODA agreement stipulates that the ODA should fund the implementation of a project, the total foreign exchange reserves, and domestic funding, will increase. In other words, full hoarding does not prevent the project from being implemented. Hoarding of the domestic currency equivalent means that there is no overall net expenditure increase (or increase in available resources) as funds are diverted from elsewhere to pay for the promised project, resulting in serious side effects (crowding out of credit) for the private sector, and high real interest rates.

The IMF refers to this as 'not absorbing and not spending ODA'. 'Not absorbing' means that the foreign currency in which ODA funding is first received is never used (for the purchase of imports), and 'not spending' means the local currency equivalent is also not used to increase the resources available for expenditure.

The central bank and the government choose to do this simply because it helps fulfil some of the macroeconomic conditions outlined above. For example:

- if the foreign exchange is not made available, it boosts reserves;
- if the foreign exchange is not made available for importers then the exchange rate is largely unaffected;
- if funds are received in the form of grants, the current account balance improves (the grant funds are a plus-side item), and if the funds are received as loans, they have no effect on the current account or the balance of payments;
- if the funds are not spent locally this protects against a fiscal deficit as there is no increased expenditure; and/or
- the failure to spend the funds locally also means there is no direct impact on inflation as the funds do not affect either the demand for goods and services or the amount of money in the economy.

This policy response avoids most of the potential problems associated with ODA funding (except, perhaps, debt accumulation if ODA funding comes in the form of a loan), but it is achieved by essentially refusing to use ODA funding as it was originally intended. In the specific case of ODA funding intended for HIV and AIDS initiatives, it seems clear that ODA funds are not only unused, but also misused. It is simply employed to increase foreign exchange reserves.

In this box of examples (see Box 11), Ghana is hoarding ODA, while the other countries are partially hoarding ODA in various ways, which will be explored next.

BOX 11. DEGREES OF ABSORPTION AND SPENDING OF ODA

	Not spent	Partly spent	Mostly spent	Fully spent
Not absorbed	Ghana (0,7)			Tanzania (0,91)
Partly absorbed	Ethiopia (20,0)		Uganda (27,74)	Mauritius (n.a., 100)
Mostly absorbed		Sierra Leone (n.a., n.a.)		Mozambique (66, 100)
Fully absorbed				

Source: Foster and Killick (2006); figures in parentheses refer respectively to percentages of aid absorbed and spent; n.a. indicates that the data are not available/clear.

2. Partial hoarding of ODA

The partial hoarding of development assistance refers to situations in which, as with full hoarding, the series of steps in the full use of ODA funds described above are not completed. However, a greater number of the steps are completed in comparison with full hoarding. There are two policy responses that result in partial hoarding:

- absorb the foreign exchange, without spending the counterpart (domestic spending),
- spend the counterpart (domestic spending), without absorbing the foreign exchange.

Absorbing the foreign exchange, without spending the counterpart (domestic spending)

This means that the government saves the domestic currency counterpart but sells the foreign exchange to finance increased net imports. Thus, the aid will affect the economy by reducing inflation, taking demand out of the economy as foreign exchange is sold for domestic currency and is then used to finance increased net imports. This can be a sound use of aid if the budget deficits and inflation need to be reduced. It may be an effective way of assisting the growth of the private sector, via reduced use of the inflation tax and less crowding-out in credit markets. However, this policy response means that none (or little) of the local currency counterpart is spent on HIV and AIDS initiatives and therefore this aspect of the ODA funding cannot have its intended impact. As with the example of Kenya (see Box 12 below), this macroeconomic policy response can result in arguments for ODA funding for HIV and AIDS to be 'off budget' (or provided to agents outside the Government such a NGOs, academic institutions etc) to ensure that the funds are spent to address HIV and AIDS.

BOX 12. A CASE STUDY OF THE EFFECTS OF PARTIAL HOARDING IN KENYA

D. Hailu (2006) investigated HIV and AIDS financing in Kenya, where HIV and AIDS financing has been increasing even while total ODA and public spending on health have been falling. In an effort to hold down the inflation rate, the government adopted restrictive macroeconomic policies. Consequently, none of the aid that Kenya received was fully spent, and it was only partial absorbed. Instead, the strategy was to use one third of ODA to increase expenditure, one third for fiscal adjustment (by reducing domestic debt) and another third to increase reserves. By partially using the ODA, Kenya succeeded in achieving its target low inflation rate. It is important to note that this strategy did not necessarily stymie HIV and AIDS control efforts in Kenya because a significant chunk of additional HIV and AIDS-related ODA was channelled through, and spent, by the non-governmental sector. Overall, ODA for HIV did not cause macroeconomic instability because the ODA was not spent, even if it was spent the amount of ODA was not large enough to upset macroeconomic conditions, and a large proportion of sending was allocated to importing condoms and essential drugs. As Hailu (2006) concludes, "In the long-term, the Kenyan case study suggests that there is room for more expansionary fiscal policy that can simultaneously address such a severe human development crisis as the HIV/AIDS epidemic and expand the country's productive capacity through the effective utilization of scaled-up external resources".

Spending the counterpart (domestic spending), without absorbing the foreign exchange

In this case, the government does spend the local currency on the intended project or programme, which means that domestic spending occurs. However, the foreign currency deposited at the central bank is not made available for general use. Since certain inputs must be imported as stimulated in the legal agreement with the donor, foreign exchange is used from elsewhere meaning less foreign exchange is accessible to other agents such as private borrowers, which means that they will bear the cost. This policy response ensures that some, but not all, of the typical targets for macroeconomic stability are met. Governments may still need to consider additional actions to ensure that all of the targets are met. For example, partial hoarding protects:

- foreign exchange reserves as they will increase as the foreign currency is not released.
- the stability of the currency because the market cannot be affected if funds are not used.
- the current account deficit (or surplus) as the ODA funding boosts the current account balance (if ODA funding is received as grants) and has no effect if it is received as loans.

However, because the funds are spent locally they do affect the government budget and, potentially, inflation. The main reasons are outlined in the following bullet points:

- budget balance – If the funds are received as grants, the government budget balance after grants remains unchanged because the increase in spending is matched by an increase in grants revenues. However, if the development assistance arrives in the form of loans, it worsens the government budget balance because the increasing spending is not matched by an increase in revenues. Instead, it appears as an increase in government borrowing and, therefore, a net increase in the budget deficit (or a smaller surplus). If the size and rate of increase of the government debt is not a problem, then this expansion of the budget deficit should not be a source of concern. However, if the government debt situation is not secure, this will likely cause a problem.
- inflation – Since the Government is spending more money there is likelihood to be an increase in inflation. To maintain low inflation, the central bank typically tries to reduce the amount of money circulating in the economy by selling government bonds (e.g., non-monetary financial assets such as stocks) to domestic banks, and sometimes other institutions and individuals, in exchange for cash. This has the effect of reducing the amount of money (cash) in the economy. Such an intervention is usually effective in holding down inflation, but it has two very important consequences, which are impractical and exacerbated in a situation where ODA funding is being scaled up:
  - the sale of bonds usually causes the interest rate to increase because there is less money in the system. This can have serious consequences for firms that depend on bank credit for working capital and/or investment. These high rates, which are often accompanied by other restrictions on credit, have dire consequences for economic growth if borrowers are unable or unwilling to take out loan
  - the high interest rates may actually attract more funds from abroad if foreigners are allowed to purchase bonds or deposit funds locally. This development may undermine the whole approach by failing to reduce the amount of money in the economy and by increasing the available foreign currency, which could affect the exchange rate as well. In this case, all of the targets, except that of reserve accumulation, are jeopardized.

Unlike full hoarding, partial hoarding by spending the local counterpart, can result in the desired increase in spending for HIV and AIDS implied by an ODA scale up. However, the use of ODA funding is still only partial because, for example, one key objective or expected by-product of ODA spending, an increase in imports, is not completely fulfilled. However, this policy response is increasingly likely to backfire in terms of ensuring macroeconomic stability as ODA funding amounts increase, because the larger the amount of ODA funding, the more bonds must be sold by the government to reduce the amount of money in the economy. Increased sale of bonds leads to higher interest rates, which affects private borrowers.

3. Full absorption and spending of ODA (or 'fully absorbing the foreign exchange and spending the counterpart')

If the ODA funding is entirely spent on additional imports, then the foreign-exchange reserves and the government budget deficit will be unchanged. The economy enjoys a boost through increased net imports, but the increased demand is matched by increased supply of net imports and there is no effect on the domestic supply-demand balance. However, unless all the aid is used to finance government imports that would not otherwise have been purchased, absorbing all the foreign exchange in higher net imports may require an appreciation of the real exchange rate, to persuade purchasers to switch enough demand from domestic to foreign goods and services (to avoid inflation caused by a supply demand bottleneck). Although the macro economies of countries may be able to adjust to this increase in foreign exchange and therefore fully benefit from the ODA funding, concerns about Dutch Disease, aid volatility and protecting strict macroeconomic measures means that full absorption and spending of ODA funding is rare.

Implicit in both the full and partial hoarding policy responses to ODA funding, is a desire to limit the use of ODA funds to maintain economic stability. While partial hoarding can be effective in achieving this aim with relatively small amounts of ODA funding, this policy response may be more problematic with larger amounts of ODA funding. The benefits and costs of the full absorption and spending of ODA on the macro economy will depend on the country circumstance, interpretation of macroeconomic stability and judicious use of macroeconomic policy interventions.

The policy response of full or partial hoarding reflects a strict interpretation of macroeconomic stability, for example, that important indicators such as inflation rates must not be allowed to deviate from narrow target ranges. This interpretation assumes that all significant economic changes are bad and reflect instability. An alternative interpretation differentiates between economic movements that can be considered part of the normal adjustment of a healthy economy to a major challenge, such as scaling up of ODA funding, from movements generated by real economic problems. This approach would address macroeconomic instability at its source while monitoring macroeconomic measures so corrective interventions can be used if there is incomplete adjustment of the economy. Using this alternative interpretation allows the economy an opportunity to adjust to the scaling up of ODA funding and for the country to gain the full potential benefits of ODA funding through both economic growth and HIV and AIDS prevention and treatment.

BOX 13. GOVERNMENTS' JUDICIOUS USE OF POLICY - A CASE STUDY OF INDONESIA

According to Chowdhury and McKinley (2006), "In Indonesia, the surge in aid inflows financed 80-90 per cent of development expenditures. This experience shows that the macroeconomic impact of aid depends critically on the policy response of government. If aid is used to expand the productive capacity of the economy or to remove critical supply bottlenecks, then there is likely to be little adverse impact associated with Dutch disease-like problems. The macroeconomic impact of aid also depends on the behavior of the central bank. For example, it could use the aid induced increase in reserves to expand low cost credit to the private sector. For instance, Indonesia used the increased flows of foreign exchange (whether due to oil booms or increased aid inflows) to expand low cost credit schemes for rural and small-scale industries. Its experience also demonstrates that the central bank can successfully manage the exchange rate to offset any appreciating effect of reserve accumulation. In short, the effectiveness of aid flows depends on a coordinated fiscal, monetary and exchange rate policy response of the government and the central bank".

SECTION 2

ELEMENTS OF AN INTEGRATED POLICY RESPONSE FOR SCALING UP ODA FUNDING FOR HIV AND AIDS AND PROTECTING THE ECONOMIC PERFORMANCE OF A COUNTRY

2.1 WHAT ARE SOME ELEMENTS OF AN INTEGRATED POLICY RESPONSE FOR SCALING UP ODA FUNDING FOR HIV AND AIDS AND PROTECTING THE ECONOMIC PERFORMANCE OF A COUNTRY?

The policy responses to the scaling up of ODA funding, of hoarding or partial hoarding described above, can succeed in protecting macroeconomic stability (and, in the process, remove the possibility of Dutch Disease), but they hold back on the full use of ODA funding, and are increasingly likely to backfire as ODA funding amounts increase. Essentially, these policy responses place the goal of macroeconomic stability ahead of the goal of complete and effective use of available resources (and, by implication, fully addressing the AIDS pandemic). Implicit in both policy responses is a rather strict interpretation of macroeconomic stability that important indicators of stability must not be allowed to deviate from narrow target ranges. One of the limitations with such an interpretation is that it treats movements in economic measures that can be seen as part of the normal adjustment of a healthy economy to a major challenge such as the scaling up of ODA funding, in exactly the same way as movements that are generated by real economic problems. Through this interpretation all significant movements in economic measures must be avoided. Therefore, the economy is never really given an opportunity to adjust to the scaling up of ODA funding even if it could do so.

The literature has identified some elements for an integrated policy response. This alternative policy response complements a conclusion drawn by Walters (2007) described in Box 14 below.

BOX 14. AID FOR HIV AND AIDS CAN INCREASE PRODUCTIVE POTENTIAL

Walters (2007) states that, "aid directed at combating the immediate impact of HIV/AIDS is likely to raise productive potential significantly in the short term, through its capacity to restore productive labour, and in the long term, through its impact on health, education and in the intergenerational transfer of knowledge. Aid directed at HIV/AIDS is also likely to be complementary with the aid supplied to achieve the broader set of MDG goals, which need to be directed at infrastructure and other supply constraints on the expansion of productive capacity. 'Dutch disease' effects, although possible, are therefore neither inevitable nor likely if aid is used judiciously. However, the high volatility and low predictability of aid are an evident danger. Volatile and unpredictable aid is the equivalent of a destabilizing shock that produces notable short run costs. In addition, such aid encourages a conservative response of government in translating aid commitments into increases in expenditure. The behaviour of donors is, in this respect, crucial; it needs to be more predictable and consistent, with a far stronger link between commitments and disbursements."

Key to this alternative policy response is differentiating between changes that are part of the normal economic adjustment and changes that indicate macroeconomic instability. The alternative policy response would address macroeconomic instability at its source (the microeconomic level), and reserve macroeconomic policy intervention as the final option to be implemented when there is clear evidence that the economy is unable to adjust to the scaling up of ODA funding.

The four elements of an alternative policy response include:

1. Allow the economy to make the adjustment
2. Enhance the economy's capacity to adjust to the scaling up of ODA funding
3. Address volatility issues
4. Apply macroeconomic measures for incomplete adjustment

Each of the four elements of this alternative policy response is explored in greater detail below.

1. Allow the economy to make the adjustment

It is usual for substantial scaling up of ODA funding to result in obvious macroeconomic effects. However, experience and economic theory indicate that if an economy is functioning well (and ODA funding is well directed and utilized), these effects can be considered part of the adjustment process. Ultimately, the most important macroeconomic measures, notably the exchange rate and inflation rate, should show clear signs of settling down to levels that do not elicit concern. A reasonable expectation is that the adjustment period for these measures would last two to three years.

The following information summarizes these measures and what their movements might look like in the normal course of economic adjustment to a scaling up of ODA funding (specific signs that an economy is unable to adjust are listed under point 4 below).

- **a (nominal) exchange rate appreciation:** This is a higher value of the domestic currency or lower cost of foreign currency. This results from the rapid increase in the availability of foreign currency, which will likely push supply ahead of demand at first, and result in a fall in the price of foreign currency (meaning a higher value for domestic currency). The price of foreign currency should recover as import demand increases (likely assisted by the initial fall in the price of foreign currency) to match or even outpace, the supply of foreign currency.
- **a higher rate of inflation:** The increased spending of ODA funding within the economy will almost certainly cause prices to increase more rapidly at first, because new demand for goods may be ahead of supply in some sectors (and, of course, there is a significant increase in the amount of money circulating in the economy). Here again, if the economy is functioning well, supply will catch up with demand in due course and the initial spike in inflation will settle down to a low or moderate level. It should be noted however, that consistently high levels of ODA funding (as would be implied by a scaling up of ODA funding for high incidence countries) may result in persistently higher levels of inflation than would have been the case before the scaling up of ODA funding. This should not require drastic policy action if inflation remains within single digits or shifts from single digits to the lower teens (see section 1.2).
- **a real exchange rate appreciation:** This is essentially the combination of higher inflation and a nominal exchange rate appreciation. Once inflation and the nominal appreciation moderate (as suggested above), the real exchange rate appreciation will also be moderated. Even if the real exchange rate remains above previous levels, if the economy is benefiting fully from ODA funding, it is likely to be able to tolerate that appreciated rate because it is better able to produce goods and services than previously.

- **an expansion of the fiscal and current account deficits:** This can be attributed to the scaling up of ODA funding only if it comes in the form of loans. Whether this should be a cause for concern depends on the degree to which the country can afford an expanding debt burden.

To allow the economy to make these adjustments, the scaling up of ODA funding would proceed unhindered by full or partial hoarding of ODA, while macroeconomic measures are monitored to determine whether their movements are in line with normal adjustment or whether they signal adjustment setbacks. When changes are not consistent with normal adjustment, corrective action (in terms of macroeconomic policy intervention), may be necessary. However, it is unlikely that many economies will adjust (to the scaling up of ODA funding) easily without a conscious attempt to enhance their capacity to do so at the microeconomic level. Thus, it is important for capacity enhancement to be the focus of policy, before and during the scaling up of ODA funding, rather than the use of pre-emptive macroeconomic intervention. Box 15 provides a summary of John Serieux's (2006) point of view.

BOX 15. AN ARGUMENT FOR THE FULL ABSORPTION FOR ODA

J. Serieux (2006) argued that if aid is used to build necessary infrastructure, institutions and human capital, both welfare and productivity benefits will be maximized. In such cases, the adverse macroeconomic results, such as high inflation and appreciation of the exchange rate, which usually accompany a scale-up of ODA, are unlikely. The author maintained that if such adverse results do occur in the short run, they should not be countered with macroeconomic policy. Correction and mitigation are called for only if these results escalate or persist. According to the author, there is a range of macroeconomic policies that would allow countries to maintain the competitiveness of their tradable goods sectors over the medium run. However, none of these approaches offers a viable alternative to effective micro-absorption of ODA over the long run.

2. Enhance the economy's capacity to adjust to the scaling up of ODA funds

Even though a few economies may adjust well to a scaling up of ODA funding without conscious intervention, most economies are unlikely to do so. For these economies, it will be important to plan and implement ODA-funded projects and programmes in a manner that enhances the capacity of the economy to adjust to the scaling up of ODA funding. Consistent with economic theory, some of the most successful capacity-enhancing policies are based on the recognition that an economy unable to accommodate an increase in ODA flows indicates some fundamental issues, not at a macroeconomic level, but at the microeconomic level (the level of the ODA-funded projects and programmes) (IMF, 2005; Walters, 2007; Serieux 2007). For instance, the inability of projects and programmes funded by ODA (as well as other local initiatives) to enhance the capacity of the economy to produce the additional goods and services that the resource inflows themselves demand, can contribute to instability.

A key economic concept, the *specificity rule*, dictates that when policy makers face a challenge within the economy (a distortion), the policies used to address that distortion should be directed at the source of that distortion. In terms of scaling up of ODA funding, the main distortion is the failure of projects and programmes to make the economy more productive, therefore, policy interventions should focus on making these project and programmes as productive as possible.

According to The Joint Programme on Strengthening National Capacities for Integrating AIDS in Poverty Reduction Strategy Processes (2007a) three-country study, projects and programmes that can enhance the economy's productivity are:

- **innovative:** chosen to address specific and pressing needs (rather than simply because money is available), and designed to elicit the maximum productive response within stated objectives.
- **efficient:** well-executed, both in terms of the quality and implementation.
- **effective:** able to achieve intended objectives.
- **coordinated:** chosen and planned to avoid bottlenecks, and integrated with other MDG initiatives as well as broader development objectives.

The intent is to ensure that ODA-funded initiatives, at the very least, do not hinder the normal functioning of the economy and, at least some of the time, improve the general functioning of the economy.

As discussed in section 1.1, ODA funding for HIV and AIDS can have specific benefits in terms of the economic performance of a country as well as for individuals, their families and communities. The reduction in HIV incidence and the provision of treatment and quality care of people living with HIV, means that individuals and caregivers are less restricted by episodes of sickness and there is less uncertainty and fear about the future allowing individuals (and firms) to invest with more confidence. If HIV and AIDS initiatives are well integrated into larger development initiatives, they can also have a significant spillover effect in many other areas. For example, expanded efforts to provide care and treatment for people living with HIV might involve the construction and upgrading of many health facilities, the training of personnel and the purchase of equipment. The following are some of the spillover effects that can be achieved by using ODA funding for HIV judiciously:

- more and better health facilities, and more trained personnel for HIV prevention and AIDS treatment and care, can also assist in the prevention and treatment of malaria and tuberculosis (TB) which will benefit individuals, households and national economy as a whole.
- HIV prevention initiatives in the community and workplace can be integrated with activities aimed at preventing other diseases, and prevention initiatives to overcome HIV vulnerability and risk have broader benefits for the individual and economy as a whole (e.g., ensuring that children orphaned by AIDS are supported to completed their education).
- the construction of facilities and other health system–related infrastructure increases demand for labour, and the development of infrastructure (such as road access to facilities) can boost many other types of economic activity.

However, obtaining these benefits calls for innovation, good planning and efficient execution on the part of those who choose and implement projects. This means deliberate (rather than arbitrary) project choice, an effective delivery system for funds, efficient execution of planned initiatives, and coordination across projects and programmes. Given that the PRSP is the primary instrument for economic planning and programme execution in the economy, ensuring that PRSPs allow for scaling up of ODA funding, and that HIV and AIDS initiatives are well integrated into PRSPs, helps to ensure these benefits (see Section 2.2). A number of useful global initiatives and tools are in place to support capacity enhancement and coordination of ODA funding (see Box 16).

BOX 16. GLOBAL INITIATIVES AND TOOLS THAT SUPPORT CAPACITY ENHANCEMENT AND COORDINATION

- The Paris Declaration on AID Effectiveness (see www.aidharmonization.org)
- The "Three Ones" principles, to achieve the most effective and efficient use of resources, and to ensure rapid action and results-based management:
  - One agreed HIV/AIDS Action Framework that provides the basis for coordinating the work of all partners.
  - One National AIDS Coordinating Authority, with a broad-based multisectoral mandate.
  - One agreed country-level Monitoring and Evaluation System.
- The 'Country Harmonization and Alignment Tool' (CHAT), developed by UNAIDS and the World Bank, to "assist national AIDS coordinating authorities (in collaboration with international partner agencies) to assess 1) the participation and degree of engagement of country-based partners in the national response; and 2) the degree of harmonization and alignment among international partners".

3. Address volatility issues

The capacity enhancement approach to facilitating scaling up ODA funding described above can be significantly undermined if the flow of ODA is volatile, as:

- it will be difficult for local managers to be **innovative** in project choice and design if the precise destination of ODA flows is highly prescribed;
- **efficient** project and programme implementation will be compromised if the timing of ODA flows is not consistent and predictable;
- ill-considered adjustments to projects may lead to a failure to meet original objectives and thus a loss of **effectiveness**; and,
- project and programme **coordination** becomes more difficult if ODA funding commitments do not actualize in terms of both amounts and timing.

It is important to consider the issue of volatility before scaling up ODA funding. Many of the problems related to the volatility of ODA funding can be reduced if ODA funding commitments are long-term rather then year-to-year. In the specific case of HIV and AIDS financing, it would be reasonable for countries to seek three or five-year funding commitments, since it is well understood that:

- a break in treatment can have serious consequences in terms of the development of drug-resistant strains of HIV;
- a break in prevention and social intervention programmes can lead to a reversal of previous gains.

The actions of macroeconomic authorities can, to some degree, help to shield projects and programmes from some of the effects of ODA funding volatility as well. While aid volatility persists, it may be necessary to retain a proportion of ODA funding, in the early stages of ODA scale-up which can be used to build up reserves for later use in filling funding gaps (both in terms of foreign currency availability and government domestic spending resources). However, this action is specifically intended to protect against aid volatility as long as it persists and should be distinguished from hoarding as pre-emptive action for the sake of immediate macroeconomic stability as described earlier.

4. Apply macroeconomic measures for incomplete adjustment

If the economy fails to elicit the necessary productive response to a scaling up of ODA funding, it remains possible that economic instability will result. In that case, the use of the conventional blunt instruments of macroeconomic policy to mitigate the effects of scaling up ODA funding (particularly inflation and exchange rate appreciations) might be justified. However, it is important to differentiate the changes in major economic measures that imply 'normal adjustment' to a scaling up of ODA funding, from those that indicate that an economy is unable to adequately adjust. With respect to the variables identified above, we can say that there is clear evidence of macroeconomic instability (and the economy is unable to adequately adjust) when:

- the (nominal) exchange rate appreciation is large and sustained;
- the increase in the rate of inflation is large and inflation remains high (what constitutes 'unacceptably high' inflation during scaling up of ODA funding might be more reasonably placed in the 'above 15 percent' range than the current restrictive view of 'above single digit'.);
- the real exchange rate appreciation is large and shows little sign of moderating;
- the fiscal and/or current account deficits have expanded and remain stubbornly large (though it bears repeating that large fiscal and current account deficits are determined more by the nature of ODA funding, whether debt-based or grant-based than its actual amount).

However, even when corrective action must be taken to restore or protect macroeconomic stability, it is still necessary to focus attention on strengthening the mechanisms used for initiating, funding and implementing ODA-funded initiatives to prevent this in the future and make adjustments as necessary. In the long run, efficiency in the use of ODA funding will help protect the economy while maximizing the benefits of ODA.

2.2 HOW CAN THE PRSP PROCESS SUPPORT THE SCALING UP OF ODA FUNDING FOR HIV AND AIDS

According to a three–country study conducted by The Joint Programme on Strengthening National Capacities for Integrating AIDS in Poverty Reduction Strategy Processes (2007a), "In all countries, the concerns about the microeconomic and macroeconomic implementation of HIV/AIDS initiatives overlap and interact at the level of inter-agency relations within the public sector. Coordinating agencies for the HIV/AIDS response and Ministries of Health are typically responsible for coordinating all, and implementing some, of the HIV/AIDS-related initiatives. Ministries of Finance and Central Banks are responsible for managing the macro economy through their fiscal and monetary policy instruments. A scaling up of HIV/AIDS initiatives and the concomitant scaling up of external assistance must be compatible with both policy environments or it will flounder." The study concludes that "there is little evidence that there is sufficient dialogue between the various agencies and sufficient buy-in by the macroeconomic managers to suggest a common agenda."

It follows that, if HIV and AIDS initiatives are to be *innovative, efficient, effective and coordinated,* they will have to be integrated into key national planning frameworks such as the Poverty Reduction Strategy Papers (PRSP) both in terms of process and outcome. According to the World Bank website, PRSPs "describe a country's macroeconomic, structural and social policies and programmes to promote growth and reduce poverty, as well as associated external financing needs. PRSPs are prepared by governments through a participatory process involving civil society and development partners, including the World Bank and the International Monetary Fund (IMF)."

One of the great advantages of the PRSP is its procedural requirement for consultation. Governments are required, by the rules that govern the development, submission and approval of the PRSP, to consult widely in the development and articulation of the PRSP, as well as in reviews of progress during the period of implementation. These rules are administered by the multilateral agencies that oversee the process and eventually approve the PRSP – the IMF and World Bank. Strengthening consultation processes to be more substantive that procedural, provides an opening for ensuring that HIV and AIDS initiatives are integrated into the broader growth and poverty reduction strategy.

However, though PRSPs may provide the best means for promoting and implementing an effective scaling up of ODA funding for HIV and AIDS, they can also provide the justification for resisting such a scaling up of ODA funding in the name of a stable macroeconomic environment. Macroeconomic policy objectives are generally defined outside the consultative process of the PRSP (usually as part of accompanying PRGF facilities). It is, therefore, quite possible that a PRSP will simultaneously promote scaling up of ODA funding for HIV and AIDS (and other MDG) initiatives, but define macroeconomic stability so strictly that scaling up ODA funding would guarantee failure to achieve that stability. In this case, the objective of macroeconomic stability would prevail (compelled by both the priority given to macroeconomic management issues in government policy and pre-existing PRGF commitments). It is, therefore, necessary to understand how macroeconomic stability in defined within PRSPs (and PRGFs) to be able to engage in the PRSP consultations that enable the scaling up of ODA funding for HIV and AIDS (and other MDG) initiatives that will benefits individuals, households, communities and the economy as a whole.

To assist those engaged in PRSP consultative processes, the following two key questions are explored in some detail below:

1. How can PRSP macroeconomic measures be viewed differently to allow the scaling up of ODA funding for HIV and AIDS?
2. How can HIV and AIDS priorities be better integrated into PRSP?

1. How can PRSP macroeconomic measures be viewed differently to allow the scaling up of ODA funding for HIV and AIDS?

As noted elsewhere in this learning resource, there is no necessary contradiction between the objective of macroeconomic stability and the scaling up of ODA funding even though scaling up ODA will usually cause some shift in major macroeconomic measures (particularly the exchange rate and inflation) in the short run. As presented in section 2.1, this can be viewed as part of a healthy adjustment of the economy over the longer term, rather than a sign of economic instability. However, if the definition of macroeconomic stability is interpreted very strictly, these changes will result in immediate corrective action or pre-emptive action. The scaling up of ODA funding is consequently either curtailed or forestalled.

Though PRSP documents are not identical across countries, they are sufficiently similar to make identification of prescribed macroeconomic objectives quite easy. All PRSP documents include a section or sub-section entitled "Macroeconomic Framework" or a similar title. This section outlines broad or specific objectives for inflation, exchange rates, monetary policy, the fiscal and current account deficits, and foreign exchange reserves. Listed below are descriptions and explanations of objectives, or macroeconomic measures, which might influence of the scaling up of ODA funding for HIV and AIDS. Each sub-section also offers suggestions on how to influence policy makers toward improving the climate for scaling up ODA funding.

The rate of inflation

In countries with medium to high levels of inflation, specific inflation targets are often set at levels far below existing ones. Meeting those targets requires strict monetary policy, which in turn often prompts full or partial hoarding of ODA funding. Examples of some of the language used to describe these inflation targets include: "achieving single digit inflation;" "maintaining CPI growth at 3 percent per year;" and "annual underlying inflation rate will be a maximum of 5 percent." Although these inflation objectives are in the majority of PRSPs, it is important to note that medium- to long-term objectives of low inflation are not incompatible with higher than single-digit inflation in the short term during a scaling up of ODA funding (particularly in the early stages). It is also possible that inflation remains within single digits during a scaling up of ODA funding, or changes very little. Acknowledging the important objective of long-term stability can also be done without prescribing specific limits or specifying short-term objectives, thereby leaving some flexibility for the short term. A more flexible approach to macroeconomic intervention could allow inflation to rise in the short term with corrective or mitigation measures being used if inflation persists or rises. PRSPs could therefore include phrases such as "controlling inflation" and "keeping inflation within acceptable limits" which would accommodate a scaling up of ODA funding, without giving up the objective of low inflation altogether.

The exchange rate

Like inflation, the (nominal) exchange rate is an economic measure that can be expected to change (over the short term) during a scaling up of ODA funding as part of normal economic adjustment. However, if macroeconomic targets call for strictly stable exchange rates, full hoarding, partial hoarding or reluctance to scaling up ODA funding is likely to be the response of macroeconomic policy makers. Unlike inflation, however, the language in PRSPs regarding exchange rate targets tends to be general, with stated objectives such as "achieving exchange rate stability" and "maintaining competitive exchange rates". Both of those statements can be interpreted quite strictly, but at the same time, neither is strictly incompatible with short-term movements in exchange rates that are not overly large. The (nominal and real) exchange rate stability can therefore be seen as a medium- to long-term goal rather than a desire for essentially fixed or depreciating exchange rates in the short term.

Fiscal and current account deficits

The relationship between the scaling up of ODA funding and fiscal and current account deficits varies. If ODA funding comes in the form of grants, it is neutral to the fiscal deficit (it adds to both expenditure and revenues) and has a positive effect on the current account deficit (it is a plus-side item). However, if ODA funding comes in the form of loans (even concessional loans), it adds to both deficits. The fundamental issue is not the size of the deficits but the degree to which borrowing is acceptable and sustainable. If borrowing is sustainable (i.e., the rate of increase in debt is within acceptable limits), then the increase in size of the fiscal and current account deficits is largely irrelevant. These deficits merely indicate that increased domestic spending is financed by foreign borrowing, not that the economy is experiencing distress. It is only if the deficits increase by an amount larger than the increase in ODA funding that there should be cause for concern. Therefore, it is possible to adjust deficit targets to reflect the expected increase in ODA funding. For example, if the increased borrowing during a scaling up of ODA funding is expected to amount to 2 percent of GDP, an increase in either of these deficits of up to 2 percent of GDP (beyond what they were before) can be expected. A smaller increase would not be unusual either. If the expected borrowing is unsustainable, attempts to maintain low-deficit targets may be justified. If ODA funding remains in loan form, any attempt to maintain low deficits is likely to lead to the hoarding of ODA. Hoarding in such situations prevent the full use of ODA funding while still incurring the debt. Therefore, if the scaling up of ODA funding is to be achieved in this context, without incurring an unsustainable debt, grant-based ODA or more concessional ODA are preferable. While governments have some say in the nature of ODA funding received, most of the decision-making power (with respect to the grant element of ODA) lies with the donor community.

2. How can HIV and AIDS priorities be better integrated into PRSP?

Countries show variability in regards to the placement of HIV and AIDS issues in PRSPs. In some cases, HIV/AIDS is treated as a separate concern within health sector issues. In other PRSP documents HIV and AIDS is integrated into the health sector agenda overall while a few second-generation PRSPs provide for a multi-sectoral AIDS response. The need for *enterprise, efficiency and coordination* (discussed in section 2.1) requires that HIV and AIDS initiatives and concerns be integrated across the full range of concerns of the PRSP beyond the health sector, particularly in high-prevalence countries. Some of the more important connections and means of integration toward that goal are outlined below.

HIV and AIDS concerns in poverty reduction initiatives

HIV and AIDS-related initiatives described with the PRSP need not be separate projects but can be integrated directly into initiatives aimed at addressing poverty. Likewise, where HIV and AIDS-related projects and programmes do exist they can, and should, pay special attention to the particular vulnerabilities of the poor and the economic consequences of HIV and AIDS itself.

HIV and AIDS concerns in labour and employment initiatives

HIV and AIDS can have both a direct and indirect effect on labour and employment issues. In moderate- to high-prevalence contexts in particular, AIDS can reduce both the active and potential labour pools as well as the quality of the available labour force when people living with AIDS are unable to work. Labour productivity suffers as a result, especially when taking into account the wider impact stemming from many workers serving as caregivers for HIV-positive individuals or children orphaned by AIDS. Absenteeism increases and employers fail to recoup investments spent toward training and preparing workers. PRSP projects and programmes aimed at improving the quality of the labour force, the efficiency of labour markets, employment insurance and related issues should include HIV and AIDS-related considerations. Similarly, HIV and AIDS initiatives should take heed of the labour and employment implications of the AIDS, for example, the impact of AIDS on health professionals.

HIV and AIDS concerns in social safety net programmes

The increased economic vulnerabilities of people living with AIDS and other HIV-affected individuals and families means that they are likely to make up a significant percentage of persons who need and seek access to social safety net programmes. Efforts aimed at improving social safety nets through PSRP structures therefore should include special consideration of HIV-affected individuals, their families, and their special needs.

HIV and AIDS concerns and other diseases

Most people working on HIV and AIDS issues are aware of the close links between HIV infection and other major diseases such as TB and malaria because their immune systems are weaker on average. Worldwide, for example, TB is the cause of death for some 30 percent of HIV-positive people who die each year. In addition, members of populations most vulnerable to HIV, including injecting drug users, migrant workers, sex workers and the poor, also have heightened vulnerability to contracting such diseases (particularly TB). Health systems that integrate HIV prevention and AIDS care with interventions for other health needs avoids duplication of services and improves efficiency in terms of service delivery and use of scarce resources overall. Patients also benefit because they can receive comprehensive care through one integrated programme or facility. Parallel systems to implement vertical disease programmes have been replaced by a focus on integrated care. PRSPs would therefore benefit from including specific language requiring such integrated health system structuring and programming.

HIV and AIDS concerns in general health programming

HIV prevention and AIDS treatment and care extend across many areas of the health portfolio. They are important factors in maternal and reproductive health, adolescent health, and basic health service delivery, for instance. For the sake of both efficiency of delivery and effectiveness, initiatives across the health portfolio should include HIV and AIDS concerns as integral parts of their approach, rather than as auxiliary projects or programmes. PRSPs should include specific language requiring such integrated health system structuring and programming.

HIV and AIDS concerns in education

Education may perhaps be the one area in which the necessity of integrating HIV and AIDS concerns (particularly that of prevention) into broader initiatives has long been recognized by those addressing HIV and AIDS. The current focus may therefore be on seeking more permanent and complete integration of HIV and AIDS concerns in education initiatives within PRSPs themselves. Integration that is more complete may for example include educational facilities ensuring that vulnerable children and students have access to an education, psychosocial support, child-friendly sexual and reproductive health services, and support to stay in school rather than provide care for the sick in the home.

HIV and AIDS concerns and governance initiatives

If ongoing scaling up of ODA funding for HIV and AIDS initiatives is to be successful, the efficient delivery and use of funds will be a critical component of that success. This speaks directly to governance concerns. Of particular importance are project development and programme procedures, project governance and the quality of local government institutions. It is therefore imperative that PRSP efforts at improving governance pay particular attention to such areas and their role in facilitating the development and implementation of projects and programmes.

HIV and AIDS concerns and funding

Many PRSP documents remain quite vague with respect to funding for articulated objectives. Only a few PRSPs explicitly outline the funding requirements and the expected sources of funds. However, if ODA funding volatility is to be addressed adequately, funding arrangements need to cover the entire operational period of the PRSP, and broad funding commitments should be an explicit part of the PRSP document. Energy should then be focused on obtaining explicit commitments from donors and governments with regard to the provision of funds (donors), the delivery of funds (donors and government) and the protection of funding levels (government).

ANNEXES

ANNEX I: WORKSHOP FACILITATION GUIDE

The following activities have been suggested to help facilitators cover the content of this publication during a workshop. For the purpose of this guidance it is assumed that the content of this publication will be used either during a half day, or two day, workshop.

It is assumed that the participants for a workshop on this issue are likely to be:

- Joint PRSP Programme members
- national governments (particularly individuals engaged in national level planning and budget management i.e., staff from NACs, Ministries of Finance, federal reserve banks, President's offices,)
- multilateral agencies
- international financial institutions (e.g., IMF, World Bank and regional development banks)
- other donors (GFATM, bilateral donors, Foundations etc)
- academic institutions
- civil society organizations (including international and national NGOs, FBOs, networks)
- businesses
- other development professionals

The two day workshop is more likely to be of interest to countries which are most likely to be directly affected by these issues. These countries are included within the Joint PRSP Programme membership.

The attached CD-Rom includes the following workshop materials: this Workshop Facilitation Guide, two workshop schedules, three PowerPoint presentations and speaking notes, and a pre- and post-workshop self-assessment questionnaire.

The facilitators will require the following to implement a workshop:

- a venue which includes group work break-out space in the main hall or as separate space(s), meals, refreshments, and accommodation (as appropriate)
- money for travel reimbursements and daily allowances (as necessary)
- workshop facilitation guides (amended as necessary)
- workshop schedules (amended as necessary)
- computer, projector and screen (for the PowerPoint presentations)
- three PowerPoint presentations
- speaking notes
- pre- and post-workshop self-assessment questionnaire (one per participant)
- plenty of flipchart paper and flipchart pens (blue, black and a few red)
- stickie stuff or Blu-Tac, scissors, a stapler
- handouts with participatory learning activity group work instructions (otherwise when the group disperse they will not be able to remember what you have asked them to do!) – you will need one handout per small group

Each participant will require the following 'handouts' during these 'workshops':

- a folder to keep handouts
- a copy of this learning resource including the attached CD-Rom
- a copy of the publication three-country study 'Addressing the Macro-Micro Economic implications of Financing MDG Levels of HIV and AIDS Expenditure'
- a copy of the Brasilia Conference Paper by Bernard Walters titled, 'The Fiscal Implications of an MDG-Related Scale-up in HIV/AIDS Financing' (See attached CD-ROM)
- copy of the relevant workshop schedule
- pre- and post-workshop self-assessment questionnaire
- note book and pen

The participants should not need copies of the PowerPoint presentation notes, or any other handouts for participatory learning activities other than the group-work instructions, as long as the participants are given a copy of this learning resource at the beginning of the workshop and encouraged to use it when appropriate. Have plenty of spare copies of this learning resource available in case participants leave their copies in their rooms during session time.

HALF DAY WORKSHOP	
Time allocation	**Suggested activities**
15 minutes	Briefly introduce the subject of the workshop
30 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding some concerns relating to the apparent conflict between scaling up ODA funding for HIV and AIDS and the economic performance of a country'
25 minutes	'Question & Answer' session (show the summary slide) A Question & Answer session should be an opportunity for the participants to ask questions concerning the presentation content and for the answers to be provided by the workshop facilitators (and fellow participants as appropriate)
5 minutes	Energizer (something quick and fun – like a prepared joke from a participant or facilitator)
20 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding some current responses to the apparent conflict between scaling up ODA funding for HIV and AIDS and the economic performance of a country'
25 minutes	'Question & Answer' session (show the summary slide)
30 minutes	Tea break
40 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding elements of an alternative policy response that allows the scaling up of ODA funding for HIV and AIDS and protects the economic performance of a country'
20 minutes	'Question & Answer' session (show the summary slide)

continued to next page

HALF DAY WORKSHOP	
5 minutes	Energiser (something fun!)
45 minutes	Participatory learning activity: Group work in country groupings to reflection on the applicability of the suggested elements of an alternative policy response, suggestions for influencing the PRSP process, and how these changes might be encouraged
5 summary	Workshop summary and close

TWO DAY WORKSHOP	
Time allocation	**Suggested activities for day one**
15 minutes	Briefly introduce the subject of the workshop
15 minutes	Pre-workshop self-assessment questionnaire
30 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding some concerns relating to the apparent conflict between scaling up ODA funding for HIV and AIDS and the economic performance of a country'
60 minutes	'Question & Answer' session (show the summary slide) - discussion questions: • Which points are not clear and need further clarivfication? • To what extent have you heard these concerns expressed? Who has expressed them? • To what extent are these concerns real or perceived? • What other concerns have you heard? Note: it is important to ask the last discussion question so that broad concerns can be raised – this is then an opportunity for the facilitator to clearly explain which concerns are directly related to the focus of the workshop and which concerns would be interesting to follow-up on after the workshop
30 minutes	Tea break
30 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding some current responses to the apparent conflict between scaling up ODA funding for HIV and AIDS and the economic performance of a country'
45 minutes	'Question & Answer' session (show the summary slide) - discussion questions: • Which points are not clear and need further clarification? • What other policy responses have you seen implemented as a result of these concerns? What has been their impact?

45 minutes	Participatory learning activity: Group work in country teams (sub-divide the country groups as necessary; max. 6 participants in one group). Ask the groups to map out: • 'What concerns are held about the macroeconomic impact of scaling up of ODA funding for HIV and AIDS in your country, and by whom (whether real or perceived)?' • 'What current policy responses are used to address these concerns and by whom?' • 'What has been the impact of these policy responses?'
60 minutes	Lunch break
60 minutes	Participatory learning activity: The group should continue mapping out the situation in their country as necessary. If some groups finish early, either encourage them to read the three-country study*, the Brasilia conference paper 'The Fiscal Implications of an MDG-Related Scale-up in HIV/AIDS Financing', or if appropriate you could ask different groups to present their work to each other within the time that is available
30 minutes	Tea break
40 minutes	Present the following PowerPoint presentation which is included on the attached CD-Rom: 'Understanding elements of an alternative policy response that allows the scaling up of ODA funding for HIV and AIDS and protects the economic performance of a country'
35 minutes	'Question & Answer' session (show the summary slide) - discussion questions: • Which points are not clear and need further clarification? • How do you feel about the four elements of the suggested alternative policy response? • To what extent is the advice on how to influence the macroeconomic policies that frame the PRSP process realistic and useful? How might you adapt them to benefit your country context? • How can efforts to strengthen the integration of HIV and AIDS into PRSPs be improved?
15 minutes	Day summary

Time allocation	**Suggested activities for day two**
10 minutes	Administration or energizer or feedback from participants
20 minutes	Recap of day 1 (partly the details of the afternoon presentation perhaps using the summary slide)
90 minutes	Participatory learning activity: Group work in country teams (sub-divide the country groups as necessary; max. 6 participants in one group). Ask the groups to: • 'Review the four-elements of the suggested alternative policy response that has been presented: Discuss whether they seem realistic and/or relevant to your country context?' • 'Review the suggestions for influencing the PRSP process: Discuss whether they seem realistic and/or relevant to your country context?'

90 minutes (continued)	Note: Either refer participants to the relevant pages within this learning resource for information on the four elements of an alternative policy response and suggestions for influencing the PRSP process, or prepare handouts for this session. Either allow the groups to use all this time for group work or ask each group to present their work. If all groups finish the task and you do not think that presentation will be worthwhile, consider introducing and starting the next participatory activity described below.
30 minutes	Tea break
120 minutes	Participatory learning activity: Group work in the same groups continued • 'Using the information from your discussions concerning the four elements of an alternative policy response and suggestions for influencing the PRSP process: Map out what would need to change (policies and approaches), and who the influential people would be, to reduce the impact of macroeconomic concerns on the scaling up of ODA funding for HIV and AIDS? Make sure that you consider what actions need to be taken to encourage the influential people to make these necessary changes?' Note: Warn the participants that they will be expected to present their work to the whole group – give them flipchart paper and pens.
60 minutes	Lunch
60 minutes	Group work presentations (either from each country or from each country sub-group) or continued group work if necessary with no subsequent presentations
30 minutes	Tea break
30 minutes	Plenary discussion - discussion questions: • What have we learned from this mapping activity? • What is still needed to be able to move forward confidently to address this issue? • What can UNDP, UNAIDS and the World Bank do to support you? • Have you agreed on how you will communicate with each other after the workshop?
30 minutes	Planning the way forward – brief session for the participants (and facilitators as appropriate) to decide how to communicate on this issue after the workshop and agree on any next steps.
15 minutes	Post-workshop self-assessment questionnaire. Once the participants have completed their questionnaire, collect any feedback volunteered by the participants (see self-assessment questionnaire for instructions for use of the tear-off section)
15 minutes	Workshop close

** 'Addressing the Macro-Micro Economic implications of Financing MDG Levels of HIV and AIDS Expenditure'*

ARV AND ART

ARV is an abbreviation of 'antiretroviral' and refers to the drugs that are used to slowing down the replication of HIV in the body. ART is an abbreviation for Antiretroviral Therapy or Antiretroviral Treatment. The term ART can be used if it clearly refers to a triple ARV drug combination.

BOND

A bond is like a promissory note or IOU given by the entity that wishes to raise funds (the bond provider) to the entity handing over the money (the bond purchaser). The purchasers of a bond is therefore a creditor, and since interest rates do not generally vary over the life of a bond, they are seen as a secure form of investment

CONDITIONALITY

Conditionality refers to commitments on economic and financial policies that governments make when they borrow, or accept grants from, the IMF, the World Bank and other financial institutions (such as regional development banks). Conditionalities may range from setting and meeting inflation targets to reducing public debts to implementing anti-corruption measures to privatizing certain public enterprises. For the most part, they are included in agreements to help resolve recipients' balance of payments difficulties and to ensure that (in the case of loans) governments are able to repay the donor.

CURRENT ACCOUNT (OR BALANCE OF PAYMENTS)

The term 'current account' refers to the net value of a nation's imports and exports. The deficit side of the ledger includes what is spent on imports, debt payments and the repatriated profits of multinational corporations. The plus side of the ledger includes what is received from the sale of exports, remittances (money sent home) from relatives abroad and grants.

DUTCH DISEASE

Countries experiencing Dutch Disease suffer from a surge in foreign exchange inflows. That development leads to an appreciated real exchange rate and higher domestic wages that render the production of exports and import competing goods (tradables) unprofitable, resulting in a significant erosion of productive capacity. Simply put, Dutch Disease refers to the loss of competitiveness in a country's export and import-competing sectors due to higher currency values.

EXCHANGE RATE

An exchange rate, or foreign exchange rate, is the price of one currency in terms of another currency. For example, if six South African rand are needed to buy 1 US dollar, then the exchange rate of the rand to the dollar is 6 rand per dollar.

FIXED VERSUS FLEXIBLE EXCHANGE RATES

Exchange rates can be either 'fixed' or 'flexible'. In a fixed exchange rate system, the rate of exchange between currencies is fixed by one or both of the governments. In a flexible exchange rate regime, the exchange rate is determined based on market forces: demand and supply for the currencies. The rate therefore fluctuates regularly, with government policy makers only able to influence changes indirectly.

FISCAL POLICY

Fiscal policy refers to a government using its budget to affect the economy by imposing new taxes, changing or removing existing taxes, and purchasing goods and services. For example, in times of recession or slow growth, the government may seek to boost the economy through expansionary fiscal policies such as increasing public spending or cutting taxes. Such policy actions may jumpstart economic growth in general. A government of a country in the midst of an economic boom may seek to cool down the economy by reducing public spending or raising taxes so that overall economic activity dampens a bit. Such 'concretionary' efforts aim to avoid potentially negative outcomes of an overheating economy (especially high levels of inflation).

HIV AND AIDS

HIV stands for 'human immunodeficiency virus'. Infection with this virus results in the progressive deterioration of the immune system, leading to 'immune deficiency'. Infections associated with severe immunodeficiency are known as 'opportunistic infections', because they take advantage of a weakened immune system. AIDS stands for 'acquired immunodeficiency syndrome' and is a surveillance definition based on signs, symptoms, infections, and cancers associated with the deficiency of the immune system that stems from infection with HIV.

INFLATION

Inflation is an ongoing process in which overall prices for goods and services rise. In that process, money loses part of its value or purchasing power, as more money is required to purchase the same good. The average percentage change in prices from one year to the next is known as the inflation rate.

INTEREST RATE

An interest rate refers to the amount charged by a lender for the 'use' of funds. The amount in interest should be repaid over and above the principal amount that has been lent out to a borrower over a stipulated period. The interest rate is expressed as a percentage (usually per year). For example, if the interest rate on a $100 loan from A to B is 10 percent, then B owes A a total of $110 at the end of a year.

INTERNATIONAL FINANCIAL INSTITUTIONS

'International financial institutions' is a term used to describe organizations that provide financial assistance in the form of loans and grants such as the World Bank, IMF and regional development banks.

INTERNATIONAL MONETARY FUND (IMF)

The IMF is an international organization comprising nearly every country in the world. As it notes on its website (www.imf.org), it seeks to "promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment." Loans are generally extended to nations experiencing balance of payments problems and related economic and financial problems. They are also extended to resource-constrained countries (particularly those defined as low-income) to help reduce poverty. IMF loans aim primarily to restore economic stability.

MACROECONOMICS

The term 'macro-economy' refers to the whole (aggregate) economy or economic systems instead of that related to individuals, individual firms, or markets (which is the domain of microeconomics). Macroeconomics is concerned primarily with major economic indicators and factors that describe and influence the past, present or future performance of national economies. These factors include levels of employment/unemployment; the size and growth of the economy as expressed through the gross national product (GNP) and gross domestic product (GDP); exchange rates; balance of payments positions; and prices (inflation and deflation).

MACROECONOMIC STABILITY

Macroeconomic instability is generally said to occur when one or more of a small number of important economic measures move outside the range that is thought to be compatible with the satisfactory performance of the economy. (The use of the phrase 'thought to be compatible' is important because it suggests a significant degree of subjectivity in the determination of what indicates instability – an issue we shall refer to later). The measures usually reviewed include the rate of inflation, the fiscal deficit, the current account deficit, exchange rate, and the level of government reserves

MILLENNIUM DEVELOPMENT GOALS (MDGS)

MDGs refer to eight development goals that UN member-states agreed to achieve by 2015. These goals are contained in the Millennium Declaration adopted by all the member countries of the UN in the Millennium Summit 2000.

MONETARY POLICY

Monetary policy refers to a central bank's adjustments to the amount of money in the economy and interest rates. A bank undertakes these adjustments when it seeks to influence inflation and exchange rates. For example, during a recession a central bank may take steps to increase the amount of money in the economy to help boost growth. Such an 'expansionary' policy action lowers interest rates, thereby improving the likelihood of more extensive economic activity. On the other hand, a government of a country in the midst of an economic boom may seek to cool down the economy by reducing the amount of money. Such a step aims to raise interest rates, thereby improving the likelihood that overall economic activities will dampen to some extent.

NOMINAL VERSUS REAL EXCHANGE RATE CHANGES

'Nominal' exchange rate changes, either appreciation or depreciation, refer to changes that are face value only: they provide information about the exchange rate changes and old and new rates, but do not take into account any other influential economic indicators. 'Real' exchange rate changes, meanwhile, are adjusted for inflation.

ODA (OFFICIAL DEVELOPMENT ASSISTANCE)

Overseas Development Assistance (ODA) refers to funds provided by wealthy country governments, UN member states or international financial institutions to governments and other institutions in the developing world. ODA funding can be in the form of grants (transfers of funds with no expectations of repayment), loans or debt relief. For a loan to be defined as ODA, it must be 'concessional', meaning it has lower interest rates and/or longer repayment periods and more flexible repayment structures compared with commercial loans provided at market rates. ODA can be provided bilaterally (government-to-government), multilaterally (such as from the World Bank, IMF, GFATM, UN agencies or regional development banks) or from private sources such as Foundations.

PRSP (POVERTY REDUCTION STRATEGY PAPER)

The broad objective of PRSPs, which are put together by countries through a government-led and (supposedly) nationally owned participatory process, is to align economic growth and poverty reduction with macroeconomic policy formulation. PRSPs outline intended and planned macroeconomic, structural and social policies and programmes over a period of three years or longer. They also list external financing needs and major sources of financing. The IMF and the World Bank are the multilateral agencies that oversee the process and eventually approve PRSPs. However, the process of formulating PRSPs involves not only those agencies and other external development partners, but also key domestic stakeholders (including civil society). PRSPs are usually updated every three years with annual progress reports.

PRGF (POVERTY REDUCTION AND GROWTH FACILITY)

The IMF's most dominant medium-term lending facility, the Extended Structural Adjustment Facility (ESAF), was renamed the Poverty Reduction and Growth Facility (PRGF) in 1999. A PRGF is, typically, a three-year lending agreement between the IMF and a member country. The IMF agrees to lend a certain amount to the country in exchange for a commitment (or conditionalities) by that country to undertake certain policy actions or achieve certain economic targets. According to the IMF, a PRGF is "framed around comprehensive, country-owned Poverty Reduction and Growth Strategy Papers (PRSPs)." In reality much of the macroeconomic framework (as well as other policy initiatives) around which the PRSPs are built are derived from the accompanying PRGF. An PRGF is a legally binding arrangement, but a PRSP is not.

RESERVES (OR FOREIGN CURRENCY RESERVES)

Foreign currency reserves (often simply called 'reserves' or 'foreign reserves') refer to a central bank's holdings of foreign currency and other foreign currency–denominated assets (such as US government bonds). A high level of foreign reserves is generally considered a sign of economic health and prudent fiscal management.

SPECIFICITY RULE

The specificity rule means that policy problems should be dealt with at the source (of the problem).

TRADABLES / NON-TRADABLES

Tradables are goods and services that can be sold to foreigners (exported) or purchased from foreigners (imported). Non-tradables are goods and services produced to meet local demand—such as building and construction, power generation, transportation and most services (including health care services).

VOLATILITY

Volatility refers to the variability and uncertainty that often arise in the flow of ODA funding from various sources. Common factors include a significant difference between the amount(s) of aid committed and the amount(s) actually disbursed by donors; untimely disbursement of aid; inconsistency in amount(s) disbursed; and variable disbursements depending on whether the economy has high or low output growth (i.e., good or bad years).

WORLD BANK

As it notes on its website (www.worldbank.org), the World Bank is "made up of two unique development institutions owned by 185 member countries—the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD focuses on middle income and creditworthy poor countries, while IDA focuses on the poorest countries in the world. Together we provide low-interest loans, interest-free credit and grants to developing countries for education, health, infrastructure, communications and many other purposes."

Introducing 'Overcoming fears of the macroeconomic impact of scaling up ODA funding for HIV and AIDS - A learning resource and CD-Rom of materials'

This publication is a product of The Joint Programme on Strengthening National Capacities for Integrating AIDS in Poverty Reduction Strategy Processes (Joint PRSP Programme). This learning resource builds on the findings of the Joint PRSP Programme and the Brasilia conference on 'Gearing Macroeconomic Policies to Reserve the HIV/AIDS Epidemic', sponsored by the UNDP Bureau for Development Policy and co-hosted by the UNDP HIV Group and the International Poverty Centre, in Brasilia, in December 2007. Further evidence has been drawn from the recent Joint PRSP Programme study: '*Three-country study of the micro/macro economic implication of scaling up MDG levels of AIDS expenditure*' focusing on Armenia, Malawi and Zambia.

The purpose of this learning resource is to explore existing concerns that scaling up ODA funding for AIDS financing to Millennium Development Goal levels could affected the economic performance of some recipient countries. These concerns are usually expressed together as, 'Massive volatile influxes of external funding destabilize recipient countries' economies and essentially retard their ability to grow at appropriate, sustainable rates (the 'Dutch Disease' effects).' This learning resource explores whether these concerns are justified, reviews existing policy responses that are used to address these concerns (which often limit ODA absorption and spending), and offers elements of an alternative policy response which allows for the scaling up of ODA funding while also protecting the long-term macroeconomic stability of the recipient countries.

The Joint PRSP Programme is an initiative established by UNDP, the World Bank, and the UNAIDS Secretariat in 2005, to strengthen the capacity of countries to better integrate HIV and AIDS priorities into national planning efforts, particularly into Poverty Reduction Strategy Papers (PRSPs). UNDP is the lead agency with overall management responsibility for this initiative as part of the response to recommendations made by the Global Task Team on Improving AIDS Coordination Among Multilateral Institutions and International Donors to make financial and technical assistance available for countries to integrate AIDS in the PRSP. The goal of the Joint PRSP Programme is to enable countries to take advantage of the PRSP processes - at whatever stage, whether planning, implementation, or evaluation - to strengthen national HIV and AIDS prevention and control initiatives, by facilitating the integration of these issues into national domestic policy formulation and execution processes.

It is hoped that this learning resource will serve as a source of concise information on this issue for the Joint PRSP Programme, policy-makers, finance authorities, donors and others involved in AIDS financing. In addition to the main text, the learning resource includes annexes with a glossary of key terms, workshop facilitation guide and bibliography, and a range of supporting materials included on the attached CD-Rom. It is hoped that this publication and CD-Rom of materials will support the exploration these issues during a workshop setting. The CD-Rom includes 2 workshop schedules, 3 PowerPoint presentations and speaking notes, a pre- and post-workshop self-assessment questionnaire, papers from the above mentioned Brasilia conference, Joint PRSP

Programme three-country study and newsletters, a summary of academic studies and other key publications, and a list of websites for relevant organizations and information.

Elements of an integrated policy response for scaling up ODA funding for HIV and AIDS and protecting the economic performance of a country?

The above-described learning resource describes the typical policy responses to the scaling up of ODA funding, which are hoarding, or partial hoarding of ODA. As discussed, these policy responses can succeed in protecting macroeconomic stability (and, in the process, remove the possibility of Dutch Disease); however, they hold back on the full use of ODA, and are increasingly likely to backfire as ODA funding amounts increase. The learning resource offers elements of an alternative policy response, which are summarized below. Key to this alternative policy response is differentiating between changes that are part of the normal economic adjustment and changes that indicate macroeconomic instability. This means that rather than hoarding ODA, adjustment problems should be addressed at their source (the microeconomic level), reserving macroeconomic policy intervention for when there is clear evidence that an economy is unable to adjust to the scaling up of ODA funding. These policy responses form the following four elements of an alternative policy response which aims to:

1. Allow the economy to make the adjustment
2. Enhance the economy's capacity to adjust to the scaling up of ODA funding
3. Address volatility issues
4. applying macroeconomic measures for incomplete adjustment

1. Allow the economy to make the adjustment

If an economy is functioning well the following represents a normal course of economic adjustment to a scaling up of ODA funding, where a reasonable adjustment period would be two to three years (specific signs that an economy is unable to adjust are listed under point 4 below).

- **a (nominal) exchange rate appreciation:** availability of foreign currency will likely result in a fall in the price of foreign currency (meaning a higher value for domestic currency). The price of foreign currency should recover as import demand increases to match, or even outpace, the supply of foreign currency.
- **a higher rate of inflation:** increased spending of ODA will almost certainly cause prices to increase, however, supply should catch up with demand and the initial spike in inflation will settle down to a low or moderate level. Consistently high levels of ODA funding may result in persistently higher levels of inflation than before the scaling up of ODA. This should not require policy action if inflation remains within single digits or shifts from single digits to the lower teens.
- **a real exchange rate appreciation:** Once inflation and the nominal appreciation moderate, the real exchange rate appreciation will also be moderated. Even if the real exchange rate remains above previous levels, if the economy is benefiting fully from the ODA funding, it is likely to be able to tolerate that appreciated rate because it is better able to produce goods and services than previously.
- **an expansion of the fiscal and current account deficits:** can be attributed to the scaling up of ODA funding only if it comes in the form of loans. Whether this is problematic depends on whether a country can afford an expanding debt burden.

To allow the economy to make these adjustments, the scaling up of ODA funding would proceed unhindered by full or partial hoarding of ODA. It is important for capacity enhancement (see point 2 below) to be the focus of policy, before and during the scaling up of ODA funding, rather than the use of pre-emptive macroeconomic intervention.

2. Enhance the economy's capacity to adjust to the scaling up of ODA funding

In terms of scaling up of ODA funding, the main distortion is the failure of projects and programmes to make the economy more productive, therefore, policy interventions should focus on making the programmes as productive as possible. Projects and programmes that can enhance the economy's productivity are:

- **innovative:** chosen to address specific and pressing needs (rather than simply because money is available), and designed to elicit the maximum productive response within stated objectives,
- **efficient:** well-executed, both in terms of the quality of implementation,
- **effective:** able to achieve intended objectives,
- **coordinated:** chosen and planned to avoid bottlenecks, and integrated with other MDG initiatives as well as broader development objectives.

As PRSPs are the primary instrument for economic planning and programme execution in the economy, ensuring that PRSPs allow for scaling up of ODA funding, and that HIV and AIDS initiatives are well integrated into PRSPs, helps to ensure these benefits (see below).

3. Address volatility issues

The capacity enhancement approach to facilitating scaling up ODA funding described above can be significantly undermined if the flow of ODA is volatile. Many of the problems related to the volatility of ODA funding can be reduced if ODA funding commitments are long-term rather then year-to-year. In the specific case of HIV and AIDS financing, it would be reasonable for countries to seek three or five-year funding commitments, since it is well understood that:

- a break in treatment can have serious consequences in terms of the development of drug-resistant strains of HIV,
- a break in prevention and social intervention programmes can lead to a reversal of previous gains.

While aid volatility persists, it may be necessary for macroeconomic authorities to retain a proportion of ODA funding in the early stages of a scale-up, to build up reserves for later use in filling funding gaps (both in terms of foreign currency availability and government domestic spending resources). This action is specifically intended to protect against aid volatility (as long as it persists) and should be distinguished from hoarding as pre-emptive action for the sake of immediate macroeconomic stability.

4. Apply macroeconomic measures for incomplete adjustment

If the economy fails to elicit the necessary productive response to a scaling up of ODA funding, it may be necessary to use instruments of macroeconomic policy to mitigate the effects of scaling up ODA. In this case, there is clear evidence that the economy is unable to adequately adjust) when:

- the (nominal) exchange rate appreciation is large and sustained,
- the increase in the rate of inflation is large and inflation remains high (what constitutes 'unacceptably high' inflation during scaling up of ODA funding might be more reasonably placed in the 'above 15 percent' range than the current restrictive view of 'above single digit'),
- the real exchange rate appreciation is large and shows little sign of moderating,
- the fiscal and/or current account deficits have expanded and remain stubbornly large (though it bears repeating that large fiscal and current account deficits are determined by the nature of the funding, whether debt-based or grant-based, rather than the amount).

Using the PRSP process to support the scaling up of ODA funding for HIV and AIDS

Poverty Reduction Strategy Papers (PRSPs) describe a country's macroeconomic, structural and social policies and programmes to promote growth and reduce poverty, as well as associated external financing needs. PRSPs are prepared by governments through a participatory process involving civil society and development partners, including the World Bank and the International Monetary Fund (IMF) (source: World Bank Website). It follows that, if HIV and AIDS initiatives are to be *innovative, efficient, effective and coordinated,* they will have to be integrated into the PRSP both in terms of process and outcome. However, though PRSPs may provide the best means for promoting and implementing an effective scaling up of ODA funding for AIDS, they can also provide the justification for resisting such a scaling up in the name of a stable macroeconomic environment as defined outside the consultative process of the PRSP (usually as part of accompanying PRGF facilities). It is, therefore, necessary to understand the PRSP (and PRGF) definition of macroeconomic stability to be able to influence the PRSP processes. So, how can PRSP macroeconomic measures be viewed differently to allow the scaling up of ODA funding for HIV and AIDS? and how can HIV and AIDS priorities be better integrated into PRSP?

HOW CAN PRSP MACRO-ECONOMIC MEASURES BE VIEWED DIFFERENTLY TO ALLOW THE SCALING UP OF ODA FUNDING FOR HIV AND AIDS?

All PRSP documents include a section or sub-section entitled "Macroeconomic Framework" or a similar title. This section outlines broad or specific objectives for inflation, exchange rates, monetary policy, the fiscal and current account deficits, and foreign exchange reserves. Listed below are descriptions and explanations of objectives, or macroeconomic measures, which might influence of the scaling up of ODA funding for HIV and AIDS. Each sub-section also offers suggestions on how to influence policy makers toward improving the climate for scaling up ODA funding.

- **the rate of inflation:** PRSP language used to describe these inflation targets include: "achieving single digit inflation;" "maintaining CPI growth at 3 percent per year;" and "annual underlying inflation rate will be a maximum of 5 percent." It is important to note that medium- to long-term objectives of low inflation are compatible with higher than single-digit inflation in the short term during a scaling up of ODA funding (particularly in the early stages). A flexible approach could allow inflation to rise in the short term with corrective or mitigation measures being used if inflation persists or rises. PRSPs could therefore include phrases such as "controlling inflation" and "keeping inflation within acceptable limits" which would accommodate a scaling up of ODA funding, without giving up the objective of low inflation altogether.
- **the exchange rate:** PRSPs language regarding exchange rate targets tends to be general, with objectives such as "achieving exchange rate stability" and "maintaining competitive exchange rates." These statements can be interpreted quite strictly, but neither is strictly incompatible with short-term movements in exchange rates that are not overly large. The (nominal and real) exchange rate stability can therefore be seen as a medium- to long-term goal rather than a desire for essentially fixed or depreciating exchange rates in the short term.
- **fiscal and current account deficits:** The relationship between the scaling up of ODA funding and fiscal and current account deficits varies. If ODA funding comes in the form of grants, it is neutral to the fiscal deficit and has a positive effect on the current account deficit. However, if ODA funding comes in the form of loans (even concessional loans), it adds to both deficits. The fundamental issue is not the size of the deficits but the degree to which borrowing is acceptable and sustainable. If borrowing is sustainable, then the increase in size of the fiscal and current account deficits is largely irrelevant. It is only if the deficits increase by an amount larger than the increase in ODA funding that there should be cause for concern. Therefore, it is possible to adjust deficit targets to reflect the expected increase in ODA funding (i.e., if increased borrowing is expected to be 2 percent of GDP, an increase in either of these deficits of up to 2 percent of GDP can be expected). A smaller increase would not be unusual either.

HOW CAN HIV AND AIDS PRIORITIES BE BETTER INTEGRATED INTO PRSP?

There is variability in regards to the integration of HIV and AIDS issues in PRSPs. In some cases, 'HIV/AIDS' is treated as a separate concern within health sector issues. In other PRSP documents, meanwhile, HIV and AIDS is integrated into the health sector agenda overall. The second strategy is marginally better than the first, but neither is truly adequate. Instead, the need for *enterprise, efficiency and coordination* (discussed in section 2.1) requires that HIV and AIDS initiatives and concerns be integrated across the full range of concerns of the PRSP, beyond the health sector. Some of the more important connections and means of integration toward that goal are outlined below:

- **poverty reduction initiatives:** PRSP HIV and AIDS-related initiatives can be integrated directly into initiatives aimed at addressing poverty and vice versa.
- **labour and employment initiatives:** PRSP projects and programmes aimed at improving the quality of the labour force, the efficiency of labour markets, employment insurance and related issues should include HIV and AIDS-related, and HIV and AIDS initiatives should take heed of the labour and employment implications of the AIDS, for example, the impact of AIDS on health professionals.
- **social safety net initiatives:** PRSP efforts to improve social safety nets should include special needs of HIV positive individuals and their families.
- **other diseases initiatives:** Health systems that integrate HIV prevention and AIDS care with interventions for other diseases avoids duplication of services and improves efficiency in terms of service delivery and use of scarce resources.
- **general health initiatives:** PRSPs should include specific language requiring integrated health system structuring and programming for the delivery of initiatives across the health portfolio (i.e., basic health service, maternal and reproductive health, adolescent health should include HIV and AIDS).
- **education initiatives:** PRSP education initiatives should be integrated with HIV (i.e., educational facilities can support vulnerable children and students to have access to education, psychosocial support, child-friendly sexual and reproductive health services, and support to stay in school rather than provide care for the sick in the home).
- **governance initiatives:** PRSP efforts at improving governance should pay particular attention to the efficient delivery and use of funds and facilitation of the development and implementation of projects and programmes
  for the scaling up of ODA funding for HIV and AIDS to be successful

Many PRSP documents remain quite vague with respect to funding for articulated objectives. Only a few PRSPs explicitly outline the funding requirements and the expected sources of funds. If ODA funding volatility is to be addressed adequately, funding arrangements need to cover the entire operational period of the PRSP, and broad funding commitments should be an explicit part of the PRSP document.

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