

Oxfam International

Submission to the International Monetary Fund's Public Consultation

2011 Review of Conditionality and the Design of Fund-Support Programs

INTRODUCTION

Oxfam welcomes the opportunity to provide an input into this review of IMF Conditionality.

Oxfam considers that the failure to analyse and prevent negative effects on the world's poor (not just by the IMF but by the world's governments) has been clearly seen in the dramatic rise in fuel and food price protests, leading in many cases worldwide to political instability and the fall of governments. Oxfam believes that in an increasingly resource-constrained world, food and fuel prices will continue to rise and hit the poor hardest. If the IMF does not reform its conditionality much more fundamentally, it will increasingly be seen as responsible for punishing the world's poorest citizens. Oxfam therefore urges the IMF to:

- Increase fiscal space for spending in LICs, by allowing fiscal deficits to remain in the 3-5% of GDP and inflation to remain in the 5-10% range;
- Base its macroeconomic (fiscal and inflation) targets and social spending floors on spending levels which would allow the maximum number of countries to attain the MDGs
- Analyse at the earliest stage the impact of the social spending floors, including whether they will be sufficient to meet the MDGs, and why they are or are not being implemented
- Assess and present transparently to the Board the impact of overall wage ceilings on social sector real wage levels and bills across all LICs with programmes
- Conduct Poverty and Social Impact Analysis (PSIAs). A systematic analysis of the social incidence of tax and spending changes, as well as fuel and food price rises, especially their combined effects on inequality and poverty, especially the incomes and spending power of the poorest citizens, as well as the ability of countries to reach the MDG income and food poverty reduction targets.
- Dramatically accelerate the introduction of social protection measures and increases in social protection spending, especially in LICs.
- Delay the abolition or reduction of fuel or foods subsidies until offsetting social protection measures are in place, and use increased levels of its own funding and other budget support to finance temporary resulting deficits.

- Increase tax revenues by introducing more progressive taxation, focusing on tax avoidance by large corporations and high-income earners, and avoiding wherever possible the introduction of regressive tax measures (or exempting the basic foodstuffs consumed by the poor from such measures).

Oxfam acknowledges that there have been several important steps forward in recent years in the design and execution of IMF conditionality, including:

- More flexibility on fiscal targets, allowing for a degree of countercyclical spending by low-income countries during the peak period of the global economic crisis;
- More flexibility on inflation targets, allowing countries to maintain lower interest rates.
- Greater tracking and prioritizing of “priority social expenditure” through social spending floors in LIC programmes
- A dramatic reduction in the use of sector-specific wage ceilings
- An increased focus on social protection measures including education spending and health spending in low income countries.

However, Oxfam continues to have major concerns about the following aspects of IMF conditionality, especially for LICs:

- An increasingly apparent return to “fiscal consolidation” and tighter fiscal targets after the crisis, which are preventing countries from accelerating progress to the MDGs
- A related reduction in flexibility on inflation targets, requiring countries to take increasingly tough monetary and fiscal measures to offset the impact of renewed food and fuel price rises
- The initial evidence that social spending floors are not being taken seriously in programme reviews and therefore having little effect on government spending
- The continued use of overall wage ceilings (in which social sectors are evidently included as they absorb most of the government wage expenditure in LICs)
- Very slow and limited progress on the introduction of social protection measures, especially in LICs
- Continued insistence in some countries on rapid abolition or reduction of fuel or food subsidies, before offsetting social protection measures are in place.
- The continued introduction of regressive taxation measures (VAT, sales taxes)
- The lack of systematic analysis of the social incidence of tax and spending changes, as well as fuel and food price rises, on inequality and poverty.

IMF Lending and Conditionality

There have been some important changes to the International Monetary Fund's (IMF) lending facilities since 2009. These were driven by the realization in the mid-2000s that borrowers had begun to avoid the Fund due to the stigma attached to entering into an IMF lending agreement; by dissatisfaction with the impact that the conditions the Fund attached to its lending had on borrowing economies and on the poor; and by the wish of Fund management to adapt their facilities better to country needs.

In terms of scale and nature of lending, the most recent developments have been two decisions by the IMF Executive Board: in April 2009 to double the borrowing limits of the poorest countries; and in July 2009 to reorganize the lending facilities the Fund has available low-income countries, in order to provide medium-term assistance through the Extended Credit Facility (ECF), shorter-term assistance through the Standby Credit Facility (SCF), and lower-conditionality rapid assistance through the Rapid Credit Facility (RCF). In addition, the IMF allocated US\$18 billion of SDRs to boost LIC reserves, established the Post-Catastrophe Debt Relief Trust Fund through which Haiti has received debt cancellation, and continued to provide non-financial assistance to countries through the Policy Support Instrument. All of these moves have been welcome responses to the crisis.

Nevertheless, low income countries are still restricted in the amount they may borrow by the limits the IMF places on borrowing related to the size of a country's quota in the Fund. These restrictions mean that overall, and in each annual tranche, the amount of IMF assistance available remains woefully insufficient to overcome the exogenous shocks to which low-income countries are regularly and increasingly subjected.

However, a much more important problem is the persistence of conditionality in IMF lending: almost all of the enhanced IMF assistance continues to come with high levels of conditionality, and the PSI sets similar levels of conditions without finance.¹ Oxfam has three key areas of concern here: macroeconomic targets; structural conditions, especially on taxation; and impact on social spending and protection.

Macroeconomic Conditionality

1) Macroeconomic Targets

The review of IMF internal lending targets, several papers the Fund has issued over the past two years, and research conducted by Oxfam and other commentators suggests that the institution temporarily relaxed its unduly restrictive views on macroeconomic policy in low income countries, during the economic downturn. This is welcome.

Research commissioned by Oxfam and produced by Development Finance International examined the budgets of 56 low income countries in 2009 and found

¹ See "What is the Point of the PSI? The Views of African Policymakers a Study for Oxfam," by Matthew Martin, Alison Johnson and Gideon Rabinowitz, Development Finance International for Oxfam International, July 2009.

that three-quarters of IMF programs allowed expenditures to rise.² This is consistent with a recent IMF study of low income countries with crisis programs that shows that on average the IMF's fiscal deficit targets were allowed to ease from -1.5 percent of GDP in 2007 to a peak at about -3.7 percent of GDP on average for 2009.³ However, there is growing evidence that there has been a sharp tightening of IMF programmes since 2009. This was already found by the DFI study, and has been reinforced by recent analysis for UNESCO, which shows deficit tightening will accelerate in 2011.⁴

There is also strong evidence of painful cuts in public expenditures in advanced and middle income countries (including Armenia, Greece, Ireland, Jamaica and Latvia). For example, public sector salary cuts in Greece and demands from the IMF to cut pensions in Romania.

The same appears to have been true of the IMF's stance on inflation targeting in low income countries: more flexibility during peak periods of world price crises, followed by less flexibility and a return to normal orthodoxy if prices fall. During the 2008 global food and fuel crises, the Fund appears to have allowed low income countries' macroeconomic policies target inflation rates at below ten percent, rather than earlier tighter targets of 2-3 per cent, because the sharp rises in global prices made it impossible to target lower inflation levels.⁵ The transition back to lower targets in 2008-09 was also made more gradual so as not to risk compromising growth. With respect to the 2008 crisis, the Fund noted:

*As food and fuel prices rose during 2007-08, inflation targets in programs were revised upward to accommodate the first-round effects of the rising world prices. As world prices fell sharply beginning in mid-2008, a **gradual transition to single-digit inflation was programmed**, leaving room for monetary policy to support economic activity during the global financial crisis.⁶*

However, since the waning of concern about global recession, the Fund appears to have renewed pressure on countries to reduce inflation, and to take stronger monetary measures to offset renewed global rises in food and fuel prices. This stance has evoked concerns, including public comment from Nobel Prize laureate Joseph Stiglitz, that such inflation targeting is still unnecessarily restrictive in low income countries, in which inflation results from externally created price shocks.⁷

² "The Impact of the Global Economic Crisis on the Budgets of Low-Income Countries," Katerina Kyrili and Matthew Martin, Development Finance International/Oxfam International, July 2010.

³ "Creating Policy Space—Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs," IMF, pg. 17, figure 5.

⁴ See "Monitoring the Impact of The Financial Crisis On National Education Financing: A Cross Country Study", background study for the 2011 EFA Global Monitoring Report, UNESCO.

⁵ In an important paper, the Fund's chief economist Olivier Blanchard publicly acknowledged that the financial crisis had forced a reorientation and rethinking of economists' conventional wisdom regarding macroeconomic policy in advanced and emerging market economies. This included a rejection of the targeting of inflation at very low rates of around 2 percent as it had in the past, and of the efficacy of fiscal stimulus in economic slumps or downturn "Rethinking Macroeconomic Policy," Olivier Blanchard, Giovanni Dell'Ariicia, and Paolo Mauro, IMF Staff Position Note, SPN/10/03, International Monetary Fund, Washington, DC.

⁶ "Creating Policy Space—Responsive Design and Streamlined Conditionality in Recent Low-Income Country Programs," prepared by the International Monetary Fund's Strategy, Policy and Review Department, September 10, 2009. International Monetary Fund, Washington, pg. 1.

⁷ Examples of such comments include those made by Joseph Stiglitz at the IMF Conference on Macroeconomics and Growth on March 7, 2011 www.imf/external/np/2011/res/pdf/jspresentation.pdf

2) Social Spending

- **Overall Social Spending**

The Fund's external statements have said that "higher social spending and better targeting" would help protect the most vulnerable during the global crisis, for example the Fund announced that the \$16.4 billion loan to Ukraine included an increase in targeted social spending amounting to 0.8% of GDP to shield vulnerable groups. There is evidence of some greater flexibility here, but it is only limited. The Fund's support for expanded deficits during the crisis in some countries allowed some governments room for additional spending to be directed to priority (often poverty-related) areas: however, on average across LICs with IMF programmes, there were falls in education and social protection spending as a % of GDP and, over 2008-10, only a 0.1% rise in MDG-related spending as a % of GDP. Evidence from UNESCO also indicates increasing slippage in actual and projected education spending levels in 2010-11. Although absolute levels of spending may increase, social spending as a percentage of GDP is falling.

- **Social Spending Floors**

In most of its recent low-income country programmes under the new facilities, the Fund has set floors on "priority social spending" as a lending condition. For example, the program in **Yemen** contains expenditure "floors" as indicative targets during each year of the program to ensure fiscal space for social protection programs.⁸ The program in **Cote d'Ivoire** identifies 36 areas of social expenditure subject to a "floor" with the intention that government expenditure in these areas be increased over the next two years. Oxfam welcomes the growing focus that these floors provide on monitoring social spending, and urges the Fund to go further by tracking and publishing regular analysis of social spending in all LICs with Fund programmes.

However, there is growing evidence that these floors are not proving effective: in countries such as Burkina Faso, they have not been met but the next programme disbursement has been made on schedule. This is because they are only "indicative targets". Oxfam would not argue that these conditions should be made more binding: instead, the reasons for spending shortfalls should be investigated and made transparent. If they reflect wider post-crisis tightening of the macroeconomic framework, the framework which should be revised to be more accommodating.

In the past, the IMF has been criticized for not allowing governments to make use of additional potential anticipated or unanticipated donor assistance, by setting overly restrictive fiscal targets which prevent additional spending.⁹ To ease this criticism, some years ago the Fund started to increase the flexibility of targets so as not to restrict social expenditures if it appears additional donor finance might materialize, by using "adjusters" (planned adjustments to quantitative targets, including relaxation of quarterly deficit targets) to allow increased spending. During the crisis

⁸ "Republic of Yemen: Request for a Three-Year Arrangement Under the Extended Credit Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Yemen," September 2010, IMF Country Report No. 10/300. Washington, DC.

⁹ "Does the IMF Constrain Health Spending in Poor Countries? Evidence and an Agenda for Action," Center for Global Development, Washington, DC, June 2007.

they have continued to use these adjusters, for example in the recent Stand By Arrangement for **El Salvador**.¹⁰ Oxfam considers that there should be greater use of adjusters.

- **Wage Bill Ceilings**

We also have concerns about continued IMF pressure on wage bills which inhibits attempts to increase spending on essential public services. The Fund says it has largely done away with public sector wage bill ceilings that were previously conditions in many of its LIC programs. In September 2009, it stated, "Today, none of the 37 Fund-supported programs in LICs contains a wage bill ceiling as a performance criterion, and only three have indicative targets — a nonbinding condition — on the wage bill." (these are Ghana, Ethiopia and the Maldives).

Moreover, formal conditionality on wage bills appears to have been replaced publicly with "behind the scene" pressure on governments to reduce spending on wages. For example, in **Sierra Leone** the IMF has not placed a formal wage bill ceiling as a condition of its program. However, a series of interviews conducted in-country by Oxfam showed that the Fund pushed the government not to move forward with a key part of health care reform and not to increase health workers salaries (which are some of the lowest in the region) to levels necessary to retain workers and to ensure that they are not forced to fall back on collecting 'informal' fees from patients.

3) Structural Conditions

There has been a welcome streamlining in the range of areas subject to structural conditionality in IMF programmes, because any structural conditionality must now be deemed to be "macro-critical." However, LIC governments indicate that the shift in the nature of structural conditions from "performance criteria" to "structural benchmarks" has made virtually no difference to the degree to which they constrain country policy options, nor to the vigour with which they are enforced. Developing country officials have noted previously that they see little difference between the IMF's binding performance criteria and ostensibly non-binding indicative targets.¹¹

In addition, Oxfam has specific concerns about two types of structural conditions:

- **Social Protection Measures**

The crisis also coincided with a new focus on social protection measures at the global level, including by the G20. The IMF has in turn, in cooperation with the World Bank begun to place a new focus on including in its programmes social protection measures such as maintaining or increasing transfers (pensions, conditional cash transfer programs, or food security schemes). It has also begun to include in some programmes measures such as maintenance or introduction of means-tested housing or housing or utility allowances, labor-intensive cash-for-work infrastructure projects, and unemployment insurance.

¹⁰ "El Salvador: Request for Stand-By Arrangement—Staff Report; Staff Supplement and Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for El Salvador," IMF Country Report No. 09/71, February 2009, International Monetary Fund.

¹¹ "What is the Point of the PSI? The Views of African Policymakers" by Matthew Martin, Alison Johnson and Gideon Rabinowitz, Development Finance International for Oxfam International, July 2009.

These steps are welcome and should be made routine in all LIC programmes. However, the focus in many countries has been on reducing the costs of social protection benefits by increasing their targeting (removing high income recipients, or adding previously excluded needy beneficiaries). This is in spite of the fact that, as with education and health care, there is considerable global evidence that excessive targeting of social protection can exclude the poorest citizens. The IMF needs to undertake much more analysis of the effects of these measures on the poorest.

In addition, Oxfam has concerns over inappropriate sequencing of IMF conditions. In some countries, the IMF has pushed governments to adopt broader measures that it fully acknowledges are harmful to the poor, before governments have been able to put into place social protection countermeasures to cushion their impact.

For example, **Pakistan** is a country in which the World Food Program estimated in 2008 that 77 million people - nearly half the country's total population - are food insecure.¹² Yet the Fund has insisted that the government remove fuel subsidies, impacting on the price of electricity and transport, before adequate social protection measures could be put into place.

The IMF approved a \$10.7 billion Stand By Arrangement in November 2008 on the condition that fuel subsidies be removed, and that fuel taxes be introduced. Pakistan's government began the process of removing the subsidies in 2009. This, caused spikes in petroleum, diesel and kerosene prices in July and September 2009, and in February 2010.¹³ A tax on fuel was imposed in July 2009.

The IMF insisted that the painful removal of these fuel subsidies be implemented before the government could fully put into place a newly-created cash transfer program - which was specifically intended to mitigate the harmful impact of the these adjustment measures. A statement issued by the Fund in February 2010 makes it clear that staff were aware that the introduction of the cash transfer program aimed at women had been proceeding slowly:

*Social protection is a key element of the program. The roll out of the Benazir Income Support Program has been slow. The pilot for introducing the new targeting mechanism, using a poverty scorecard, has been completed in 15 districts and covering 2.1 million people. A comprehensive plan for nationwide rollout of the poverty scorecard based targeting has been prepared with the help of the World Bank and the rollout is expected to be completed by end-March 2011.*¹⁴

Yet the IMF continued to push for implementation of adjustment measures despite the government's delay in providing essential transfers to the poor. Finally,

¹² "Food Insecurity in Pakistan 2009," Abid Qaiyum Suleri and Sahib Haq, World Food Programme Pakistan assessment, 2009.

¹³ "Pakistan Petrol Tax Row Continues, July 10, 2009, BBC News, "Pakistan Government Raises PoL Prices," September 1, 2009, Dawn Media group, "High Petrol Prices Plagues Pakistanis, Hu Weiwei, February 3, 2010, Xinhua.

¹⁴ "Statement by an IMF Staff Mission on Pakistan," Press Release No. 10/43, February 16, 2010. (Accessed at <http://www.imf.org/external/np/sec/pr/2010/pr1043.htm>. Please note typographical error in document's date.)

government coalition partners in parliament threatened to desert the ruling coalition in early January 2011, and the government rescinded some of the fuel increases.¹⁵

Harmful sequencing is also at issue in other cases in which the Fund has pushed for the removal of fuel subsidies. For example, in the **Kyrgyz Republic** widespread public riots which sparked by hikes in consumer prices for electricity. The hikes in electricity rates were a result of a ceiling on expenditures related to the electricity sector placed by the IMF as a lending condition.¹⁶ This condition was placed despite the government's statements in its letter of intent to the IMF that the targeting of social protection schemes posed a difficulty.¹⁷ These public protests resulted in substantial loss of life, and lead to the overthrow of the Kyrgyz President Kurmanbek Bakiyev in April 2010.¹⁸ Protecting vulnerable populations must be the primary priority in any process of removal of unsustainable subsidies.

In **Mozambique**, in 2008, the Fund, working closely with the World Bank, placed in its program a combination of revenue floors and restrictions on government borrowing that necessitated the removal of urban transport subsidies. This in turn caused the price of diesel fuel to increase. At least three people were killed in public protests of this measure in February 2008.¹⁹ Subsequently, the government again used force in September 2010 against people protesting increases in the price of bread, electricity and water.²⁰ While the increase in the price of water was associated with a World Bank-supported water sector project, the hikes in electricity prices were attributable to IMF pressure to remove budget subsidies, and continued pressure to avoid government borrowing and maintain revenues at program floors.²¹

- **Regressive Taxes**

IMF conditions on tax policy have frequently insisted that program countries raise revenues through the application of consumption taxes, which are frequently regressive. Such conditions have included the introduction of new taxes; increases in existing sales taxes or value-added taxes; or the elimination of exemptions intended to benefit low income consumers. Regressive value-added or sales taxes are conditions in programs in Jamaica as noted below, the **Maldives, Kyrgyz Republic,** and **Cote d'Ivoire**.

¹⁵ "Pakistan Fuel Price U-Turn 'A Mistake': the US and the International Monetary Fund have criticised the Pakistani government's decision to reverse a recent fuel price rise," BBC News, January 7, 2011.

¹⁶ "Kyrgyz Republic: Sixth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Kyrgyz Republic," IMF Country Report No. 08/175, International Monetary Fund, June 2008, pg. 22.

¹⁷ Ibid, pg. 44.

¹⁸ "What Next for Kyrgyzstan?" Lally Weymouth, Washington Post, April 16, 2010, and "Electricity Plays a Key Role in Kyrgyzstan Uprising," Davida Woods, April 19, 2010, World Resource Institute,

¹⁹ "Riots Force Mozambique to Scrap Bus Fare Hike," Mail & Guardian On Line, February 7, 2008, and "Mozambique Riots Push Fuel Down," February 13, 2008, BBC News

²⁰ "At Least Four Die in Mozambique Food Riots," CNN International, September 1, 2010, and "Troops Clear Barricades, Mozambique Riots Persist," September 2, 2010, Maputo, Mozambique, Reuters

²¹ "Republic of Mozambique: 2009 Article IV Consultation, Fourth Review Under the Policy Support Instrument, and Request for a Twelve-Month Arrangement Under the Exogenous Shocks Facility - Staff Report; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for the Republic of Mozambique," International Monetary Fund, July 30, 2009.

In December 2009, the Prime Minister of **Jamaica**, Bruce Golding, announced a package of what he termed "harsh conditions" mandated by the IMF.²² These measures were so controversial that the prime minister withdrew them a week later, citing "public anger."²³ They involved eliminating exemptions to the value added tax on basic food items such as vegetables, bread, sardines and fish meal. A series of new, more progressive, income tax measures was introduced shortly thereafter, but a hike in fuel taxes was maintained. After these new measures were adopted, the IMF's \$1.2 billion Stand By loan was approved in February

Fund staff have acknowledged to Oxfam that they included these measures as conditions for lending with little or no prior analysis of the impact of a particular proposed measure on the poor, or analysis of how the new measure might impact on the overall equity of the tax system. This is alarming given that in almost all developed countries tax incidence analysis is routinely carried out when new taxes are proposed, and in some countries legal requirements exist that such analysis be disclosed to the public and to the lawmakers expected to vote on any new measures.

Fund staff in the past have stated that most low income countries do not routinely carry out tax incidence analysis, and that there is a lack of special purpose units within the finance ministries of borrowing governments capable of producing such analysis. More recently, the Fund has suggested that it may consider incorporating such analysis into its technical assistance work. The Fund should also consider providing budget support rather than technical assistance for tax incidence analysis; supporting developing country governments to build capacity to undertake tax incidence analysis themselves. These suggestions need to be implemented immediately. However, they do not go far enough: governments and the Fund should routinely conduct poverty and social incidence analysis of exogenous shocks such as fuel and food price rises, as well as all major tax and spending measures before agreeing programmes, so that they can be confident that the overall impact of the programmes will reduce income and food poverty, and will increase spending destined to reach the Millennium Development Goals.

4.) Process

Oxfam is concerned the review process did not consult more directly with impacted people in programme countries. There is a clear need for in-depth country case studies and deeper consultations with all relevant stakeholders in programme countries.

Oxfam believes that the Fund should have provided more information on measuring the impact (including social impact) of conditionality in past programmes.

Conclusion

This review offers a great opportunity for the fund to further reform its conditionality practice to ensure they do not harm poor people. There are three key areas of concern; macroeconomic targets, structural conditions and impact on social spending and protection. Oxfam urges this review to propose the following changes in IMF policy immediately and for the board to endorse these findings:

²² "Jamaica reshapes tax package linked to IMF deal," Horace Helps, Kingston, Jamaica, December 26, 2009, Reuters.

²³ Ibid, Reuters Dec. 26, 2009.

- Increase fiscal space for spending in LICs, by allowing fiscal deficits to remain in the 3-5% of GDP and inflation to remain in the 5-10% range;
- Base its macroeconomic (fiscal and inflation) targets and social spending floors on spending levels which would allow the maximum number of countries to attain the MDGs
- Analyse at the earliest stage the impact of the social spending floors, including whether they will be sufficient to meet the MDGs, and why they are or are not being implemented
- Assess and present transparently to the Board the impact of overall wage ceilings on social sector real wage levels and bills across all LICs with programmes
- Conduct Poverty and Social Impact Analysis. A systematic analysis of the social incidence of tax and spending changes, as well as fuel and food price rises, especially their combined effects on inequality and poverty, especially the incomes and spending power of the poorest citizens, as well as the ability of countries to reach the MDG income and food poverty reduction targets.
- Dramatically accelerate the introduction of social protection measures and increases in social protection spending, especially in LICs.
- Delay the abolition or reduction of fuel or foods subsidies until offsetting social protection measures are in place, and use increased levels of its own funding and other budget support to finance temporary resulting deficits.