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The Macro-Micro Nexus in Scaling-Up Aid: The Case of HIV and AIDS Control in Kenya, Malawi and Zambia

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I. Introduction

About 33 million people currently live with HIV. The disease has reduced life expectancy by about 20 years. Nearly 12 million children are orphaned. It is now well established that the epidemic demands an immediate increase in resources. The main questions that arise are where the resources will come from, and whether they can be fully spent and absorbed.

Photo by Danny de Bruyne.

One major source of financing for HIV and AIDS control is external aid. A recent report by the International Monetary Fund (IMF) computed the macroeconomic implications of scaling-up aid as promised by the G-8 at Gleneagles. The assessments for Benin, Niger and Togo indicate that scaling-up aid will put moderate to sizable pressure on inflation and exchange rates (IMF, 2008).

The debate continues as to whether increased external assistance causes macroeconomic instability. On the one side there are fears of a "Dutch Disease" effect. As a result, many countries' macroeconomic and budgetary frameworks may not be expansionary enough to scale-up MDG levels of expenditure, particularly through public spending programmes. Recently, however, the threat of Dutch Disease as a result of aid spending has been questioned because of a lack of evidence or contradictory data.

Several publications by the former International Poverty Centre and now International Policy Centre for Inclusive Growth have emphasised the urgent need for large-scale, broadly targeted government programmes to respond to the HIV and AIDS epidemic. The recommendations were as follows:

- fiscal and monetary policies have to be expansionary in order to respond effectively to the epidemic; and
- macroeconomic management must encourage full spending and absorption of aid.

In this *Policy Research Brief* we add that:

> An increase in government expenditure, combined with proper micro-management through the greater coordination, efficiency and implementation of innovative projects and programmes, will lead to a more effective response and may prevent macroeconomic instability, as succinctly argued by Serieux et al. (2008).

II. Fears of Macro Absorption and Spending of Aid

To see how fears of macroeconomic instability have curtailed an effective response to the control of HIV and AIDS, we look at the cases of Malawi, Zambia, and Kenya. As of 2006, Malawi had an HIV and AIDS prevalence rate of 14 per cent among the adult population, defined as those in the 15–49 age group, while Zambia's prevalence rate in 2007 stood at 14.3 per cent. In response to the crisis, HIV-related resource flows have increased significantly in both countries and the projections are that more resources will be forthcoming. Kenya's prevalence rate is much lower, having fallen from 14 per cent in 2001 to 7.8 per cent in 2007. Nonetheless, controlling HIV and AIDS remains a pressing issue in this country as well. Although there has been an overall decline in the aid that Kenya receives, it is still one of the top 10 recipients of assistance for HIV and AIDS control. Malawi, Zambia and Kenya are thus confronting a human development crisis and all of them receive resources to respond effectively—but they are not using these resources fully. Why?

Recently, IPC's *One Pager* #67 showed the state of aid spending and absorption *before and during the aid surge periods.* The findings are summarised in Tables 1, 2 and 3 (See next page).

Malawi absorbed the available aid, but only 59 per cent was spent through government fiscal expansion. As a result of high absorption (100 per cent), international reserves were lower. At the same time, the real exchange rate depreciated and the inflation rate fell by 15.4 percentage points. Interestingly, full absorption of aid did not lead to macroeconomic instability.

About 39 per cent of the aid was absorbed in Zambia, while 6 per cent was spent. The level of international reserves increased and the inflation rate declined. The real exchange rate appreciated. The restrictive macroeconomic stance resulted in a less encouraging exchange rate outcome.

Table 1
Malawi: Aid Spending (Ratios Expressed as a Share of GDP)

Periods Compared	Amount of aid absorbed	Amount of aid spent
Before aid surge (1999–02) vs. aid surge period (2003–06)	100%	59%
Relevant aggregates	**Relevant periods**	
Inflation	Before aid surge	28.0
	Aid surge period	12.6
Real effective exchange rate	Before aid surge	103.2
	Aid surge period	75.5
Average reserves level ($US millions)	Before aid surge	213.3
	Aid surge period	182.2

Table 2
Zambia: Aid Spending (Ratios Expressed as a Share of GDP)

Periods Compared	Amount of aid absorbed	Amount of aid spent
Before aid surge (2001–03) vs. aid surge period (2004–06)	39%	6%
Relevant aggregates	**Relevant periods**	
Inflation	Before aid surge	21.7
	Aid surge period	18.1
Real effective exchange rate	Before aid surge	108.2
	Aid surge period	139.6
Average reserves level ($US millions)	Before aid surge	322.1
	Aid surge period	373.3

Table 3
Kenya: Aid spending (Ratios Expressed as a Share of GDP)

Periods Compared	Amount of aid absorbed	Amount of aid spent
Before aid surge (1995-99) vs. aid surge period (2000–04)	33%	22%
Relevant aggregates	**Relevant periods**	
Inflation	Before aid surge	6.4
	Aid surge period	4.5
Real effective exchange rate	Before aid surge	69.9
	Aid surge period	72.6
Average reserves level ($US Millions)	Before aid surge	735
	Aid surge period	1,244

In Kenya, 33 per cent of the aid was absorbed and 22 per cent was spent. Much of the aid was used to settle domestic debt and build up reserves. The inflation rate declined and the exchange rate appreciated. Kenya also adopted a pre-emptive macroeconomic policy.

The low level of spending in Malawi, Zambia and Kenya is related to strict macroeconomic conditionalities that limited fiscal expansion. As a recipient of aid from multilateral organisations, Malawi was advised to establish a set of conditionalities to restrict full absorption and spending of HIV and AIDS-related assistance.

Examples of these conditionalities include a floor on the net foreign assets of the monetary authorities; ministries and departments to make payments centrally to the Accountant General; and ceilings on central government wages and salaries, so that they are kept under 7 per cent of the total budget for wages and salaries.

Malawi's medium-term objectives and budget framework were too restrictive to allow MDG levels of expenditure to be scaled-up. Total government spending is forecast to fall from 42.9 per cent of GDP in 2004/2005 to 39.5 per cent in 2010/2011. Revenue projections are also pessimistic: the forecast is a decline by 0.3 per cent of GDP. Fiscal policy focuses on keeping the overall balance at less than 1 per cent of GDP, and the inflation targets are rates of under 5 per cent.

According to the IMF (2006, p. 11), "reducing the domestic debt burden will remain the cornerstone of the fiscal strategy. This will be attained by expenditure restraint (wages, goods and services, pensions)." Indeed, fear of inflationary pressure was so great that representatives of the Ministry of Finance, during an interview with one of the authors of this *Policy Research Brief*, expressed their concern that too much money had come into Malawi through aid.

Similarly, in Zambia, a number of macroeconomic and fiscal measures are in place to curb spending. The Medium-Term Framework allows for only partial absorption and very little spending of aid. Fiscal policy is focused mainly on keeping the overall balance at under 2 per cent of GDP; the inflation targets are rates of less than 5 per cent; policy is to reduce domestic borrowing to less than 1 per cent of GDP and increasing international reserves.

Kenya also has a conservative monetary policy. The inflation target agreed upon in the Poverty Reduction and Growth Facility (PRGF) programme and the Poverty Reduction Strategy Paper (PRSP) for 2005–2007 was 3.5 per cent. The PRSP states that the "objective of the fiscal policy is to maintain revenues at above 21 percent of GDP and achieve a sustainable overall deficit (including grants) of below 3.2 percent of GDP over the 2003/2004–2005/07 period" (Government of Kenya, 2005, p. 32). However, since the budget (including grants) was in surplus

during the scaling-up period of aid, there was clearly enough fiscal space to increase spending on HIV and AIDS.

Total public expenditure on health has also been declining steadily. Meeting Kenya's National HIV and AIDS Strategic Plan (KNASP) targets requires an increase in HIV and AIDS spending from the 2005/06 amount of Ksh25 billion by 2009/2010, or from US$228 million to US$605 million. A country study by Hailu (2007) calculated a deficit of Ksh 1 billion for the resources required. The share of HIV and AIDS expenditure has increased over time, but, since public health spending has not increased; public resources for HIV and AIDS control are likely to have come from a reallocation of health expenditure or a reduction in other areas.

III. Potential for Micro Absorption

While spending and absorbing aid are determined by fears of macroeconomic instability, there is room to focus on absorption of aid at the microeconomic level. In other words, while spending and absorbing aid may have macroeconomic manifestations, the instabilities are often tied to outcomes at the microeconomic level.

The central point is that the macroeconomic outcomes depend very much on the quality of the microeconomic management of HIV initiatives financed by official development assistance (ODA). If the programmes and projects at the micro level are responsive to needs (enterprising), efficiently implemented, able to meet existing needs (effective), coordinated with other initiatives (to avoid duplication and encourage positive externalities), and successful in addressing MDG-related challenges, the necessary supply response will counter the possibility of macroeconomic instability (see Serieux et al., 2008).

What is not justified is a pre-emptive approach where by the macro managers limit the availability of resources for HIV initiatives without evidence of poor programme and project selection at the micro level. There should be constant interaction between the macro and micro managers, such that HIV initiatives are enterprising, efficient, effective and coordinated in order to ensure the appropriate supply responses, while the macro managers adopt a proactive stance. These issues are illustrated in Table 4, which presents the four possible outcomes related to management of HIV initiatives.

The perfect outcome is the one in which macro managers assume a proactive role by ensuring that all available resources are disbursed to HIV initiatives, while micro managers ensure that programmes and projects are coordinated, properly planned, and implemented both efficiently and effectively (outcome (1) in the Table 4). Poor selection of programmes and projects, as well as poor implementation, result in bottlenecks, replication and other attributes that limit any supply response. This in turn entails a high probability of macroeconomic instability, which leads macro managers to be cautious and to restrict full spending and absorption of resources.

IV. Country Experiences

The governments of Malawi, Zambia and Kenya have based their response to the HIV and AIDS epidemic on the principle of the "Three Ones". However, a Malawi country study by Hailu and White (2008) revealed problems of coordination, efficiency and innovativeness in the response to HIV and AIDS. In particular, the principle of the Three Ones in Malawi was compromised by a lack of clarity about the functions of some of the structures set up to tackle the epidemic, particularly in relation to the National Aids Commission (NAC). There was ineffective coordination in the national response, mainly because of conflicting roles and duplication of efforts.

Interviews with organisations that implement projects revealed a lack of interaction with macroeconomic institutions such as the Reserve Bank or the Ministry of Finance to discuss HIV and AIDS funding-related issues. With respect to efficiency and effectiveness, we find a lack of clarity about roles and mandates at the national and district levels. Efficiency was also hampered by the numerous and complex conditions attached to aid by donors, and by the unpredictability of donor funding. Low absorption of financial resources was also exacerbated by a severe shortage of human resources, particularly in the health sector. High vacancy rates in this sector stemmed from poor working conditions and better paid opportunities working outside the public health service and/or abroad.

Zambia and Kenya share many of the same problems as Malawi in micro-managing the response to the HIV and AIDS crisis, particularly with respect to poor of coordination and failure to invest adequately in human resources (Hailu and Njelesani, 2008; Hailu, 2007). In Zambia, about 68 per cent of professional posts in the health sector are currently unfilled. Some 70 per cent of posts for doctors, 81 per cent for nurses and 79 per cent for laboratory technicians are vacant.

According to the National AIDS Spending Assessment, only 1.5 per cent of funding allocated to HIV and AIDS expenditure was devoted to incentives for human resources. Zambia's response is also hindered by donors' complex procurement procedures. Hailu and Njelesani (2008) also identified limited national ownership of HIV and AIDS programmes and policies, leading to the prioritisation of upward over downward accountability.

Table 4

Macro and Micro Management Responses to Increased Aid Flows (for Funding HIV and AIDS Initiatives) and Likely Outcomes

		Macro Managers	
		Proactive	*Pre-emptive*
Micro mangers	*Enterprising* *Efficient* *Effective* *Coordinated*	(1) Greatest potential for an effective response (to HIV and AIDS) and little possibility of macroeconomic instability.	(2) Response to HIV and AIDS likely to be inhibited by the volume and reliability of funding.
	Not-enterprising *Inefficient* *Ineffective* *Uncoordinated*	(3) Supply response likely to be inhibited by the range, efficacy and efficiency of projects. Macroeconomic instability is a distinct possibility.	(4) Responses to HIV and AIDS challenges are likely to be ineffective as well as insufficient. Macroeconomic instability is possible.

The trend in Kenya's health sector is the same. The policy of wage ceilings combined with reduced spending has led to a lack of resources in the sector, including a shortage of qualified health professionals, medicine and supplies.

The Assistant Minister for Health, for instance, argued that Kenya urgently needs 10,000 new health workers. To meet the national targets, Kenya must scale-up expenditure to 4 per cent of its current GDP, which is equivalent to 85 per cent of total health spending.

Sadly, the failure to spend aid, in conjunction with a policy of inflation-targeting and cuts in health spending, is the story in Malawi, Zambia and Kenya. Poor micro-management and an austere macroeconomic policy stance have effectively curtailed spending of aid intended for HIV and AIDS control. These countries need to adopt a proactive macro stance combined with more effective micro-management.
We offer the following recommendations:

a) Relax the macroeconomic policy and budget framework in order to allow fiscal stimulus.
b) Improve the coordination, efficiency and effectiveness of HIV and AIDS programmes and projects.
c) Increase the effectiveness of the national coordinating agencies, particularly in mobilising and disbursing resources, as well as engaging donors to streamline funding requirements.
d) Strengthen the role of the NACs in all countries, which can lead to greater coordination and communication between the various actors involved. In Zambia, for example, this could improve coordination between NGOs and the government, which is now severely lacking.
e) Encourage the implementation of innovative projects and programmes (such as workplace programmes and cash transfer schemes) that tend to have larger welfare effects, so as to stimulate the supply responses and increase productivity.
f) Reverse the decline in health expenditure particularly in light of linkages between HIV and AIDS and other diseases such as tuberculosis and malaria.
g) Provide debt relief that will create the additional fiscal space needed to allocate sufficient resources to combat the HIV and AIDS epidemic.

V. Conclusion

Until very recently, the debate on responding to the HIV and AIDS crisis centred on donor fatigue among developed countries and the lack of adequate funds to manage the crisis. For all three countries studied, funds are not the immediate problem. HIV- and AIDS-related assistance has increased and is projected to rise further in the future. Rather, the need is for full absorption and spending of the funds available. Since both Malawi and Zambia are among the top 10 countries with the highest prevalence rates, it is crucial to manage the response effectively. Kenya has a much lower prevalence rate. Indeed, thanks to a scaling-up of ODA for HIV and AIDS financing, Kenya's prevalence rate has declined significantly. But there is a need to use the existing resources in order to respond to unmet demand.

Thus, scaling-up and fully absorbing and spending aid for the alleviation of HIV and AIDS should be the main priority of these governments, outweighing even macroeconomic stability in importance. While it is clear that fears of Dutch Disease are exaggerated and to some extent unfounded, we argue that proper micro-management, combined with an expansionary macroeconomic policy and budgetary framework, can mitigate inflationary pressures and lead to successful responses. ■

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1. This article is based on case studies commissioned by the HIV/AIDS Group, Bureau for Development Policy, United Nations Development Programme (UNDP).

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