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Why Not 'Front-load' ODA for HIV/Aids?

by John Serieux, Assistant Professor, Dept. of Economics, University of Manitoba and Terry McKinley, Acting Director International Poverty Centre

Global funds available to combat HIV/Aids are estimated to reach about US$ 9 billion in 2007. Although this amount will be only about half of what is needed, it is, nevertheless, substantial. Used effectively, such donor financing could help stem the pandemic's spread and mitigate its effects. In fact, disbursing the balance of such financing early on - 'front-loading' it - should be a priority. But there is considerable resistance to doing so. Why is this the case?

Two major concerns predominate. Donors and recipient-country central banks worry about destabilizing the economies of countries. Recipient governments worry about the volatility of donor disbursement. So a gradual phasing in of ODA is often preferred, on all sides. But is this the approach best suited to confront a human development crisis of such magnitude? Moral imperatives aside, one can also make practical arguments that 'front-loading' would improve ODA's effectiveness.

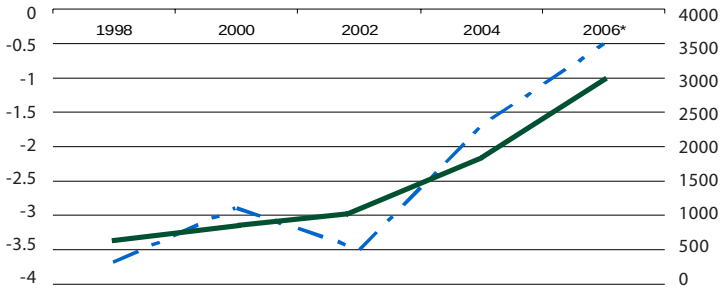
The effectiveness of ODA depends on three conditions: (1) governments are able to use the ODA to increase spending aimed at combating the epidemic; (2) the foreign exchange provided through ODA is used to increase relevant imports; and (3) HIV/Aids spending reaches its intended target and is applied, quickly and effectively, to its intended objective.

However, recent trends in developing countries suggest that the first two of these imperatives are not being fulfilled. Governments are tightening up their budgets and thus not spending all available ODA. And central banks are stockpiling reserves instead of releasing them for needed imports. The Figure shows that in developing countries from 1998 to 2006 a) the fiscal balance of central governments moved from -3.7 per cent of GDP to only -0.5 per cent; and b) reserves rose from about US$ 691 billion to almost US$ 3 trillion.

In sub-Saharan Africa, the fiscal balance of central governments was projected to reach a surplus of 0.4 percent of GDP in 2006 (compared to -3.7 percent in 1998) while reserves were projected to reach about US$ 123 billion (compared to only about US$ 28 billion).

Governments have adopted an excessively cautious stance because of the numerous financial, debt and balance of payments crises of the 1990s. They are afraid, in particular, that more (ODA-related) spending will increase the prices of domestic goods and services. By causing wages to increase and the exchange to appreciate, such inflation would make the country's exports more expensive to produce and less competitive abroad. This is the so-called 'Dutch disease' effect. However, the evidence for this effect is weak. Moreover, if ODA is successful in mitigating some of the detrimental effects of HIV/Aids, it is likely to rule out such an effect by encouraging the use of excess capacity and improving all-round productivity. In this context, when governments spend the available ODA and central banks sell the corresponding foreign exchange, the related price and exchange rate effects are likely to be both moderate and transitory.

Fiscal Balance (% of GDP), dotted line
Reserves (US$ Billions), solid line



Source: IMF, World Economic Outlook 2006, Tables 18 & 35. * denotes projected.

ODA is urgently needed to treat the mounting number of people living with Aids and halt and reverse the deadly spread of the pandemic. In this fundamental sense, the sooner ODA is disbursed, the better. A maximal effort early on would also imply the need for less ODA in the future because fewer people would need to be treated and, by safeguarding human capabilities, higher future productivity would be assured. These are sufficient reasons for front-loading HIV/Aids financing.

However, there are other compelling reasons to adopt such a strategy. The effectiveness of government spending in combating the disease (i.e., whether expenditures are properly targeted and have their intended impact) depends on building up national capacities, in the form of extensive public investment in infrastructure, institutions and human resources. The sooner such capacities are created, the more effective ODA would be. This would imply that the marginal rate of return of even scaled-up future aid flows (the welfare impact per additional US dollar) would remain high.

The need to manage the volatility of ODA is further justification for front-loading ODA. Central banks should, indeed, have some latitude to accumulate international reserves (in combination with deferred spending by governments) early on so that they can smooth future expenditures if ODA drops. Having such a buffer is critical because once treatment of HIV/Aids is initiated, interruption (because of lack of funds) can be disastrous. But such a stance should not be confused with amassing reserves to protect the currency and short-circuiting the resulting monetary impact of government expenditures by 'sterilization' (which drives up interest rates). This latter approach contradicts the whole purpose of providing HIV/Aids financing and undermines its effectiveness.

Reference:

John Serieux. 2007. "Managing the Exchange Rate Consequences of Scaling up HIV/Aids Financing." Conference Paper for the international conference on "Gearing Macroeconomic Policies to Reverse the HIV/Aids Epidemic" jointly sponsored by IPC and the HIV/Aids Group of UNDP.

International Poverty Centre (IPC)
SBS – Ed. BNDES, 10º andar
70076 900 Brasilia DF Brazil
Telephone: +55 61 2105 5000

www.undp-povertycentre.org
povertycentre@undp-povertycentre.org