

Calvin McDonald
Advisor
Africa Department
International Monetary Fund
Washington DC 20431
USA

14th June 2007

Dear Calvin,

Response to your letter of 17th May 2007

Thank you for your detailed response to our report, *Confronting the Contradictions*.¹ We are pleased to see the debate progress beyond the panel discussion at the 2007 IMF/World Bank Spring Meetings. We would like to take this opportunity to clarify some of the points raised in your letter and to highlight findings from our research on the impact of IMF macroeconomic advice on teacher recruitment in Malawi, Mozambique and Sierra Leone.²

More than 18 million new teachers are needed worldwide in order to meet the Education for All goals by 2015. ActionAid's research in these three countries identified IMF conditionality on low wage bill ceilings as one of the key barriers preventing governments from hiring enough teachers and thus providing quality education to all children.

We therefore welcome your statement that the Fund will "...restrict the use of wage bill ceilings"³ and that when it does use them as performance criteria and indicative targets in its loan programmes it "...is committed to use ceilings more selectively and transparently."⁴ The recognition that wage bill ceilings do little to promote effective civil service reform is a step forward. In the coming months we hope the Fund will clarify when and how this policy shift will be operationalised in all countries that still have wage bill conditions attached to their loan agreements, including Malawi and Sierra Leone.

We agree with the IMF that it is sensible budgeting for governments to place a limit, or ceiling, on their wage bills. Uncontrolled and excessive expenditure on wages can indeed lead to instability. However, our research finds that the level of the ceiling is often set artificially low and often with little consideration of the number of teachers needed. Interviews with close to 100 government officials, parliamentarians, civil society organisations (CSO), and donors in Malawi, Mozambique and Sierra Leone revealed that education ministries have no say on wage ceiling levels and

¹ ActionAid, *Confronting the Contradictions: The IMF, wage bill caps and the case for teachers*. April 2007.

<http://www.actionaid.org/main.aspx?PageID=581>

² IMF, *A Response to ActionAid International* by Calvin McDonald, May 17, 2007

<http://www.imf.org/external/np/vc/2007/051707.htm>

³ IMF CSO Newsletter, May 2007 (<http://www.imf.org/External/NP/EXR/cs/eng/2007/052507.htm#civil>); IMF survey

(<http://www.imf.org/external/pubs/ft/survey/2007/041107.pdf>)

⁴ IMF, *A Response to ActionAid International* by Calvin McDonald, May 17, 2007



exercise little influence over their overall budgets. Our findings show that both of these are partly determined by restrictive macroeconomic targets in IMF loan agreements. Removing wage bill ceilings as loan conditions is but the first step. The ceiling may no longer be a condition, but it may still be too low for government to hire the number of teachers needed to ensure quality education. Our research suggests freezing or reducing the wage bill is often used as a 'blunt instrument' to keep overall government spending in check, so as to achieve single digit inflation targets or reduce the fiscal deficit. Our report notes that *"The IMF may have varying degrees of influence in directly setting the wage bill ceilings. However, by insisting on overly restrictive macroeconomic policies that constrain government spending on wages, it is in part responsible for the persisting teacher shortage."* The three countries we researched all target inflation rates of 5-7% by 2009/10. Twenty-two additional countries reviewed for the report are also targeting inflation in the single digits despite their different spending needs given their country-specific contexts. This blanket use of a 5-7% inflation rate was corroborated by the Independent Evaluation Office's recent report on the role of the Fund in Sub Saharan Africa.⁵

However, to ensure a state of economic stability that will allow for national development, macroeconomic policies must be sufficiently flexible to allow governments to finance long-term investment in human capital. In relation to setting wage bill ceilings your letter stated that *"there must be a solid macroeconomic justification. The Fund is firmly committed to explain such a decision and the decision making process that led to it."* Regrettably your letter did not explain what "macroeconomic justification" applies to the three countries. You do state that these countries *"have reached a reasonable degree of stability with strong positive growth."* Why continue imposing stringent inflation and deficit targets, which in turn necessitate low wage ceilings, on these "stable" countries? Now that Malawi has achieved a reasonable degree of stability, when will the wage bill ceiling be removed as a performance criterion in PRGF agreements? In Sierra Leone, when will the wage bill cease to be an indicative target?

At present, government is faced with trading off investment in teachers to meet unjustifiably restrictive macroeconomic targets. ActionAid recognises the difficulty in balancing macroeconomic targets with social goals and the complex discussions that must take place in order to ensure coordination between these policy realms. When those affected by policies are involved in the decision-making process, solutions that ensure macroeconomic policies complement social goals are more likely to be agreed. ActionAid therefore advocates that the Ministry of Education, parliamentarians, CSOs and teachers unions be consulted on macroeconomic policies which ultimately affect the national budget and sector allocations.

Your letter highlighted that, *"countries ... must reclaim control of their budgets. They must count on reliable sources of income, and on realistic spending plans that are based on sound sector plans."* We believe that a fundamental prerequisite for countries to reclaim control of their budgets is for the IMF and others to stop placing conditionalities on macroeconomic policies. Governments should be empowered to choose from a number of spending options and be able to align these with the macroeconomic policies that are best suited to their needs. It is not a question of the IMF showing 'flexibility' and giving countries a bit more leeway with wage bill ceilings, for example by allowing them to raise the ceiling by a percentage point here or there as in Mozambique, granting

⁵ Independent Evaluation Office. *An Evaluation of the IMF and Aid to Sub-Saharan Africa*. 12 March 2007. <http://www.ieso-imf.org/eval/complete/pdf/03122007/report.pdf>



exemptions for a specific sector as in Malawi, or permitting 'top-ups' as in Sierra Leone. Rather the IMF should hand back control of policy making processes to sovereign governments, the only bodies that citizens can hold to account for the use of public resources and the fulfilment of basic rights. Governments must be given the space to choose the appropriate macroeconomic policies for their national development rather than having only one model to work from.

In addition, we agree that the lack of donor aid going to education is a serious barrier to the recruitment of more trained teachers. We commend the Fast Track Initiative (FTI)'s recent pledge to support education in Sierra Leone (\$13 million) and Mozambique (\$79 million). We ask the Fund to clearly indicate how and when it intends to engage with the FTI and work with recipient countries to realign their macroeconomic policies to ensure this aid can be used to expand the teaching force. We would also encourage donors to support governments in understanding the macroeconomic implications of increased government spending and in exploring alternative policies that allow for both stability and increased expenditure.

We welcome the suggestion of greater flexibility by the IMF in revaluating wage bill ceilings in each of these countries – but to date that flexibility has merely been a token gesture. In Mozambique, where the wage bill ceiling was raised from 6.5% to 7.5% of GDP, it has only permitted the government to hire 10,000 of the 12,000 teachers requested to *work towards* achieving a 54:1 pupil teacher ratio (PTR). Internationally agreed standards suggest that quality education constitutes a PTR of 40:1. With only 10,000 teachers, by the end of 2007, the Ministry of Education only expects to meet a 71:1 PTR. In Sierra Leone the government is forced to ask the IMF for top-ups because the ceiling is too low to meet the demand for teachers. In Malawi, the wage bill ceiling continues to be a performance criterion.

ActionAid agrees that countries do face difficulties in recruiting and managing public servants, given skills shortages, limited training capacity and the lack of comprehensive civil servant databases. Our report states that these capacity constraints "*can all be seen to stem from an accumulated lack of sufficient investment in the education system over many years*". To address these capacity constraints effectively, particularly in the case of teacher training, more investment rather than less is needed. The overall lack of investment in education and low wage bill ceilings have led the Ministry of Education to adopt second-best solutions, such as cutting the number of years of training so as to double the number of teachers available per year. In addition those teachers with fewer years of training also receive lower salaries, allowing the Ministry of Education to hire more teachers while still respecting the wage bill ceiling. Similarly in both Sierra Leone and Mozambique government has encouraged the use of untrained teachers or contract teachers who receive lower salaries. Low wage bill ceilings have led governments to compromise the quality of their investment in teachers and teacher training, not allowing spending to increase significantly in these key areas while failing to effectively reform the civil service.

We welcome your statement that "*We must ensure we do a better job and we do our part.*" We believe that the Fund will do a better job for poor people when it is able to provide unbiased advice to governments on a range of macroeconomic policy options, including options for financing greater investment in priority poverty-reducing sectors, which may at times demand more expansionary fiscal and monetary approaches. Playing such a role in turn requires the IMF to step away from the use of conditionality to wield direct control over economic decision-making.



We ask the Fund to further clarify its plans for reducing and removing loan conditionalities. We also believe it would be useful for the IMF to:

- engage in more open discussions with parliamentarians and civil society on economic policy choices and their impacts
- highlight the alternative macroeconomic policies discussed in its own research, staff reports and publications from peer reviewed journals
- work with other agencies to support governments to explore a range of policy options about the benefits and costs of different inflation and deficit targets
- participate in the FTI Steering Committee and Partnership meetings to work with donors and governments towards developing alternative scenarios making it possible to increase education expenditure to levels required

We look forward to learning how the Fund's policies will change to better serve the national development goals of governments – and how the IMF will accord governments more space for determining their own macroeconomic policies in line with fulfilling the rights of citizens to good quality education.

The following pages clarify the misunderstandings noted in the IMF's letter to us concerning Malawi, Mozambique, and Sierra Leone. In Malawi the discrepancy in data attests to a lack of transparency and clarity on behalf of the Fund. The Fund's comments regarding Mozambique fail to acknowledge the influential role it continues to play in setting the level of the wage bill ceiling and therefore the number of teachers that can be hired. Meanwhile in Sierra Leone, the government openly states that it has been forced to cap the number of teachers as a result of the wage bill ceilings, which are directly determined by IMF policies.

Yours sincerely,

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On behalf of ActionAid International

Attachment: Country Specific Responses

cc Rodrigo de Rato



Country-specific Comments:

Malawi

The data included in the ActionAid report is taken directly from official documents of the Fund, available on their website. If differences exist in the figures ActionAid has cited then the Fund has not been sufficiently transparent and clear in making public countries' macroeconomic policies.

The IMF's letter claims: "The wage bill ceiling is not set at 7.2 percent of GDP as indicated in the report."

It is stated in the Second Review of the PRGF in 2006 that the wage bill ceiling was set at 7.2% of GDP. Table 1 below highlights that from 2005-2007 the wage bill ceiling has remained between 7.7% - 7.2% of GDP. As stated on page 22 of the ActionAid report "There continues to be a wage bill ceiling: a new PRGF began in 2005, committing the government to a ceiling of less than 8%.⁶ However, it has consistently been below this level: 7.4% for 2005/6⁷, 7.2% for 2006/7, and it is set to remain at the same level over the medium term."

Table 1: Summary of wage bill ceilings in IMF documents, Malawi (2005-2009)

Source Document		2004/5 (proj outturn)	2005/6 (proj)	2006/7 (proj)	2007/8 (proj)	2008/9 (proj)
July 2005 LOI		7.7%	7.7%	Less than 8%		
Aug 2005 Request for PRGF	Inc Health SWAp	7.7%	7.9%	8.4%	8.2%	8.1%
	Excl Health SWAP	7.6%	7.6%	7.6%	7.4%	7.4%
March 2006 – First Review of PRGF	Inc Health SWAp	7.5%	7.5%	7.4%	7.3%	7.2%
	Excl Health SWAP	7.5%	7.2%	7.1%	7.0%	6.9%
December 2006 – Second Review of PRGF	Inc Health SWAp	7.5%	7.4%	7.21%	7.23%	7.20%
	Excl Health SWAP	7.5%	7.1%	6.9%	6.9%	6.9%

The Article IV Consultation and Third Review of the PRGF prepared on January 31, 2007 notes a slight increase in the targeted wage bill to 7.6% of GDP excluding the Health SWAp. However, this document was only made available to the public on May 3, 2007. These figures were not included in ActionAid's report which was published a month earlier, in April 2007.

The IMF's letter asserts "The Fund programs have emphasised spending on social sector programs."

ActionAid has never suggested otherwise and agrees that HIPC conditions did support prioritisation of social sector spending, and there are references in earlier IMF statements that stress the importance of the social sectors. However, the question is, how does the Fund expect the government to fulfil the requirements for HIPC within a highly constrained budget, within a limited wage bill ceiling and while education is not the only priority sector? Does it require the budgets of all other priority sectors be reduced to meet the needs of education? Spending on education and teachers in particular, inevitably continues to be a secondary priority to meeting these macroeconomic targets.

⁶ Government of Malawi. *Letter of Intent; Memorandum of economic and financial policies and technical memorandum of understanding*. July 2005

⁷ International Monetary Fund. *Second Review of the Malawi PRGF*. IMF Staff Report. 2006.



The IMF's letter alleges: "The Action Aid report missed an opportunity to discuss the real constraints facing the education sector in Malawi."

We discuss exactly those training capacity constraints you mention on page 5 of our report and we raise the issue of teacher training in general on page 7 and 8, referring directly to Malawi. ActionAid stresses, however, that it is the lack of funding for training colleges that has hampered the capacity to train as we discuss above. Furthermore, the imposition of a wage bill ceiling itself has done little to address the need for a unified civil servant database.

The IMF's response shows how the training capacity constraint has been overcome in Malawi. The training program can now take a total of 6,000 students at a time, 3,000 in college for a year and 3,000 in schools. The first cohort of 3,000 new trained teachers will graduate in October 2007. Now that the IMF has confirmed that the capacity constraint has been removed, will the government be able to recruit them given the current level of the wage bill? The IMF's response provides no assurances that the wage bill ceiling will be adjusted sufficiently to add these teachers onto the payroll. Equally important, there is no mention that the wage bill ceiling will be removed as a performance criterion. If it remains as such, the government risks being blocked from increasing teacher recruitment and raising teacher salaries in the future. The IMF provides no new information that counters our concerns.

Mozambique

The case of Mozambique highlights the continued impact IMF macroeconomic policies have on determining the level of the wage bill ceiling even after it has been removed as an indicative target in the PRGF. The central issue is that even with this increase, the ceiling is too low to hire the number of teachers needed and that this ceiling continues to be determined by the IMF's overly restrictive macroeconomic policies.

The IMF's letter claims: "The paper argues that the IMF 'continues to constrain teacher recruitment in 2007.' This is incorrect. The 2007 budget reflects the hiring of 10,000 teachers."

These 10,000 teachers will only allow for a 71:1 PTR by the end of 2007. As Table 3 highlights, the PTR in 2006 was as high as 74:1. Because of the 6.5% ceiling on the wage bill set in 2004, the Ministry of Education was only able to hire 4,715 teachers of the 11,500 requested in 2005. As a result the PTR rose to 74:1. Where the IMF has allowed the wage bill ceiling to rise in Mozambique, the policies it implemented in the past has meant a rising demand for teachers today. The 10,000 teachers hired in 2007 are not sufficient to address the teacher shortage that was made worse by the 6.5% wage bill ceiling.

Donors have also expressed their concern that the PTR remains high in Mozambique despite government hiring these 10,000 teachers.⁸ At the current level of recruitment Mozambique expects to achieve a 54:1 PTR by 2015. This continued concern calls for greater clarification of macro policies by the Fund, and a larger discussion of how the wage ceiling can be further increased to accommodate the number of teachers needed.

The IMF's letter argues: "IMF does not decide on the level of teacher recruitment as it is outside the expertise of the Fund."

The IMF does influence the level of teacher recruitment. In 2006 donors and the Ministry of Education had to appeal to the IMF, not the Ministry of Finance, to lift the ceiling by 1% of GDP and remove it as an indicative

⁸ Programme Aid Partners. *Aide-Memoire 2007. Joint Review.* April 30, 2007.



target, so that government could hire additional teachers and health workers.⁹ This was one of the main reasons why the IMF met with the Ministry of Education.

Even though the wage bill ceiling was removed as an indicative target in 2006 and raised to 7.5% of GDP, other macroeconomic targets have become more restrictive. Inflation is targeted to fall to 5% while government expects to cut back on borrowing.¹⁰ As an inevitable consequence of these stringent targets, the wage bill ceiling must be kept at an unacceptably low level considering the teacher shortage. Mozambique will not achieve a 40:1 PTR – the internationally agreed standard that constitutes a quality education. The flexibility the IMF claims it has shown in regard to Mozambique by removing the ceiling as an indicative target is not enough to make a significant impact on the quality of education.

The IMF's letter claims: "the Minister of Education noted that human capacity constraints (both personnel and training capacity) and lack of long-term financial commitments by donors remained major impediments to expanding teacher recruitment"

Serious capacity constraints to train more teachers in Mozambique continue, as do the government's efforts to address them over time. As we noted above, the Ministry of Education has attempted to address this problem by cutting the number of years of training in half for primary school teachers. Yet more government spending is needed to ensure the quality of training does not fall with the number of years of training. With 10,000 applicants for the 3,000 places available for the new teacher training programme in 2007, it can hardly be said that there is a constraint in terms of the number of people who want to join the profession. The main constraint in this respect remains financial. Therefore, throughout the report ActionAid calls for more long-term predictable aid. Section 5, point 3, focuses entirely on the need for donors to keep their promises to fill the financing gap to achieve Education For All.

Sierra Leone

The Ministry of Education of Sierra Leone has clearly stated that the ceiling on the wage bill, which is agreed with the IMF as part of the government's loan programme, has left the Ministry of Education little choice but to place a cap on the number of teachers.

The IMF's letter claims: "There is no cap on the number of teachers in the Fund-supported program"

ActionAid has never stated that there was a cap on the number of teachers in the Fund-supported programme. Ministry of Education documents state that the 33,122 cap on teachers in 2007 was necessitated by the overall ceiling on the wage bill, which is set as an indicative target in the 2006 PRGF.¹¹ The following section from the Education Sector Plan shows that the IMF did indeed influence the level of the wage ceiling, "... *There is an obvious need to hire more qualified teachers, but a ceiling on teacher employment made necessary by MoF/IMF requirements has made that impossible... in setting the level of wage bill cap/reduction, reference must be made to the expenditures required to meet the MDGs and EFA goals in order to ensure that macroeconomic policies are not counter-productive to the realisation of these goals.*"¹² With additional funding from the FTI soon to be available, there is clear urgency to discuss the wage ceiling and thus underlying macroeconomic policies so more teachers can be hired.

⁹ Republic of Mozambique. "Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding" April 2006.

¹⁰ Republic of Mozambique. *Fifth Review of Under the Three-Year Arrangement under the Poverty Reduction and Growth Facility*. January 2007

¹¹ Republic of Sierra Leone, *Teacher's Salary Schedule*. Ministry of Education, Science and Technology. 8 March 2006;

Republic of Sierra Leone. *Budget Speech 2007*. Ministry of Finance

¹² Republic of Sierra Leone. *Budget Speech 2007*. Ministry of Finance. p. 23



The IMF's letter asserts: In discussing the ceiling on the total wage bill, the Ministry of Finance indicates the number of needed new teachers – as agreed with the Ministry of Education – and the wage bill is adjusted to accommodate these hirings.

As the above statement from the Education Sector Plan explains, this ceiling was not agreed upon with the Ministry of Education, nor was it based on calculations of teachers needed. In fact, the Government of Sierra Leone has reined in the wage bill upon IMF's advice. In 2005, the ceiling was set at 6.1% of GDP, and is expected to decrease marginally to 5.9% of GDP in 2008.¹³ The Fund states, "The staff took the view that reining in the wage bill and improving control of wage expenditures needed to be addressed with urgency."

The IMF letter states: "the program projected a 17 percent increase in the wage bill in part to accommodate the hiring of an additional 3,000 teachers. It is expected to increase by another 14 percent in 2007, reflecting the cost of recruiting 2,000 additional teachers."

The increase in wage bill ceilings mentioned above is misleading. While it is a step forward, it still means that the government can only hire a small number of additional teachers because the wage bill increase covered several items in both 2006 and 2007. These included police officers, pensions and gratuity and a general salary increase.¹⁴ This means that the PTR will not decrease significantly given growing enrolment and the high rate of teacher attrition.

The IMF letter alleges: The paper incorrectly states that following IMF advice, the government has curtailed expenditure, bringing inflation rates down from 12.1 percent in 2005 to a projected 5 percent in 2008.

ActionAid's report states that in "all three countries, inflation is expected to fall by 5% by 2009/10" not 2008. The 2006 PRGF request confirms that "Monetary policy would be aimed at supporting macroeconomic stability and would target a reduction in inflation to single digits in the medium term."¹⁵ Later in the document the figure 5 % is set as the target rate.

The IMF letter argues: "In reality, total expenditure will increase about 2.7 percent of GDP to 27.3 percent of GDP by 2008 to allow a significant increase in development (capital) expenditure...while protecting pro-poor expenditure."

The total expenditure will indeed increase substantially due to HIPC completion point resources. The Government explains in the 2006 Memorandum of Economic and Financial Planning that competing priorities necessitate investment in infrastructure and power generation. However, "...recurrent expenditures, on the other hand, are expected to contract in terms of GDP, reflecting the limited resource envelope."¹⁶ Pro-poor expenditure will increase only nominally, at 1% of GDP, partly due to the limits on deficit spending and the overall resource envelope as prescribed in the PRGF agreement. The number of teachers needed and the number of children in school will all however increase.

The facts cited in this response have been taken directly from IMF and Government documents. If, as the IMF noted in its response, these facts are not correct, ActionAid appeals to both the IMF and government to make publicly available the correct figures upon which the wage bill ceiling is based, or rather, reduced as shown above.

¹³ Republic of Sierra Leone. *Request for a 3-year Arrangement Under the PRGF*. IMF Report No. 06/183. May 2006, p. 18.

¹⁴ IMF 2007; Republic of Sierra Leone 2006.

¹⁵ IMF 2007.

¹⁶ Republic of Sierra Leone, *Memorandum of Economic and Financial Policies*. Ministry of Finance, 2006.

