

# Plenary Session on Macro Linkages to Poverty Reduction

- Importance of Economic Growth and Macro Stability to Poverty Reduction
- Linkages Between Fiscal, Monetary, and Exchange Rate Policies and Poverty Reduction
- Financing the PRS in a Manner Consistent with the Growth and Macro Stability Objectives

# I. Importance of Economic Growth and Macro Stability to Poverty Reduction

# Economic Growth is a *Necessary* Condition for Poverty Reduction

- Economic growth is the single most important factor influencing poverty
- Strong association (not causation) between national per capita income and national poverty indicators
- Growth is driven primarily by private sector capital accumulation
- Objective should be to establish conditions to facilitate private sector investment

# ...But Not a *Sufficient* Condition

- Growth also depends upon key structural measures
  - Regulatory reform
  - Privatization
  - Civil service reform
  - Improved governance
  - Trade liberalization
  - Financial sector reform

# The *Distribution* of Growth Matters

- No trade-off between equity and growth
- Growth associated with progressive distributional changes will have a greater impact than growth which leaves distribution unchanged
- Hence, policies which improve the distribution of income and assets will also form essential elements of a country's poverty reduction strategy
  - Land tenure reform
  - Pro-poor public expenditure
  - Measures to increase the poor's access to financial markets

# As Does the *Composition* of Growth

- Growth in sectors where the poor operate will have a greater impact on reducing poverty than growth in other sectors
- Strategies for sector specific growth should focus on:
  - removing *distortions* that impede growth in a particular sector
  - *empowering* the poor and *creating the conditions* which allow them to move into new and existing areas of opportunity

# Macro Stability is *Necessary* for Growth

- Macro instability has generally been associated with poor growth performance
- Private investment is negatively influenced by uncertainty and macro instability
- In the absence of macro stability, domestic and foreign investment will be diverted elsewhere

# Macro Instability Hurts the Poor

- Inflation is a regressive and arbitrary tax which disproportionately hurts the poor
  - Poor tend to hold most of their financial assets in the form of cash
  - Poor are less able to protect the real value of the incomes and assets than are the better off
- Inflation can also have an adverse impact on output growth

# Elements of Macro Stability

- Sound policies send clear signals to the private sector
- Prudent macro policies can result in low and stable inflation, which positively impact on the poor
- Moving towards debt sustainability creates conditions for steady progress on growth and poverty alleviation

# Elements of Macro Stability (cont.)

- Maintaining an appropriate exchange rate policy promotes balanced economic growth in line with comparative advantage
- Maintaining an adequate level of net international reserves allows a country to weather a temporary shock without reducing pro-poor spending

## II. Macro Policy and Linkages Between Fiscal, Monetary, and Exchange Rate Policies and Poverty Reduction

# Macro Policy

- Two Main considerations
  - Assessment of the appropriate *policy stance* to adopt in a given set of circumstance
  - Choice of specific macroeconomic *policy instruments*
- Specific stance will depend on particular situation facing the country
  - Instability/disequilibrium
  - Stabilization
  - Stability/steady economic growth

# Fiscal Policy

- Fiscal Policy can have an impact on the poor through:
  - The effect of the aggregate fiscal stance on the macro economy
  - The distributional implications of tax policy and public spending

# Fiscal Policy (cont.)

- Structural fiscal reforms can also have beneficial effects on the poor in terms of more efficient and better targeted use of public resources
  - Budget and treasury management
  - Public administration
  - Governance
  - Transparency and accountability

# Monetary and Exchange Rate Policies

- M&E policies can affect the poor through three primary channels
  - Inflation
    - Regressive tax
    - Negative effect on rate of growth
  - Output
    - Changes in money supply can affect output
    - Exchange rate regime can buffer exogenous shocks
  - Real exchange rate
    - Affects external competitiveness and growth rate
    - Can have a distributional impact on the poor

# Polices to Insulate the Poor Against Shocks

- How should economic policy be designed to reduce the adverse impacts of shocks on the poor?
- What specific policies can governments undertake to insulate the poor from the consequences of shocks by removing existing distortive policies?

# Social Safety Nets

- No cost-effective policy that will insure against all possible shocks
- Crucial to have social safety nets in place
  - Resources allocated to social safety nets should be protected during economic crises and/or adjustment
  - Safety nets should already be operating before economies get hit by shocks so that they can be effective in times of distress
- If safety nets are not in place when shocks occur, then second-best policies may be needed

# Removing Market Distortions

- Asset market distortions prevent poor from saving and insulating themselves against shocks
  - Foreign exchange controls
  - Controlled interest rates
- Policies that:
  - Increase borrower information
  - Promote better financial sector credit allocation
- Reduce the pro-cyclical nature of fiscal policies
  - Treat every favorable shock as temporary and every adverse one as permanent
  - Find ways to “tie hands” to resist pressure to spend windfalls

### III. Financing Poverty Reduction Strategies in a Manner Consistent with Growth and Stability Objectives

# Financing Poverty Reduction Strategies

- Development of a *comprehensive* and *fully costed* draft Poverty Reduction Strategy
- Can the strategy be financed in a manner that would *not jeopardize* macro stability and growth objective?
- Need to *integrate* the poverty reduction and macroeconomic strategies into a *consistent framework*

See Diagram 1

# Conceptual Framework

- Step 1: Full Costing of PRSP
- Step 2: Assessment of Spending Program
- Step 3: Scope for Domestic Revenue
- Step 4: Scope for Net Domestic Borrowing
- Step 5: Scope for External Financing
- Step 6: Determination as to Whether PRS  
Can Be Financed in a Manner Consistent  
with Growth and Stability Objectives
- Step 7: Iterative Process to Find Optimal  
Outcomes

# Things to Keep in Mind

- *No rigid pre-determined limits* regarding a country's fiscal stance
- Process requires juggling a number of parameters and *weighing trade-offs*
- This is an *Iterative* process
- May wish to consider *alternative macro scenarios*
- May wish to develop appropriate *contingencies*