Pro-Poor Growth: New Realities and Emerging Questions[i]

Friends,

I am thankful to the organisers for inviting me to participate in this Seminar. The document of the Asian Development Bank (ADB) on the subject is very comprehensive and incisive. It is difficult to add much to it so far as strategies outlined therein are concerned. There are, however, some new realities, especially due to compulsions of globalisation and technological progress that impinge on policies relating to poverty alleviation. Similarly, the changing balances in the policy mix between the State and the Market affect the role of multilateral financial agencies, which need to be addressed. I propose to set out the emerging issues in the light of the Indian experience in reform, and its impact on poverty, to illustrate the process of pro-poor growth and would conclude with a few general observations.

<u>Globalisation and Technological Progress</u>

Globalisation necessarily involves greater competition and a drive towards efficiency. In such a situation, the Government concerned would face severe limitations in imposing taxes that are out of alignment with the international imposts – be it tax on cross-border flows of commodities and services or domestic production. In fact, some stipulations, such as those under the World Trade Organisation (WTO), impose severe constraints on tax-discretion of national Governments. Furthermore, expansion of activities of multinational corporations with huge scope for transfer-pricing (which is becoming increasingly difficult for bureaucracy to detect in view of product complexities), the expanding scope for cross-border services where incomes and expenditures get interwoven, the increasingly large element of service embedded in goods, the growing use of electronic commerce, and the easiness of international travel result in a situation where higher than internationally prevalent rates of taxation become counterproductive. Moreover, when trading in physical products is replaced by that in digital products, issues of tax jurisdiction become paramount. High rates of taxes on financial capital or individuals with highly tradable skills would also be difficult. All these factors limit the capacity of Government in raising resources on a significant scale for large-scale public spending - in particular the spending in favour of the poor. To take care of the poor, it is possible to have mandated or regulatory prescriptions on other institutions such as corporates but such a course of action will tantamount to taxing domestic entities and tending to make them globally non-competitive. The major instrument for public action in favour of the poor in the framework of globalisation would have to be through higher growth, and through orientation of the pattern of growth to impart benefits of such growth to the poor.

Given the constraints on taxation as instruments for raising resources to benefit the poor, globalisation would have to ensure that expenditures are prioritised in favour of public goods including institutional development, environment and basic public goods like education and health. To the extent public expenditures are pre-empted to maintain global competitiveness, they serve both growth and the poor.

One important consequence of globalisation is that it tends to direct resources towards activities where private returns are high. This has implication for poverty. Globalisation may, therefore, require strengthening the presence of government in certain sectors, where social returns are higher than private returns.

In the above background, there are two important areas requiring attention. First, how does the international community enable countries, which have a large existing population of the poor, typically among the relatively low income countries, to handle the problem of fiscal constraints imposed on them by globalisation.

There is also the more general issue of the impact of globalisation on governments. With globalisation, most goods and services as well as all factors, especially capital and technology tend to be mobile over the borders but mobility of people is not free. Governments have to manage the social dynamics, including tensions, of residents without a reasonable freedom to manage corresponding economic factors. The problem is especially acute in respect of countries, which start with an overhang of large-scale chronic poverty. There is perhaps a need for the international community to consider arrangements that provide support to them to assure a level playing field between such countries during a transition period. Dealing with chronic poverty may also require a well-designed and well-managed social safety system. Globalisation with its pressure points on reducing the role of the government may in fact, exaggerate the problem of chronic poverty for a longer period, when the asset distribution is skewed and direct entitlements of poor are curtailed.

There is also a case for attending to transitory poverty, which may be man-made, due to large scale financial crises, as happened recently, or acts of nature such as drought and flood. International institutional arrangements to tackle both transitory and chronic poverty may be needed to protect the globe from several adverse consequences.

Briefly stated, globalisation requires international safety-nets for the poor on a global scale and the international community including the ADB has to consider this aspect while promoting growth, and the pro-poor aspect of growth among member countries. The question is how do we devise them?

Technological progress has been a driving force in growth, and indeed globalisation. This process has given rise to some sense of job-insecurity among the workforce, both in developed and developing societies. Fears are not restricted to effects of financial crises alone, but are related to the process of technology-led growth itself. The growing worker insecurity is a result of fear of potential job-skill obsolescence. The problem is far more serious when there is a large workforce which is yet to acquire or be imparted skills, since the policy question arises as to what types of skills are relevant. Completion of secondary school level has so far been, by and large, enough to equip a worker with skills to last a lifetime, perhaps with occasional on-job training. This may not be so in future. In fact, high-skill biased technology-change on a global scale may undermine efforts at reduction in poverty, though growth may be significant unless there is equally high spillover effect. Also, the distributional impact of globalisation may be addressed. The question is : What are the choices available to policy-makers in developing economies with concentration of the poor to tackle this technology induced insecurity?

<u>State, Market and Multilateralism :</u>

People, Governments and multilateral institutions have been committed to ending poverty, but there were serious ideological differences among governments on how to achieve this goal. In this context, differences were acute in regard to relative roles of the state and the market. However, more recently, there has emerged a reasonably common ground in the approaches to solving economic and financial problems. The near-convergence of ideology reflects the growing linkages or integration among the economies, leading to greater compulsion to find common solutions. The consensus seems to be veering towards redefining the role of the state to take full advantage of markets in maximising growth and welfare, in the context of the overall reduction in the power of the State or Governments relative to individuals. Technology has widened, deepened, and spread rapidly among all, with the result individuals (to include corporates or non-governmental organisations) are able to operate and organise themselves with access to the same level of technology and even resources as the Governments. As a result, Governments seem to be powerless in enforcing censoring of news, especially on the net. This shows that the balance between government and individuals has changed in alignment with the changing balance between the State and the Market.

Further, mobility of goods and services, especially capital flows, among nations increased enormously, and most large capital flows are on private account. Thus, international financial flows also reflected the changing balances between the State and the Market.

Reflecting the movement towards ideological conformity, multilateral institutions have become more representative of all nations with a virtual universal membership. These institutions which were created by governments, are necessarily subject to changing balance against governments and in favour of individuals, including markets. The multilateral institutions like the Bretton Woods institutions or the ADB have, as a result, become more representative, and relatively less significant in terms of resources transfer; and yet more critical in terms of their influence on the function of the economies in the increasingly integrated world. It is, however, clear from the recent developments that in the context of the changing balances, the institutions which are purely creations of governments require additional clout to be effective. The question is : how to build international arrangements that will include non-governments for addressing global challenges.

There is also a discernible change in the recent past on what constitutes the global challenge. Till a few years ago, the balance of payments was the domestic problem of a country needing policy corrections by the government but often on the advice of the International Monetary Fund. Now it is clear that it has become a global concern requiring international coordination. For instance, poverty in an intricately interconnected world has the potential of having a contagion effect through, internal health hazard say, a virus or a disease, and could pose a global challenge.

The recent institutional innovations such as the Financial Stability Forum and the G-20 are interesting examples of informal arrangements to ensure stability by combined national and international endeavours. These do, however, include governments, central banks, regulators, and multilateral institutions. Similar initiatives could be considered in respect of poverty alleviation. It is in fact possible to harness managerial skills, and to the extent possible, material or financial resources of individuals and corporates to aid the process of poverty alleviation – both transitory and chronic.

The UN Secretary General, Mr. Kofi Annan, has come up with an idea that the UN needs to focus on people rather than governments, and harness technology for humanitarian purposes. Indeed, it may be useful to explore a *Poverty Alleviation Forum (PAF)* with close involvement of corporates, technology-leaders, financial intermediaries, and non-governmental organisations or self help groups, say under the aegis of an international organisation such as the ADB. The main objective of such a forum should be to arrive at a consensus on managing globalisation, while ensuring not merely financial stability, but also poverty-alleviation.

Reform and Poverty Issues in India

Currently, there is an interesting debate in India on the impact of economic reform on poverty alleviation. The data and analysis, whether in terms of direct poverty ratios or indirectly looking at unemployment and wages are reported to suggest that in the 1990s, especially in the years after the onset of reforms in mid-1991, rural poverty reduction has been arrested while urban poverty recorded a decline. Though the conclusions of these studies are tentative and reliability of data is often questionable, it is noteworthy that the increased GDP growth and moderate inflationary pressures have helped alleviate poverty.

In linking poverty reduction with reform and growth in India in the nineties, the first question that arises is with regard to the counter factual, viz., if there were no reform, would the reduction in poverty ratios have continued. Perhaps, the policy package of the ‘eighties, which delivered a respectable rate of growth in GDP and a reduction in poverty, was unsustainable, since the achievements during the ‘eighties were, in a sense, based on borrowed money, both domestic and external. It can even be argued that the price for such unsustainable policies of the ‘eighties is being paid in the ‘nineties. Further, it could be argued that, in view of the international and domestic uncertainties, particularly in the recent years, the vulnerability of the economy and also of the poor would have been severe in the absence of reform. For example, the latest oil shock went almost unnoticed in India.

The second question, given the increasing inequalities among the States in respect of growth performance in the reform period, relates to whether the poverty reduction has taken place mainly in those States which have registered impressive improvements in real growth of State Domestic Product (SDP). Some fast growing States especially in Southern and Western India appear to have recorded a decline in poverty, while some others, where poverty is concentrated and SDP growth is lagging do not appear to show reduction in poverty.

Furthermore, the Rural Development Report released recently by the National Institute of Rural Development highlights the huge intra-State inequalities and provides explanatory factors for such inequalities. Thus, State-level and intra-state level analyses deserve to be looked into carefully before arriving at the conclusion that the reform-strategies have not been successful in reducing poverty.

The third question relates to what Dr. C. Rangarajan (former Governor of the Reserve Bank of India and presently Governor of the State of Andhra Pradesh) pointed out viz. the fact that all poverty-alleviation programmes of the pre-reform era have been continued during the reform period. It must be noted that major poverty alleviation programmes such as the Public Distribution System (PDS) continue to operate and the PDS continues to be virtually absent in the States where there is concentration of poverty. Hence, the effectiveness of anti-poverty programmes is dependent mainly on how focussed are the efforts at implementing them.

The fourth question is a possible linkage between the sectoral composition of growth in Gross Domestic Product (GDP) and the existence of poverty. Studies reveal that growth of the primary-sector has a significant impact on rural poverty, while growth in the tertiary sector has on urban poverty. Growth in the secondary sector, does not on the other hand, seem to have a significant impact on poverty.

Finally, the fact remains that, while evidence of stagnation on poverty-levels is not conclusive, there is no evidence of significant reduction in the aggregate of people below poverty line to correspond with the impressive economic performance as per macro-economic indicators such as growth in GDP and inflation. This calls for a review of public policy to assure a pro-poor policy in pursuit of growth.

Public Policy for Pro-Poor Growth

In terms of public policy, it would be useful to take into account the experience in the pre-reform as well as the post-reform periods and the constraints imposed on public policy due to globalisation and technological change, and explore the emerging questions on the appropriate policy package to enable the pro-poor view of growth to succeed. The issues in this regard clearly appear to be many, and a few major ones are listed here.

First, given the fact that the status of agriculture is an important determinant of rural poverty, should there be a greater focus on public investment in agriculture, which has been decelerating recently?

Second, is it possible that, as some studies indicate, expenditure on roads, agricultural research and irrigation have a greater impact on poverty alleviation than expenditures on direct poverty alleviation programmes?

Third, is it possible that higher growth in agriculture facilitated by deregulation/liberalisation, would contribute to a more rapid reduction in rural poverty?

Fourth, whether improvements in the design and implementation of poverty reduction programmes including the public distribution system would yield the desired results?

Fifth, whether removal of all price based subsidies, direct or indirect, and substitution with income-transfers be more efficient anti-poverty programme?

Sixth, studies have also shown that in periods of 'distress' such as drought, poverty alleviation programmes make impressive welfare impact. In such an event, is there a case for substantial and automatic launching of such programmes on a massive scale while in normal circumstances, public investments, especially in agriculture and social infrastructure take overriding priority?

Seventh, what would be the role of local bodies, which are being revamped in many States, and of non-Governmental organisations, in both growth oriented and poverty alleviation programmes? Would it be appropriate to consider them as good vehicles for such centrally designed programmes only or should they be encouraged to take interest in multidimensional approach to poverty alleviation and empowerment of the poor?

Eighth, one question relates to the link between the instrument of poverty alleviation and the objective which is best illustrated with food-subsidy. The changes in the budget-allocation for food subsidy could reflect changes in the level of stocks of foodgrains and the carrying-costs rather than any concrete provision of benefit to the consumers. In this context, the Reserve Bank of India has commissioned a study on fiscal and monetary implications of our buffer stock operations of foodgrains.

Ninth, while the poor are heavily concentrated in some parts of India, many of our programmes directed to the poor are not adequately availed by them. For example, micro finance initiatives taken by RBI have shown impressive results, and though spread over almost all the States, two-thirds of micro-finance activity is in evidence in the Southern region. Experience shows that the outreach of micro finance tends to be small and it pays dividend to those who are capable and efficient. Actually, it is successful in areas with potential for non-farm activities and among clients with skills in non-farm business. RBI is continuing its efforts to spread micro finance to other areas as well, but clearly it can be only one of several approaches to poverty alleviation.

Finally, economic reform, in a broad sense, would encompass realigning of relative functions of the Centre and the States. In our context, it means greater emphasis on the development of social infrastructure and physical infrastructure. Most of the social and a significant part of the physical infrastructure lies in the domain of the States. Expenditure responsibility of the States is, therefore, likely to grow in social sectors, particularly in education, health, sanitation and nutrition, even after reckoning for some unbundling as also for private provisions.

On the interstate plane, the new reality is a greater role for market-based resources for the development of a State. So, while the States need to be encouraged to compete for resources in the market, there should exist mechanisms in the transfer of resources which would differentiate between the ability-consistent efforts and the ability-enhancing efforts. This means that States which already have a reasonably developed institutional-support base and a strong fiscal position can garner resources from the market and, consequently, reduce their dependence on Central transfers. In States where the institutional setting is underdeveloped, public policies may have to address the issue of improving their ability to access financial markets, while, at the same time, augmenting their resource base through transfers to help prepare them for a greater degree of self-sufficiency. This has greater relevance now than before due to market orientation of the reform-process and observed regional inequalities, heightened by concentration of the poor in underdeveloped States. The Reserve Bank of India had a series of meetings with State Finance Secretaries and in the latest meeting held last week, RBI has been involved in three tasks viz. reducing interest burden on States' debt, increasing maneuverability of State budgets and analysing the multidimensional aspects of State budgets.

Overall, the contribution of Reserve Bank of India in this regard should be considered in several aspects, price-stability being the most critical. One of the strengths of the Indian system is a strong aversion against inflation. The secular inflation rate has been very moderate even under difficult circumstances, and volatility has been minimal. A strong anti-inflationary bias in the macro policies provides a bulwark against an adverse impact on poverty. The weakest segments of society have no defences against inflation and hence the oft-quoted dictum in India is that an anti-inflationary policy is the best anti-poverty programme and it is in this context that the role of the RBI gains pre-eminence.

Conclusion

Let me conclude with some very well-known general observations.

In the ultimate analysis, markets, however efficient they are, are not democratic institutions in the strictest sense, since customer's vote is proportionate to his/her purchasing power. Secondly, labour is different from capital since the owner of capital can withhold if he/she thinks that the return is not adequate while labour cannot withhold because it will then not be able to survive. He or she has to work to live. Thirdly, the poor can give according to their ability but if such abilities cease to have markets, they cannot get what they need even if the need is minimal. Fourth, resource-transfer to the rich is described as 'incentives' while income-transfer to the poor is described as a 'subsidy' – commonly perceived to be a derogatory term. Finally, pro-poor oriented growth is thus possible when intellectual community and policy makers treat markets with the suspicion that they deserve and the poor with the respect that they need.

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[i] Presentation made by Dr. Y.V. Reddy, Deputy Governor, Reserve Bank of India at a Seminar on 'The New Social Policy and Poverty Agenda for Asia and the Pacific' by the Asian Development Bank, Chiang Mai, Thailand on May 5, 2000.