

**PRO-POOR FISCAL AND MONETARY POLICIES:
TOWARDS CORRECTING STRUCTURAL INJUSTICE
IN SOUTH ASIA**

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Introduction

The argument of the paper

The central premise of my paper is that poverty eradication is not about money but about justice. Throwing money at programmes for poverty alleviation, for the best part of half a century, has done little to correct the injustices which condition the lives of the poor. Rather, poverty has been perpetuated in many Third World countries but particularly in South Asia, because social and political injustice remain writ large across our societies. This programmatic and aid driven approach to poverty alleviation has ghettoized the issue of poverty alleviation in a self-contained universe of micro-oriented programmes and projects targeted to specific groups of the poor. Such micro-programmes, from their conception, remain incapable of redressing the injustices which drive poverty or of providing the coherent vision needed to eliminate poverty. Financing such poverty alleviation programmes tends to degenerate into welfarism and thus remain unsustainable without the largesse of aid donors.

The approach to poverty has undergone a sea change in the last 5 years. Today poverty reduction is projected as the primary mission of the international development community which was reaffirmed at the Millennium Summit in New York. The SAARC heads of state, in the Dhaka summit of 1993, had already proclaimed their commitment to eradicate poverty from South Asia by 2002. They obviously failed to honour this commitment but felt obligated to reaffirm this goal in the Kathmandu summit of January 2002. This contemporary emphasis on alleviating poverty originates in the growing awareness in the development community that the prevailing agendas for policy reform over the last two decades have actually perpetuated poverty.

However, there is little evidence that this heightened global or regional commitment to reduce poverty is likely to make a significant difference in the conditions of the poor. The *Poverty Reduction Strategy Papers* (PRSP) under preparation across South Asia and elsewhere, largely under pressure from the aid donors, have emerged as the instrument of choice for meeting the challenge posed by the Millennium goals. There is little evidence, however, that the PRSPs will provide for much more than business as usual. The PRSPs seek to build upon the ongoing agenda of structural adjustment reforms, underpinned by safety nets for the victims of these reforms, backed by somewhat higher levels of

investment in human development. It is argued here that this structural approach of the PRSPs is no more likely to reduce poverty than the plethora of anti-poverty programmes which have been in place across South Asia over the last two decades. Nor are the PRSPs likely to be more fully-owned than the earlier regime of donor imposed reforms in South Asia. The PRSPs, as with an earlier generation of reforms, have failed to address the structural sources of poverty and injustice. This has left South Asia as the repository of the largest congregation of the world's poor. It is arguable that failure to correct the structural injustices which perpetuate poverty are today fuelling the social tensions which are posing a challenge to the fragile democratic institutions of South Asia.

A credible agenda to eradicate poverty needs to put in place a set of policies and institutions which serve to empower the poor to participate, on more equitable terms, in the dynamics of the development process. Such policies should serve to transform the poor from being the incidental beneficiaries of economic growth to becoming one of its prime movers. Such an approach suggests that the eradication rather than just the alleviation of poverty should remain central to the design of policy reform in South Asia. Policy interventions to correct these structural injustices which sustain poverty would need to focus on enhancing the capacity of the poor to own income generating assets, participate more equitably in the market place as well as in accessing opportunities for human development and to be effectively represented in the institutions of democracy.

The coverage of the paper

The policy and institutional reforms needed to correct the structural injustices which perpetuate poverty cover a broad canvas. However, the focus of my presentation will limit itself to discussing the design of pro-poor budgetary and monetary policies, along with the restructuring of institutions which implement these policies. The goal of these reforms would be to correct some of the injustices faced by the poor through interventions designed to substantively broaden their economic opportunities. Whilst my presentation has a global applicability the policy discussion is more specifically focused on the eradication of poverty in South Asia. The paper is structured around three sections:

- Redesigning budgetary policy to reach public resources to the poor.
- Restructuring monetary policy.
- Institutions for the poor.

Redesigning budgetary policy to reach public resources to the poor

Restructuring the budget

Budgetary policy is ultimately all about making choices. Thus, public expenditure budgets serve as instruments for governments to determine their allocative priorities as between different activities and groups of people. Fiscal policies determine who will pay for these expenditures or who will be provided with incentives to guide their investment and consumption decisions. Budgetary policy serves as an explicit measure of the priorities of a governments towards the poor. In practice, however, at least in South Asia, budgets are rarely as explicit as they need to be in a democratic society. This makes it possible for Finance Ministers to speak eloquently in their annual budget speech before parliament about their commitment to alleviate poverty. However, their budgets tend to avoid actually setting any explicit goals to serve the poor. In consequences, the concerns of the poor remain marginalized in the budgets of most developing countries.

In the absence of any explicit structuring of the budget to serve the poor, most budgets, at least in South Asia, contain a plethora of projects/programmes, ostensibly targeted to the poor. In many least developed countries (LDCs) such pro-poor programmes tend to be underwritten by a variety of aid donors. Such programmes are usually not integrated within a coherent strategy to reduce poverty. Indeed, most Finance Ministers would be hard put to keep track of this cornucopia of projects implemented by national, regional and local governments as well as innumerable NGO's, much of which are underwritten by donors. This proliferation of aid programmes has contributed to a state of near anarchy in the area of poverty alleviation which has inevitably lent itself to waste and corruption. Thus, a significant part of the expenditure targeted to the poor, does not directly reach the poor, due to high transaction and delivery costs, which often enrich the non-poor or expatriate and local consultants.

Much of this misdirection of public expenditure is concealed under opaque budgetary practices which make it impossible to identify the share of the budget directly reaching the poor or estimating its outcomes on the circumstance of the poor. In this respect,

targeted aid programmes are no less likely to carry high transaction costs, with poor outcomes and weak sustainability.

Any serious attempt to dedicate public expenditure budgets to the concerns of the poor should be transparently structured. The annual budget should clearly identify not just broad allocations ostensibly invested in poverty alleviation but would also itemise projects explicitly targeted to the poor. This should clearly quantify resources directly reaching the poor and indicate the outcome of the expenditures on their lives. Such statements should also attempt to include the expenditure and programmes of the NGOs who remain no less in need of public accountability for their stewardship of the needs of the poor as does the government.

At the same time, the budget should identify the numbers of people whose poverty would be alleviated as a result of these pro-poor programmes/projects and should spell out at the end of the financial year, how far such targets have been realized. A number of such efforts, usually at the level of civil society, have periodically attempted to re-estimate the national budget in order to isolate its financial contribution towards poverty eradication. However, such efforts remain underresourced and carry unresolved conceptual problems so that they have not been very effective in persuading Finance Ministers to more carefully calibrate their budgets to reach the poor. Nor have likeminded donors been any more successful than civil society in spite of various efforts at promoting budgetary reform through provision of technical assistance.

Inducting the poor into the budgetary process

Apart from targeting public expenditure to the poor the more serious limitation of the budgetary process lies in the absence of consultation with the poor. A quite disproportionate amount of time is spent consulting business leaders and economists on budget design. Much less, if any, effort is invested in consulting the poor about what they expect from the budgetary process. Some consultative exercises, often at donor initiative, have tended to produce some rather self-conscious exercises where the sponsors end up hearing what they want to hear. The current fad of the *Poverty Reduction Strategy Paper*

(PRSP) is the most recent and visible effort by donors at encouraging recipient governments to consult the presumed beneficiaries of national poverty reduction strategies. A number of civil society initiatives to consult the poor have yielded more promising results. However, unless such consultations originate in the felt needs of governments and the poor themselves, rather than the outcome of donor-driven agendas, they tend to degenerate into episodic exercises in providing some catharsis for the aid givers.

Ideally, it is governments who should reach out to the poor whose votes elect them to office. Such an effort should not, however, manifest itself as a pro-forma, pre-budget exercise in bureaucratic tourism of some rural areas but should be institutionalized into the structures of governance. The consultative process, each year, should be preceded by a process whereby the concerns of the poor are systematically recorded and reviewed by the budget makers before they embark on their annual consultative encounters with the poor.

All such efforts at making budgets more transparent and consulting the poor will be meaningless if they do not end up reprioritizing public expenditures to put resources into those sectors that serve the poor. This process will have to precede the task of ensuring that allocated resources actually reach the poor. However, redirecting budget priorities is not a positive sum game and the political economy of a society needs to be taken into account in any discussion on the allocative priorities of the budget. If the poor are to compete with the Defense Forces or pay rises for bureaucrats, to influence the allocative choices of the Finance Ministry, they will need to collectively empower themselves to compete in the political arena rather than to depend exclusively on the good sense of the policymakers.

Fiscal policy

The instruments of fiscal policy in many developing countries are usually not designed to address the concerns of the poor. It must, therefore, be recognized that fiscal systems can also be redesigned to do more than provide incentives for business enterprises and relief to the poor. The poor are also producers of goods and services and remain sensitive to the

incentives offered by a well-designed fiscal policy. The instruments of direct as well as indirect taxation need to be calibrated to make better use of their distributive and poverty reducing power. Fiscal specialists should be invited to join hands with poverty specialists to rethink the design and mechanisms for formulating a fiscal policy which can better serve the needs of the poor.

Restructuring Monetary Policy

Taking micro-credit out of the ghetto

Nowhere is there a greater need for developing a macro-perspective for poverty eradication than in the area of monetary policy. The instruments of monetary policy appear to be exclusively targeted towards ensuring macro-economic stability, moderating inflation and meeting the credit needs of the corporate sector. The financial needs of the poor, once left to the informal sector, have now been segregated into the micro-credit market. This apartheid within the monetary system remains a major anomaly in the global development discourse. The micro-credit movement has, in many ways, revolutionized the banking system of many countries such as Bangladesh by moving a large segment of the rural population, from the informal to the formal capital market through access to institutional credit. In Bangladesh 15 million poor households, mostly women, have graduated from the informal money market into organized banking, where recognition of their innate sense of fiduciary responsibility for repaying loans and making regular savings has been institutionalised. These numbers are comparable to those who participate in the commercial banking system. No less important, the micro-credit system has established the creditworthiness of the poor and laid to rest the myth that only men of property should be eligible to access the institutional banking system.

I do not here intend to go into the merits and limitations of micro-credit or to suggest that it is the panacea for poverty eradication. Indeed, I would argue that, by its very nature, micro-credit can never aspire to eradicate poverty since it only addresses one component of the various markets which condition the lives of the rural poor. It is arguable that by locking the poor into the micro-credit system, based on the fiduciary responsibility of the household, they have been excluded from participating in the macro-economy, have been

isolated from collective action and condemned to live on the fringes of the poverty line. It is, therefore, not surprising that countries with the most substantive exposure to micro-credit, remain mired in poverty. Having said this much, I would, in no way, aim to diminish the enormous contribution of micro-credit in alleviating poverty and distress, as well as enhancing the selfworth of the poor. Having recently completed a 6 year tenure as Chairman of the Board of Grameen Bank I can speak with some authority on the subject and take pride in the pioneering achievements of Professor M. Yunus and his colleagues at the Grameen Bank.

Regrettably, few Finance Ministers in the developing world have registered the crucial lessons from the micro-credit revolution that the poor are bankable and creditworthy. The logic of this discovery would be to enable micro-credit organisations to graduate into corporate financial institutions, owned by the poor. This, indeed, is the path followed by Grameen Bank which is a corporate body with over 2 million shareholders, composed mostly of poor women, who are also the clientele of the Bank. Bangladesh and indeed a number of other developing countries, are ready to sustain many more such banks, owned by the poor and serving the poor. Given the high level of non-performing loans in the regular banking system of Bangladesh, the fact that Grameen Bank, with a credit volume comparable to the largest commercial banks, can limit its portfolio of non-performing loans in the range of 10%, demonstrates that it has the capacity to operate competitively as a commercial bank, whilst serving the needs of the poor. There is, today, no reason why such organizations, of the maturity of Grameen Bank, should not graduate into the macro-finance system by accessing the deposits of the public and even marketing its assets at the global level, through such financial instruments as securitisation, which are in widespread use in more advanced financial systems.

Restructuring financial services to serve the poor

If Grameen Bank can move upmarket, there is no reason why commercial banks should not redirect their loan portfolios to the poor on account of their creditworthiness, particularly in an environment when many of their largest commercial borrowers remain habitual defaulters. This is not to suggest that commercial bankers have to immediately move out of their air-conditioned offices and visit each client in their village home, as is

the practice with the micro-credit organisations. A number of banks are already using NGOs and, in the case of Kishorgonj sub-district in Bangladesh, community-based organizations, to retail banking services to the poor. Commercial banks have to adjust their perspective as well as portfolios to the market opportunities provided by the poor.

Corporate banks may be more inclined to do this if the government were to incorporate such a redirection of banking services into the design of financial sector reforms. The World Bank has, for many years, been promoting financial sector reforms across the developing world. Regretably, there is no evidence of any insistence by the World Bank that the reform process should also aim to restructure the macro-financial system to deliver financial services to the poor, on grounds of both market efficiency as well as reducing poverty.

Mutual Funds for the Poor

Apart from the issue of redesigning monetary policy to deliver credit to the poor, the monetary system also needs to put in place a much wider spectrum of financial instruments which can serve to mobilize the savings of the poor. An organisation such as Grameen Bank has accumulated Tk. 10 billion (about \$187 million) in savings from its 2.3 million members. All these savings remain on deposit with Grameen Bank and are used for further lending to its members. Savings mobilized by other NGOs such as BRAC, ASA, *Proshika*, as well as by individual households, indicate that the poor remain formidable savers. In India, a large number of small community organizations in Andhra Pradesh State, organized under the SAPAP programme, have in aggregate, accumulated savings of around \$180 million which remain on deposit with the banks.

The monetary system needs to design special financial instruments to attract these micro-savings into the corporate sector, particularly where it can be structured to serve the poor. Again, Grameen Bank has taken the initiative in launching the first Mutual Fund of the poor, where it is providing opportunities for investing a small fraction (Tk. 150 million) of the savings of its members, in a managed, close-end, Mutual Fund which would invest

its portfolio in the corporate sector. The potential of this experiment has to be tested within the small, rather unstable capital market of Bangladesh.

Whatever may be the fate of the Grameen Fund, the concept of Mutual Funds for the poor provides a significant institutional mechanisms to move the poor out of the village economy and into the more dynamic corporate sector, to a stage where a significant share of corporate wealth could be owned by the poor. The savings of the poor can not only augment the savings base but also broaden the investment capacity of the economy, whilst transforming the poorest rural household into stakeholders in the process of national economic growth.

The channeling of the savings of the poor into corporate investments should be matched by the reverse flow of urban savings to finance the corporate as well as micro-credit needs of the poor. An integrated monetary system is a two-way street where financial intermediation by the banks should be able to channel the savings of the urban middle class to underwrite the investment needs and creative capacity of the poor as also to finance rural based small and even medium enterprises. Many such enterprises could, themselves be owned by organized groups of the poor assembled in community based organizations. Within such a perspective, credit from the commercial banks should also be made available to organizations of the poor to leverage their investments in the corporate sector.

Such an integrated financial system carries obvious risks associated with the nature of the market mechanism, as well as the probity of the corporate sector, which will demand special safeguards to protect the interests of the poor. The capital markets of South Asia are not the most secure havens for the better-off, let alone the poor. Therefore, designing a secure portfolio of assets for the poor needs to be very carefully structured and managed with complete transparency to sustain the confidence of those who have no past exposure to the stock market. But unless these opportunities for linking the poor to the corporate sector are explored through widening the horizons of monetary policy, the poor will remain permanent captives in the ghetto of the micro-economy.

Expanding the stakes of the poor

The Mutual Fund is but one institutional mechanisms to link the poor to the corporate sector. The underlying premise of the Mutual Fund is the notion of creating possibilities for the poor to own corporate assets. Financial policy could accordingly be restructured to ensure that all assets, from urban land, to real estate development, from banks to corporate trading houses, could be redesigned to accommodate the poor as equity partners. The two institutional instruments to make this possible remain the Mutual Fund and the need for private limited companies to transform themselves into public limited companies. Here monetary and fiscal policy can provide incentives to encourage the corporatisation of private wealth along with the reservation of space for equity ownership of this wealth by the poor.

It may be suggested that the opportunities for democratizing ownership of corporate wealth should not be limited to the rural poor but could be extended to workers, to own shares in the enterprises where they work. In Bangladesh, 1.2 million women, mostly from the rural areas, who earn monthly wages of around \$30, provide the substantive value addition in Bangladesh's principal export of readymade garments. These women workers, who, in transplanting themselves from a rural to a metropolitan society, have had to undergo a cultural and social metamorphosis, also deserve to be made stakeholders in the most dynamic sector of the economy. Similarly, workers in banana, tea, sugarcane or palm oil plantations could be given an equity stake in the enterprises where they work. Similarly, small cash crop farmers could be offered an equity stake in the agro-processing corporations which add value to their primary product. Such an equity state in the process of value addition to their labours will ensure that poor workers and farmers will not remain trapped in a low wage, primary producing prison but can share in the profits and value addition created by their labour.

Institutions of the Poor

Collective action by the poor

The poor survive as individuals with no institutional persona. The primary task of building institutions for the poor should be to enable them to rediscover their collective identity. The forging of such a collective identity does not, however, develop out of

abstract notions of identity but is likely to emerge out of a process of collective action. Such collective action tends to be constructed around particular social actions or through shared participation in pursuit of economic gain. Here, if the poor are to be mobilized for collective action, special institutions of the poor, may need to be constructed. Two such institutional arrangements are discussed below:

Corporations of the Poor

Over the last two decades the NGOs have come to play a growing role in most developing countries, principally as delivery agents, contracted by donors to deliver certain services targeted to the poor. Whilst it may be argued that their institutional efficacy, systems of accountability and even cost-effectiveness can be improved, it is generally accepted that NGOs tend to be more effective in delivering resources directly to the poor than the machinery of state. It has, however, been argued that the emergence of the NGOs as aid contractors keeps them heavily dependent on aid. Indeed, in many developing countries where official aid dependence is declining, the external dependence of NGOs, have increased whilst large numbers of their employees have come to depend on continuous inflows of aid to sustain their livelihood. This has provided donors with new sources of external influence within the Third World. This external dependence is increasingly compromising the role of NGO's as social mobilizers and advocates of the poor since they cannot afford political or social confrontation with the government who still mediate aid inflows or even the socially powerful. There are many conspicuous exceptions to this trend in South Asia. A number of NGO's, exclusively committed to gender, human rights, environmental and other areas of social activism have exposed themselves to enormous risk in challenging the state and local elites on behalf of the deprived.

It is suggested that the long term sustainability of the development NGOs, depends on their establishing themselves as financially autonomous institution of civil society. Various paths to fiscal autonomy are available. The future of the NGO as an economic institution lies in its ability to use its institutional capacity, which extends into rural communities with direct access to vast numbers of the poor, to use this reach to link the poor to the market. This can be done through transforming NGOs into corporations of the

poor, where their micro-beneficiaries are transformed into the owners of a corporate NGO. Through such a measure, the individual weakness of the poor could be aggregated into the legally recognized power of the many. Initially only a small number of NGOs would have the organizational capacity and resources to evolve into nationally competitive corporate bodies. However, smaller NGOs can also evolve into more modest corporate entities. Even a single village based NGO could evolve into a small enterprise which could mobilize the poor to own the village pond, build and maintain rural roads or trade in commodities produced or consumed by the poor.

Community based organizations of the poor

The NGOs are not the only agency for forging collective solidarity within the poor. Community based or self-help organizations of the poor, cooperatives and activity based organizations, which bring groups of the poor together, should aspire to forge an institutional identity. 6991 community based organizations (CBO), covering 132,000 households, have been organized in 6 countries of South Asia under the *South Asian Programme of Poverty Alleviation (SAPAP)* to jointly undertake savings and investment. In Pakistan, the *National Rural Support Project* has organized 11,000 community organizations with 241,000 members to participate in similar community actions in their village. In the state of the Andhra Pradesh the World Bank is assisting a programme for reducing poverty which plans to socially mobilize 5 million of the rural poor in CBOs to collectively participate in economic activity.

Corporitising these CBOs will provide the legal foundations for collective action, to enable these bodies of the poor to access credit, enter into contractual relationships and deal with international organizations. The precise legal persona of these corporations may vary from limited liability companies, with the poor as equity owners, to cooperatives with the poor as partner members. But the common feature of all such corporate entities of the poor is that they much operate in the market place and generate income rather than limiting themselves to survive as savings and loan associations.

Global responses

Neither the concept of building corporations of the poor or the Mutual Fund, depend exclusively on the government for its advancement. NGOs are at liberty to reconstruct their corporate identity, as are the poor to organize themselves. Though in some countries such a process may require enabling legislation. The international development community can, however, help to accelerate such a process of economically empowering the poor, by redirecting their aid programmes towards supporting the emergence of such corporate bodies of the poor committed to acquire command over income-generating assets. This could suggest provision of resources to support acquisition of land, water bodies, leveraging purchase of shares, building capacity to compete in the market, and enhancing the knowledge base of the poor, particularly to participate in the IT revolution. Indeed, all such programmes could themselves derive from a new generation of locally owned structural adjustment reforms, premised on the financial empowerment of the poor. The multilateral as well as bilateral development agencies would thereby need to restructure their aid priorities to move beyond their traditional welfare oriented strategies of poverty alleviation towards investing in graduating the resource poor into the realm of the market economy. In this task aid financing could be used to leverage commercial bank financing so as to broaden the pool of resources which could be directed towards enhancing the stake of the resourceless in the dynamic sectors of the national as well as global economy.

Conclusion

The international community, national governments, particularly in South Asia where they are already committed to eradicate poverty, as well as those who claim to speak on behalf of civil society, have to decide whether we are really serious about not just reducing but eradicating poverty. We need to recognize that poverty persists in the world, in spite of the rhetoric of world leaders meeting periodically in global or regional summits, because we do not confront the sources of poverty. We continue to support by our indifference, a global and national order where the poor remain insufficiently equipped with material as well as human capital and are kept political disenfranchised. This injustice compels the poor to participate on unequal terms in the market and exposes them to a lifetime of unequal opportunities. The central task of mobilizing finance for poverty eradication should therefore be directed towards ensuring that an increasing share of global resources are invested in correcting the injustices which sustain global poverty.