SENIOR POLICY SEMINAR V

AERC CREA

Macroeconomic Policy and Poverty Reduction IN AFRICA

AERC Senior Policy Seminar V

Dar es Salaam, Tanzania

February 2002

Matthew Martin and Johnson Nyalla

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By
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The African Economic Research Consortium

The African Economic Research Consortium (AERC), established in 1988, is a public not-for-profit organi-zation devoted to advanced policy research and training. The principal objective is to strengthen local capacity for conducting independent, rigorous inquiry into problems pertinent to the management of economies in sub-Saharan Africa.

In response to special needs of the region, the AERC Research Programme has adopted a flexible approach to improve the technical skills of local researchers, allow for regional determination of research priorities, strengthen national institutions concerned with economic policy research, and facilitate closer ties between researchers and policy makers. The Training Programme augments the pool of economic researchers in sub-Saharan Africa by supporting graduate studies in economics as well improving the capacities of departments of economics in local public universities. AERC is supported by donor govern-ments, private foundations and international organizations.

Macroeconomic Policy and Poverty Reduction in Africa: AERC Senior Policy Seminar V

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Contents

List of Abbreviations

AERC	African Economic Research Consortium
CEPA	Centre for Policy Analysis (Ghana)
CGE	Computable general equilibrium
FDI	Foreign direct investment
HIPC	Highly indebted poor country
HIV/AIDS	Human immunodeficiency virus/Acquired immune deficiency syndrome
IDRC	International Development Research Centre
IFI	International finance institution
KIPPRA	Kenya Institute of Public Policy Research and Analysis
MDGs	Millennium Development Goals
MTEF	Medium-term expenditure framework
PRSP	Poverty reduction strategy paper
REPOA	Research on Poverty Alleviation (Tanzania)
SPACO	Special Poverty Alleviation Coordination Office (The Gambia)
SPS	Senior Policy Seminar
UNDP	United Nations Development Programme

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Reducing Poverty Is the Key Issue

This report presents the highlights of the fifth of AERC's Senior Policy Seminars, which focused on Macroeconomic Policy and Poverty Reduction. Some 52 policy makers and researchers from 20 African countries attended the event, held in Dar es Salaam, Tanzania, on 12–14 February 2002. Most of the policy makers who participated are directly responsible for, or substantively involved in, the development of poverty reduction strategies in their countries.

The seminar examined nine themes in policy making to reduce poverty in Africa:

- Poverty diagnosis
- Macroeconomic policies and poverty reduction
- PRSP processes and designing pro-poor macroeconomic policies
- Health and education policies for poverty reduction
- Designing and implementing anti-poverty budgets
- Balancing and targeting poverty reduction spending policies
- Real sector and structural policies for poverty reduction
- Financial sector reform policies for poverty reduction
- Forecasting and modelling poverty reduction

The overall aim of the Senior Policy Seminars in general is to:

- Present the latest research on issues that are central to current African economic policy making;
- Provide a forum for the exchange among African policy makers and researchers of their experiences of best practice in policy making and research in key policy areas; and
- Define an agenda for future joint policy-oriented research and analysis.[1]

> The poor will always be with us if all we do is collect data on them. Designing policies to eradicate poverty is Africa's most urgent challenge.
>
> Hon. Daniel Yona, Minister of State for Poverty Reduction in the Office of the Vice President of Tanzania

[1] The first Senior Policy Seminar was held in Nairobi in March 1995. SPS II, held in Abidjan in November 1996, addressed financial sector reform and SPS III, in Accra in October 1997, discussed fiscal policy. The fourth Seminar convened in Gaborone in February 2000 under the theme of Resource Mobilization in Sub-Saharan Africa.

Setting the Stage

Chair/Moderator: Dr. Delphin Rwegasira, Executive Director, AERC, Nairobi, Kenya
Welcome by: Mr. Daudi T.S. Ballali, Governor, Bank of Tanzania
Opening address: Hon. Daniel Yona, Minister of State, Vice-President's Office, Tanzania

AERC Executive Director Dr. Delphin Rwegasira chaired the opening session, which featured a welcome from Daudi T.S. Ballali, Governor of the Bank of Tanzania, and the formal opening address by Hon. Daniel Yona, Minister of State for Poverty Reduction in the Office of the Vice President of Tanzania.

Minister Yona stressed that how to manage the economy in order to reduce poverty was the most important issue facing Africa, and would largely determine whether Africa could reclaim its rightful place in the 21st century, in an increasingly globalized and competitive world. Sub-Saharan Africa's poverty indicators remain the highest in the world, and HIV/AIDS poses a major threat to future development in an increasing number of countries. In the 1960s and 1970s, Africa's policies undermined its own prospects, but in the 1980s and 1990s most countries embarked on reforms and attained macroeconomic stability. The world community has increasingly provided support, most recently by embracing debt cancellation under the Enhanced Highly Indebted Poor Country (HIPC) Initiative. As a result, the key issue is how to use the favourable domestic and international policy environment to reduce poverty and raise the standards of living of the people: the focus of this seminar.

> Stabilization is yesterday's agenda. It is time to focus on growth and poverty eradication – we can't leave everything to the market because capitalism works only if properly regulated.
>
> Daudi T.S. Ballali, Governor of the Bank of Tanzania

Poverty Diagnosis and Data

Chair: Prof. Terry Ryan, Former Economic Secretary, Government of Kenya
Presenter: Prof. Germano Mwabu, University of Nairobi, Kenya
Discussants: Ms. Cristina Matusse, Ministry of Planning and Finance, Mozambique
Dr. Benno Ndulu, World Bank, Tanzania

The first phase of the AERC project on "Poverty, Income Distribution and Labour Markets in Sub-Saharan Africa" was the subject of a paper presented by Professor Germano Mwabu, one of the coordinators of the project. Professor Mwabu reviewed the various dimensions of Africa's poverty, and the data required to assess trends. He focused on income poverty, with three fundamental conclusions:

- The percentage of the population that is poor remained broadly constant in Africa during the 1990s.
- However, the number of poor people increased by 34% owing to population growth.
- Nevertheless, the rate of impoverishment slowed dramatically later in the decade, with the annual growth rate dropping from 4% to 0.33%.

Professor Mwabu also pointed to the poor quality of data for poverty analysis in Africa. He said that inconsistent methodologies from poverty surveys and national accounts statistics made the data inconsistent and the analysis of the impact of growth on poverty problematic. He stressed the need to strengthen and harmonize national statistics systems and to focus more on collecting qualitative data on non-economic dimensions of poverty.

In the ensuing discussion participants focused on:

- The different ways of measuring income poverty in different countries. Participants cited the need to have a variety of methods for measuring and profiling poverty for different purposes: comprehensive living standards surveys for benchmark data; smaller-sample surveys to allow more frequent updating of data; and participatory and perception-based surveys of the poor and their attitudes towards government policy and services.
- The failure of many countries to include the informal economy in their analyses.
- The need to focus more on non-income characteristics of poverty, such as those of the United Nations Development Programme (UNDP), which focus on access to basic services or human needs, and the ability to use human capabilities to the full, and those of the World Bank, which focus on increasing the power, voice and security of the poor.
- How best to disaggregate surveys and use the resulting data (by gender, region, age, type of household, etc.) in order to target poverty reduction policies.

There is need for a variety of methods for measuring and profiling poverty for different purposes.

Macroeconomic Policies and Poverty Reduction

Chair: Mr. Peter Noni, Director of Economic Policy, Bank of Tanzania

Presenter: Dr. Ibrahim Elbadawi, World Bank, USA, for Prof. Ali Ali, Arab Planning Institute, Kuwait

Discussant: Dr. Gervase Maipose, Department of Political and Administrative Studies, University of Botswana

Dr. Ibrahim Elbadawi presented a paper by Professor Ali Ali surveying the results of studies that analyse the links between macroeconomic policies and poverty reduction. The paper also examined the feasibility of achieving the Millennium Development Goals (MDGs) in sub-Saharan Africa. Its main conclusions were:

- The studies have not looked in enough detail at all the transmission channels between macro policy and poverty through relative prices, the labour market, returns to assets and public transfers, and their wider socioeconomic impacts.
- Many model-based or econometric studies, trying to relate poverty levels to policy performance assessments or adjustment programmes, are too general and too sensitive to underlying assumptions to provide reliable policy lessons.
- Studies of the relationships between poverty and macroeconomic variables such as growth and inflation have produced highly conflicting results.
- If Africa is to attain the dramatically increased GDP growth rates needed to reach the MDGs, it must engineer a sustained increase in the investment rate, and establish durable and effective social safety nets.

> Too many studies analysing the links between macroeconomic policy and poverty have focused on income rather than other types of poverty.

The author cited his own preliminary findings that none of the key macroeconomic policy variables affect poverty reduction, implying that it is largely determined by per capita consumption and the Gini coefficient. He also noted conclusions by Ali and Elbadawi that

> It is important to be explicit about trade-offs between excessive stabilization and growth, in order to be clear about the impact of stabilization on poverty reduction.

growth-oriented policies must be complemented with distribution-sensitive policies if the poor are to benefit.

The subsequent discussion revolved around practical lessons for countries, notably the need to:

- Set feasible growth targets in poverty reduction programmes, and use poverty elasticities to calculate potential effects of growth.
- Disaggregate the analysis of the impact of adjustment policies on poverty reduction, to look at the impact of individual macroeconomic and structural policies through different transmission channels.
- Define “investment” carefully, especially whether public or private investment and the scale or quality of investment are more important to growth.
- Mobilize large increases in external and domestic savings to engineer a dramatic increase in investment, and whether this is feasible.
- Take international and national preventive measures to overcome the potential impact of external and domestic shocks on investment.
- Take account of the different causes and effects of inflation in different countries and move away from the standard monetary paradigm.
- Provide greater “fiscal flexibility” in adjustment programmes to allow countries to invest more in physical and human capital in the short term.

- Analyse in more detail whether countries should target exchange rate stability or flexibility to maximize their competitiveness and growth prospects.
- Identify the degree of trade and capital account liberalization that is most conducive to poverty reduction.
- Be more explicit about trade-offs between excessive stabilization and growth, in order to be clear about the impact of stabilization on poverty reduction.

Designing Pro-Poor Macro Policies in the PRSP Process

Chair: Prof. Mukwanason Hyuha, Makerere University, Kampala
Presenters: Prof. Joseph Semboja and Dr. Dirk Bol, REPOA, Dar es Salaam
Dr. Dominique Njinkeu, AERC, Nairobi
Discussants: Mr. Peter Gakunu, Ministry of Finance and Planning, Kenya
Mr. Thierno Seydou Niane, Ministère de l'Economie et des Finances, Senegal

Two presentations were made in this session. The first, a paper co-authored by Prof. Joseph Semboja and Dr. Dirk Bol and presented by Dr. Bol, detailed Tanzania's poverty reduction strategy paper (PRSP) process, which largely builds on earlier pro-poor orientations and processes of Tanzania's policy formulation. The process has included well-designed systems for monitoring poverty and the impact of public expenditure, and provoked greater public debate about macroeconomic policy. Growth remains modest, however, with the domestic private sector lagging behind foreign investment in mining and tourism. Rural development and agriculture in particular are problematic, posing major risks of not attaining ambitious poverty reduction targets. Excessive aid dependence with insufficient coordination behind the PRSP imposes a heavy burden on the public sector's management capacity. The national debate on pro-poor growth needs to be broadened to discuss distributional issues, taxation and credit policies, civil service reform, decentralization, and how to make government permanently accountable for policy.

The paper also suggested a wide range of questions for further research:

- The poverty effects of all macroeconomic policies, especially tax policies.
- Integrating different poverty models into the macroeconomic framework.
- Distributional and employment effects of various growth patterns.
- The desirable balance between state and market in agriculture.
- The balance between social sector spending needs and macro stability.
- How to reduce the vulnerability of the poor to external shocks.
- How to improve representation of the poor in policy making.

Tanzania's PRSP process provoked greater public debate about macroeconomic policy.

In the second presentation, Dr. Dominique Njinkeu examined a wide range of PRSPs across Africa and Latin America. He noted that there are many concerns about the failure of PRSPs to include the policies necessary to achieve pro-poor growth, or to analyse their potential consistency with the macroeconomic framework. It is therefore vital to focus on pro-poor policies that target the poor directly, with adequate indicators to capture impact and extensive reliance on non-market instruments.

Such pro-poor policies include pro-poor and efficient tax systems, well costed anti-poverty expenditure programmes, and savings and investment and financial/ monetary sector policies oriented to promoting access of the poor to financial intermediation. Others are agricultural policies that focus on value added, diversification to reduce vulnerability to shocks, and provision of infrastructure such as markets and roads; and programmes to reduce structural constraints to competitiveness and transactions costs for trade and investment.

The process of PRSP development needs to be rationalized, he said, reducing the number of donor-driven initiatives and building capacity to implement policy at the local, provincial and national levels, especially to negotiate the external financing, trade and investment that are beneficial for poverty reduction. In many countries this will require PRSP "think tanks" and the mainstreaming of emerging policy issues in university curricula and research programmes, in order to develop national capacity to undertake the necessary analytical work.

Capacity building efforts should focus on analysis and policy design rather than data gathering.

The discussion centred on four sets of issues:

- How to build institutional structures and capacity in government and civil society. There was consensus that capacity building efforts should focus on analysis and policy design rather than data gathering, and that most countries required a fresh look at processes in order to improve coordination and provide more time for forward planning rather than crisis management.
- How to further increase ownership and participation, especially through decentralization and deeper involvement of civil society in macroeconomic policy issues, without raising excessive expectations about the ability of government to respond to popular concerns.
- The need to provide more policy space for national consultations on pro-poor strategies by reducing and delaying donor and international financial institution (IFI) interventions in the formulation of PRSPs.
- Various policy questions that have been inadequately treated in PRSPs, including: the macroeconomic framework and pro-poor growth; agriculture and rural development; diversification and

technological improvements; cross-sector or cross-region linkages; environmental sustainability; employment and labour markets; long-term forecasts of how to reach the MDGs; and the effects of globalization and the risks of related shocks.

There is need to provide more policy space for national consultations on pro-poor strategies by reducing and delaying donor and international financial institution interventions in the formulation of PRSPs.

Health and Education Policies for Poverty Reduction

Chair: Dr. S.B. Likwelile, Director of Poverty Eradication, Tanzania
Presenters: Prof. Mwangi S. Kimenyi, KIPPRA, Nairobi
Dr. Rachel K. Gesami, AERC, Nairobi
Discussants: Mrs. Nomusa Tibane, Ministry of Economic Planning, Swaziland
Ms. Mahen Sumnar, Special Poverty Alleviation Coordination Office, The Gambia

Professor Mwangi Kimenyi and Dr. Rachel Gesami examined the options for pro-poor health and education policies. They pointed especially to the need for:

- Improving the access of the poor to services, through availability by ensuring sufficient facilities and wider scope of services, and affordability by providing services at a cost that the poorest can afford.
- Targeting services on the poor, through their geographical location, specific programmes to overcome individual problems (e.g., tuberculosis control programmes, pre-school education) and income transfers to reduce inequality of access.
- Efficient allocation of scarce budgetary and personnel resources, by focusing on the programmes with maximum poverty impact, reducing duplication in different programmes and testing new pilot programmes.
- Decentralizing the delivery of services to improve effectiveness and accountability to local populations.
- Community participation in the design of policies through advance consultation and through surveys of service quality.
- Greater focus on gender, women's health care and girls' education.
- Establishing priorities among the many competing necessary programmes.

Efficient allocation of scarce resources requires focusing on programmes with maximum poverty impact, reducing duplication in different programmes and testing new pilot programmes.

Participants then raised seven main sets of issues:

- The role of reducing or eliminating user fees in improving access to services.
- How to ensure sustainability and long-term maintenance of services once initial capital investments have been made.
- Concentrating on quality and appropriate technology of services through user questionnaires and independent evaluations as well as quantity of spending.
- Exploring different delivery methods, such as decentralization, traditional medicine and Koranic education, and the roles of public and private sectors.
- The need to look beyond a gender focus to explore all of the different vulnerable groups (children, elderly, etc.) and how to target them.
- Specific themes that require more emphasis in PRSPs, including nutrition/food security, HIV/AIDS, family planning and reproductive health, preschool education, school feeding programmes, adult literacy, vocational and secondary education, and the role of safe water in health promotion.
- Examining these sectors for their interlinkages and links with other sectors.

PRSPs need greater emphasis on nutrition/food security, HIV/AIDS, family planning and reproductive health, education, school feeding programmes, and safe water.

Designing and Implementing Anti-Poverty Budgets

Chair: Prof. Allechi M'Bet, Chief Economic Advisor, Côte d'Ivoire
Presenters: Prof. Akpan H. Ekpo, University of Uyo, Nigeria
Dr. Ernest Bamou, University of Yaounde, Cameroon
Discussant: Mrs. Neo Gaetsewe, Ministry of Finance and Development Planning, Botswana

Professor Akpan Ekpo and Dr. Ernest Bamou presented two papers, a joint one on anti-poverty spending design and one by Professor Ekpo on pro-poor tax policies. The first paper stressed the political nature of the budget process, which can overrule technical advice, and the need to eliminate the investment–recurrent expenditure distinction and move to programme budgeting, allocating funds by pro-poor objectives. The paper also looked at the introduction of medium-term expenditure frameworks (MTEFs), which have many advantages in principle but need to be reinforced by more stable donor resources, greater integration with poverty reduction objectives, and reinforced government capacity for tracking and evaluation of spending.

The paper cited the need for:

- Going beyond social services and infrastructure in the design of anti-poverty spending to include expenditures on governance (decentralization, budget management, judiciary, security), and ensuring that all spending is fully costed.
- Tracking all budgetary expenditure for its impact on poverty reduction, rather than creating separate accounts and funds for "anti-poverty" spending.
- Ensuring maximum and earliest possible popular participation of the poor in defining budget priorities, to balance excessive interventions of interest groups and the donor community.

> The political nature of the budget process can overrule technical advice.

The paper also highlighted the key areas for research as being how to:

- Move to programme budgets and MTEFs successfully.
- Analyse the poverty reduction impact of all budget spending.
- Enhance popular participation to make decentralized budget monitoring the norm, and overcome distortion of the budget process by interest groups.
- Examine country-specific circumstances to test the scope for increasing expenditure without provoking inflation or crowding out private investment.

The second paper provided an analysis of the need to balance equity, incentive and efficiency motives in formulating tax policy. After discussing the theory of possible trade-offs among these objectives, Professor Ekpo showed that the emphasis in African tax reforms has been on efficiency rather than equity. Objectives of tax policy have not been clearly defined, with many measures introduced to overcome budget imbalance, attract foreign investment or discourage certain types of consumption, and little consideration for their effects on poverty reduction. Further research is therefore urgently needed on the preferences of African citizens as to tax policies and their distributional effects, the risks of less equity from increasing indirect taxes, and the negative effects of user charges on access to basic services. Other studies should look at the utility of tax incentives and exemptions in promoting domestic and foreign investment, the effect of tax policies in rural/urban, gender or regional inequality, and the desirability of decentralization in tax collection and revenue allocation.

The seminar participants then identified four key sets of policies in pro-poor budgeting:

- Pro-poor expenditure design through budgeting by programme and objective, with identified and costed expenditure in the framework of an MTEF, which is then executed and tracked through a process of decentralization and participatory evaluation.
- Pro-poor revenue policies that ensure equity among income groups and other groups (gender, rural/urban, regional), minimize the trade-offs between equity and economic efficiency, and make sure that all types of individual taxes (espe-

cially user charges for basic services and tax exemptions given to investors) are evaluated for their effects on poverty reduction.
- Analysis of the combined incidence and behavioural effects of expenditure and tax on poverty and utilization of public services by the poor.
- Policies to mobilize donor funding to support poverty reduction strategies – notably how to overcome instability or shortfalls in donor funding, maximize the quality and value for money of aid, and ensure aid flows via the budget.

African tax reforms have emphasized efficiency rather than equity.

Balancing and Targeting Poverty Reduction Spending

Chair: Mr. Peter Gakunu , Ministry of Finance and Planning, Kenya
Presenter: Dr. Bernadette Kamgnia, University of Yaounde II, Cameroon
Discussant: Mr. Ermiyas Tenkir, Ministry of Economic Development and Cooperation, Ethiopia

Dr. Bernadette Kamgnia presented the different methods that can be used to balance and target poverty reduction spending among different groups of the poor – individual, geographic, indicator-based or self-targeting. Her paper discussed the strong generic evidence for targeting three types of imbalances (gender, urban/rural, regional), as well as the policies needed to combat their determinants, especially social protection and insurance. These include:
- Labour-intensive employment support through public works.
- Micro-finance and micro-credit to provide financial capital for the groups.
- Social funds to finance community development projects.
- Cash transfers such as social assistance, child support and fee waivers.
- Transfers in kind such as food, energy and provision of housing.

Targeting poverty reduction spending through social protection schemes and programmes is inevitably an inaccurate science.

The paper cautioned, however, that countries will need to identify for themselves the key vulnerable groups and determinants of their poverty before designing policies to target them. Finally, targeting poverty reduction spending through social protection schemes and programmes is inevitably an inaccurate science, producing leakages of spending to the non-target population, and therefore needs to be evaluated continually through combined behavioural and incidence analysis of the impact of spending, and refined in order to ensure that delivery is optimal. Much more research is needed than is reflected in most current PRSPs on the nature of key vulnerable groups in African economies, the determinants of their poverty and how to target them through policy measures.

The discussion added several crucial elements to the analysis:

- The need for comprehensive poverty profiles and participatory poverty assessments as a basis for understanding the determinants of poverty and identifying potential target groups.
- How to judge the relative priority of targeting by geographical region, by indicator of poverty and by type of poverty-vulnerable group.
- The complexity of vulnerable groups, which could include classifications by age – children or the elderly – or female/child-headed households, orphans, street children, prostitutes, drug-users.
- Taking into account gender, ethnic and religious discrimination as determinants of poverty and designing policies to combat them.
- The relative roles of public and private provision of safety nets and welfare.

> Much more research is needed than is reflected in most current PRSPs on the nature of key vulnerable groups in African economies, the determinants of their poverty and how to target them through policy measures.

Real Sector and Structural Policies for Poverty Reduction

Chair: Dr. William Lyakurwa, AERC, Nairobi
Presenter: Dr. Abena Oduro, University of Ghana, Ghana
Discussants: Mr. Theo Kiruopeto, Ministry of Finance and Economic Planning, Rwanda
Mr. M. Gaomab, Bank of Namibia, Namibia

Dr. Abena Oduro focused above all on agriculture, indicating that to reduce poverty the priorities should be:

- Increasing production and productivity through strengthened extension services, investment in research, information flows and coordination among all actors, the encouragement of farmer groupings for participation, micro finance, health and education attuned to the needs of the poor, and land reform.
- Increasing the incomes of the rural poor through greater participation in the market, by making farming more profitable, reducing risks of food insecurity, and reducing transaction costs by improving transport and market infrastructure and information flows.

Both of these elements will require an increase in agricultural spending, based on careful analysis of the major barriers to production and commercialization.

Pro-poor industrial policies need to target diversification into rural non-farm activities (based in turn on agricultural growth), through credit, skills training, information on market opportunities and the formation of industry-based groups. Urban industrial policy centres on creating employment opportunities through technical advances in clusters of small-scale industries. These will require infrastructure and network brokers, as well as micro finance and technical/vocational training. The key target groups in the service sector need to be the small trader, who requires credit and market information, and small-scale tourism, by encouraging links to larger projects.

The paper also dealt with cross cutting issues such as whether it is possible to privatize and regulate industries and services in a pro-poor manner, and the need to target the poor carefully in all interventions. It ended with proposals for future research centred on rural non-farm income generation, agricultural liberalization and privatization, and participation of the poor through decentralization.

> Pro-poor industrial policies need to target diversification into rural non-farm activities.

A rich discussion revolved mostly around rural development issues, with participants stressing the need to build policies on a foundation of food security, on which the producers' ability to diversify into other crops and commercialize produce depends. They also highlighted the positive effects of empowering farmers through land reform and tenure policies and through farmer groupings. Water and energy were cited as key service sectors with a major impact on poverty and where more research was needed on pro-poor policies. Some participants mentioned the potential positive role of foreign direct investment (FDI) in reducing poverty in some of these sectors, if it was designed with the aim of being labour-intensive or increasing the access of the poor to services. Finally, it was acknowledged that all sectors were interlinked and somewhat dependent on one another and therefore no sector-specific policies should be allowed to lag behind others.

Financial Sector Reform Policies for Poverty Reduction

Chair:	Dr. Gray Mgonja, Ministry of Finance, Dar es Salaam
Presenter:	Dr. Nii Sowa, Centre for Economic Policy Analysis (CEPA), Ghana
Discussants:	Ms. Mahen Sumnar, SPACO, Gambia Mr. Saidou Djibo, Ministry of Finance, Niger

Dr. Nii Sowa's presentation dealt with key policy issues related to the financial sector's role in poverty reduction. He noted that several studies have confirmed that the poor can and do save. Drawing on experiences in Ghana and elsewhere, he said the poor need and demand financial services, but the formal sector rejects them and so they seek services from the informal sector, including deposit collectors,

> If we use the generally accepted income definition of the poor as those with little or no money, one then wonders what kind of financial services they will demand. Can those with little or no money save or invest?

moneylenders, and rotating savings and credit associations. Even in the informal sector, however, access to credit is severely limited for small farmers, tenants and entrepreneurs – and in particular women. Micro finance programmes have been more successful in reaching the moderately poor than the extremely poor.

While financial sector reform has helped stabilize economies, Dr. Sowa pointed out that most researchers agree that stabilization – though necessary – is not likely to lead to poverty reduction. But financial sector reform can directly lead to poverty reduction if it causes restructuring of the financial system in a way that makes credit available to the poor and therefore improves their welfare. Targeted programmes and services are required, and understanding the financial service behaviour and preferences of the poor can be a good guide to product design and development. Policies and programmes that target the poorest of the poor under micro-finance institutions must market financial products suitable for this category of people and reduce the entry barriers they face.

Even so, credit alone may not be enough to help poverty reduction. Other financial and non-financial services that may be needed include insurance and pension schemes for the poor, but these must be provided in partnership with the formal sector and government must create a favourable legal framework for their operation.

A number of observations were made. More emphasis needs to be given to micro-finance systems, including appropriate legislation, and it is necessary to ensure that the system is not bureaucratic, a problem that may dwarf the whole effort. Legislation is necessary to ensure that the system remains dynamic and that the poor do not risk their hard earned savings. Micro-credit services should be brought near to the needy so that they can access services more readily. Steps should also be taken to find appropriate mechanisms for drawing in the informal sector, including by enabling linkages between formal and informal institutions.

Participants then discussed the following sets of issues:

- The effects of financial sector reforms on poverty.
- Why it was so difficult for the poor to access a high-cost banking system.
- The need to diversify into non-bank financial institutions and capital markets, which would promote investment, growth and poverty reduction.
- The savings and investment behaviour and needs of the poor and of small-scale enterprises.
- Best practices in micro-finance schemes, based on the perspectives of their customers – the poor and small enterprises.
- Lessons from the informal and semi-formal sectors that could be applied in the formal sector.

- The complexities of monitoring, legislating for and regulating the financial sector.
- That monetary policy – unlike fiscal policy – by its nature is not useful for addressing issues of income distribution and poverty.
- That the structural adjustment programmes and financial reforms had minimal impact on poverty reduction.

Finally, there was general agreement that the financial sector was only a service sector and its ability to reduce poverty would depend on real sector policies and the capacity of the poor to absorb funds and invest them well.

Most developing economies are characterized by dual financial systems running parallel:
- Monetized and non monetized
- Formal and informal systems

The poor are usually found within the non-monetized informal systems.

Forecasting and Modelling Poverty Reduction

Chair: Prof. Augustin Fosu, AERC, Nairobi
Presenter: Dr. Babakar Fall, Senegal
Discussant: Dr. Njuguna Ndung'u, IDRC, Nairobi

Babakar Fall presented a survey of the different models and tools available to policy makers for forecasting and modelling, and of their utility to policy makers based on the experience of the Senegalese government. He first outlined the indicators of poverty and their determinants, and possible ways to integrate them into the framework of macroeconomic policies. His main findings were:

- Traditional economic models used in programming by the Bretton Woods institutions pay very little attention to poverty reduction.
- Many recent attempts to build models have extended these, and are therefore of limited use for analysing a few policies because they track only a few of the determinants of poverty and are also based on simplifying assumptions that may not apply in Africa.
- Social accounting matrixes and CGE models offer better routes for analysis and have been successfully used as tools for policy analysis by many countries. They have onerous data requirements, however, and in some countries may prove to be institutionally unsustainable.
- Almost all existing models measure only the income indicator of poverty. As a result, many countries are using a

combination of different models, as well as simpler tools that allow them to test the impact of individual policies, or to forecast the potential impact of public spending and other government policies on non-income poverty indicators.

- African governments require capacity building assistance in the adaptation and use of different tools, but also need to decide up front which ones are useful, based on criteria such as credibility with the Bretton Woods institutions, data needs, coherence with the macro framework, appropriateness/adaptability to country circumstances and whether they cover non-income poverty.

Traditional economic models used in programming by the Bretton Woods institutions pay very little attention to poverty reduction.

The discussion concentrated on institutional issues in forecasting and modelling and how to ensure that any model would be sustainable and used for policy formulation, rather than just producing interesting research results. Participants stressed that coordination among different government departments and civil society was essential to avoid a multiplicity of models producing results that other actors did not find credible. They also underlined the need for different types of models to analyse short-term (adjustment and crisis management), medium-term (overall policy frameworks especially for the budget) and long-term (how to reach the Millennium Development Goals) environments. These should

There is an inevitable tension between adapting models to national circumstances, and losing credibility with an international community that is accustomed to standardized models.

ideally be developed from the bottom up, with determinants of poverty being identified by the poor themselves, and countries should all benefit from and adapt a choice of comprehensive macroeconomic and sector- and policy-specific tools. Finally, there is an inevitable tension between adapting models to national circumstances, and losing credibility with an international community that is accustomed to standardized models. This can be overcome only by extensive transparent discussions with international institutions, policy makers and civil society.

Key Issues for Further Analysis and Research

Chair: Dr. Delphin Rwegasira, AERC, Nairobi, Kenya

Closing response: Prof. Augustin Fosu, AERC, Nairobi, Kenya

Following the plenary discussions, participants met in working groups to agree on major issues requiring additional analysis and research. They agreed that almost all areas discussed in the seminar needed more research, given the underdeveloped state of research into poverty reduction in Africa, and the need for continuous refinement of poverty reduction policies in African countries to cope with new circumstances.

From the discussions during the seminar and the presentations by the working groups to the final plenary session, the key emerging research issues are poverty measurement, macroeconomic policy, the PRSP process, health and education, pro-poor budgeting, balancing and targeting of poverty policies, real sector policies, financial sector reforms, and modelling and forecasting. The group also came up with suggestions for the way forward for the links between research and policy.

Poverty Measurement

Participants felt that in general, too much focus has been placed on data gathering and monitoring rather than policy analysis. Nevertheless, a few issues remain for studies that could look at best practices in monitoring poverty in the following areas:

- How to include the informal economy in measurements of income poverty
- How best to measure inequality and its determinants
- How to quantify analysis of non-income poverty, especially powerlessness, voicelessness, insecurity and development of human capabilities.
- How to combine conclusions of "perceptions by the poor" and data-based methods.
- How to monitor frequently enough (e.g., quarterly) for policy making, with a sufficient sample size, but taking into account monitoring capacity constraints.
- How to disaggregate monitoring by region and gender to help target support.

> Future analysis should focus on the feasibility of attaining the Millennium Development Goals and the resulting financing needs.

Macroeconomic Policy, Growth and Poverty Reduction

- ***Growth–poverty reduction links:*** Basic techniques of analysis of the links between growth and poverty reduction (e.g., poverty-growth elasticities and the potential poverty effects of adjustment policies) were said to be well treated in existing studies. Therefore future work should focus on the feasibility of attaining the Millennium Development Goals and the resulting financing needs, the effects of shocks on growth and poverty reduction (and how they can best be prevented), and the best methods of domestic and external financing of poverty reduction.

- ***Macroeconomic policies:*** The central concern here was about how to reorient macroeconomic policies to maximize growth, employment and poverty reduction, especially for those countries that could be considered to be "post-stabilization". This would involve researching some of the major linkages in stabilization policy – inflation causes and effects, effectiveness of monetary policy, room for fiscal flexibility, and the potential positive and negative effects of flexible exchange rates, opening of external accounts and related shocks – in order to identify key areas for greater focus on growth.

PRSP Process

Participants favoured a comparative study looking at lessons from many countries on best institutional structures to develop PRSPs. This would examine how best to streamline processes while at the same time maximizing popular ownership and participation, fulfilling popular expectations of PRSPs, and limiting donor/IFI intervention to only the most appropriate issues and timing. It would also identify the capacity building needs of government and civil society to improve the quality of debate.

In terms of PRSP content, participants felt many areas had been insufficiently treated in interim PRSPs (and some full PRSPs) and needed more analysis, especially:

- The macroeconomic framework and pro-poor growth.
- Agriculture, rural development and diversification.
- Employment and labour markets.
- The relative roles of state and market in poverty reduction.
- The risks of "shocks" and efforts to protect against them.

> Lessons from the PRSP process would suggest ways of maximizing popular ownership and participation, fulfilling popular expectations of PRSPs, and limiting donor/IFI intervention to only the most appropriate issues and timing.

Health and Education

The most critical areas for further study here were:

- The factors impeding use of health and education services, including physical distance, affordability and other socio-cultural factors that reduced demand.
- The long-term sustainability of services and the relative stress on investment and recurrent expenditures and on increasing the efficiency of expenditure.
- The "appropriateness of the technology" of the services, especially the relative impact of different levels of education and health services on poverty reduction. For example, on education, the impact of secondary, vocational and professional education; and on health, preventive versus curative health services.
- Analysis of delivery needs to focus on best practice in decentralization and popular participation, and decentralized technical and managerial needs.
- Sub-sector issues were also highlighted, notably nutrition and food security policies, the design of programmes against pandemics such as malaria, tuberculosis and HIV/AIDS, preschool education programmes, and adult literacy programmes.

Pro-Poor Budget Design and Implementation

Issues in this category related to revenue mobilization and expenditure allocatation:

- ***Revenue:*** Here the top priority for the policy makers was how to mobilize domestic budget revenue in ways that minimize the tax burden on the poor and maximize equity across income groups, genders and regions. Much more detailed studies are needed of the incidence and effects of specific taxes such as indirect taxes and user charges on the poor, as well as re-examinations of the priority and effects of tax cuts for wealthier members of society such as foreign investors and donors. It would also be useful to study the combined incidence of expenditure and tax policies on poverty and inequality. Another area for analysis is donor funding of budgets – especially best practice in overcoming instability or shortfalls in aid and how to line up donors behind PRSPs.

- ***Expenditure:*** While some countries are relatively advanced in designing anti-poverty expenditure programmes, with programme budgeting/budgeting by objective, medium-term expenditure frameworks and fully costed expenditures, for others, studies of best practice in anti-poverty budgets would be valuable. All agreed that the execution and tracking of expenditures through decentralization and participation were under-analysed – the core issue being how to empower the poor in the process.

> The top priority for the policy makers was how to mobilize domestic budget revenue in ways that minimize the tax burden on the poor and maximize equity across income groups, genders and regions.

Balancing and Targeting Anti-Poverty Policies

The focus of further work in this area should be on designing better indicators and policies for geographical targeting to overcome urban/rural and regional imbalances, and on improving welfare protection and safety nets for vulnerable groups such as children, the elderly, female/child-headed households, orphans, and street children.

> The key cross-cutting concern is how to ensure a legal and regulatory framework that empowers the poor by enforcing their property rights and rights to basic needs and labour protection.

Real Sector/Structural Policies for Poverty Reduction

Agriculture, rural incomes and related cross-cutting themes anchored the recommendations in this broad area:

- ***Agricultural policies:*** These were the top priority for all participants, with particular stress on how to:
  - Increase production and productivity (extension, research, technology)
  - Increase product commercialization (infrastructure, information)
  - Empower farmers – through group structures and land reform policies
  - Assure food security through food stocks and ways to combat climate shocks

  However, the most important area of all was thought to be how to diversify rural incomes through non-farm activities, including agro-industry.

- ***Other sectors and cross-cutting issues:*** Additional worthwhile research topics were the urban industrial sector – especially its promotion through clusters, legal changes, labour skills and infrastructure; and the most effective ways to provide basic infrastructure such as rural roads/transport, water, energy and communications. Underlying all of these was a key cross-cutting concern: how to ensure a legal and regulatory framework that empowers the poor by enforcing their property rights and rights to basic needs and labour protection.

Financial Sector Reforms for Poverty Reduction

Here policy makers wanted to look at best practices in institutions that reach the poor directly and provide them with a framework for savings and investment. As a result, the most important area for research was on best practice in the legislation, regulation and monitoring of micro-finance and informal/semi-formal sector institutions in order to maximize competition, reduce interest rates and widen the access of the poor to finance. All such research should start from a focus on the savings and investment behaviour and needs of the poor, notably those involved in micro enterprises, and their capacity to absorb/invest funds (and government's role in training them to design and manage financeable projects).

Modelling and Forecasting

Policy makers felt that AERC and its research network could play a valuable role in helping them to choose among and implement existing models, on the basis of their data needs, institutional location, credibility with IFIs/policy makers/civil society, adaptation to national circumstances and priorities, time horizon, and integration of non-income measures of poverty. In the longer term, the Consortium could also help with bottom-up development or adaptation of tools relevant to country circumstances, and with training in and the institutionalization of such tools in government and with civil society institutions.

Ways Forward for Policy Maker – Researcher Cooperation

Policy makers and researchers reaffirmed their views from earlier Senior Policy Seminars that they can cooperate relatively easily in almost all sub-Saharan countries, overcoming issues of mutual trust, data confidentiality and different working methodologies.

They urged AERC to identify a few priority areas from the list above that could be targeted for multi-country studies by joint teams of policy makers and researchers, possibly in cooperation with other regional organizations, and disseminated through as many forums as possible, including a future Senior Policy Seminar.

They also reiterated their past requests for AERC to be more proactive in exchanging information on policy research, by:

- Creating a network of policy makers and researchers.
- Disseminating its own and other independent research findings on policy priorities to target groups through electronic executive summaries/abstracts.
- Feeding these results through published policy briefs into executive forums, retreats and international meetings so as to reach decision makers.
- Continuing the extension of its outreach to francophone policy makers, and focusing more on Portuguese-speaking African countries in future.

In response, the AERC Research Director, Professor Augustin Fosu, underlined AERC's commitment to feed the conclusions of the seminar back to its wide network of researchers, and to encourage them to pursue research that would help African governments to design policies for eradicating poverty in the continent. As an immediate step, he said the conclusions and recommendations of the Seminar would be presented in a special session of the Biannual Research Workshop to be held in Nairobi in late May 2002.

Noting further synergies between the Seminar and other AERC efforts related to poverty reduction, Prof. Fosu called attention to the Consortium's "Poverty Project" – a comprehensive thematic research effort that focuses on Poverty, Income Distribution and Labour Market Issues. The first phase of this project has created poverty teams in a dozen countries in sub-Saharan Africa, many of whom have been involved directly or indirectly in the preparation of the poverty reduction strategy papers in their respective countries. In addition, AERC's capacity building efforts have contributed directly to the potential of other researchers and policy makers to take part in economic management in many African countries.

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Annex 2 – List of Papers Presented

Poverty in Sub-Saharan Africa, *by Prof. Germano Mwabu, University of Nairobi (based on AERC project on Poverty, Income Distribution and Labour Markets)*

Macroeconomic Policies and Poverty Reduction, *by Prof. Ali Ali, Arab Planning Institute, Kuwait, and Dr. Ibrahim Elbadawi, the World Bank, Washington, D.C.*

Designing Pro-Poor Macroeconomic Policies in the PRSP, *by Prof. Joseph Semboja and Dr. Dirk Bol, Research on Poverty Alleviation (REPOA), Dar es Salaam, and Dr. Dominique Njinkeu, AERC*

Health and Education Policies for Poverty Reduction, *by Prof. Mwangi S. Kimenyi, Kenya Institute of Public Policy Research and Analysis (KIPPRA), Nairobi, and Dr. Rachel K. Gesami, AERC*

Designing and Implementing Anti-Poverty Budgets, *by Prof. Akpan H. Ekpo, University of Uyo, Nigeria, and Dr. Ernest Bamou, Ministry of Finance, Cameroon*

Balancing and Targeting Poverty Reduction Spending Policies, *by Prof. Bernadette Kamgnia, University of Yaounde II, Cameroon*

Real Sector and Structural Policies for Poverty Reduction, *by Dr. Abena Oduro, University of Ghana*

Financial Sector Reform Policies for Poverty Reduction, *by Dr. Nii Sowa, Centre for Economic Policy Analysis, Ghana*

Forecasting and Modelling Poverty Reduction, *by Babakar Fall, Deputy Director of Forecasting, Ministry of Finance and Economic Planning, Senegal*

Annex 3 – Seminar Programme

Fifth AERC Senior Policy Seminar
Poverty Reduction and Macroeconomic Management
Dar es Salaam, Tanzania, 12–14 February 2002

DAY 1 – 12 FEBRUARY

08h30– 09h30 Registration

09h30–10h30 **Session 1: Opening Session**
Chair/Moderator: Dr. Delphin Rwegasira, Executive Director, AERC, Nairobi, Kenya
Welcome: Mr. Daudi T.S. Ballali, Governor, Bank of Tanzania
Opening address: Hon. Daniel Yona, Minister of State, Vice-President's Office, Tanzania

10h30–11h00 TEA/COFFEE BREAK

11h00–11h15 Objectives and Structure of Seminar, by Dr. Matthew Martin, Debt Relief International, UK

11h15–12h45 **Session 2: Macroeconomic Policies and Poverty Reduction**
Chair: Mr. Peter Noni, Director of Economic Policy, Bank of Tanzania
Presenter: Prof. Ali Ali, Arab Planning Institute, Kuwait/Dr. Ibrahim Elbadawi, the World Bank, USA
Discussant: Dr. Gervase Maipose, Dept. of Political and Administrative Studies, University of Botswana

12h45–14h00 BUFFET LUNCH

14h00–15h30 **Session 3: Poverty, Income Distribution and Labour Markets in Sub-Saharan Africa**
Chair: Prof. Terry Ryan, Former Economic Secretary, Government of Kenya
Presenter: Prof. Germano Mwabu, University of Nairobi, Kenya
Discussants: Ms. Cristina Matusse, Ministry of Planning and Finance, Mozambique
Dr. Benno Ndulu, World Bank, Tanzania

15h30–16h00 TEA/COFFEE BREAK

16h00–17h30 **Session 4: Designing Pro-Poor Macroeconomic Policies in the PRSP Process**
Chair: Prof. Mukwanason Hyuha, Makerere University, Kampala
Presenters: Prof. Joseph Semboja and Dr. Dirk Bol, REPOA, Dar es Salaam
Dr. Dominique Njinkeu, AERC, Nairobi
Discussants: Mr. Peter Gakunu, Ministry of Finance and Planning, Kenya
Mr. Thierno Seydou Niane, Min. de l'Econ. et des Fin., Senegal

19h00 Cocktail/Reception

DAY 2: 13 FEBRUARY

09h00–10h30 **Session 5: Health and Education Policies for Poverty Reduction**
Chair: Dr. S. B. Likwelile, Director of Poverty Eradication, Tanzania
Presenters: Prof. Mwangi S. Kimenyi, KIPPRA, Nairobi
Dr. Rachel K. Gesami, AERC, Nairobi
Discussants: Mrs. Nomusa Tibane, Ministry of Economic Planning, Swaziland
Ms. Mahen Sumnar, SPACO, Gambia

10h30–11h00 TEA/COFFEE BREAK

11h00–12h30 **Session 6: Budget Design and Implementation**
Chair: Prof. Allechi M'Bet, Chief, Economic Advisor, Côte d'Ivoire
Presenters: Prof. Akpan H. Ekpo, University of Uyo, Nigeria
Dr. Ernest Bamou, University of Yaounde, Cameroon
Discussant: Mrs. Neo Gaetsewe, Ministry of Finance and Development Planning, Botswana

12h30–14h30 BUFFET LUNCH
Speaker: Dr. Shanta Devarajan, World Bank, USA
Topic: Macroeconomic Policy when Poverty Reduction is the Objective

14h30–16h00 **Session 7: Balancing and Targeting Poverty Reduction Spending Policies**
Chair: Mr. Peter Gakunu , Ministry of Finance and Planning, Kenya
Presenter: Prof. Bernadette Kamgnia, University of Yaounde II, Cameroon
Discussants: Mr. Ermiyas Tenkir, Ministry of Economic Development and Cooperation, Ethiopia

16h00–16h30 TEA/COFFEE BREAK

16h30–18h00 **Session 8: Real Sector and Structural Reform Policies and Poverty Reduction**
Chair: Dr. William Lyakurwa, AERC, Nairobi
Presenter: Dr. Abena Oduro, University of Ghana, Ghana
Discussants: Mr. Theo Kiruopeto, Ministry of Finance and Economic Planning, Rwanda
Mr. M. Gaomab, Bank of Namibia, Namibia

DAY 3: 14 FEBRUARY

09h00–10h30	**Session 9:**	**Financial Sector Reform Policies and Poverty Reduction**
	Chair:	Dr. Gray Mgonja, Ministry of Finance, Dar es Salaam
	Presenter:	Dr. Nii Sowa, CEPA, Ghana
	Discussants:	Ms. Mahen Sumnar, SPACO, Gambia
		Mr. Saidou Djibo, Ministry of Finance, Niger
10h30–11h00	TEA/COFFEE BREAK	
11h00–12h30	**Session 10:**	**Forecasting and Modelling**
	Chair:	Prof. Augustin Fosu, AERC, Nairobi
	Presenter:	Dr. Babakar Fall, Senegal
	Discussants:	Dr. Njuguna Ndung'u, IDRC, Nairobi
12h30–14h00	BUFFET LUNCH	
14h00–15h30	**Session 11:**	**Working groups**
	Introduction by Dr. Matthew Martin	
	Identification of Key Issues and Methods for Future Policy-Oriented Research	
	Role of Future Senior Policy Seminars	
15h30–16h00	TEA/COFFEE BREAK	
16h00–7h30	**Session 12:**	**Plenary Presentation of Working Group Findings and Discussion on Priorities for Follow-up**
	Chair:	Dr. Delphin Rwegasira, AERC, Nairobi, Kenya
17h30	Closing	
	Response:	Prof. Augustin Fosu, AERC, Nairobi, Kenya
19h30	Closing Dinner	

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