

Pro-Poor Economic Growth Research Studies

Proceedings: Discussion Session II

July 1, 2003, 9:00 – 4:30 pm
The Willard Hotel

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PRO-POOR DISCUSSION SESSION II AGENDA

9:00 Welcome and Introduction: Tim Mahoney (EGAT/PR), Emmy Simmons (EGAT/AA), and Al Berry (BIDE/University of Toronto).

THEME 1: Lessons from Country Studies

9:20 Lessons from Asian Countries (Indonesia and Sri Lanka with comparison to Egypt's experience)

Presenter: Gus Papanek (BIDE)

Commentator: Bob Aten (ANE/SPO)

10:15 Coffee

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15:10 Coffee

15:20 Finance

Presenter: Al Berry (BIDE/University of Toronto)

Commentator: Kate McKee (EGAT/PR/MD)

16:05 Closing: Al Berry, Gus Papanek, and James Elliott (EGAT/EG).

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PRO-POOR DISCUSSION SESSION II PROCEEDINGS AND NOTES¹

9:00 Welcome and Introduction: Tim Mahoney (EGAT/PR), Emmy Simmons (EGAT/AA), and Al Berry (BIDE/University of Toronto).

Emmy Simmons

A pro-poor growth focus is important because it is new for the agency. Many at USAID think that USAID is amazingly silent about commitment to reduce poverty. By setting up this Office as one of two offices – two leaves of a book – we’ll be able to sharpen expectations of what we can achieve both with economic development writ large and with microenterprise development which is explicitly expected to reduce poverty. An explicit discussion of poverty reduction is long overdue in the Agency.

This kind of discussion has one foot in analytics and one in practice. This is an important contribution to our bureau in that it represents the best of theory/analytics and best of country cases. Where do the case studies get us? Are they just nice stories? We should go one step beyond that. We need to extract from empirical reality what it is we know about pro-poor growth. Do these stories have pre-destined or predictable ends? Can they be rewritten en route? All of us in development believe the latter. What is important about each individual case study and what does it tell us about our overall approach and how we intervene in other countries?

Al Berry

One of our great challenges is the combination of theory and research with the practical issues of policy implementation. Today we’ll present lessons from the country studies from three different regions and this afternoon we’ll focus on sector studies. One of the unpredicted benefits of the structure of this project is that some things you learn better in country study and others in sector context. One of the distinctions we’ve been continuously drawing in policy recommendations is between the “yes’s” and the “no’s.” We are coming up with quite a few no’s.

This morning we’ll have Gus Papanek on Asia – Indonesia and Sri Lanka with some comparison to Egypt. Later we’ll look at South America, and Africa.

THEME 1: Lessons from Country Studies

9:20 Lessons from Asian Countries (Indonesia and Sri Lanka with comparison to Egypt's experience)

Presenter: Gus Papanek (BIDE)

Commentator: Bob Aten (ANE/SPO)

Gus Papanek

Egypt is included in this presentation because it is more like Asian countries than African. All three changed radically to market-oriented outward looking growth oriented strategy. As one

¹ Any errors in these proceedings are the responsibility of the DAI note-takers – these notes were taken by hand, that is without recording devices.

would have expected, those radical reforms resulted in a higher rate of growth. They did in two of countries, but not in the third. [Discussion of charts and tables in Program.]

The three stories here show us that the relationship between economic strategy and the rate of growth is much more complex than some are inclined to assume. The first assumption is that getting prices right leads to economic growth. But country studies have shown that there is substantial variations in terms of economic strategy and growth rates in three countries.

The second assumption is that higher rates of growth are always beneficial for the poor. The most dramatic is the Sri Lanka story, where there is a clear divergence between the rate of growth and the rate of growth of income of poor. By 2002, the income of the poor had increased to 150% of where it was in 1970 while income per capita had risen 200%. The income of the wealthy had increased 3 fold and that of poor 1.5 times. In Egypt, there are only 3 observations – income distribution improved, but after the opening of 1991. In Indonesia, beginning in late 1960s, there was a high correlation between the income of poor and rate of growth of average income. The story is less clear cut since the crisis, but quite consistent. During the worst of the crisis the poor suffered most, but since recovery they have done relatively well.

The story is not quite clear cut. On the whole it supports the notion that a higher rate of growth is good for the poor. Factors which play a role whether or not a high rate of growth was achieved and impact on poor are composition of growth and labor intensity. The way that growth creates income for poor is through employment. So growth must be labor intensive. One of the factors that matters is how rapidly agriculture and construction grow. Conversely, if growth is in petroleum, timber felling, or other capital-intensive activities, benefits to poor can be negligible.

The poor are greatly affected by the rate of inflation. Earlier regression analysis shows it takes about 18 months to 2 years for nominal wages to catch up with inflation.

The averages that we are using hide huge regional disparities. Even in small homogeneous country like Sri Lanka there are great regional disparities. If we had regional disaggregation we could get a clearer picture.

Migration and remittances in both Egypt and Sri Lanka are a huge factor. About one million Sri Lankans working in the region pushes up wages in the region and country and when people come flooding back, wages drop.

Government welfare expenditures matter. In Sri Lanka food subsidies reached as much as 5% of GDP for substantial periods of time in the late 70s. Now, it is less than one percent, which has negatively impacted the well being of the poor.

Three unanswered questions:

- 1) Sri Lanka: Why did the poor not benefit proportionally from higher rate of growth? Why, for a few periods, did they benefit more than proportionately?
- 2) Egypt: Why did growth not accelerate with reforms and what has been the consequence for the poor?
- 3) Indonesia: What has happened to the poor since the crisis? There is conflicting evidence.

Discussant: Bob Aten

[See Appendix for Aten's actual notes]

It is difficult to deal and think grandly about economic development. I know the most about Indonesia. One view of how to alleviate poverty is that direct services and direct efforts may be the best way to do it. A second view holds that the indirect benefits of growth on poor is more efficient. This seems peculiar to all but economists. Gus has gathered interesting data tried to draw reasonable conclusions about the two views. I'll try to talk from general to specific. Indonesia had long patterns of economic growth from 60s to 77 that ineffectively benefited poor. It was the poster child for impact of good economics on economic growth, but fell apart in late 1990s. A corrupt system has been succeeded by even more corruption. There is corruption in governing style that has been translated through to the provinces. Solve corruption by getting close to people, get them upset about it and make changes. But, Indonesia could spiral out of control. Will the long dictatorship of Suharto be followed by a stable system?

Egypt started with major assets – Suez, cotton, oil. We've been putting lots of money into economic reform in Egypt. For part of last decade it was beginning to look like real benefits from all investments. It raises the question of whether we are going to concern ourselves with economic development and growth. Egypt is still a dictatorship. When it transitions to a new government will Egypt become Indonesia? There have been major social investments, similar to what occurred in Indonesia. Sri Lanka tried redistribution. And built services for poor. Sen seemed to be advocating a strategy of redistribution there. Gus pointed out that it worked for a while and has gone away. Growth has occurred and the poor benefited less than proportionately. One question: Sen's work may have overstated the case. Corruption enters into this part of the story as well. If one is going to build institutions to deliver services, one has to make sure they are not captured. In Sri Lanka they were captured by the middle class.

The most plausible conclusion, if we are serious about making economic development work, is a combination of direct expenditures benefiting poor with appropriate institutional support (see NIE and its protégés). All three are an essential combination. The Indonesia story may look as if it is independent. Indonesia does not have solid institutions. And it gives me pause. My sense is that there is resistance to making the institutional change. In all three countries direct spending affects the poor in the form of improved education and health, which helps lay the foundation for economic growth. Good macroeconomics appeared to make a difference as did policy reforms. Institutions may be the reason why there is not a one-to-one with macro fundamentals and growth. Indonesia's successful growth was because of Suharto's good macro policy, but eventually it became more and more corrupt, with worsening performance. Income from natural resources has helped, but institutional development is weak so it is difficult to see them realizing potential. Sri Lanka did not have the outside money that Egypt did – budget problems have created many of the deficiencies, but it is small enough and US is interested enough that we might put money there too. One comment on inflation in Indonesia – Gus has to make assumptions about the role of tradables – we are not talking about a process that has as much impact on macro as we think.

That strategy is probably worth supporting – but we are probably right too. We need to support macro with institutional development. We must tackle the issue of corruption.

Q&A:

Juan Butari: I am concerned about the way we measure poverty using income for the lowest proportion of income earners at *one* point in time. We are limited by indicators that we have. I am concerned that jumping to policy conclusions that don't take into account mobility in and out of poverty over time is very dangerous.

Gus Papanek: It is always best to use panel data that follows families overtime. It has been done in Indonesia – the Indonesia Family Life Survey – supported by USAID. It has followed a large sample of families over time. Yes, there is mobility and of course some families move out of or into poverty. We use poverty incidence as principal indicator. This is the weakest measure we have because the poverty line is very sensitive to changes in prices. Poverty incidence data is highly sensitive because in many countries people are congregated just around the poverty line. I have always used the income of the poorest 40%. I also advocate using wage data.

Marty Hanratty: It is not surprising that you found a range of growth elasticities in each case. It might be that institutions, policies and rules of the game really do make a difference in affecting rate of poverty decline. It is easier to corrupt government delivery than private sector. Are the poor affected disproportionately by corruption in society?

Jim Elliott: I am doubtful about the way data for GDP per capita is presented in the graph. More reasonable way of presenting it would be to graph on a logarithmic scale.

Dirk Stryker: To follow up on the corruption question, one of the dimensions of poverty is empowerment of the poor. The data tell us the story that when you look at cross section there is pretty good correlation between growth and poverty reduction, but within a country there can be high variation. We need to look at poverty reduction in terms of sustainability – is growth due to resource base, foreign aid, remittances, transfers? There are ways in which the poor may benefit or not, but they are not in the hands of the poor. The poor have not gained power to push those things that will benefit them in the long run. Corruption undermines empowerment of the poor because they don't have the resources to deal with it. Interested in any observations you may have that the poor become more empowered?

Tim Mahoney: Indonesia served as the poster child for reducing poverty, with phenomenal growth in agriculture and success of family planning. Population growth came under control – this had an important impact on poverty reduction.

Gus Papanek: The same was true of family planning in Sri Lanka. You can see a big difference in growth rate in per capita income due to the drop in population growth rate. It would be interesting to attempt a multiple regression analysis to see which factors matter, to see whether we can get a handle on these relationships. My conclusion from these three studies is that growth is still fundamental. The elasticities vary, and it is surprising that they vary as much as they did. Even during periods of high growth there are some circumstances under which large groups of poor are left out. In those cases then it is important to deliver benefits to the poor. How do you do it? Not through the private sector – because private sector is not necessarily better than government – but through self-targeted systems. Labor-intensive public works at low wages are key, otherwise they become patronage programs. Deliberate targeting doesn't seem to work and is extremely difficult to carry out. There is also geographic targeting, and the example of Indonesia seemed to be quite good. Even the worst of these programs do achieve somewhat disproportionate benefits for the poor.

10:25 Lessons from African Countries (Uganda and Zambia)

Presenter: John Harris (BIDE/Boston University)

Commentator: Juan Buttari (AFR/SD)

John Harris:

NOTE: See Appendix for Uganda and Zambia PowerPoint Presentation

Uganda is one of the least urban countries. The economy is primarily smallholders working on their own land – less than 14% is hired labor. Uganda had as standard a structural adjustment program as you can find.

The key story was to allow private trade. When this was being debated in 1987 and 1991/92 the general notion was that if you let the exchange rate go, it wouldn't get passed through to farmers. There was a large belief that even if it did get passed through there would be no response. Both of those assumptions were wrong.

The most stunning single piece of information: coffee producer price compared to world price. Increased prices were received at the farm gate.

Who has benefited from growth? Almost everyone. A very nice set of monitoring studies has been done: World Bank and the Swedes; Paul Collier, Simon Appleton; all of these are a model of doing these kinds of measurement right.

There has been little change in inequality. Social capital important concept in the poverty reduction story – social capital forged in the bad old days. I would like to do further work in this area.

Areas of concern include targeting: more being is being spent but bang for the buck is unclear at this point.

The curse of riches is a Zambian story: when world copper prices plummeted and oil prices increased, it was a double whammy.

Zambia is trying to maintain structure that is based on copper rents and mineral wealth. A democratic government was elected in 91, new SAPs were implemented. Poverty went up and got worse.

There has been some small improvement but there are still extraordinary poverty numbers – among small scale farmers for example the poverty rate was 90% in 1991 down to 84% in 1998.

Why are there such differences between Uganda and Zambia?

Uganda had major violence and destruction, Zambia had a slow cancer – maybe it is better to have a shock and recover rather than slow destruction. In Uganda the formal economy withered – the real economy was subsistence and parallel market driven.

Uganda had less government structure to protect while Zambia didn't really liberalize as promised.

Social capital is a factor. This is real conjecture but Uganda had developed social capital in the form of local voluntary organizations that provided some basic services during the collapse of effective government.

The moral of the story with similar policies and different outcomes is that initial conditions and structures matter.

Juan Butari – commentator:

I really liked the Uganda paper, the conclusions support my own thinking.

The main poverty reducing mechanism here has been economic growth, not redistributive or targeted measures. For us in AID this is quite important, especially as one of us this morning reminded us that there are 2 camps – one on the macro growth side, one on the targeted measures side. Being in the former camp, which is dwindling, the paper conclusions are very insightful.

Economic growth took place as a result of two factors, one the restoration of security. The country suffered under years of violence, and restoration worked wonders.

It is a combination of macro and micro factors that can create incentives for more competitive markets. This is one difference between Uganda and Zambia: Uganda opened markets and created incentives. The ability to enter and exit is something that John documents well in the paper.

Another contribution of the paper is the importance of having a small but critical cadre of technicians in a position of influence that can impact the formulation of policy, etc.

I also liked the point about Uganda being a land-locked and tropical country. Recent literature has exaggerated the importance of geography in development. This is an example of success in land-locked tropical country, even in the context of being surrounded by countries in turmoil.

Policy is of great importance. The paper underlines the importance of governance problems, essentially corruption.

I have the impression that John struggles with the issue of how important the structural shifts in the economy were in terms of having an impact on poverty reduction. Why, if structural shifts did happen, weren't they more important in explaining poverty reduction?

Just the restoration of security and order worked wonders – all sectors recovered and caught up. In USAID I see in our strategies that we should allocate resources to the sectors where the production is taking place – I think that this is a danger because we should pay more attention to thinking in incremental terms and perhaps the additional resources might have a higher return in other sectors. This is why the importance of focusing on the structural shifts is so high in my mind.

How did Uganda succeed where others have failed? There was a commitment to reform in government – the government took ownership. In reality, to me, not many countries have failed because in fact not many countries have implemented the Washington consensus. Even prior to the government 'owning' the reform, one sees a pickup of the economy in terms of GDP, etc. This again points to the importance of having a cadre of influential people, even in the midst of a very divided government, able to have the ear of the people who made decisions.

I would encourage more attention to the issue of aid dependency, which is very high, and what it means for Uganda. I think that for the 2001/2002 period the amount of aid was about 12% of GDP, half of which went to direct budget support. This raises the question of sustainability.

The paper highlights the big impediment that corruption poses, but the paper ends with optimism. A big concern I have is that Uganda has had a personalistic style of government. While the government has taken steps to combat corruption, corruption really has meant privileges for people close to the center of power. In 2006 power will be handed over to a democratically elected government – only then can we say that there has been a break from the past.

Zambia has been a disaster up to 2000, everyone agrees. It is not so much that policies didn't work, but they weren't really implemented. In 2000 some measures were implemented (including privatization), and microeconomic policies that should be stressed. Zambia's 2000 might turn out to be Uganda's 1992.

Q&A:

Dirck Stryker: I did a study of Uganda last year as part of poverty reduction work for PPC. Everything you say is true. The broad tendencies are very alarming. The value of exports in real terms has been essentially flat throughout this entire period (last 9 or 10 years). There was big growth in coffee exports in the beginning, a boom in the mid 90s, but following that they declined, mostly in the last few years because of world market price.

Growth came from the restitution of order, security, and macro stability, but subsequently it is hard to attribute the boom that was taking place to sources that are really responsive to policy. Most of this is the growth in foreign assistance. More than any other factor it has been the growth of foreign assistance plus remittances (to some extent) that drive the economy. Foreign assistance is the leading sector. What is very disturbing about this is that Uganda has as you mentioned a large amount of resources flowing into direct budget support. There are major problems in education, water, access roads, etc. All of these are essentially non-tradables, causing over-valuation of the exchange rate. The tradables sector is where you really need to get sustainability. The macro situation, as a result of the poverty reduction program, will have long-term benefits but in the medium term is having a devastating impact on the source of growth in the economy.

Ralph Cumming: Uganda is put forth as a success story. I think that is faint praise. I question whether there is any African country that is going to make it. There are not a lot of success stories. I think we need to look at those, and ask what did they do. India halved the poor population, Indonesia has done much better than that. What did they do? There was tremendous commitment by government. Policies and investments changed. No single African country has made that sort of commitment. 40 years of perspective is useful.

Back when we were starting out, Africa was the continent that was going to make it. They were writing off the India's, Bangladesh's, Indonesia's. You have to have that huge commitment to get over that hump. Once you get over that hump it is a lot easier. I don't see it in Egypt or any other African country today.

Jim Elliot: I am struck by the importance of social capital and local voluntary organizations. The parallels that come to mind are Haiti where USAID can only work with local voluntary organizations.

Joan Atherton: I would like to expand on 3 or 4 variables in the comparative frame. One is the institutional level, both public and private. Second is differential government investment choices. What would you say relatively about the country choices? Third is how the social capital of the organized labor sector played out in both countries. And fourth is the effect of south Africa, both pre-and post-apartheid.

John Harris: The incidence of corruption is treated in Collier's work. The larger the firm, the more likely you are to pay bribes, especially if you are trying to get services like telephone, water hookup or anything that has to do with getting anything in and out of the rail line. Land-locked means long delays, if you know anything about supply chains.

On the role of aid, it is difficult to figure out how much aid there is. I first went to the WDI. Uganda is the middle of the bunch (looking at per capita figures). Zambia is higher. Other numbers show 15-18% of GDP. Another series shows 3-5%. You have what sounds like a big flow of aid but it is not easy to interpret how large it is. I think the question is right: are you going to be able to get out of aid dependence? Private investment is growing.

Ralph asks: is this a success? The answer is relative. Relative to Zambia – sure. What about relative to Burma, Laos? Botswana has been a success. On the HIV issue, Uganda has paved the way in dealing with it (stabilized at 6%). This leads into the question about the NGOs – in Uganda these have been home-grown responses, not outposts of international aid organizations. How institutions have changed, what's indigenous, is very interesting... it has been a village by village change in behavior, reducing stigma, and so on. I think that is really worthy of further look.

Easterly loves Zambia as a bad example. He has a good chart that shows that if all investment had been done right, Zambia would have per capita income of \$30,000. What happened to that investment, why was it so unproductive? It was tied with debt. Maybe HIPC will help. Unproductive investment hung a millstone around their necks.

On the role of organized labor – the privileged position of labor has been undercut. There is an interesting political economy question in the role of South Africa.

Samira Salem: Zambia liberalized quicker than South Africa. There is anecdotal evidence that you have South Africa 'invading' the Zambian markets. Competition is hurting the Zambian market, which seems to be a general rule if you liberalize much faster than your trading partners

11:20 Lessons from Latin American Countries (Peru and Brazil)

Presenter: Sam Morley (BIDE/IFPRI)

Commentator: Clarence Zuvekas (MSI)

Sam Morley:

Note: See Appendix for Peru and Brazil PowerPoint presentation

There are large differences in the two economies. Peru has the Andes, and the costal strip is narrow. Arable land is small. Brazil's main feature is its size.

Economic growth is good for reducing poverty, but this is far from the complete answer. Paying attention to labor intensive sectors is very important.

We might have paid more attention to other dimensions of poverty than just income. Health and education indicators are also important. Peru has room for more tax revenue, Brazil not as much. It is necessary to avoid overvalued exchange rate, I agree, but a policy of exchange rate depreciation is dangerous. El Salvador and Honduras have this problem exaggerated. Tourism and fruits and vegetables have done well despite the devalued exchange rate due to its cushion.

Peru – does it have a cushion to work with? We have to be careful here. Competitiveness can be improved with the removal of export taxes, streamlining export paperwork (especially for small producers), disciplined fiscal policy over a long period of time, financial sector reforms (interest rates), grades and standards, and rule of law. Competitiveness is affected by a lot more than

exchange rates. We need to focus on other areas. Not tax incentives – in Costa Rica these are very expensive, they have high benefits but high costs. They have to have a phase-out plan.

For Peru deficits, maybe 3% at outside is appropriate to not scare away outside investors.

Employment creation has occurred in the manufacturing sector, but there are limits here. Look at non traditional agriculture exports and assembly versus manufacturing. What is needed is a strategy for transforming labor market into higher skilled jobs. This is poverty alleviation versus poverty reduction. They need to target assets for the poor – education, infrastructure in poor geographical areas... but only invest infrastructure in areas with good economic potential.

In looking at poverty elasticity it is useful to throw out 1986, which distorts the relationship. And calculate growth elasticity in the 1990s excluding pension schemes.

Q&A

Peter Timmer: How do you place the LAC countries in the hierarchy of commitment to growth and poverty reduction in these seven case studies?

Kate McKee: What is the relationship between poverty and extreme poverty, policy changes that were advocating these opportunities differently?

Jim Elliot: On the impact measured in social indicators, we found that indicators did not reflect changes in GDP per capita but were maintained or increasing in both reforming and non-reforming countries. Was this the case in Peru or Brazil? Peru had stronger poverty reduction record.

[unknown]: Stabilization plans were bad for the poor, but inflation plans were good?

Sam Morley: Recession really hurts the poor in the short term, but inflation plans in the long term were beneficial.

You can have improving education and health indicators even though there might be a recession. If poverty was going up, extreme poverty was going down, even in recession. Peru really made a conscious effort to invest in the countryside, especially for security reasons, despite the recession. You can make poverty-targeted investments. Brazil has education credits – a billion per year – paying parents to send their kids to school. This is a poverty targeted investment – these kids have more cultural capital in the long run.

On exchange rates in Dutch disease countries, the conclusion is that it depends. Mineral exports do not create employment directly. In both Peru and Brazil there was rapid growth. The trouble is that the government sector expands – tendency for corruption because it taxes the export sector to create unproductive government jobs. Chile was able to diversify their sectors to create more productive, non-mineral jobs.

One problem is that exchange rate devaluation and appreciation is not stable. The ups and downs can be tremendously destructive. Governments have to find a sustainable equilibrium, and stick with that. No entrepreneur can plan an investment strategy under Argentina's fluctuations.

THEME 2: Lessons from Sector Studies and Issues Papers

13:15 Privatization and the Poor

Presenter: Gus Papanek (BIDE)

Commentator: Tim O'Hare (EGAT/PR/PASSN)

Gus Papanek:

This paper looks at the common idea that there is a general loss of jobs through privatization and increased prices of goods consumed by the poor and asks: to what extent is this true?

Utilities are the public enterprise being most widely privatized. The first impact is on prices. Lee Jones looks at prices and finds that in 50% of firms prices did increase, some examples show as much as 40%. Other 50% stayed the same or declined (as much as 33%). It is not clear cut and universal that prices always rise. Privatized firms were able to expand much more rapidly – the poor benefited from this expanded access. It is better to have access at a higher price, than no access at a lower price. The net balance is favorable.

The second impact is on employment. Public firms were overstaffed about 40%. Privatization resulted in loss of jobs. Some countries made firms keep all employees for the first three years. This was not permanent because, privatized firms were able to expand quickly and create jobs. So labor gained on the net. Most of the people who lost their jobs were not the poor. They had been allocated on social relations and nepotism.

The fiscal effects were not the gains from the government for selling off, but the secondary effects of taxation and reduced subsidies.

Privatization also has a macroeconomic activation effect, that is greater availability of power supplies, reduction of brown outs, black outs, and briberies to get connected. This was hard to track, however.

How did buyers of the companies fare? All fared well – foreign and domestic.

The negative effects that seem to take place were not supported by this study. One study by Nancy Birdsall reached opposite conclusions – she includes the transitional economies in her study. Many of those privatizations were corrupt – ownership transferred from government to former communists. It is good to enforce buyers not to fire people, and to let growth support extra people. It is also good to require them to expand access and make new investment in rural areas.

Tim O'Hare, commentator:

There had been some disconcerting effects of privatization. In Peru and Bolivia privatizations were revoked. This is the wrong message. This does not bode well for Mexico's efforts to privatize the electric utility. Fox wants to privatize, but it would require an amendment to the constitution.

In Egypt the state owned banking system financed state owned enterprises. This represents a drag on the entire system. They cannot privatize until the debt is resolved. They need risk-based supervision.

To free up the entrepreneurial spirit of Mexico, they have to privatize PEMEX – the petroleum industry. The management of PEMEX gave 6-7 mill dollars to the leadership of the union. In the private world, these people would pay fines or go to jail.

USAID originally led privatization in the newly independent states. I hope that this paper on privatization and the poor will renew USAID's faith in the benefits of privatization.

Q&A:

Question: We are told to expect higher quality, but I did not see evidence of this in the paper.

Gus Papanek: This was not addressed, but wider access does go under quality.

Comment: You have to look at privatization of utilities in a broader context – deregulation, liberalization. Public utilities are natural monopolies. Once you privatize, you need a regulatory structure – price regulation. Rather than regulate prices, there is usually liberalization – granting of licenses coupled with certain obligations (such as expansion into rural areas). In Zambia they set up two licenses to create competition. Combination of liberalization and privatization can have explosive results – the impact is enormous.

13:40 Education

Presenter: Jere Behrman (BIDE/University of Pennsylvania)

Commentator: Don Sillers (EGAT/PR/PASSN)

Jere Behrman:

See Appendix for Educational Sector Study PowerPoint Presentation

Don Sillers, Commentator:

I have nothing but praise for this paper. It is an excellent resource for enriching our understanding of education in the development process.

Earning potential & education are very important. The real question is the gap between public and private returns. Key recommendations are based on a thorough review of the literature on investment priorities in education. There is a link between exchange rate policy and education. USAID is crafting a new education strategy. I was pleased to see a plug for non-government schools, publicly funded, but competitively supplied education. Loosening government control over education can cause political and religious divisions.

The paper highlights pre-school as a high priority; however, even the primary level has severe restraints. How should USAID and host countries prioritize expansion of primary education versus development of pre-school?

Q&A:

Question: Do people still not see rates of return? Are there imperfections in knowledge?

Question: What is the life cycle of public goods?

Question: On social versus private – slow absorption rate of high school graduates?

Question: Very interesting focus on male versus female. Any data on urban versus rural?

Jere Behrman: There are differences in social rates of return because of knowledge imperfections. There is some evidence of these differentials. The most efficient way is to provide information, not subsidize price. Address imperfection directly. Scholarships are one effective way.

On the life cycle of public goods, it is difficult for public and private sectors to hypothesize how the market will run. I don't see any difference between picking winners between public and private.

On absorption of high school graduates, most individuals are absorbed in labor force even if there is not extremely high growth. The question does tie into overall strategy, getting prices right.

On urban vs. rural question, there are some returns in rural areas.

Comment: It is not a question of providing more information, society has to recognize that the return on education is considerable.

Jere Behrman: The gender gap and rate of education have increased dramatically in last three decades. I agree that information is not the answer to everything. Changing behavior may be the way to address this. Mandates may not work without addressing why it is a problem.

Question: What are the social returns on vocational ed?

Jere Behrman: Change is accelerating – the generalized skills of learning how to learn are more important than a particular technique.

14:25 Agriculture

Presenter: Peter Timmer (DAI)

Commentator: Susan Thompson (EGAT/AFS)

Peter Timmer:

I have three topics to discuss: Why are we doing agriculture, the framework, and some comments on what it is going to take to get agriculture moving.

Why agriculture? This is the second time around, and I'm not going to repeat the first comments. The first time I focused on links between agriculture and economic growth and a bit about why agriculture growth relates to poverty reduction. I reported that that connection between agriculture and poverty reduction depended crucially on the starting point regarding asset distribution. I did that research under CAER. I also emphasized then the dependence of the connection between agriculture & poverty reduction on the technology and population density and rural infrastructure. It is difficult to build infrastructure in a sparsely populated country like Uganda for example.

This time I want to emphasize a different reason why agriculture is on our agenda. Over the last 2 months I've realized that agriculture is back on our agenda here in DC because it has become much more intellectually interesting. There are three very important revolutions underway that involve agriculture.

First: there is a team headed out to Indonesia right now to look at **biotech**. The biotech revolution is not about GM foods and the debate between the Europeans and the US. The biotech revolution is about plant variety and genetic improvement – whether or not we are

bringing in genes. There is more excitement among agriculture technology than there has been for 25 years. There really is something going on. This probably won't show up in the statistics in 10, 15 years.

Second is the **supermarket revolution** and what it is doing to the nature of food supply chains. This is already a fait accompli through Latin America, now rapidly in the coastal area of China, also Indonesia. I went to the opening of a Carrefour hypermarket in Bandung... I was blown away by the selection. And everything was grown locally except apples from Washington and grapes from Australia. Carrefour is working with local farmers through associations. Multinational corporations – Carrefour, Tesco, Walmart – are bringing technology that has been developed for supply chain management into these very poor countries. They bring with them global procurement systems. The mantra of procurement officers is force costs out of the procurement system. They lower cost and increase quality by driving down delivery costs of the produce even while they enforce safety systems... It is very difficult for small farmers to stay in the system (they can't keep up with safety, hygiene, etc. standards). Who is going to survive 5-10 years from now in the supply chain? Small farmers got squeezed out in Latin America.

The third area is the understanding of **poverty dynamics**. DFID is working on this, there is pro-poor growth research at the World Bank... There is real interest in poverty again in the donor community. Understanding the dynamics of poverty and how we reduce it is important. Macro growth is crucial to sustain poverty reduction. We can do short-run stuff but it is palliative, poverty alleviation, not poverty reduction. We're learning that the connections between the growth process and poverty reduction are highly varied. It varies by country, by time period within country, and it varies by sector: which is my story. Most of that sectoral variation seems to be driven by labor intensity. The source of growth in agriculture is a labor intensive type of product rather than land or capital... We want to focus on labor intensity and where that growth is coming from.

I have argued with Scott Pearson that there is no inherent distinction between tradables and non-tradables. The literature that draws this distinction is not very helpful in trying to understand labor absorption into this model. John Mellor's new model of economic development is the convergence of tradables to non-tradables...

This is all why it is exciting. The framework is in Figure 1 (see Discussion Session II Program). Figure 1 shows that there are two dimensions to pro-poor growth. The horizontal axis is the elasticity of poverty reduction with respect to growth. The overall rate of growth is the y axis. Clearly the poor have an interest in being down in the southeast quadrant. They want rapid growth and differential connection to that growth. It turns out that it matters a lot you're your starting point is to how well the poor connect. But the historical record is not all that great. There are these incredibly powerful case studies. From 1970 – 1995 the Indonesian economy grew at 5% per capita and 6.5% for the poor... understanding the Indonesian story is a rice technology story, a rural infrastructure story, there big investments in rural education, rural health & family planning, etc. Both a large share of the growth and a huge share of the differential comes out of rural policy in that story. And that is where I will stop for now.

Susan Thompson, commentator.

Regarding USAID's reengagement in agriculture, this paper is fantastic and coming at a very timely moment both for the strategy and other work we are doing. I thought that rather than summarizing the paper I would actually look at how this contributes to what's going on in the

Agency right now. One of the things I particularly appreciate is emerging issues – supermarkets, biotech. Perhaps missing is a strategy that we are working on to end hunger: promotion of regional trade in Africa. We the Agency need to pay attention to good economic governance. It is embedded in each thematic area but it disappears when we talk about programming.

What do we do in failed and failing states? We put economic governance as an underpinning for getting the agriculture right. In many of the places in which we work that is not going to be there. This again raises the issue of sustainability.

What are the links between agriculture and nutrition & health? Timmer says increased production will get us there. But: trickle-down theory is not going to play out. We as an office of agriculture need to have discussions with the nutrition policy people.

Human capital comes up over and over again. But we think that is a matter for the education people, the health people. One of the problems is that we need as an Agency to start talking to each other – we need to talk about RURAL, not agriculture.

On poverty traps – what do we do? IFPRI has also done work on marginal areas. Both concepts very important to the agriculture story.

One of the questions we always ask is: what is going to happen with this work? What is USAID going to do with it? Tim Mahoney is now the head of the USAID delegation to the DAC Poverty Reduction Network. One activity is agriculture & pro-poor growth. One of the first things they've asked for is the links between agriculture and pro-poor growth in a four-page summary. Guess where that is coming from?

Q&A:

Dirck Striker: Supermarketization scares me, and the implications for small farmers. I've been working with the World Bank and USAID on trade capacity building in Mali. They are so far behind in terms of being able to meet the supermarket standards that it is just very hard for them. Mali isn't unique. In Indonesia all the products were local, but procurement doesn't recognize national boundaries. There is a tendency now for these sorts of standards to be applied not only in the industrial countries but within the poor countries as well and are the small farmers going to be able to make it? The agriculture practices and requirements placed on people trying to export... it is really very scary because most of these countries won't be able to make it. What are they going to do? We have to think that problem through.

Sam Morley: I want to go back to my concern with backward areas. What is your recommendation for these backward areas, what would you do?

Kate McKee: Aren't there some commodities, crops, products for which there are actually diseconomies of scale? Are we getting too caught up in this phenomenon – how do you think it will play out?

Peter Timmer: On promoting regional trade in Africa, is there in fact a revolution coming in the Doha Round, etc. There is increasingly sharp tension in the US government over that question. We take away more with our agriculture policy than we give with our aid policy and there is much more understanding of that impact here in DC now – people are agitated. We're not going to make much progress unless the third world provides the leadership & gets its act together – the cotton producing story in Africa is an example. There is real scope for change by the end of this decade, we'll see substantially less distorting rich country agriculture policies... I was pessimistic about the Uruguay Round, and I was right. But I am optimistic about Doha.

On the governance theme: the Natsios Report was correct to start with governance. If we can't get these issues right then we won't get very far. Don't we have to have governments buy in to the poverty reduction agenda? If we can't, there is no hope. The MCA might offer real incentives for governance – it will put real pressure on. Providing external incentives to governments is exciting. Steven Radelet is very optimistic.

On failed & failing states, military & counter-terrorism efforts in the context of humanitarian assistance & food aid: the historical experience is dreadful on that record. This is the frontier of development economics. There is a powerful economic dimension in this but we just don't know how to proceed. It will probably be very painful as we learn.

On poverty traps: intellectually I believe very deeply in this, I am a fan of Robert Vogel's work. England and France were in poverty traps. It takes some kind of external shock to break you out of it. I don't see that as being the big story in poverty at the moment because the real price of food has fallen so radically in the last 50 years that just shortage of calories can not be the answer.

On backward areas: migration plays a major role here. The solution to rural poverty in Appalachia was to move. It is the same as northern Brazil. Are there palliative things that can make things better? Investments in education & health, for example.

The supermarket thing IS scary. Tom Reardon could nail down the horror stories. Small farmers in Nicaragua are growing tomatoes, then supermarkets want a particular quality, tomatoes grown to certain standards, and farmers can't do it, so supermarket brings them in from Costa Rica. 40% of food sales in Nicaragua are in supermarkets. These buyers are really heartless, looking for lowest cost, most reliable, European standards. It looks like there is an awful lot of Africa that is going to have a hard time meeting those standards – much of it is poor agricultural conditions in the first place.

All of your apple juice now comes from China. Orchards in Washington and Oregon are being torn down and high quality wine grown instead. You can move up the value chain. Global procurement systems are going to move around.

On economies of scale – a lot of fruit & vegetables and high quality livestock is very labor intensive so doesn't scale up real well. But quality control and meeting standards has some scale elements to it. But as you push costs out of the system the only return will be to the scarce resources and the returns will end up in the hands of the system rather than in the hands of the poor.

15:20 Finance

Presenter: Al Berry (BIDE/University of Toronto)

Commentator: Kate McKee (EGAT/PR/MD)

Al Berry:

See Appendix for Finance presentation

Why does this all matter? Microfinance is labor-intensive. Small firms are a lot more labor intensive than large and government firms. So success of SME sector has potential for great success in employment generation (the model is Taiwan).

The basic function of finance is to raise investment. Four characteristics distinguish pro-poor finance system to non-pro-poor. 1 to 3 are getting the right amount of credit to agriculture, micro- and small and medium enterprises.

Four is to help to generate savings that flow into investment in pro-poor activities. There has been a revolution in microfinance, which has proven that you can do a lot of things that people thought couldn't be done 25 years ago. Now we are in the revolution. What is the final impact and how do we achieve as much as we can from it?

Small and medium non-agricultural enterprises have come on the screen as an important sector. In the last 10 years leading decision makers have supported the importance of SMEs. The interest is there, but no recipe. What are the tested/proven ways of making sector flourish?

Microfinance side interest rates can be at market levels without killing the deal, rates of repayment are surprisingly good. But it is hard to achieve all these things in a systematic and sustained way. What is the final aggregate impact of microfinance programs? How much do we need to worry about loan activity is a near zero-sum game? This has to do with elasticity of demand for the product. There has been a great dichotomy between people in the field and those with the big picture view of what is going on. The challenge in microfinance was to develop a new sorts of institutions and that challenge has been met. New challenge is how far can they go and what is the impact?

On SME finance, the institutional question still looms. How do we make private commercial banks function better? What does better-functioning mean? How do we distinguish a good bank from not so good? Across the world there is a wide range of successfulness in achieving/not achieving this objective. The issue is not whether full coverage is feasible or not. When you look at whole SME sector in a country you might see it growing smoothly over a period, but the growth is highly concentrated over a few firms. The growth potential and possible credit support at the right time (when they have their growth opportunities) is crucial. Because it's a foregone conclusion that almost all firms up to a certain size range will be self-financed at first. It matters that these funds be facilitated. We haven't worried enough about facilitating savings. There are a variety of ways in which the savings of low-income people can be facilitated.

Recommendations:

No's—

- Shouldn't have below-market interest rates in microfinance institutions.
- Credit shouldn't be forgiven.
- Governments shouldn't provide credit.

You do need strong regulatory supervisory systems for the financial institutions.

Recognize that many institutions are far less efficient. On SMEs it remains to be seen how successful. Some margin of unachieved efficiencies – so support/policy interventions such as support for training of bank operatives who it is hoped will become efficient in dealing with SMEs. And support to lowering the transaction costs to dealing in the SME sector with the intent of providing coverage down the size range, including subsidized opening of new branches.

Ex-post evaluation is important in the SME sector because it is so experimental.

Kate McKee, commentator:

The distinction between microenterprises and SMEs and the assumptions we make about its link to pro-poor growth. There is the question about the missing middle – we don't find so many SMEs in many economies.

We definitely need better empirical understanding of SMEs. It matters what types of firms generate profits and jobs, and who gets profits and jobs. At the macro level, how important are these to economy? The assumption is that they are more likely to generate jobs. But, what do we do? In Bolivia there is quite substantial penetration into the microfinance market.

I agree on the value of finding ways to serve more SMEs. But, financial technology to serve the missing middle is lacking.

On the question of microfinance – what do we mean by it? USAID just doesn't think about potential to get incomes growing. We also need to look at asset dimension of this as well. Access to quality financial services helps households reduce risk and vulnerability. This has implications for families in financial crisis. Also, improved nutrition, education, and payment of school fees. The vision that most in the field have for microfinance is looking for diverse financial services. Savings are important. Other products including housing products often support enterprise activity of households. Insurance and remittances. Need to take the links between facilitating remittances and their productive use. Need to look a bit more broadly in terms of pro-poor framework you have in mind.

Talking about specialized niches, our vision is not about one size fits all. A healthy financial system it will likely have diverse types of financial services. The vision is of the financial sector deepening with pro-poor patterns. Deeper and broader services available to poor.

Policies to encourage this:

- 1) Liberalization of financial sector is necessary but not sufficient condition to deepening and broadening.
- 2) Create a more enabling environment for microfinance services. The requirement that banks reserve 100% on any unsecured loan is a killer for this type of loan.
- 3) Encouraging the exit of the state from direct delivery and subsidization of transactions.

For banks to serve SMEs key breakthroughs they need a) cash-flow based lending; b) application of particular information technology that allows you to aggregate information about borrowers; c) microfinance generating graduates; d) adoption of efficiencies of microfinance into banking system.

Another issue we need to wrestle with is a chicken and egg situation – need for credit or markets? We need to be careful about our understanding of what credit can and cannot do. So we need to think about business services that can help businesses develop. PRSPs don't really mention private sector development. How are we going to get there?

Q&A

John Harris: Most of what we know about poor households involves some form of consumption smoothing. Savings are important. SMEs frequently use the phrase “undercapitalized”. It is seldom that a firm goes under because of lack of fixed capital but cash flow. We don't necessarily have to provide capital to firms that will use it – subcontracting. We need to look at the system. How do poor households and SMEs buffer themselves where there is a lot of variance. Need to build financial institutions that can deal with these challenges.

Dirck Stryker: What is it about microfinance institutions that have been successful that has not been applied to SMEs? Why can't we use lessons from microfinance institutions applied and move them into SMEs?

Tim Mahoney: What are new products? Home improvement loans? Talking about a period of repayment not common? What about insurance – what kind is available for poor households?

Tim O'Hare: Will regulatory function be extended from Central Banks to SMEs? Will Basel accords apply to microfinance lending? What about capturing remittances? Calls out for regulation.

Answers:

Al Berry: It won't be same regulatory agency. We've seen a number of problems arise which call for regulation. There are a lot of accounting problems in microfinance. What is a good regulatory framework and who should handle it?

Kate: On the regulation question the debate is now a consensus. If deposits aren't taking from general public, don't regulate. Who should regulate? Want it to be the Central Bank because it pretty reliably has legitimacy. Policy trade off is the protection of depositors integrity of financial system and access goal and comes to a head in regulatory capacity (which is generally very limited).

On Dirck's question – some solutions can be applied. One is collateral substitutes – group pressure, the loss of good name, is hard to scale up. As loan amounts get larger willingness to cross-guarantee loans gets difficult. Two is a stepped up loan – when discontinuous opportunity can be problematic. This poses some challenge in terms of risk to institutions. Three is underwriting the household. As the firms revenue start to dwarf the household this is less of a solution. At some point they need to start taking flexible forms of collateral.

Finally, on new products, we are starting to see development of new products and research. Home improvement loans are something we are seeing – this is not problematic if they can do household underwriting. Insurance products – credit and life insurance can be provided. Natural disaster insurance is interesting – the key issue is pooling risks.

16:05 Closing: Al Berry, Gus Papanek, and James Elliott (EGAT/EG).

Al, Gus, and Jim Elliot thanked all participants for attending, remarking that the discussion had been fruitful and would be of great use going forward.

Appendix:

1. Bob Aten's presentation comments – Egypt, Indonesia & Sri Lanka
2. John Harris' PowerPoint Presentation – Uganda and Zambia
3. Sam Morley's PowerPoint Presentation – Peru and Brazil
4. Jere Behrman's Powerpoint Presentation – Education
5. Al Berry's presentation comments – Finance

Thinking About Gus's Papanek's Pro-Poor Presentation on Egypt, Indonesia, and Sri Lanka

Robert Aten*

July 2003

Introduction

Whenever I try to think grandly about economic development, I always wish I knew more. My bias is that I believe, among the three countries under consideration, I know the most about Indonesia but still not enough. I have not even been to Sri Lanka although I provide back up economic support to the Mission there.

In my simple approach, the group meeting today was established in large measure to consider the comparison between two views of how to reduce or alleviate poverty in developing countries:

1. The view that provision of direct services to the poor – direct efforts to alleviate poverty -- may be the best way to reduce poverty (this approach seems quite plausible to non economists but not necessarily plausible to economists);
2. The view that the indirect benefits of macroeconomic growth on the poor are a more efficient and effective approach to benefiting the poor than direct services provision to the poor (on its face, this approach is peculiar because of its indirectness to all but we economists to whom it is quite comfortable and normal).

As I have known Gus Papanek over the past decade, I have seen him as seeking honestly to find and carry out good analysis. While Gus believes strongly in the crucial

* Senior Economist, Asia Near East Bureau, Technical Support Staff. The views presented here are those of the author only and not necessarily those of the USG or USAID. This paper has not yet been cleared by USAID, and may not be quoted or referred to until that happens.

importance of good macroeconomics, he is probably more willing than most economists to consider the importance of the approach of providing direct services to the poor. That makes him relatively unusual among economists (including me) whom I think generally have a tendency to favor the second approach.

Gus has gathered very interesting data about three labor abundant countries and tried to draw reasonable conclusions about the two views above. His work also and of necessity represents the logic of the continuing effort necessarily to try to aggregate from the specific to the general. I do not find in his conclusions strong support for approach one. Given his interest in/hope for success of approach 1 and his honesty, that fact provides me with skepticism about whether approach 1 alone is the answer.

Generalizations

The other way to reason about issues is from the general to the specific. So let's try that in this case. This approach has the inherent error of being unable to explain all the detailed contradictions that constitute life. It is also very selective. About these three countries, I would have said in the abstract:

- Generally, Indonesia had a long pattern of decades of economic growth from the 1960s to 1997 that quite effectively benefited the poor. Perhaps a poster child for the beneficial impacts of good macroeconomics (only?) on economic growth. But it fell apart in part (as Gus's data show) after the 1997 economic crisis, and the fall of former President Suharto. One can make the case that the corrupt system that Suharto put into place has been succeeded by still more corruption as an honest center was not built and no one knows the way

forward (See my own work and that of McLeod, 2003 among others). There is an exception in the Indonesian political process for good macroeconomics, but the military and the civilian politicians probably do not understand/accept the necessary institutional support for reform that is required to again achieve rapid economic growth. This makes it hard not to be a little skeptical of how Indonesia's future will sort itself out.¹

- Egypt started with major assets in the form of the Suez Canal, the antiquities, and cotton. Egypt has to be the poster boy for the view that trying money as the basis for economic development is workable. For decades, after the late 1970s when the US decision to aid development was taken to try money, it looked as if nothing much would happen. Pushing on a string for many years. But the last decade appears to look as if major benefits in the form of pro-poor economic growth have finally been achieved, although the macroeconomic benefits of reform seem limited. It is possible to argue that that was because the reforms that have been achieved were more apparent than real.² Still a dictatorship. When the transition comes, will it become Indonesia? Is it the benefits of continuing education and health care, just luck, or the advantages of persistence?
- Sri Lanka tried redistribution, direct services for the poor, and built indicators for the poor that seemed highly successful to many observers, particularly

¹ Decentralization was probably required in Indonesia to improve the efficiency of government services, to promote democratic decision-making, and most important to keep the nation-state of Indonesia together after the secession of East Timor. However, it is profound negative side effect of the process that corruption was also decentralized. There is an argument that decentralization will eventually bring to the fore local officials who will fight corruption. I believe it will be true in Indonesia. See for example, Matt Moffett, Staff Reporter, "In Argentina, Tough Mayor Shows How to Clean House," *The Wall Street Journal*, July 1, 2003, p. 1.

² I am not an Egypt specialist, so this is a very tentative conclusion.

Amartya Sen who won the Nobel prize in economics in 1998 for wonderful technical work on welfare economics. Sen also has been seen as advocating the case for a special role for Sri Lanka as a special beneficial case for the strategy of redistribution as the vehicle for supporting pro-poor economic growth. That approach did seem to work in Sri Lanka for a number of years, but has now foundered on the ability of the middle class corruptly to capture the redistribution and because of the adverse effects of the approach on government fiscal/budgetary discipline. Sen's superb technical economic work together with his advocacy of Sri Lanka's approach has caused that approach perhaps to be overvalued as a special case about the possible disconnect between GDP per capita and the beneficial impacts on the poor (there is a disconnect, but in my view based on my reading of Sen and related literature on Sri Lanka is that the benefit is largely limited to health, where well being and longevity are key variables with causal value independent of personal income. So, perhaps a short-term benefit of a few decades is ensuing followed by continuing budget crises as the corrupted middle class and the political process fights over the limited spoils). Sri Lanka has as Gus shows for a number of years now achieved substantial beneficial economic growth now that both political parties are willing to support it.

Integrating Remarks

Perhaps the most plausible conclusion is that if we are serious about making economic development work, we might try a combination of direct expenditures benefiting the poor, good macroeconomics, much more money for development from

outside the nation being developed than we have normally yet tried, and strong efforts at internal institutional development (the new institutional economics and its protégées).

- In all three of these cases, an investment in direct spending affecting the poor in the form of improved education and health care did help over decades to lay a foundation for decent but minimal economic growth.
- In all three countries, good macroeconomics appeared to make a difference, and policy reforms seem to be critical (although not perfect in their beneficial effects on the poor). Together with direct investment, this good macroeconomics probably provides the necessary upside for sufficient economic growth in fact to reduce poverty successfully.
- Indonesia succeeded for many years because of the natural resource increment it could exploit. That is, like Egypt, it too tried money. The main characteristics of Indonesia's successful economic growth for several decades arose because of now-deceased President Suharto's dictatorship and his interest in good macroeconomics on a cyclical basis (good macro led to his trying more rip-offs led to economic failure led to his trying good macroeconomics again 3-4 times over his long dictatorship).
- The potential for benefiting from the vast Indonesian natural resource increment led to very serious corruption, and built in a corrupt decision making system on both the military side and the civilian side that only permits decent macroeconomics as a government policy to be uncorrupted. This corruption is a direct consequence of how Suharto ran the economic system. Money from natural resources helped but the institutional

development is so weak that it is hard to see the way forward beyond good macroeconomics. The benefits of economic growth brought under such a dictatorship have a long term downside. The Indonesian political and military process thinks all but decent macroeconomics is fair game for corruption.

- In my view, it is quite likely that it will be some time, if ever, before the adverse effects of the “successful” but highly corrupting Suharto system are worked through in Indonesia. There are reformers in strong positions in Indonesia, and they can be worked with. However, the corruption is probably endemic. Hopefully this judgment is too pessimistic.
- Sri Lanka did not have either the outside money or the major natural resource factors, and its effort to redistribute without them foundered on budget problems. However, it is small enough, and apparently we are interested enough so that money might be tried. (Have a conflict for many years and end it to much international aid?)

One Technical Comment:

Gus’s work on the poor and inflation in Indonesia after the 1997 economic crisis.. Inflation is important but there are qualifiers. The standard qualifier is the extent of goods that are tradable. Gus’s work consistently shows major adverse impacts of inflation on the poor. In the wake of the 1997 economic crisis, I was on the border between East and West Timor talking with locals at a local market far from cities. Not a single international good traded at that local market. My recollection is that salt and cigarettes were the only manufactured good sold. As Gus says aggregates can be

misleading. Locals said the hardest part about changes was that the simple manufactured goods available became so expensive they could not be purchased. Do Gus's inflation data reflect these differences? I doubt it. Is it systematically the case that poor and isolated groups have very little in the way of tradables in their market basket of goods? Almost certainly. Do Gus's data on the impacts of inflation on the poor potentially overstate the adverse effects of inflation caused by exchange rate depreciation on the poor? I think yes.

Bottom Line Personal Judgments

The anthropologists, sociologists, political scientists and Gus (?) are probably right that strategy 1 is worth supporting, despite its potentially corrupting problems. Economists with a strong interest in macroeconomics are probably right too. Ten rounds and no decision.

To do institutional reform, the other possible factor, requires a broader approach than just macroeconomics, is necessary to support such economics, requires working both inside and outside government, and requires a long time frame. Yet, the more we work inside government, the more likely it is that capture of government programs, such as happened in Sri Lanka with their anti-poverty programs, will be the outcome.

The answer as some civil society advocates believe is not to work solely outside of government. Reform of civil society and the introduction of democracy is very important, and in my view a necessary condition for stable long-term economic growth. But I believe very very strongly that success in civil society organization will not ultimately reform the institutions of government without reformers working inside government – institutional reform within government must be carried out.

Reconstruction and Poverty Alleviation in Uganda: 1987-2001

John R. Harris
March 26, 2003

Geography

- Landlocked
- Tropical
- Fertile in South
- Dry in North and East
- Distinct ethnic groups in different regions

Colonial Period

- 1900-1962 British Protectorate
 - Principally smallholder agriculture
 - No permanent European Settlement
 - Dominant commercial role of Asians
 - African Education strong in South
 - Military recruited from North
- Part of East African Common Market
 - Partnered with Kenya and Tanzania
 - Common infrastructure services

Post Independence Regimes

- First Obote Government
 - 1962-69 parliamentary democracy
 - Ethnic conflict in 1966 - worsening in 71
- Idi Amin Military government 1971 - 1979
 - Expelled Asians in 1972 distributed property to military
 - Rapid decline of economy (about 40% decline in GDP/POP)
- Tanzanian-led invasion and Interim Regime 1979 - 1980
- Second Obote Government 1981 - 1985
 - Further economic decline
 - Widespread human-rights abuses
 - Guerilla war in South and West
- Army takes over in July 1985 -- war continues

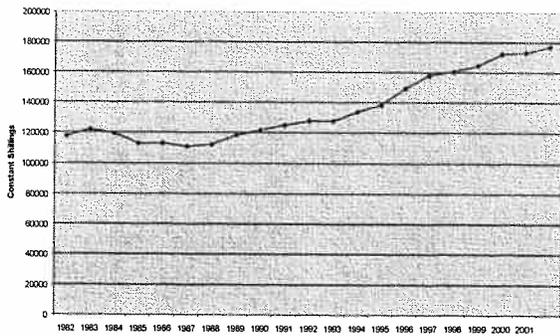
Museveni Regime (Jan. 1986 - present)

- Guerilla movement takes over
- Immediate tasks
 - to create security
 - begin rehabilitation of physical infrastructure
 - control inflation
 - reestablish fiscal system
 - stimulate exports to deal with BOP crisis
 - Reform - reconstruction of Civil Service
 - Negotiate international assistance

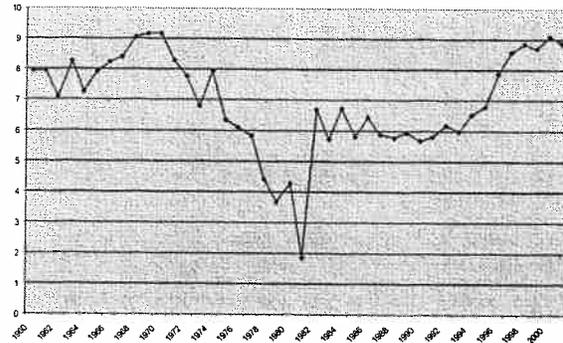
Evolution of The Economy

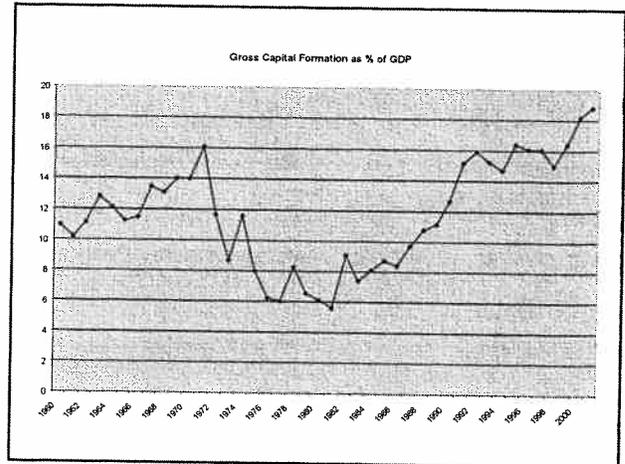
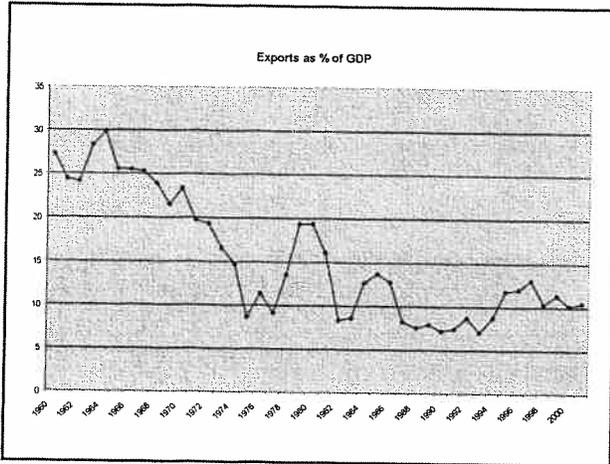
- Real GDP / POP (See Chart)
 - Since 1990 growth - cumulated 50%
 - No regular data for earlier period- best guess, 2000 level about equal to 1962 (independence) level -- still lower than 1972
- Manufacturing share of GDP (See Chart)
 - Reflects collapse of "formal sector" and recovery since 1994
- Export share of GDP (See Chart)
 - Sharp declines 1970-76
 - Variations responding to international coffee prices 78-82
 - Slow recovery since 1993
- Gross Capital Formation as % of GDP (Chart)

Uganda - Real GDP/POP
1982-2001



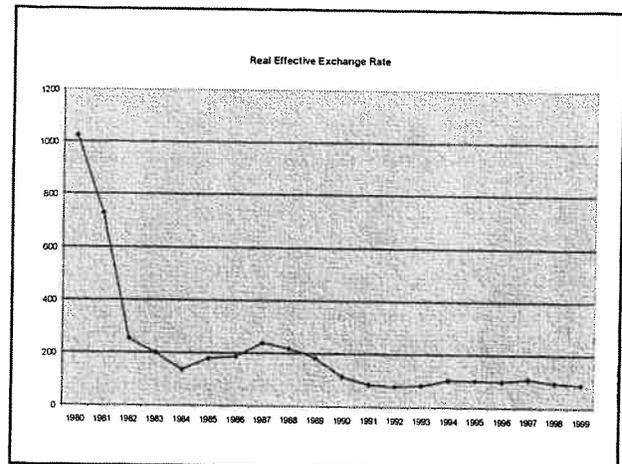
Manufacturing % of GDP

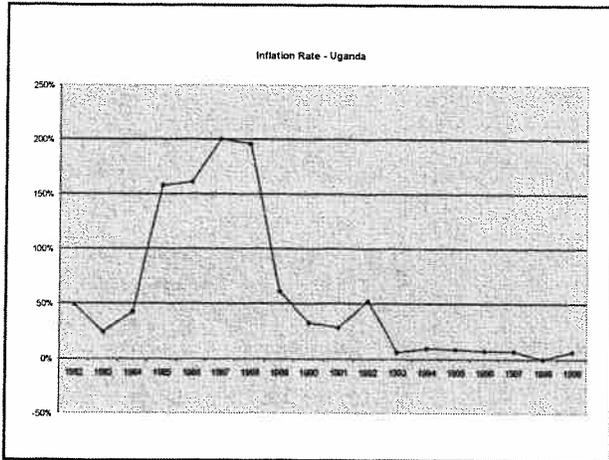




Principal Policies

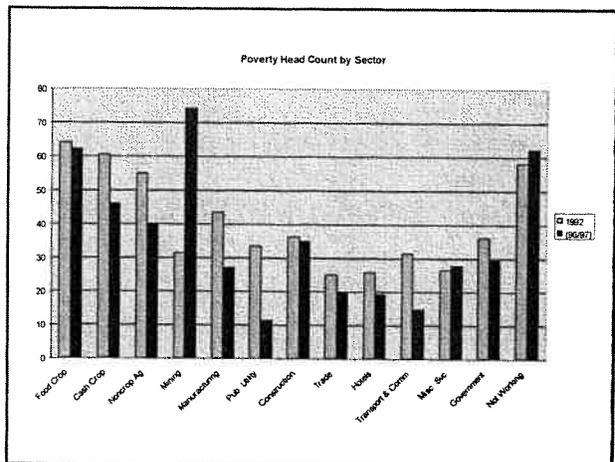
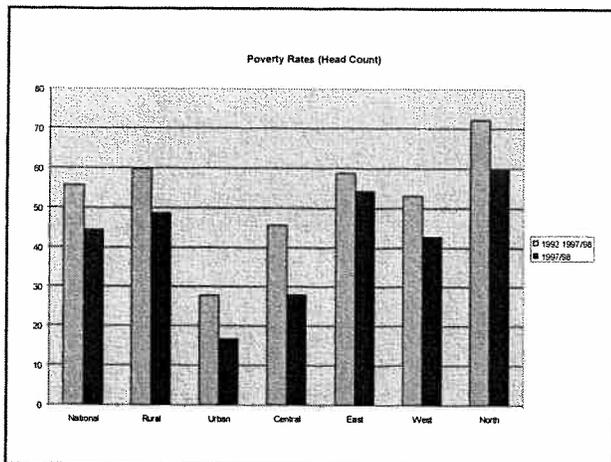
- Restoration of order (except in Northeast)
- Allow Exchange rate to float
 - Black market premium declined from 250% in 1988 to zero in 1993
 - Real Exchange Rate depreciates
- Impose fiscal discipline
 - Revenue raised from 10.4% of monetary GDP in 91/92 to 15.5% in 98/99 with tax reform that reduced marginal rates.
 - Reduced monetization of deficits.
- Liberalize Crop Marketing Systems

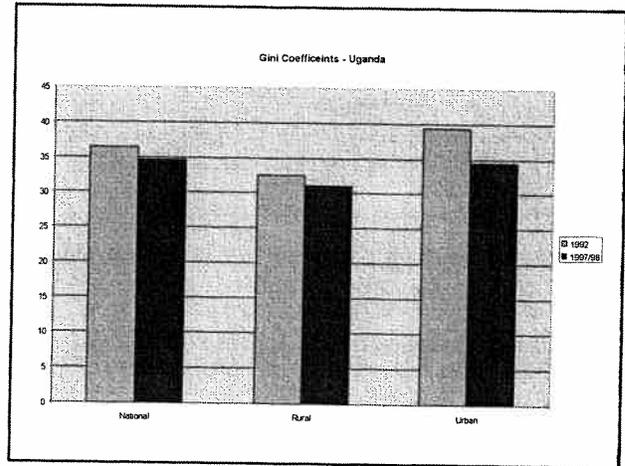
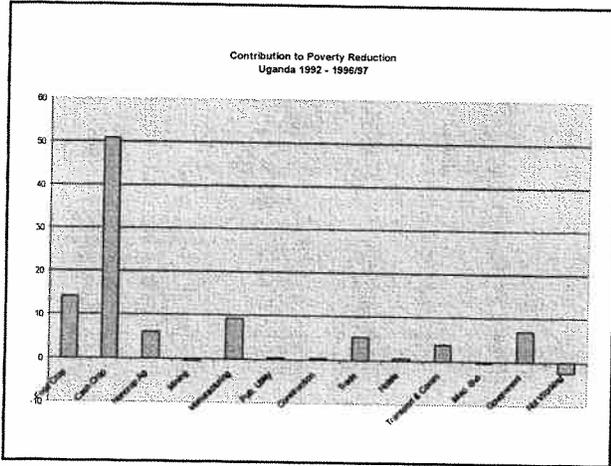




Who Has Benefited from Growth?

- Significant reduction in Head Count and Poverty Gap Measures (Charts) between 1992 and 1997/98
- Reductions in both rural and urban areas and in all regions
- Reductions in all occupations except mining and not working
- Over 50% of overall reduction from the cash crop sector.
- Inequality has also been slightly reduced (Gini Coefficients)





Poverty Eradication Action Plan

- “The main objective of Government is to eradicate poverty. The Poverty Eradication Action Plan (PEAP) is therefore the central planning tool of Government.” (Uganda Poverty Reduction Strategy Paper Progress Report 2002)
- The PEAP has four major pillars
 - Sustainable economic growth and structural transformation
 - Ensuring good governance and security
 - Increasing the ability of the poor to raise their incomes
 - Improving the quality of life of the poor

The Impetus for Reform

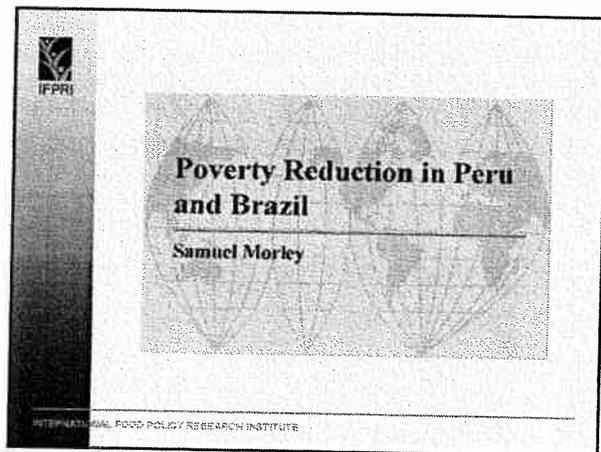
- Important role of international donors. Aid has been significant.
- Uganda first country to qualify for debt relief under the HIPC initiative.
- Extraordinary small group of “technocrats” supported by President on the basis of results

Areas of Success

- Continuing economic growth. Some diversification
- Successful expansion of schooling -- universal primary education almost achieved. Quality??
- Mobilization of the poor through NGOs for poverty assessment.
 - People report little progress in poverty alleviation in contrast with the measured data! (Similar to Dilip's report on privatization of utilities)
- Africa's most successful effort in dealing with HIV/AIDS

Areas of Concern

- Difficulties in effective health care delivery. Persistence of high mortality among infants, young children and mothers. Little change in mortality indicators.
- Inefficiency in the water sector -- significant increases in funding has led to modest increases in output.
- Problems in increasing quality of services and targeting them to the poor.
- Corruption remains a major problem
- Continuing insecurity in the North and Northeast.



Key features of the period since 1990 in Latin America

- Almost every country adopted the Washington consensus reforms
- Slowdown in growth since 1995
- Rise in income inequality
- Extreme poverty about 17% under \$1 per day. (80 million people). Has been rising since mid 1990s.

The growth slowdown

- Worse in South America-growth falls from 2.9% per year 1990-94 to .5% 1995-99.
- S. America in recession 40% between 1995-99, compared to only 12% in C. America (excl Jamaica).
- Performance over entire 90s is worse than 1950-80-the period of import substitution.

Decline in export growth after 1995- the main reason for slowdown

- Widespread decline in export growth in almost every country in region-particularly in S. America.
- Good performance in Mexico, C. Rica and D.R. disguises bad performance elsewhere.
- Exports rose by 22% in those three between 1997 and 1999 but fell by 9% elsewhere.

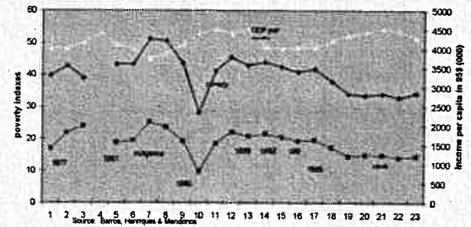
Poverty trends in Peru

Year	Poverty			Extreme Poverty		
	ELAC	CUMTIO	INE	ELAC	CUMTIO	INE
1970	50.0			25.0		
1979	46.0			21.0		
1986	52.0	41.6		25.0	18.4	
1991		55.3			24.2	
1994		53.4			19.0	
1997		50.7	42.7		14.7	18.2
2000		54.1	48.4		14.8	15.0
2001			49.8			19.5

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Poverty trends in Brazil

Figure 1: Income per capita and poverty



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Growth and Poverty Reduction-Brazil

	pov elasticities	growth of income	growth of poverty	yearly growth rates.	
				income	poverty
1970s	-0.445	0.6364	-0.2041	0.0562	-0.0250
1980s (79-90)	-2.781	-0.0347	0.1026	-0.0032	0.0089
1990s	-4.055	0.0617	-0.2188	0.0067	-0.0271

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Growth and Poverty reduction in Peru

Sub-period	(1)	(2)	(3)	(4)	(5)
	% Change in GDP/capita	% Change in Poverty	Ratio (2)/(1)	% Change in Extreme Poverty	Ratio (4)/(1)
1970-79	+8.4	-8.0	-1.0	-16.0	-1.9
1979-86	-2.2	+13.0	-5.9	+19.0	-8.6
1986-91	-33.5	+32.9	-1.0	+31.5	-0.9
1991-97	+26.0	-8.3	-0.3	-39.3	-1.5
1997-00	-1.7	+6.7	-3.9	+0.1	-0.1
1997-01	-3.1	+16.6	-5.4	+30.1	-9.7

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Conclusions from data

- Poverty falls with growth, but elasticity is higher in recession than recovery.
- In 1990s both countries do well.
 - Inflation control-91 in Peru, 94-5 in Brazil
- Peru-Faster growth and rural social investment.
- Brazil- progress in spite of slower growth. Role of rural pension reform in 92-3.

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Rural poverty reduction

- Both countries made big improvements in rural indigence.
 - Peru-falls from 38% to 30% in Andes and 39% to 31 % in Amazon (94-2000)
 - Brazil-from 46% in 1990 to 27% in 1999.
- Bigger percentage reduction than in urban areas and it continued after 1999 while urban was rising.
- How? Rural social investment in Peru, rural pensions in Brazil.

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Lessons from two countries

- High rates of inflation hurt the poor
- Controlling high inflation was very favorable to poor in both countries.
- You can reduce extreme poverty with well targeted social spending.
 - Foncodes and other programs in Peru
 - Rural pensions, disability safety nets, bolsa escola in Brazil. Reduced indigence by ten percentage points.

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Social spending and burden of pensions in Brazil

Social Sector	Average 1990-91		Average 1997-98	
	social spending per capita (\$7 dollars)	social spending as % GDP	social spending per capita (\$7 dollars)	social spending as % GDP
Federal Social Spending	476	11	605	12.5
Education, science & tech	55	1.3	43	0.9
Health, food and nutrition	115	2.7	95	2.0
Soc. Security and assistance	254	5.8	423	8.7
labor and training	36	0.8	35	0.7
housing and sanitation	16	0.4	9	0.2
State and local	310	7.1	402	8.3
Education, science & tech	107	2.4	145	3.0
Health, food and nutrition	41	0.9	79	1.6
Soc. Security and assistance	97	2.3	117	2.4
labor and training	14	0.4	10	0.2
housing and sanitation	51	1.1	51	1.0
Total, consolidated	786	18.1	1007	20.8
Education, science & tech	162	3.7	188	3.9
Health, food and nutrition	156	3.6	174	3.6
Soc. Security and assistance	351	8.1	540	11.1
labor and training	50	1.2	45	0.9
housing and sanitation	67	1.5	60	1.2

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Social assistance and social security

- Brazilians say they are spending a lot (11% of GDP) and targeting badly. Should be able to eliminate poverty. Misleading.
- Only 2.2% is in compensatory programs (1.1% rural pensions), rest is contributory pensions-private sector and gov't.
- Spending too much on old, not enough on education and the young.

Targeting of social spending

- World Bank said only 13% of social spending goes to bottom 20%. But that is the pensions.
- Excluding contributory pensions and unemployment insurance which are not safety nets, 35% goes to the poor. Its well targeted, but small-2.25% of GDP. Pensions are about 9%.

Fiscal burden and crowding out in Brazil

- Tax burden is 32-34%, but still no fiscal equilibrium.

	Rate of Investment (% GDP)		Saving (% of GDP)			
	current prices	constant prices	external	National		
				total	public	private
1961-63	15.4	19.1	-1.4	14.1	2.5	11.5
1964-80	19.8	21.7	2.4	17.5	3.6	13.9
1981-93	21.2	17	1.1	20	-1.5	21.5
1994-2000	19.7	16.5	3.3	16.4	-5.4	21.8

Making more progress on poverty reduction in the future

- Getting higher sustainable growth rates. Exchange rate policy and higher investment.
- Investing in education. Share of GDP down to 2.9% in 90s, and to 3.9% in Brazil.
- Creating employment
- Doing something about backward areas, Northeast in Brazil and Sierra-Selva in Peru.

Educational Sector Study: Pro-Poor Economic Growth Effects of Policies and Activities

Jere R. Behrman

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EGAT's Office of Poverty Reduction
meeting on July 1 2003 to review work by
Development Alternatives, Inc. (DAI) and the Boston
Institute for Development Economics (BIDE)

Introduction

- *Education most usefully defined to include a broad range of learning activities.*
- *Education widely thought to be central for promoting efficient growth and for increasing assets of the poor to bring them out of poverty over time, if not immediately.*
- *Paper reviews what we know and do not know about pro-poor economic growth effects of policies and activities in educational sector, drawing on the substantial literature in this area.*

- *Education is broadly defined as noted, but given concentration in the literature on formal schooling, this review also of necessity concentrates on formal schooling.*
- *Paper indicates, based on imperfect available knowledge, recommendations about what to do and not to do in this sector, the prioritization of strategies and how such recommendations depend on different country conditions and thus the topology of countries.*

- *Recommendations regarding what to do and what not to do in the educational section can not be made in a vacuum. To understand what we know and what we do not know, some framework for analysis necessary (Section 1).*
- *Basic aspects of patterns in the most-emphasized form of human capital, schooling, with regard to associations with regions, time, per capita income and adult women's schooling in order to provide some perspective (Section 2).*
- *Recommendations for educational policy and pro-poor economic growth (Section 3).*

1. Frameworks for Analysis

- 1.1 Why Frameworks For Analysis Necessary
- 1.2 Analytical Frameworks for the Determinants of Investments in Education
- 1.3 Empirical Issues – Measurement
- 1.4 Empirical Issues – Estimation of Effects of Investments in Education
 - 1.4.1 Experimental Evaluation
 - 1.4.2 Econometric Estimates of Impacts of Investments in Education
 - 1.4.3 Implications for Analysis of Endogenous Policies

Illustration of Caveat on Estimation and Causality:

Jere R. Behrman and Mark R. Rosenzweig, "Does Increasing Women's Schooling Raise the Schooling of the Next Generation?" *American Economic Review* (March 2002)

Conventional wisdom:

- (1) important return to women's schooling is increased schooling of their children.
- (2) increasing women's schooling has greater beneficial impact on children than increasing men's schooling.

Existing studies, however, may overstate impacts of women's schooling on children's schooling:

- (1) intergenerational schooling associations may reflect intergenerationally correlated genetic ability endowments
- (2) assortative mating means that more schooled women marry more schooled and more able men.

Estimates of the Effects of Mother's and Father's Schooling on Children's Schooling: Married Female Monozygotic (MZ, Identical) Twins

	Cross-section	Cross-section	DMZ
Mother's schooling	.332 (6.88)	.133 (2.64)	-.274 (1.89)
Father's schooling	-	.251 (5.34)	.133 (1.87)

1.5 Basic Policy Motives --Private Versus Social Returns and Distribution

- 1.5.1 Efficiency/Productivity
- 1.5.2 Distribution
- 1.5.3 Policy Choices to Increase Efficiency and to Improve Distribution – Policy Hierarchies

1.6 Methodology for Economic Evaluation of Investments in Education

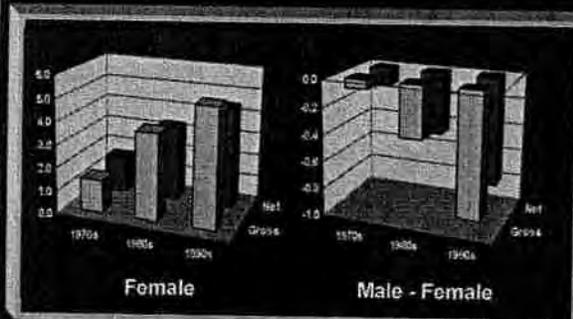
2. Patterns in One Central Form of Education – Schooling

- 2.1 Region
- 2.2 Time
- 2.3 Income
- 2.4 Adult Female Schooling
- 2.5 Multivariate Associations

Female Enrollment & Male-Female Enrollment Gaps: Variation over Time

- Female primary enrollment rates rose from 67% in the '60s to 91% in the '90s (and 93% in 2000), & secondary enrollment increased from 21% in the '60s to 61% in the '90s
- Gender gap in primary enrollment decreased from 15 to 7 percentage points, while the gap in secondary schooling decreased from 6 to 2 percentage points
- Average expected female schooling increased by almost 90%, from 5.8 years in the '60s to 11.0 years in the '90s, and gender gap fell by 1.3 years during this period
- Primary-secondary enrollment gap narrowed substantially (by more than 25 percentage points), although secondary enrollment levels still lagged substantially behind primary ones

Expected Years of Schooling by Time



Female Enrollment & Male-Female Enrollment Gaps: Variations by Region

S. Asia, sub-Saharan Africa & Middle East & N. Africa lagged behind developed countries by as much as 56, 46, and 31 percentage points in primary enrollment

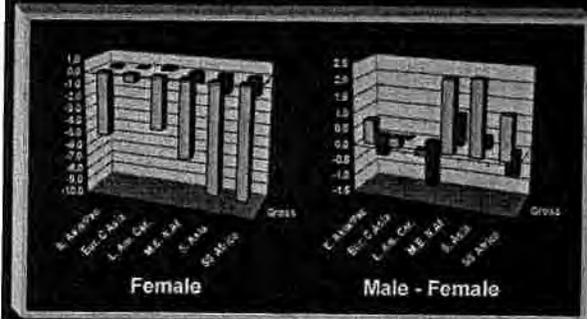
- Secondary enrollment rates were even lower (lagging behind by 59, 66 and 44 percentage points)
- Gender gaps, too, largest in these regions

E. Asia & Pacific, Europe & Central Asia, and Latin America & the Caribbean lagged behind in prim. enrollment by only 12, 6, & 5 percentage points – but by close to 40 percentage points in sec. enrollment

Compared to girls in developed countries, girls in Sub-Saharan Africa & S. Asia would have 9 less years of schooling

- Girls in the Middle E. & N. Africa, E. Asia & the Pacific, & Latin America & the Caribbean, would have 5 less years of schooling, on avg.
- The gender gap was the widest in South Asia and the Middle East & N. Africa (2 years), followed by sub-Saharan Africa (1.4 years)

Expected Years of Schooling by Region

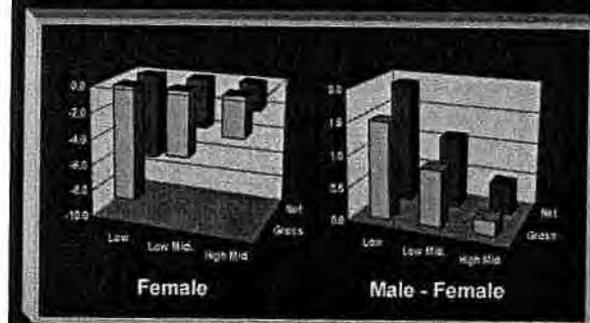


Female Enrollment & Male-Female Enrollment Gaps: Variation by Income

Girls in low-income group received 8.8 years less schooling than those in high-income group; those in lower-middle and upper-middle-income groups lagged behind by about 5 and 3 grades. Gender gap in schooling decreased from 1.7 grades in low-income countries, to 1.1, 0.4 and 0.2 grades for successively higher income-group countries.

Female primary enrollment rate in low-income countries increased from 53% to 88%, 97%, and 102%, in lower-middle, upper-middle, and high income countries. Female secondary enrollment rate rose from 16% to 38%, 50%, and 77%. Primary level gender gap increased by 3, 9, and 17 percentage points, respectively, as income levels fell.

Expected Years of Schooling by Income

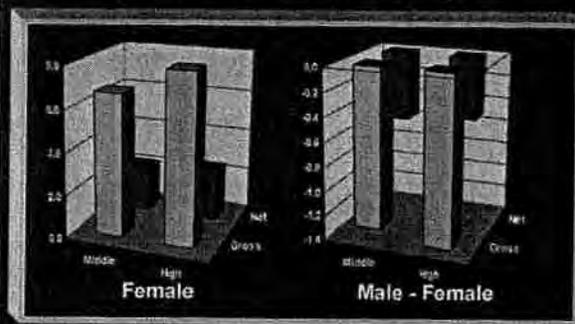


Female Enrollment & Male-Female Enrollment Gaps: Variation by Adult Female Schooling

Progressing from low to middle and high adult female schooling levels (i.e., below 6 years, to above 6 years, to above 9 years):

- Female primary enrollment went from 79% to 101%
- Secondary enrollment rose from 29% to 83% to 94%
- Expected years of schooling rose by 6.7 & 8.2 years on avg
- The male-female disparity in expected schooling dropped from 1.3 to close to zero, & then to -0.1 (i.e., favoring females over males)

Expected Years of Schooling by Average Adult Female Schooling



3. Key Recommendations Based on Available Literature

1. Recognize that education is more than formal schooling (pre-school PIDI Bolivia; ABEL Bangladesh, Ghana, Senegal bcr 19.9)
2. Distinguish between private and social rates of return to different types of education and be conscious of policy hierarchies (rare-India for learning, Kenya for worms)
3. Recognize that rates of return to investing in education of poor appear fairly substantial in many cases – comparable or exceeding those to many other investments, with those females at least as high as those for males (bcr 3.3 for Colombian scholarship, 1.7 for Progresca, 1.7 for PIDI)

4. Recognize that rates of return to education depend importantly on market, policy and cultural contexts (India technological change; LAC policy changes; aging populations, no magic bullets)
5. Focus on parts of lifecycle in which returns are likely to be highest and include health and nutrition support among policy tools (Pakistan, Philippines, Zimbabwe, Mexico, Kenya)
6. Improve school access for basic education (Indonesia, Pakistan, Bangladesh, Colombia)
7. Consideration should be given to improving educational quality, not just to increasing quantity of education (Brazil, South Africa, Israel, India, Mexico, Bangladesh, Kenya, Nicaragua)

8. Before using mandates to attempt to increase education, obtain more information about their effects
9. Consider using incentives in form of scholarships for students from poor families to increase their education (Bangladesh, Mexico, Brazil, Colombia)
10. Improve information about what educational providers are providing (Kenya "teach to test")
11. Improve information and evaluation of rates of return to alternative strategies for increasing education (Mexican Progresa/Oportunidades, Kenyan experiments)