In this paper, we...

• Present an analytical framework to identify the links between macroeconomic and social protection policies from an inclusive growth perspective.

• analyze how these policies interact.

• present the design and the objectives of some social protection programmes, emphasizing how they interact with the growth goals.

• Present the implications of these interactions in fiscal space.

• G20 “”lite”” version available for perusal
Objectives of macroeconomic policies

• While macroeconomic policies can have many objectives, there is consensus that there are three core objectives of such policies viz:
  • Stable Growth;
  • Price Stability;
  • External Sector Equilibrium.
Objectives of social protection policies

• With social protection policies, the picture is more complicated; for the purposes of this paper, we generalize two overarching objectives of social protection policy

• **Equity**: *not* a deontological objective; different from inequality.

• **Vulnerability**: the possibility of regress from an attained state of wellbeing.

=> Can arise from the existence of a particular demographic or societal feature (gender, ethnicity, poverty, disability) that can impair the ability of a socio-economic group to withstand exogenous shocks, including macroeconomic shocks

=> focus of “safety nets”
The links

In Table 1, page 3 and the ensuing discussion, we have focused on the links between two major macroeconomic policy objectives – growth and price stability and two social policy objectives: equity and vulnerability.
Growth-equity

• In the late 1990s the bilateral and multilateral development agencies placed increasing emphasis on poverty reduction in developing countries – MDGs
• The focus shifted from broader issues of equity to the more specific issue of poverty reduction.
• Higher levels of growth would reduce poverty with complementary microeconomic measures.
• The task therefore was to maximise growth and then, through income transfers (domestic and aid financed) and poverty reduction programmes, to use the benefits of such growth to reduce poverty – Kaldor Hicks
Not a consensus

• Pro-poor growth? What is it?
• Equality of opportunity
• Rise of emerging economies: challenge to “you can’t redistribute poverty” adage
• Jobless growth, demographic dividend seen as missed opportunities
• Inclusive growth: ensuring that the growth process was targeting at better inclusion of citizens – as workers, entrepreneurs and consumers of public and private goods – into the delivery of growth
Price stability and equity

• The traditional approach to the price stability objective has been to focus on the overall price level, using monetary or fiscal instruments.

• These instruments are used to target a desired rate of overall inflation and to smooth excessive volatilities in such inflation.

• **Subsidies and tax concessions** used to control specific prices and to ensure that poor and vulnerable groups were able to access key basic goods and services.
Price stability equity vulnerability

Within inclusive growth approach 2 differences

(1) Transfers, public works, rights based guarantees used more broadly, often replacing subsidies and tax concessions

(2) Recognition of the countercyclical value of social expenditure
An analytical framework

• Macroeconomic policy analysis focuses on its own objectives as do social policies

**Result:** dissonance in discourse with social protection being seen purely as “costs” to the public exchequer and macroeconomic policies being, in turn being viewed as “constraints”.

• But the recent experience of emerging developing economies and middle income countries shows that there is considerable potential complementarity between the two
An analytical framework

The simple analytical construct presented has the following message (page 6)

• Growth occurs through a combination of
  => increases in the application of resources (capital and labour)
  => improvements in the productivity of these resources, and
  => improvements in innovation (whether technical, procedural or institutional) that enable more to be produced with the application of the same quantum of resources.
Key conclusion

Growth is more inclusive when the returns from each of the above growth process from participation accrues to those on the wrong side of the income distribution divide.

Two key changes in approach
(1) Growth is a target not a maximand
(2) There is no factor exhaustion
Making this happen involves

(a) using the factors of production owned by these groups more intensively to deliver growth
(b) Increasing the returns (e.g. through human capital and capability improvements) to their factors of production
(c) Increasing their share of gains from institutional and technical changes that increase overall productivity
Analytical framework

The role of social policies is to make interventions that make all or any of the above happen possible.

Examples:
Brazil, India Ethiopia Brazil Mexico Colombia

• The above examples indicate an important departure in conceptual approach from the safety net approach.
Fiscal space

Issues to consider:

(1) Social protection, if more than about safety nets, is more than a “”regrettable necessity””
It is key to inclusive growth

(2) It contributes to fiscal stability by delivering on the stabilisation and allocation functions as much as the traditional redistribution function when not used as a Kaldor-Hicks instrument
Fiscal space

(3) Social protection is financed out of current expenditure. In developing countries, these are typically permanent in the short term

- They also require increases in expenditures to secure the increases in the supply of public and merit goods
- Macroeconomic prudence requires a zero current deficit except in times of temporary cyclical stress
- With inclusive growth, these expenditures decline as a proportion of total expenditure in the long term.

- The time frame is therefore critical to assess their fiscal sustainability
Key fiscal lesson

• Social protection spending must be for highly specific objectives that deliver development results within the planning horizon.

• The development impact of such expenditures can then be expected to enhance the taxable capacity of the economy and allow for a broadening in ambition of the social protection programme in the medium term.

• If the above is true then there are ways to argue for fiscal space.
4 ways to argue for fiscal space

(1) Flagship social protection programmes -- low outlays as a percentage of GDP. (Table 2)

(2) When compared with expenditures on a “regrettable necessity” such as military expenditure, such programmes are magnitudinally small (Table 2)

(3) Latin America MIC experience provides a real time path to finding prudence-consistent fiscal room if revenue growth is income elastic

(4) Dropping Kaldor-Hicks affords scope for expenditure switching