The IMF Conference on
Economic Policy and Equity
Opening Remarks by Stanley Fischer
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Introduction

Welcome to this conference on "Economic Policy and Equity," a part of the IMF's continuing efforts to better understand equity, and to integrate equity considerations in the operational work of the Fund. This event comes three years after our 1995 conference on income distribution and sustainable growth, and provides an opportunity to follow up on the findings of the earlier conference, to compare its findings with subsequent experience and to attempt to distill lessons for the future. Over the next couple of days, we look forward to a lively debate about what more the IMF should be doing to strengthen its advice to member countries to promote equitable policies.

Let me start with a question whose answer is almost self-evident: Why do equity considerations matter for the Fund?

First, as a matter of social justice, all members of society should share in the benefits of economic growth. And although there are many important arguments about precisely what constitutes a fair distribution of income, we accept the view that poverty in the midst of plenty is not socially acceptable. But, second, there is also an instrumental argument for equity: adjustment programs that are equitable and growth that is equitable are more likely to be sustainable. These are good enough reasons for the IMF to be concerned about equity considerations—whether it be poverty reduction or concerns about income distribution in the programs the IMF supports.

Let me confess that we are using the words "equity" and "equitable" as a way of avoiding the question of whether our concerns are with poverty *per se* or income and wealth distribution. The answer is: with poverty, for sure; with income distribution, sometimes.

Sometimes, reforms designed to achieve macroeconomic stability and growth may impact negatively on the poor, especially in the short run. To deal with this, many IMF-supported programs provide for budgetary outlays on temporary social safety nets to transfer income or protect the consumption of the poor. Over the long run, some policies that promote equity also promote growth—particularly increasing spending on health and education. And of course, we should never forget that the best way to reduce poverty on an enduring basis is to achieve sustained high rates of economic growth. The largest reductions in poverty in the course of human history were achieved in this way by Asian economies over the last three decades.

Given its mandate and limited resources, the IMF draws on the expertise of other institutions in its program design and monitoring; these institutions include the World Bank,regional development banks, the UNDP, ILO, and other UN agencies. In close collaboration with these institutions, the IMF assists member countries in integrating social policies in the macroeconomic framework, to ensure that these social policies are consistent with sustainable macroeconomic policies over the medium term.

The 1995 conference

The 1995 IMF conference on income distribution and sustainable growth provided guidance on the analytical and conceptual issues related to growth and inequality. The conference reached the following seven broad, sensible, and not necessarily novel conclusions:

- first, sound macroeconomic and structural policies emphasizing low inflation, realistic exchange rates, and an outward-oriented trade policy should generally be consistent with growth, reduced poverty, and improved equity over the long run;
- second, the government has a crucial role in providing and encouraging investment in human capital, which not only contributes directly to growth but also affects the distribution of income;
- third, the fairness of an economic system should be assessed not only in terms of whether individuals are able to move up the economic ladder but also in terms of whether income and wealth are acquired justly;
- fourth, the impact of growth on income distribution depends on the source of the growth, the policies followed to achieve it, and how the fruits of this growth are distributed;
- fifth, reductions in inequality encourage growth over the longer run by preventing inefficient redistributive policies that may originate from the political process;
- sixth, well-targeted and cost-effective social safety nets can help those adversely affected by structural reforms; and
- finally, the IMF should pay attention to the distributive implications of its advice.

We have tried to apply that advice and, to that end, have taken a number of concrete initiatives. For example, we have

- continued to incorporate social safety nets in IMF-supported programs and to emphasize the elimination of unproductive spending (such as excessive military outlays) and the shifting of expenditures toward the provision of basic social services (such as basic health care and primary education);
- increased our emphasis on "second generation" structural reforms—for example, ensuring the rule of law, dismantling monopolies, and reforming labor markets—to

ensure that the benefits of growth are widely shared;

- carried out country-specific studies (e.g., in Brazil, Indonesia, and the Philippines) on poverty and income distribution with a view to integrating them in our policy advice;

- improved the collection of data on government social expenditures, and the monitoring of social output indicators in member countries, particularly the heavily indebted and poor countries; and

- invited an external evaluation of the social aspects of adjustment programs in ESAF countries, the findings of which are now being incorporated in our own work and in our collaborative work with the World Bank;

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The Asian crisis has once again highlighted the importance of equity in the design of IMF-supported programs. In dealing with this crisis, it is essential to restore financial stability and contain the global contagion effects. But it is also critical to ensure an orderly adjustment that minimizes the impact on the poor and does as much as possible to protect the remarkable strides in poverty reduction these countries have achieved in past decades.

In these countries, adjustment programs include elements to cushion the impact of the downturn on the poor and the unemployed. For example:

- In Indonesia, where we are working closely with the World bank, the recently revised program includes temporary subsidies to protect low-income groups from the rise in the prices of food and other essentials—and more will undoubtedly be necessary in the next phase of the program. The program also makes provision for higher spending on health and education, subsidized credit for small and medium-size enterprises, and labor-intensive public works.

- In Thailand, the government has initiated temporary labor-intensive public works programs with the assistance of the World Bank and the Asian Development Bank. In addition, social spending is being strengthened by expanding scholarship and loan programs to minimize the number of student dropouts, and budgetary resources are being reallocated to health programs for the poor.

- In Korea, unemployment insurance is being expanded, and allocations for social assistance have been increased.

What are the goals for this conference?

To frame the discussion, let me pose four questions:

First: How widespread is the increasing trend in income and consumption inequality that we have observed in some parts of the world?

Whereas Latin American and Sub-Saharan African countries have exhibited high levels of inequality for some time, there is increasing evidence that inequality may be rising—including in some G-7 countries. In many developing countries, inequality has also taken on a regional dimension: average incomes in urban areas are significantly higher than in rural areas. And, of course, the transition to a market economy in the former centrally planned economies has raised concerns about rising inequality. We would be interested in discussing how these trends manifest themselves as policy issues in different countries.

Second: Has globalization tended to increase or reduce inequality within countries?

The debate over the impact of globalization on income distribution has been vigorous. On the negative side, it is argued that globalization has led to a growing income gap between skilled and less-skilled workers; limited the ability of governments to tax capital and thus led to an increased need to tax labor; and limited the ability of union workers to achieve a union wage premium, changing the bargaining power of workers vis-à-vis capital.

But globalization has enabled greater specialization in production and the dispersion of specialized production processes to geographically distant locations, thereby spreading the benefits of trade and technology to all parts of the globe. Globalization has also meant thatmany developing countries have been able to accelerate investment and growth by attracting capital flows to expand investment and increase growth.

To a large extent, globalization is simply the continuation of the trend toward greater international economic integration that has been under way for the last 50 years. That was the intention of our founding fathers, who met at Bretton Woods, and who hoped to restore the global prosperity that had been ravaged by two world wars and the Great Depression. The difference is that distance is no longer the impediment it once was, and markets today are larger, more complex, and more integrated than ever before—and that globalization of capital markets is increasing apace.

We believe that open world markets are in the long-run interests of all countries. As you know, there has been a great deal of research on the question of whether it is opening to trade or changing technology that has widened wage differentials within the United States and in other industrialized countries. The answer that seems to be emerging is that it is mainly the nature of technological change. We hope you will address this question—particularly as it relates to developing, newly industrialized, and transition countries—and what the answer might imply for the appropriate mix and effectiveness of redistributive policies.

Third: Do income redistribution policies necessarily slow economic growth?

This question is particularly important in designing policies to reduce poverty. Some countries have actively promoted redistribution policies to reduce poverty, whereas others have relied more on growth to reduce poverty and improve equity. Underlying the latter strategy is a concern that policies that aim overtly to reduce inequality may retard growth. Even when equity-oriented policies are designed and formulated, there are constraints on their implementation. We need to ask under what circumstances are there trade-offs between income redistribution and efficiency; how important are such trade-offs; and what, if anything, can be done to mitigate them, given the legal, political, and other constraints on redistributing income.

Fourth: What are the most effective policies for promoting equity?

Although poverty reduction and equity can be affected by a broad array of macroeconomic policies and structural reforms, we have generally viewed fiscal policy as the most direct tool to these ends. The five key ingredients in the IMF's approach to equitable fiscal policy are:

- an approach to fiscal management that supports macroeconomic stability and enhances the prospects for sustained high quality economic growth--the best way to lower poverty on an enduring basis;
- implementation of a fair and efficient system of taxation--ideally a system of easily administered taxes with broad bases, moderate tax rates, and a minimum number of exemptions;
- reductions in unproductive expenditure;
- improvements in the composition of expenditure to promote the reduction of income inequality and increase equality of opportunity; and, as mentioned before,
- well-targeted social safety nets.

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These are demanding questions. They are also important questions. I hope you—academics, government officials, and religious and trade union leaders—will be able to help think through these issues as well as advise on what more the IMF can and should do in the context of its existing—primarily macroeconomic—mandate.

Thank you for coming, and thank you for the advice you will be giving us over the next two days.

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