

“Stability and Growth for Poverty Reduction”

By Christine Lagarde, Managing Director, International Monetary Fund

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It is a great pleasure to be here with this distinguished audience, and to host the Bretton Woods Committee Annual Meeting at the IMF. Let me thank Bill Frenzel and Richard Debs for their welcome.

“Ending poverty in a generation” is the theme of this year’s meeting. I want to commend President Kim for staking this high ground, and to salute the courage of his commitment to end poverty by 2030.

I am pleased also to see my dear friend Jim Wolfensohn. Jim’s intellectual leadership transformed the World Bank and he helped put tough issues like corruption and debt relief on the global agenda. Thank you, Jim, for continuing to lend us your indispensable energy and wisdom. For 30 years, the Committee has played a key role supporting the work of the IMF, Bank and other institutions. Your efforts to promote understanding of our mandate and your strategic guidance have helped us adapt to new realities. I want to express my profound appreciation for your support.

Back to poverty: we should first acknowledge that the world has seen major progress. As you know, the Millennium Development Goal to “halve the proportion of the world population” living in extreme poverty by 2015 was met five years early.

Moreover, in the three-speed global recovery now underway, the developing countries are leading the pack. After Asia, Sub-Saharan Africa is currently the second-fastest growing region. However, we cannot pat ourselves on the back just yet. There are still 1.3 billion people living under \$1.25 a day; and over 2 billion people living under \$2 per day.

Also, while numbers are important in themselves, they are not enough. It is ultimately about enriching human lives and enabling human potential.

Today I would like to discuss the role of the IMF in this effort. I have three messages:

- 1) Economic stability is essential for poverty reduction.
- 2) Growth and equity are mutually reinforcing, and necessary for sustainability.
- 3) Fiscal policies can improve equity and lower poverty.

1. Economic stability: essential for reducing poverty

I will begin with the over-riding importance of economic stability. We have learned that output declines caused by economic crises are the biggest source of long-lasting welfare losses among developing countries. For this reason, the first best contribution that the IMF can make to reducing poverty is to help avoid crises.

On average, it takes 6-12 years for developing countries to return to pre-crisis per capita GDP levels after an initial output drop.

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Moreover, this is not only an issue for developing countries. In the United States, for example, per capita GDP in 2012 was estimated to be about 9 percent lower than what it would otherwise have been without the global crisis.

Job losses are another huge cost of crises. Today, over 200 million people are still unemployed. This has immense economic and human costs.

So, first principle: economic stability is paramount for poverty reduction.

For this, the Fund’s role is clear: helping members build policy frameworks that minimize booms and busts, avoid home-made crises, and strengthen countries’ resilience in the face of external shocks.

In recent years we have stepped up efforts to help low-income countries cope with crisis. We significantly increased the resources available to low-income countries, upgraded our lending instruments and, crucially, we continue to charge zero interest on all concessional lending.

2. Growth and equity: mutually reinforcing and necessary for stability

Let me turn to my second point—growth and equity. I have been talking about preserving the total size of the economic pie by avoiding crisis. What about expanding the pie and making sure it is distributed more fairly?

Rising income inequality is a growing concern for policymakers around the world. Over the past 25 years, income inequality has increased in most advanced and developing countries, though it started to decline after 2000 in some regions.

This has not gone unnoticed: the Arab Spring and “Occupy movement”, though very different, were motivated in part by discontent with these trends. Let’s look at some numbers:

- The top 0.5 % of the global population holds over 35% of global wealth.
- In some countries like Canada, South Africa, the United Kingdom, and the U.S, inequity has soared in the past 25 years. In the U.S., the share of pre-tax income of the richest one percent of the population rose from 8 percent to 18 percent of the total.

What does this type of steep income pyramid mean for access to education for those in the lowest income quartile? What might it mean for social stability or growth?

The IMF has started to look more closely at this. Recent work has shown that prolonged periods of steadily rising output are associated with more equality in income distribution. In other words, more equal societies are more likely to achieve lasting growth.

So, equality is good for growth, but is growth good for equality? It may be a necessary condition for reducing poverty, but it has not always reduced inequality.

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There is solid evidence that social policies targeted to reducing poverty and promoting human development can have a powerful impact. For example, conditional cash transfer programs in Brazil and Mexico contributed to about 20 percent of the decline in inequality over a ten year period.

3. Fiscal Policies to reduce poverty

This brings me to my third point. What more can the Fund do to advance this kind of “inclusive” growth?

Fiscal policy is key. The good news is that, in advanced economies, fiscal policy has played a major role in reducing inequality in the past 30 years. The bad news? This impact has been declining since 2000.

Why? Because many countries have adopted reforms that have reduced progressivity in the tax and spending mix, that is, reduced the generosity of social benefits and lowered income tax rates, particularly at top brackets.

In developing countries, fiscal policy has generally been less effective at reducing income inequality. This is because tax and spending levels, as a share of output, are much lower, sometimes half the level of advanced countries. In addition, tax systems are often less progressive because of a lower tax base and greater reliance on indirect taxes. Yet there are fiscal policies that can help divide the pie more fairly.

On the revenue side, these are policies that help build stronger, more reliable revenue bases by reducing exemptions, combating tax evasion, and strengthening administration.

On the spending side, the Fund will continue to push for high-quality public goods and services. A priority has been protecting and augmenting social spending to reduce poverty and exclusion. For example, despite this long global crisis, two-thirds of sub-Saharan African countries have been able to expand public spending on health and education in real terms.

Reform of energy and other generalized subsidies is also critical. In 2011, energy subsidies represented about US\$2 trillion in fiscal resources worldwide —2.5 percent of global GDP. In developing countries, much of these subsidies benefit the middle and upper classes. On average, the richest 20 percent of households in developing countries capture 43 percent of total fuel product subsidies compared to 7 percent by the poorest 20 percent—six times more! These subsidies are not reaching the poorest households and are diverting public resources away from spending on health and education.

In addition, removing these subsidies would benefit the planet, reducing CO2 emissions by an estimated 13 percent.

Conclusion: institutions and governance

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Let me conclude with a word on institutions and governance. As you know, strong institutions and accountability go hand in hand with economic stability, sustained growth, and human development. The book “Why Nations Fail” by Daron Acemoglu and James Robinson made a very convincing case for this.

Institutions must be accountable to taxpayers and citizens; otherwise, striving to reduce poverty is like building a house on a bed of sand.

Good governance also matters at the IMF. In an ever-changing world, we must mirror our evolving membership. So we are pressing ahead with our quota and governance reforms. We have made very good progress but the leadership of our largest shareholder is a critical element. As you may know, the U.S. authorities recently submitted the 2010 package of reforms as a supplement to the budget. We welcome this and hope for prompt approval.

I would like to thank the Bretton Woods Committee for your support on this issue in the past.

To sum up, I am fully behind President Kim’s goal to end extreme poverty by 2030, and I pledge to work together with him on this.

With the right partnerships and the right policies, we can indeed see the end of poverty in our generation.

Nobel Prize-winner Muhammad Yunus said “Once poverty is gone, we’ll need to build museums to display its horrors to future generations. They’ll wonder why poverty continued so long in human society – how a few people could live in luxury while billions dwelt in misery, deprivation and despair.”

I truly look forward to that day.

Thank you.