Caleb M Fundanga: The MDG-consistent monetary policies

Talking notes by Dr Caleb M Fundanga, Governor of the Bank of Zambia, at the official opening of the UNDP organised workshop on Macroeconomic Analysis and Modelling in Support of Millenium Development Goals-Based Planning, Lusaka, 29 October 2007.

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Introduction

First and foremost, I would like to thank the UNDP through the Resident Representative, Mr Aeneas C. Chuma, for inviting me to say a few remarks at the opening of this important international workshop on "Macroeconomic Analysis and Modelling in support of Millennium Development Goal (MDG)-Based Planning". Let me also welcome you all, especially those who have traveled from other countries to come and attend this workshop.

I understand that the aim of this workshop is to strengthen the foundation laid for MDG-Based planning processes in Africa on the issues of pro-poor polices and macroeconomic modelling and to explain what an MDG-Consistent Medium-Term Expenditure Framework (MTEF) is all about. The workshop is also intended to sensitise and enhance your knowledge of pro-poor policies in the context of MDG-Based planning and strengthen understanding and skills in MDG-Consistent Macroeconomic Modelling and MTEF. Furthermore, at the end of the workshop, participants should be able to:

- Better understand the linkages between macroeconomic programming and strategic planning;
- Plan steps to be taken with respect to sustainable capacity development for macroeconomic modelling and strategic budgeting at various country levels; and
- Strengthen the national ownership and leadership in MDG-based planning and implementation process.

Mr Chairman, Central banks the world over have a critical role to play in a country's economic development. As you may all be aware, central banks' monetary and supervisory policies are implemented to ensure that there is price and financial system stability to promote macroeconomic development. In this regard, monetary policies or any other policy for that matter that are not consistent with the MDGs in the current macroeconomic dispensation should be considered irrelevant to the welfare of our countries. It is for this reason that, without exception, monetary policies in the developing countries have to be MDG-consistent.

Price stability

The primary objective of most central banks is price stability, which is achieved through the implementation of appropriate monetary policy. High inflation is a major source of concern to any country as it poses a threat to economic development. It is in this context that a central bank's primary role is to reduce inflation to low and stable levels.

The benefits of price stability, which are also important factors to the attainment of MDGs are: effective planning; lower investment costs; increased public and foreign investor confidence in the economy; improved external sector competitiveness; and accelerated economic growth needed to reduce poverty levels.

(a) Effective planning

When prices are stable, corporate institutions, governments, civil society and individuals are able to draw up their expenditure plans well into the future. In particular, companies will be

able to reliably plan with some degree of certainty for their operations and long-term investment in fixed assets that will expand their production capacity and output and lead to increased employment as well as enhancement of incomes. Similarly, a government is able to make more accurate projections of revenues expected to be collected in future and thus more effectively plan its current and capital expenditures that are likely to benefit the poor.

(b) Lower cost of investment

Interest rates being the cost of funds will inhibit borrowing for investment if they are too high. Interest rates, therefore, are an important factor in attaining price stability. Low and stable interest rates, which are possible with the achievement of low inflation, create conducive credit conditions that improve accessibility and availability of credit to the productive sectors. Improved access to credit by the private sector will result in increased investment and production which ultimately leads to higher economic growth and improvement in standard of living.

(c) Increased public and investor confidence

Price stability in a country leads to investor and public confidence in the economy and results in increased foreign capital inflows. As alluded to earlier, a relatively stable exchange rate coupled with low inflation facilitates long-term planning for investors.

(d) Improved external competitiveness

In countries were there is low and stable inflation, exports become competitive and this has often led to the increase in export earnings, thereby improving the Balance of Payments (BoP) and ultimately contributing to accelerated economic growth. In this context, the benefits of a stable currency are clear as noted by Jeff Sachs in the UN's recent report "A Practical Plan to Achieve the Millennium Development Goals" which states that: *"The private sector needs a supportive macroeconomic framework. International and domestic macroeconomic stability minimizes uncertainty for businesses. Businesses cannot buy inputs or sell products internationally when the local currency is unstable against other currencies – or if the country is experiencing high inflation with constant readjustment of prices and loss of confidence"*[1].

(e) Sustained economic growth

Mr Chairman, when a country attains price stability, economic growth on sustained basis is likely to follow. Accelerated economic growth, of at least 8% per year, is a sure way of ensuring that most of the MDGs are attained in our developing countries. This has the positive impact of reducing poverty levels of the people as it increases their disposable incomes and eventually improve their standard of living.

(f) Reduction of poverty

Usually, some people think that achievement of low inflation is not important to the achievement of MDGs. This assertion should be dismissed using macroeconomic analysis and modelling, which I expect the participants at this workshop to actively be involved in. Even a simple econometric analysis will show that high inflation in a country erode peoples' disposable incomes and, therefore, reduces their purchasing power, particularly the vulnerable that may not have the resources and skills to hedge or protect themselves against

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[1] http://www.unmillennuimproject.org/reports/fullreport.htm.

the effects of high inflation. Attainment of low and stable inflation, therefore, leads to people particularly the poor being able to afford to buy the goods and services that they need in order for them to lead a decent life. Low inflation implies that more people will have stable or improved income that may raise them above the poverty datum line and thus reduce the high incidences of poverty.

Financial system stability

In addition to the attainment of price stability using monetary policy, the central bank's other pillar is the responsibility of ensuring financial system stability. Financial system stability is the prevention of disruptions to the financial sector that are likely to cause significant costs to real output. It compliments monetary policy implementation, as monetary policies are transmitted through financial institutions. If the financial system is unstable, monetary policy will not be effective.

In summary, the central bank, such as ours, has a key role in the attainment of the MDGs through the implementation of appropriate monetary and supervisory policies that ensure price and financial system stability. Macroeconomic analysis and modelling are key components in arriving at sound and effective macroeconomic policies which will contribute to poverty reduction through the acceleration of economic growth and facilitate the achievement of the MDGs.

In a nutshell, Mr Chairman, one can simply state that low inflation coupled with a developed and stable financial system, will enhance higher economic growth. Sustained and higher growth will create more jobs and subsequently increase people's income. An increase in people's incomes will contribute to alleviation of poverty as it will improve their capacities to access the human basic needs such as food, shelter, education, and health.

Further, with increased investment (and a growing economy) partly on account of price and financial system stability, Government revenue is more likely to rise, therefore enabling the Government to improve the provision of education and health services, the two which are among the key tenets of poverty reduction. Furthermore, increased Government revenue will allow more investment in infrastructure such roads needed to transport produce from various production centres to markets thereby enhancing the incomes, particularly those of rural communities. This would contribute to the achievement of MDGs.

With these few words, Mr Chairman, I would like to urge you, the participants, to be interactive in your discussions as this is one of the ways the workshop would add value to your knowledge and skills. I wish you fruitful discussions as you share your valuable experiences in macroeconomic analysis and modelling in support of Millennium Development Goals.

I thank you for your attention.