Growth Still Is Good for the Poor

Do some macroeconomic policies and institutions support shared prosperity directly—and not just by supporting overall growth?

The share of the population in absolute poverty has fallen sharply in the developing world over the past three decades, from 52 percent in 1980 to 21 percent in 2010. Much of this reduction has been due to rapid growth in large and initially poor developing countries such as China and India. These past successes are making the World Bank's austere threshold for absolute poverty of $1.25 a day less relevant for many developing countries. This has led the World Bank to put a new institutional emphasis on tracking shared prosperity, defined in terms of the growth rate of the incomes of the poorest 40 percent of households, and to publicly commit to the twin goals of ending extreme poverty and fostering shared prosperity in the developing world.

This new emphasis on shared prosperity naturally raises two key questions. First, to what extent does *shared prosperity* differ from simple *prosperity*, which could be defined as overall income growth? Second, are there macroeconomic policies and institutions that can directly support shared prosperity other than through their effects on overall growth?

Dollar, Kleineberg, and Kraay address these two questions in a recent paper, elaborating on earlier work by Dollar and Kraay in "Growth Is Good for the Poor" (*Journal of Economic Growth* 7 [2002]: 195–225). The authors find a strong equiproportionate relationship between overall growth and average income growth in the poorest quintiles. The reason is that changes in the income share of the poorest quintiles—the difference between prosperity and shared prosperity—are on average small and uncorrelated with aggregate growth.

The findings are based on analysis of data covering 118 countries over the past four decades. The authors decompose the income growth of the poorest quintiles into average income growth and increases in the share of income accruing to the poorest quintiles. In their core specification, which regresses the average income growth of the poorest quintiles on overall average income growth, they find a slope coefficient very close to—and not significantly different from—one, indicating that the incomes of the poor increase on average at the same rate as overall incomes. Moreover, a standard variance decomposition indicates that three-fourths of the cross-country variation in the income growth of the poorest 40 percent of the population is due to growth in average incomes. These results underscore the importance of overall growth for improvements in living standards among the poorest in societies.

The historical record of the past four decades provides little guidance on which macroeconomic policies support shared prosperity as distinct from aggregate growth

Although growth in average incomes accounts for most of the income growth in the poorest quintiles, it is nevertheless important to investigate the role of macroeconomic policies in driving the remaining variation. If, for example, there are some policy combinations that increase the share of income accruing to the poor while sustaining a given growth rate, these would naturally be preferred from the standpoint of promoting shared prosperity. But if trade-offs existed in the sense that pro-poor policies might lead to lower average growth rates, policy makers would have to be aware that these effects can offset each other in pursuit of the goal of promoting shared prosperity.

The authors investigate how the income share of the poorest quintiles correlates with a variety of country-level variables commonly thought to matter for growth, such as trade openness and macroeconomic and political stability. They also examine a number of variables considered by the broader literature to matter directly for inequality, such as primary school enrollment, inequality in educational attainment, government expenditure on education and health, and agricultural productivity.

Using Bayesian model averaging as a tool for systematic data analysis, the authors find little evidence that any of the policies and institutions reflected in these variables are significantly correlated with growth in the incomes of the poor beyond any direct effect of these variables on growth itself. This of course does not imply that there are no policy interventions that might promote an increase in the income share of the poorest quintiles. But it does tell us that the historical record of the past four decades provides little guidance on which macroeconomic policies support shared prosperity as distinct from aggregate economic growth.

These findings suggest both good and bad news for promoting shared prosperity. The good news is that policies that promote economic growth will on average also raise the incomes of the poor, thereby promoting shared prosperity. The bad news is that we cannot identify specific macroeconomic policies that are particularly conducive to promoting shared prosperity other than through their direct effects on economic growth. This underscores the challenge in defining practical actions and approaches to tackle the goal of promoting shared prosperity.

David Dollar, Tatjana Kleineberg, and Aart Kraay. 2013. *"Growth Still Is Good for the Poor." Policy Research Working Paper* 6568, *World Bank, Washington*, DC.