The Composition of Growth Matters for Poverty Alleviation

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No lasting poverty reduction can occur in the absence of sustained production growth. However, growth's sheer size does not appear to be a sufficient condition for rapid poverty reduction. This paper argues that not only the size of economic growth matters for poverty alleviation but also its composition in terms of intensive use of unskilled labor, the input that the poor can offer to the production process.

The paper first illustrates the connection between poverty reduction, labor intensity, and sectoral growth through a simple theoretical model. Then, considering the model's insights, it conducts cross-country empirical analysis. The paper finds that the impact of growth on poverty reduction varies from sector to sector and that there is a systematic pattern to this variation. Value-added growth in sectors that are more labor intensive tend to have stronger effects on poverty alleviation. Thus, agriculture is the most poverty-reducing sector, followed by construction, and manufacturing; while mining, utilities, and services by themselves do not seem to contribute to poverty reduction.

After this sectoral-driven empirical analysis, the paper conducts a more direct test of the model by considering poverty reduction a function of not only aggregate growth (which would represent growth's *size* effect) but also a measure of labor-intensive growth (which would represent its *composition* effect). The results confirm that poverty alleviation indeed depends on the size of growth. However, they also indicate that poverty reduction is stronger when growth has a labor-intensive inclination (see graph below). This central result is robust to the influence of outlier and extreme observations, holds true for various poverty measures, and is not driven away by alternative explanations. Finally, analysis on the mechanisms through which labor-intensive growth reduces poverty allows us to conclude that this positive effect does not require or imply redistribution from rich to poor. Although labor-intensive growth improves the relative standing of the poor, its main effect on poverty is given by its beneficial impact on their absolute income.

From a normative perspective, this study does not provide grounds for "industrial" (or selective) policies as it does not deal with the sources of sectoral growth, the complex links across sectors, or the political economy of government intervention. Instead, the paper suggests that policy distortions that discourage labor employment or induce capital-biased technological innovation are ill-advised to reduce poverty.

Poverty Reduction and Labor Intensive Growth

Partial-regression observations, controlling for per capita GDP growth