Pro poor growth: A review of what we know
(…and of what we don’t)

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(The World Bank, PRMPR)
Plan of the presentation

- Poverty, growth and inequality
  - What is the relative importance of growth and inequality for poverty reduction?
  - What do we know about the sensitivity of poverty to growth?
- The relationship between growth and inequality
  - Does faster growth “per se” lead to more inequality?
  - Does less inequality “per se” lead to less growth?
- Policies and poverty
  - Is a pro growth strategy the best pro poor strategy?
  - Are there policies that present growth poverty trade offs?
From policies to poverty...
Some papers focus on the growth & distribution - poverty relationship

- Growth
- Income Distribution

Poverty Outcome
Others on the growth - inequality relationship

Growth

Income Distribution
Finally, others on the impact of policies on growth and inequality
Giving a picture like...
To anticipate results...
Poverty, growth and inequality

Poverty Outcome

Growth

Income Distribution

Poverty Outcome
Poverty, growth and inequality

- We know that growth is good for poverty reduction.
- We also know that growth accompanied by progressive distributional change is even better (at least if per capita income is above the PL).

- But...
  - In practice, how important is each of these elements for poverty reduction?
  - What do we know about their determinants?
    - Impact of lower inequality on the growth elasticity of poverty.
Relative importance of potential sources of poverty reduction

Kraay (M 03) finds that:

- About 40 percent in short-run changes in (HC) poverty can be explained by growth in average incomes.
- In the medium- to long-run about 75 percent in (HC) poverty is due to growth in average incomes.
- Cross country differences in the sensitivity of poverty to growth in average incomes are very small.

This would suggest that

- A policy package focusing on growth should be at the center of any pro poor growth strategy (at least if we adopt a long-run horizon).
The sensitivity of poverty to growth

- Ravallion (EL 97) focuses on how the growth elasticity of poverty is related to inequality:
  - Changes in (HC) poverty = k(1-Gini) * growth

- Ravallion (M 04) improves this (empirical) model but the basic message remains the same.

- This implies that the poverty reduction associated to a given growth rate is negatively related to the existing level of inequality:
  - For a given growth rate, more unequal countries will find it harder to reduce poverty.
  - Reducing poverty fast will require paying attention to distributional issues.
The sensitivity of poverty to redistribution

- Bourguignon (M 02) finds that (at least for P0) the log-normal approximation to income distribution seems to be extremely precise:
  - This permits identifying precisely the contribution of growth and distributional change for poverty reduction.
- Two factors through which inequality may affect poverty:
  - Pure redistribution effect
  - Impact on the growth and inequality elasticities of growth
The sensitivity of poverty to growth (under log-normality)

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**Some simulations...**

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All in all...

- Growth is crucial for poverty reduction, but distributional change also matters.
- On the balance of pro growth and pro poor policies:
  - In countries with very low income, it will be difficult to achieve poverty reduction only through distributional change.
  - In contrast, in richer countries, redistribution can be effective.
  - In very unequal countries, the impact of a given growth rate on poverty reduction will be small.
  - In contrast in more equal countries, the impact of a given growth rate on poverty reduction will be more effective.
  - Finally, in very poor and very unequal countries...
The relationship between growth and income distribution

Growth

\[ \uparrow \]

Income Distribution
The relationship between growth and income distribution

- Impact of growth on income distribution
  - Technological change may lead to a rise in inequality through a shift in relative labor demand towards skilled labor.
  - But growth can also lead to an increase in the pool of skilled workers and therefore reduce inequality.

- Impact of inequality on growth
  - Investment indivisibilities or higher propensity to save in the rich may imply that inequality is good for growth.
  - Political economy, crime, or incentives to increase human capital considerations may imply that equality enhances growth.

- Impact of redistribution on growth
  - Incentive considerations may imply that redistribution negatively affects growth.
  - Capital markets imperfections considerations may however imply that redistribution positively affect growth.
The relationship between growth and income distribution

- Impact of growth on income distribution
  - Dollar and Kraay (JEG 02) - no impact
  - Easterly (JEG 99) - no impact
  - Chen and Ravallion (WBER 97) - no impact
  - Deininger and Squire (WBER96) - no impact

- Impact of inequality on growth
  - Forbes (AER 00) - positive
  - Li and Zhou (RDE 98) - positive
  - Barro (JEG 00) - no impact
  - Alesina and Rodrik (QJE94) - negative
  - Perotti (JEG 96) - negative

- Impact of redistribution on growth
  - Easterly and Rebelo (JME 93) - positive
  - Perotti (JEG 96) - positive
Some implications...

- Lack of a trade off between growth and income distribution:
  - Standard growth enhancing policies should be at the center of poverty reduction strategies.

- Impact of inequality/redistribution and growth
  - We need to investigate this issue much more with theoretical and empirical work that evaluates the channels through which these variables are related
    - Political economy
    - Incentives
    - Capital market imperfections
    - Education and skills
Policies/institutions and poverty

Policy

Growth

Income Distribution
Policies/institutions and poverty

- Probably the most interesting part of this debate both for policy makers and for operational staff.
- Unfortunately it is the weakest strand of the literature.
- Usually based on cross country regressions that have produced mixed results. Focused has been on:
  - Potential impact of policies/outcomes on growth and inequality.
  - Potential conflicts between the growth and the poverty impact of some policies.
  - Potential dynamics in poverty (different short and long run effects).
Policies and poverty

- Dollar and Kraay (JEG 02) and Kraay (M 03)
  - Find little evidence that relative incomes are correlated with standard explanatory variables used in the literature.
    - Implication: Adopt a pro growth package

- Barro (JEG 00), Li and Zhou (AEF 02), Lundberg and Squire (EJ 03) and Lopez (M 03)
  - Find some evidence (still weak) that some pro growth policies may negatively affect inequality (potential trade offs)
    - Implication: When adopting a pro growth package keep an eye on the possible impact on inequality (at least in the short run).
## Policies and inequality

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Summing up...

- There seems to be some consensus in a few areas:
  - Growth is fundamental for poverty reduction, and in principle growth “as such” does not affect inequality.
  - Growth accompanied by progressive distributional change is even better than growth alone.

- But beyond that there seems to be little else:
  - The role of inequality seems more significant in the short run.
  - We know very little about the potential impact of initial inequality levels and redistribution on growth. We however know that inequality is a brake for poverty reduction.
  - There may be some policies that present growth-inequality trade-offs, but admittedly we know very little regarding about the potential impact of policies on inequality.