

Development Research Group

Knowledge in Development Note 4

Equitable Growth

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Should the mission of poverty reduction focus only on economic growth, or does growth leave substantial poverty in its wake? And if growth is insufficient, what additional policy interventions should accompany pro-growth reforms to accelerate poverty reduction?

What do we know?

Over 1981-2004 (the longest period for which reliable consistent calculations are possible), there was a trend decline in the global incidence of extreme poverty and in the total number of poor. World Bank research has found that the number of people below the common standard of \$1 a day (at 1993 purchasing power parity) fell by about 500 million over 1981-2004 — from about 1.5 billion to a little under 1 billion. About half that decline was since 1990.¹

However, this remarkable achievement was due in large part to China, which achieved an historically unprecedented reduction in extreme poverty since market-oriented reforms began around 1980s. If one takes China out of the calculations, there has been disappointingly little progress against extreme poverty in the rest of the developing world as a whole. The number of people living under \$1 a day outside China was about 850 million in both 1981 and 2004.

If the aggregate rate of absolute poverty reduction in the 1990s is maintained, it will be sufficient to achieve the U.N.'s Millennium Development Goal of halving the 1990 \$1 a day poverty rate by 2015. But, again, progress has been highly uneven, and Sub-Saharan Africa, in particular, is not on track for meeting this goal, and neither are many countries in other regions.

How important are differences in the rate of economic growth in accounting for this uneven past progress? And how important will growth be for faster progress against poverty? Such questions have long been at the center of development policy debates. Some observers dispute that the poor benefit from the kind of growth typically seen in the developing world. Some acknowledge that growth reduces poverty, but that it is inevitably accompanied by widening inequalities in poor countries. Such inequalities, it is feared, pose a threat to future growth and weaken the impacts of aggregate growth on poverty. World Bank research has tried to inform this debate with sound evidence and to explore what governments might do to make growth more equitable.

Economic growth in poor countries need not come with higher relative inequality, but it does tend to mean a larger absolute gap between the rich and the poor

Conventionally, inequality is expressed in relative terms: if all incomes are doubled then inequality is unchanged. A common empirical finding from research at the World Bank is that changes in *relative* inequality at the country level have little or no correlation with rates of economic growth. Over the 1980s and 1990s inequality increased roughly half the time during spells of growth, though the proportion rose somewhat in the 1990s, as the growth processes in many reforming economies have put upward pressure on inequality. The famous Kuznets Hypothesis—that with growth in a low-income country, inequality first increases then starts to fall after a certain point—has generally not been borne out by experience in growing developing countries.

The picture changes if one looks instead at absolute differences in incomes. This accords with many people’s perceptions of what “inequality” means, as the “gap between the rich and the poor.” Absolute inequality tends to rise with economic growth in developing countries.²

Yet absolute poverty falls with economic growth

Bank research has found that measures of absolute poverty (with the poverty line fixed in real terms over time) tend to fall with growth, and that the incidence of poverty typically does not fall unless there is growth in income per capita. That is what one expects given that, among growing developing economies, relative inequality tends to fall about as often as it rises. With positive growth in the developing world as a whole, there was a trend decline in the incidence of absolute poverty and the total number of poor over the bulk of the 1980s and 1990s.

Specific growth periods and specific policies can have adverse distributional impacts

Although growth is not correlated with (relative) distributional shifts, this does not mean we can be complacent about the possibility of adverse distributional impacts during specific spells of growth and about specific policies that promote growth. Take trade reform. Some studies have found that expanding external trade, on average, neither increases nor reduces relative inequality. Other studies have found evidence that inequality tends to rise within poor developing countries as trade expands. With some exceptions, the bulk of the evidence suggests that trade expansion is typically good for economic growth—and that even when it comes with higher inequality, the absolute levels of living of the poor tend to rise, though this can take time.

Research also shows that there can be considerable heterogeneity in the welfare impacts of trade expansion and liberalizing trade reforms.³ Some poor people gain, but some lose. Generalizations can then be hazardous. This heterogeneity in impacts holds important lessons for the social protection policies that are often needed in conjunction with economywide reforms.

Trade reform may be one of the more contentious areas, but there has also been much debate about other economywide policies. Macroeconomic stabilization policies are often criticized for hurting the poor, though the evidence is convincing that

macroeconomic instability can be very painful to poor people. For example, inflation is invariably found to lead to lower living standards for poor people in the short term. Why? Because they depend on outputs and factors (including unskilled labor) whose prices tend to fall in real terms during inflationary periods. The failure to stabilize may well do more harm than stabilization.

The design of stabilization programs is the key. The composition of spending cuts can be crucial to the incidence of the costs of stabilization. But this can create tension with the political economy of stabilization. There is evidence from several studies that spending favoring the nonpoor is protected during fiscal contractions.

A given rate of growth can result in markedly different rates of poverty reduction

By probing more deeply into the causes of the diverse impacts of growth on poverty, Bank research has pointed to some important implications for the policies needed to reduce poverty rapidly, in addition to promoting higher growth. Two sets of factors can be identified as the main causes of the differing rates of poverty reduction at given rates of growth.

The first factor is the *initial level of inequality*. The evidence suggests that one cannot expect absolute poverty to fall without growth, but the higher the initial inequality in a country (even if it does not change), the less that the gains from growth tend to be shared by the poor. In other words, a smaller initial share tends to mean a smaller subsequent share of the gains from expansion. The evidence clearly shows that when initial inequality is high, poverty is relatively unresponsive to growth.⁴

Research has also suggested that initial inequalities in specific dimensions can impede prospects for future growth. When the opportunities for advancement are highly unequal in a society, it is no surprise that this constrains the prospects for both growth and poverty reduction.⁵ This can arise from credit market failures that prevent poor people taking up profitable investment opportunities, including those in human capital.⁶ High inequality countries may then face a double handicap in fighting poverty: they see less growth, and the growth that does occur is less effective in reducing poverty.

A second factor is *changing income distribution*. What happens to inequality in growing economies can make a big difference to the rate of poverty reduction. Among growing economies, the median rate of decline in the \$1 a day headcount index is 10 percent per year for countries that combined growth with falling inequality, but only 1% per year for countries with rising inequality. For both groups poverty tends to fall, but at very different rates. Among contracting economies poverty rises on average, but much faster when inequality is rising rather than falling.

In many countries the geographical and sectoral pattern of growth is an important factor behind changes in the distribution of income

Many large countries—including Brazil, China, India, Indonesia, Mexico, and Thailand—have persistent geographic concentrations of poverty, often in remote and agriculturally marginal regions: forests, mountains, semi-arid zones, and areas with poor soils. In the developing world as a whole, such environmentally constrained regions are home to 1.3 billion people, including some of the world's poorest.⁷

Higher growth in a number of developing countries has come with widening regional disparities and often little or no growth in poor lagging areas. For example, the faster economic growth in India during the 1990s has not reached the states where it would have the most impact on poverty nationally.⁸ Agricultural growth has also lagged in growing economies relative to the (primarily urban) non-farm economy. As a result, the overall growth process in India has tended to become less pro-poor over time. The same appears to have been happening in China where there is evidence of geographic “poverty traps” in the midst of robust national growth.⁹

And in recessions, too, it matters greatly where one lives. For example, Indonesia's severe financial crisis of 1998 had highly diverse impacts across different areas, with the urban poor feeling the brunt of the crisis.

Current and future research directions

The challenge for future research is to better understand the factors that constrain poor people from participating in the benefits of a growing economy, and to draw out the lessons for the types of policies needed for reducing poverty rapidly in addition to promoting economic growth.

We have learned that more rapid poverty reduction requires a combination of more growth, a more pro-poor pattern of growth, and success in reducing the inequalities that limit the prospects for poor people to share in the opportunities unleashed by a growth economy.

Achieving a more pro-poor pattern of growth

A majority of the world's poor still live in rural areas, and this is likely to remain true for some time to come. Agriculture and non-farm rural development should thus remain a high priority for sectoral policies. But past interventions have had a mixed record. New approaches based on community-driven development have held promise but need careful monitoring and evaluation, recognizing the likely heterogeneity in performance across different institutional settings.

Recognition of the regional disparities in growth and poverty and growth have prompted renewed interest in explicitly geographic dimensions in policymaking, especially in the light of newly available geographical information systems and insights from the new economic geography. A potentially important emerging finding is the strong role of urban agglomerations in boosting the productivity of industrial firms,¹⁰ and many countries are making “growth pole” investments with the hope of spurring territorial development. There are few examples of success, however, and many questions

remain: Do the increases in productivity reduce poverty? What are the available policy instruments for promoting growth poles? Does such growth spill over to the hinterland? Are rural infrastructure investments in agriculturally marginal areas effective in reducing poverty and mitigating migration to cities? Does it make sense to move jobs to people, or people to jobs? Is there a tradeoff between achieving greater regional equity—such as by focusing on areas with high poverty *rates* but low poverty *densities*—and poverty reduction in the aggregate?

Investing in poor people

The physical and human assets of poor people are keys to their prospects for participating in the benefits of a growing economy. This fact ties the discussion here to a number of other areas of past and ongoing research. The combination of interventions needed will naturally depend on country and regional circumstances. But some clear pointers have emerged from research:

- Delivering better schooling and health care to the poor is crucial to achieving pro-poor growth.¹¹
- In rural economies, security of access to land through tenancy reform and titling programs is arguably no less important.¹²
- In some circumstances, rural infrastructure development can also play a decisive role; research has pointed to the potential importance of rural roads to achieving more pro-poor growth processes.
- Better instruments for credit and insurance can help, both in smoothing consumption and underpinning otherwise risky growth-promoting strategies.¹³
- Removing biases against the poor in taxation, spending, and regulatory (including migration) policies can also be important.¹⁴

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Endnotes

Most Bank documents cited in this summary are available through the documents and reports portal of the World Bank <http://www-wds.worldbank.org/>. The word “processed” describes informally reproduced works that may not be commonly available through library systems.

¹ For recent calculations see S. Chen and M. Ravallion. 2007. “[Absolute Poverty Measures for the Developing World, 1981-2004](#).” Policy Research Working Paper 4211.

² For recent evidence see M. Ravallion, “A Poverty-Inequality Trade Off?” Background paper to [World Development Report 2006: Equity and Development](#) and *Journal of Economic Inequality* August 2005.

³ For an overview of the evidence on this point see M. Ravallion. 2006. “Looking Beyond Averages in the Trade and Poverty Debate.” *World Development* 34(8):1374-1392.

⁴ These numbers draw on M. Ravallion. 2004. “[Pro-Poor Growth: A Primer](#).” Policy Research Working Paper 3242, World Bank, Washington, DC.

- ⁵ This is an important theme of the [World Development Report 2006: Equity and Development](#). Washington, DC.: World Bank.
- ⁶ Chapter 5 of the [World Development Report 2006: Equity and Development](#) reviews the evidence of such credit-market failures and how they impinge on the relationship between inequality and growth.
- ⁷ [World Development Report 2003: Sustainable Development in a Dynamic World](#). Washington, DC: World Bank, p. 60.
- ⁸ Gaurav Datt and Martin Ravallion. 2002. "Has India's Post-Reform Economic Growth Left the Poor Behind." *Journal of Economic Perspectives* 16(3): 89–108.
- ⁹ Jyotsna Jalan and Martin Ravallion. 2002. "Geographic poverty traps? A Micro Model of Consumption Growth in Rural China." *J. Applied Econometrics* 17: 329–46.
- ¹⁰ Somik Lall and Sanjoy Chakravorty. 2005. "Industrial Location and Spatial Inequality: Theory and Evidence for India." *Review of Development Economics* 9(1): 47–68.
- ¹¹ [World Development Report 2004: Making Services Work For Poor People](#). Washington, DC: World Bank.
- ¹² [Land Policies for Growth and Poverty Reduction: A World Bank Policy Research Report](#). Washington, DC: The World Bank and Oxford University Press, 2003.
- ¹³ For a recent overview of the arguments and evidence see the 2005/06 [World Development Report: Equity and Development](#), Chapter 5.
- ¹⁴ There is a large literature; a recent overview of the evidence for Latin America can be found in Chapter 9 of David de Ferranti, Guillermo Perry, Francisco Ferreira and Michael Walton, [Inequality in Latin America: Breaking the History?](#) Washington, DC: World Bank, 2004.