

Development Policy

Lecture 7

Growth is Good for the Poor



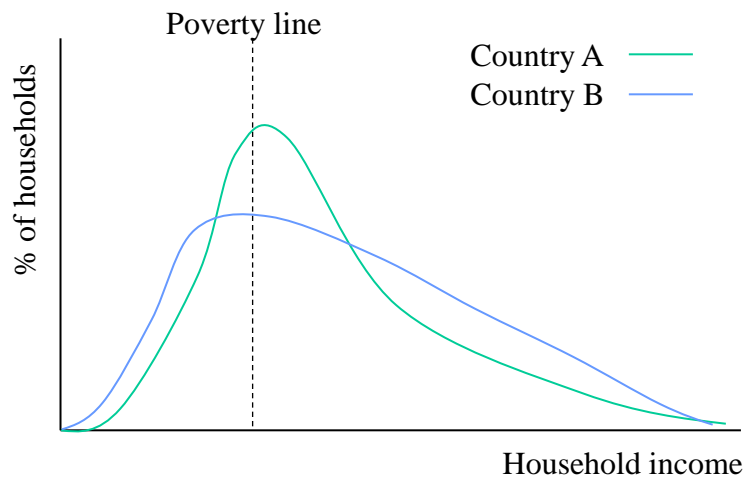
**Development Myth #5
Economic Growth is all that is
needed to reduce the incidence of
extreme poverty.**



What is poverty?

- Level of income or consumption below an accepted standard or poverty line.
 - Absolute poverty: Fixed in terms of purchasing power
 - Relative poverty: Distance from some measure of central tendency, for example $\frac{1}{2}$ median income.
- How is it measured?
 - Headcount index: % population below poverty line
 - Poverty gap: Mean income shortfall below poverty line as % of the line.

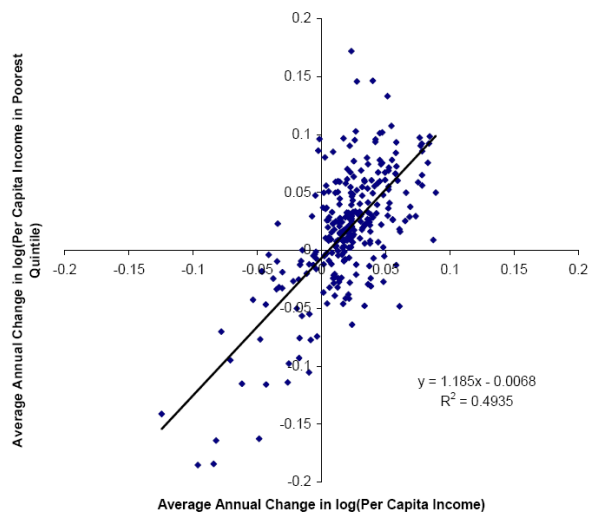
Some headcount rate, different poverty gap



Headcount and poverty gap rates at \$1.25 per day poverty line

Country	Year	Headcount rate	Poverty gap ratio
China	2005	15.9	3.95
India	2005	41.6	10.5
Indonesia	2009	18.7	3.62
Malaysia	2004	0.5	0.06
Philippines	2006	22.6	5.48
Thailand	2004	0.4	0.03
Vietnam	2008	3.1	2.29

Income growth: Poorest vs. average



Growth and poverty reduction

- Impact of growth on poverty depends on:
 - initial inequality: lower initial share for the poor means that less of incremental income accrues to the poor
 - inequality trends: rural vs urban, agricultural vs non-agricultural, upland vs lowland, farm owners vs tenants and agricultural laborers.

Dollar and Kraay: Growth policies are not bad for the poor

1. Low inflation
2. Low levels of government consumption
3. Financial development
4. High trade/GDP ratio
5. Rule of law

Data used by Dollar and Kraay are available on the Fulbright School intranet.

Dollar and Kraay: Growth determinants of incomes of the poor

	Trade Volumes		Government Consumption/GDP		log(1+Inflation Rate)		Financial Development		Rule of Law Index	
	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.
ln(Per Capita GDP)	1.094	0.108 ***	1.050	0.085 ***	1.020	0.089 ***	0.995	0.119 ***	0.914	0.105 ***
(Exports+Imports)/GDP	-0.039	0.088								
Government Consumption /GDP			-0.571	0.419						
ln(1+Inflation)					-0.136	0.103				
Commercial Bank Assets /Total Bank Assets							0.032	0.257		
Rule of Law									0.084	0.069
P-Ho: $\alpha=1$	0.386		0.555		0.825		0.968		0.412	
P-OID	0.257		0.168		0.159		0.350		0.279	
T-NOSC	-0.751		-0.506		-0.261		-0.698		-0.945	
# Observations	223		237		253		232		268	

Dollar and Kraay: Anti-poverty policies that are not good for the poor

1. Primary education: associated with growth but not poverty reduction
2. Social spending: spending on health and education does not increase incomes of the poor
3. Agricultural productivity: not significantly related to either growth or poverty reduction.
4. Formal democratic institutions: Associated with higher incomes of the poor but not robust.

Dollar and Kraay: Other determinants of the incomes of the poor

	Years Primary Education		Social Spending		Agricultural Productivity		Voice		Voice with Macro Controls	
	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.	Coef	Std.Err.
ln(Per Capita GDP)	1.067	0.088 ***	1.025	0.101 ***	0.985	0.104 ***	0.933	0.095 ***	1.117	0.098 ***
Years Primary Education	0.014	0.031								
Government Consumption/ GDP			-1.553	0.547 ***						
Social Spending /Total Public Spending			-0.664	0.429						
Agricultural Relative Productivity					0.060	0.081				
Voice							0.095	0.053 *	0.029	0.058
P-Ho: $\alpha=1$	0.448		0.803		0.886		0.480		0.233	
P-OID	0.213		0.028		0.166		0.302		0.419	
T-NOSC	-0.384		0.594		-0.837		-0.970		-0.767	
# Observations	222		111		197		265		207	

Foster and Székely 2008

General means of the form:

$$\mu_{\alpha}(x) = [(x_1^{\alpha} + \dots + x_n^{\alpha}) / n]^{1/\alpha}$$

For all $\alpha \neq 0$, and for $\alpha = 0$:

$$\mu_{\alpha}(x) = (x_1 + \dots + x_n)^{1/n}$$

Arithmetic mean: $\alpha = 1$

Geometric mean: $\alpha = 0$

Harmonic mean: $\alpha = -1$

$$\log \mu_{\alpha}(x)_{i,t} - \log \mu_{\alpha}(x)_{i,t-1} = c + \gamma(\text{year}) + \beta(\log \mu_1(x)_{i,t} - \log \mu(x)_{i,t-1}) + \varepsilon_{i,t}$$

Foster and Székely 2008

TABLE 1
GROWTH ELASTICITY OF GENERAL MEANS (INDEPENDENT VARIABLE IS GROWTH IN MEAN INCOME)

Coefficient	Parameter Value $\alpha = 0$	Parameter Value $\alpha = -1$	Parameter Value $\alpha = -2$	Parameter Value $\alpha = -3$	Parameter Value $\alpha = -4$
General mean	1.03 4.5	0.97 3.6	0.81 1.6	0.55 0.23	0.33 0.2
Year trend	0.00014 0.47	0.0023 0.87	0.00078 0.81	0.005 0.36	0.0042 0.22
Constant	-0.298 -0.48	-0.58 -0.9	-0.64 -0.065	-0.21 -0.45	-0.59 -0.32
Number of observations	154	154	154	154	154

SOURCE: Author's calculations.

*Each of the elasticities reported is estimated from a separate regression.
t statistics appear under each coefficient.

Is public spending good for the poor?

“The first requirements of high labor productivity under modern conditions are that the masses of the population shall be literate, healthy, and sufficiently well fed to be strong and energetic”

Jacob Viner, *International Trade and Economic Development* (1953)

Datt and Ravallion (1999)

- “When is Growth Pro-Poor? Evidence from the Diverse Experiences of India’s States” (World Bank research paper)
- 15 Indian states 1960-1994: higher farm yields, more development spending reduced poverty.
- Non-farm growth reduced poverty *more* when literacy rates are higher.
- “More than half of the difference between the elasticity of the headcount index of poverty to non-farm output for Bihar (the state with lowest elasticity) and Kerala (the highest) is attributable to the latter’s substantially higher initial literacy rate.

Trade and growth

- Harrison 1996 and Yanikkaya 2003: Countries that trade more (higher trade volumes) are likely to grow faster (same as Dollar and Kraay).
- But, paradoxically, higher tariffs are either not related or positively related to growth (Clemens and Williamson 2001; Rodriguez and Rodrik 1999; Yanikkaya 2003).
 - East Asian countries have subsidized exports and protected domestic industries: not less intervention, but less biased intervention.
 - Protecting sectors with greater potential for productivity growth, supporting exporters for foreign exchange earnings and jobs.
- But is a policy of trade openness good for the poor?
 - Topalova 2007: Poverty reduction slower in Indian rural districts subject to more trade liberalization
 - Goldberg and Pavcnik 2007: No evidence of link between trade liberalization and urban poverty in Colombia. Poverty decreased the incomes of the poorest did not rise.
 - The key is mobility: If poor people cannot move to where the better jobs are, trade will not help them.

Trade and poverty

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Productivity growth as the source of economic growth

- Dollar and Kraay are right: growth *is* good for the poor. But growth is not the result of small govt, trade, rule of law, and low inflation
- Productivity growth is the source of economic growth AND poverty reduction.
 - But our understanding of productivity growth is less than perfect.
 - Investment, education, technological innovation and institutional development are all factors, but difficult to quantify

Policy implications

- Growth *is* good for the poor
 - but not necessarily *all* of the poor
 - often it is *good* for the poor but *better* for the rich
- The key to growth is productivity, not necessarily or just trade and financial liberalization
- Scope for government action
 - Health and education to ensure that people can take part in economic growth
 - Remove other barriers to participation (limits on migration, discrimination)