



Growth with equity is good for the poor

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Executive summary

Three years ago the President of the World Bank committed his institution to overcoming what he described as "the tragedy of exclusion." He has attempted to shift the focus away from 'trickle down' economics and towards growth with equity, or pro-poor growth. Today, his vision is under increasing attack not least from within the World Bank. The basis of this attack is set out in a document written by David Dollar and Aart Kraay of the Policy Research Department of the World Bank entitled *Growth is good for the poor*. The report argues that economic growth is closely associated with poverty reduction, and that globalisation and openness bring the same benefits to the poor as to the non-poor. Notwithstanding a small caveat indicating that growth alone may not be enough, the clear message of the report is that standard economic policies on liberalisation will generate the growth and distribution patterns needed for success in poverty reduction.

Growth is good for the poor reflects an ideological hankering for a return to the golden age of free market economics in the 1980s. Openly supported by some northern governments, it is an attempt to radically change the direction of development policy. The poverty-focussed growth agenda developed by Mr Wolfensohn is being progressively undermined by a revival in free market fundamentalism represented by Messrs Dollar and Kraay. This is bad news for poverty reduction. Current patterns of economic growth are failing to benefit the poor on anything like the scale required to meet the 2015 target of halving income poverty. The change in policy direction advocated by *Growth is good for the poor* will provide a cast iron guarantee that the target will be missed.

In Oxfam's view, *Growth is good for the poor* suffers from two defects: namely, it is anti-poor and anti-growth. It is anti-poor because it ignores the critical role of income distribution in shaping opportunities for poverty reduction. And it is anti-growth because extreme inequality and the poverty associated with it, wastes productive potential on a vast scale.

Much of the Dollar - Kraay report is spent attacking a red herring. The authors reject the view (held by almost nobody) that growth is bad for the poor, and contrast it with their (equally implausible) belief that economic growth is benefiting all in equal measure. **Economic growth is self-evidently good for poverty reduction**, since without growth, the average incomes of the poor cannot rise over time, with attendant implications for poverty. But growth is not all that matters. At any given level of average income, the incidence of poverty is determined by income distribution. The larger the share of any increment to growth captured by the poor, the faster the rate of poverty reduction. Highly unequal countries are bad at converting growth into poverty reduction because they have to grow faster than more equal countries to achieve the same level of income gain for the poor.

That growth is good for the poor is a statement of the obvious. The real question is what type of growth is best for poverty reduction, and which policies will help to bring about more equitable patterns of growth. Similarly, even if it were the case that the poor benefit from growth in the same proportion as the wealthy, the initial distribution of income would still determine the rate of poverty reduction.

For policy makers concerned with poverty reduction, the aim should be to sustain high growth, but with the poorest 20 per cent capturing a proportionately larger share of the increment to growth. Of course, any improvement in distribution achieved at the expense of growth would have adverse implications for poverty reduction. But there is no necessary trade-off between equity and efficiency, and there is plenty of evidence to suggest that countries with more equal income distribution have higher growth. Where extreme inequalities reinforce poverty they act as a barrier to growth by restricting the productive potential, undermining investment, and limiting the capacity of a large section of the population from responding to incentives created through market reforms. Bluntly stated, inequality is not just bad for social justice, it is also bad for economic efficiency.

Experience in the 1990s illustrates the importance of distributional factors. East Asia is the only developing region now on target for achieving the 2015 goals. By contrast, economic recovery in Latin America has produced derisory results, with the incidence of poverty falling by just 1 per cent. High growth, backed by high rates of conversion from growth into poverty reduction, has been central to East Asia's achievement. Each percentage point of growth in the region produces four times as much impact in terms of poverty reduction as in Latin America. If East Asia had achieved the same growth rate but had converted growth into poverty reduction at the Latin American rate, there would be 22 million *more* people in the region living in poverty. Conversely, if Latin America had transformed growth into poverty reduction at the same rate as East Asia, there would be 3 million *fewer* people living below the poverty line.

Latin America's experience refutes the claim that growth alone is sufficient to achieve poverty reduction on the scale required. Distribution of the benefits from growth in the region reflect the small share of national wealth trickling down to the poorest 20 per cent. In Brazil, this group accounts for 2.5 per cent of national income, compared to 9.2 per cent in Indonesia. As a result, Brazil has to grow at almost four times the rate as Indonesia to achieve the same average income gain for the poorest 20 per cent.

Improved income distribution would strengthen the linkage between growth and poverty reduction. Unfortunately, there is evidence from many countries that wealth gaps between rich and poor are widening. Recent household survey data from the Inter-American Development Bank from fifteen countries in Latin America shows worsening income distribution. In India, wealth gaps between the rural poor and urban population, and between rich and poor states, are weakening the impact of growth on poverty. Similarly, rising inequality has contributed to an increase in poverty in China. Failure to reverse these trends through more equitable growth strategies will place the 2015 targets beyond reach.

Governments have a key role to play. Poor people are frequently excluded from the opportunities created by globalisation by inadequate access to productive resources, weak marketing infrastructures, illiteracy and poor health. Government action in these areas is vital to achieve a wider distribution of opportunity. Redistribution through fiscal transfers is one option. But the real challenge is to create the conditions in which poor people can produce their way out of poverty, contributing to national wealth creation in the process.

Growth is good for the poor fails to address the real challenge facing policy makers in this area. The challenge is to establish which types of growth are more likely to improve income distribution, and to develop policies to achieve more equitable patterns of growth. While Dollar and Kraay claim to reject the trickle down approach to poverty reduction, this is precisely what they offer. Some of the World Bank's major shareholders could usefully recall the experiences of their own countries before allowing the World Bank to travel the route recommended by Dollar and Kraay. For instance, during the 1980s, both Britain and the United States experienced sustained increases in prosperity, accompanied by dramatic increases in inequality and child poverty. Many developing countries suffered the same experience under the auspices of IMF and World Bank adjustment programmes that corresponded closely to the prescriptions offered in *Growth is good for the poor*. Returning to the failed models is not a viable strategy for addressing the poverty reduction challenges of the future.

Growth with equity is good for the poor

Background

Three years ago the annual address given by World Bank President James Wolfensohn at the IMF-World Bank meeting was entitled *The challenge of inclusion*. It set out a clear commitment to growth with equity. While acknowledging that economic growth and globalisation was generating important benefits for many, Mr Wolfensohn spoke of “the tragedy of exclusion”. The address set out a bold vision for the future, with the World Bank President calling on the international community to reduce the huge disparities in income and opportunity preventing the poor from participating in economic growth. “In too many countries,” he said, “the poorest 10 per cent of the population have less than 1 per cent of national income, while the richest 20 per cent enjoy over half.” Mr Wolfensohn concluded by pledging that the World Bank would work with others to change this picture and increase the share of wealth captured by the poor.

Today, this approach to development is under open attack, not least within the World Bank. The emphasis is shifting away from policies for achieving growth with equity, and towards policies geared toward growth alone. Distributional concerns are being removed from the political agenda. The highly-publicised report produced by David Dollar and Aart Kraay of the World Bank’s Development Research Group, entitled *Growth is good for the poor*, is a recent example of the new trend. It represents an attempt to refute the case for more equitable patterns of distribution, as set out in early drafts of this year’s World Development Report.

If *Growth is good for the poor* were just a research exercise, it could be dismissed as weak but largely irrelevant. Unfortunately, it comes with the imprimatur of the World Bank. The report represents a conscious attempt to shift the policy debate away from a concern with equity - and it will have a major bearing on policy choices made by southern governments and aid donors. This is of major concern because the specific choices it advocates are the wrong ones for poverty reduction.

Briefly summarised, *Growth is good for the poor* argues that existing patterns of globalisation are inherently good for poverty reduction. In place of Mr Wolfensohn's commitment to growth with equity, Dollar and Kraay are at one with their colleagues in some of the darker recesses of the IMF in arguing that ‘standard pro-growth macroeconomic policies’ are the most effective route to poverty reduction. The abysmal record of these policies in achieving poverty reduction in much of the developing world is ignored. Income distribution and public investment in health and education are regarded as peripheral to the core challenge of implementing policies to produce high growth. The clear message to governments and donors is “leave it to the market”. That message reflects an ideological hankering for a return to the “golden era” of free market economics, and to the discredited “trickle-down” approach to poverty reduction that guided World Bank and IMF policy advice to such disastrous effect in the 1980s.

In Oxfam's view, the Dollar and Kraay report suffers from two defects: it is 'anti-poor' and 'anti-growth'. It is anti-poor because it fails to address the key question of how to share the benefits of growth more equitably. And it is anti-growth because high levels of inequality are not just bad for poverty reduction, but also for economic efficiency. Extreme inequalities in land ownership, access to productive assets and income distribution serve to exclude poor people from access to market opportunities, and to undermine investment.

Contrary to claims advanced by Dollar and Kraay, few development agencies would contest the view that economic growth is a necessary requirement for poverty reduction. **But it is not the only requirement. The rate at which growth is converted into poverty reduction also matters. Growth associated with positive distributional changes in favour of the poor will have a greater impact on poverty than narrowly-based growth, in which the benefits are captured by the wealthy.** Crudely stated, the larger the share of any increment to growth captured by the poor, the faster the rate of poverty reduction. Conversely, the higher the level of inequality, the weaker the linkage between poverty reduction and growth.

The choice facing policy makers is not whether or not to go for growth - there is no alternative. It goes without saying that growth is necessary for poverty reduction and that the incomes of the poor will increase with growth. **The real question is how to convert growth into poverty reduction at the rate required to achieve the 2015 targets.** At a time when growth is increasingly associated with rising inequality in many countries, the challenge is to increase the share of growth captured by the poor. For policy makers concerned with poverty reduction, inequality does matter. If distribution can be improved without adverse implications for growth, then the rate of poverty reduction can be increased. In fact, there are good reasons why pro-poor distributional changes might have positive outcomes for growth. Where extreme inequality reinforces income poverty, it restricts investment by the poor and undermines the development of markets. Similarly, smallholder agriculture is more efficient than large-scale agriculture, in terms of both productivity and employment generation. For this reason redistribution of land has potential to be a pro-growth and pro-poor policy.

The relationship between economic growth and poverty reduction is of direct relevance to the challenge of meeting the 2015 target of halving income poverty. There is growing evidence that rising inequality is weakening the linkage between growth and poverty reduction. Parts of the developing world, such as Latin America, have succeeded in restoring macro-economic stability and growth, but with limited benefits for poverty reduction. In India, home to the largest number of people living below the poverty line, the impact of growth on poverty reduction is diminishing. By contrast, countries in East Asia have succeeded in combining high growth with rapid poverty reduction. If the world is to achieve the 2015 targets, developing countries need to grow on the East Asian pattern, rather than the highly unequal Latin American pattern. That is why it is essential that the quality of growth and distributional factors are given equal emphasis in the policy debate on growth and poverty reduction.

The world according to Dollar and Kraay

Much of the Dollar - Kraay report is spent caricaturing the arguments of others in order to create convenient straw men. The view (held by almost nobody but presented as widespread) that growth is bad for the poor is subjected to a withering critique. In the world of Dollar and Kraay, the choices are simple: if you are not 'pro-growth', you are 'anti-poor'. And if you are 'pro-growth', so the argument runs, then globalisation, liberalisation and free markets are the keys to success. Pro-poor distributional changes are seen as too slow, and too insignificant, to support poverty reduction on any scale. It follows that economic growth is the only effective route to poverty reduction.

For the benefit of the non-technical reader, the conclusions are stated in media-friendly sound-bites designed to send a clear message to policy makers. The basic argument can be summarised in three such sound-bites:

- **'Growth is good for the poor'**. The central contention is that the "income of the poor rises one-to-one with overall growth" and that there is "no apparent tendency for growth to be biased against poor income households."
- **'Standard pro-growth macroeconomic policies are good for the poor'**. The report finds that "private property rights, stability and openness directly create a good environment for poor households to increase their production and income." Macro-economic stability and low inflation are not just pro-poor, they are "super-pro-poor". By contrast, the regression exercise purports to show that 'voice' and democratic institutions are statistically insignificant for growth and distribution. Primary education has small benefits for growth and no benefits for income distribution.
- **'Globalisation is good for the poor'**. This sub-divides into two propositions. First, "trade openness is good for the poor" because it raises average incomes and the incomes of the poor in roughly equal proportion. Second, and more controversially, the report concludes: "we do not find any evidence that capital account liberalisation is anti-poor."

How good for the poor is growth?

The principle 'discovery' made by Dollar and Kraay is that during periods of economic growth the average income of the poor increases by exactly the same proportion as overall income. They argue that income distribution patterns are irrelevant to poverty reduction. However, their report claims that there is no evidence of economic growth or greater openness being associated with rising inequality. The data upon which the latter conclusion is based is drawn principally from the 1970s and 1980s. Given that so much of the rapid trade liberalisation and capital account liberalisation associated with globalisation took place in the 1990s, there is a discrepancy between evidence and policy conclusions.

The purpose of this brief note is not to enter into a technical debate on econometric methods. However, it is worth noting that the Dollar and Kraay findings are inconsistent with other surveys. For instance, research carried out at the Institute for Development Studies in Sussex using data from 143 growth episodes found that the income share of the poorest 20 per cent fell in 69 cases.

The more serious problem with the Dollar and Kraay study is that it demonstrates the potential for absurd questions to produce absurd answers, even with the most sophisticated econometric models.

Even if it were true that economic growth raises the average income of the poor as much as the rich, policy makers with an interest in poverty reduction should be concerned with the share of the poor in national wealth. This is because for any given level of average income, the extent of poverty will depend on how income is distributed. Similarly, the distribution of any increment to growth will determine the rate at which growth is converted into poverty reduction. Highly unequal societies are bad at converting growth into poverty reduction. The rate of conversion - or 'the poverty reduction efficiency of growth' - matters because the more unequal the country, the faster the rate of growth needed to achieve any given level of poverty reduction.

The contrasting experiences of Latin America and East Asia illustrate the point. During 1990-1998, Latin America achieved real per capita economic growth rates of just under 2 per cent annually. But, despite this strong economic performance, the number of people living below the poverty line increased by 4.4 million, while the incidence of poverty fell by just over 1 per cent. By contrast, growth in East Asia lifted 174 million people out of poverty. Economic growth accounts for much of the difference, with per capita incomes in East Asia rising at 6 per cent per annum. But differences in the rate of growth rate are not the only factor. The rate of conversion from growth to poverty reduction is also critical. This can be expressed as the ratio of growth to changes in the incidence of poverty. The ratio of growth to poverty reduction in Latin America is 1: 0.08, compared to 1:0.30 per cent in East Asia. **Every percentage point of growth in East Asia reduces the incidence of poverty at four times the rate achieved in Latin America.**

This difference matters. Even without an increase in economic growth, if Latin America had achieved East Asia's rate of conversion from growth to poverty reduction, there would be 3 million fewer people living below the poverty line. By contrast, if East Asia had been converting growth into poverty reduction at the Latin American rate, the incidence of poverty would be 9 per cent higher. This would translate into another 22 million people living below the poverty line.

Such outcomes point to the critical role of income distribution. The relatively small number of poor countries that are on target for achieving the 2015 goal of halving income poverty have achieved a wide dispersion of growth. For instance, both Uganda and Vietnam have achieved a rate of conversion from growth into poverty reduction (on the basis of national poverty lines) in the ratio of around 1: 0.4. Uganda has reduced income poverty from 56 per cent to 44 per cent since 1992, lifting 1.5 million people out of poverty. Other countries in sub-Saharan Africa will need to achieve a similar rate of conversion from growth into poverty reduction in order to achieve the 2015 target, making the optimistic assumption that per capita income growth can be

maintained in the range of 2-3 per cent. This implies a major distributional shift in the pattern of growth, since sub-Saharan Africa currently suffers from Latin America-style patterns of income distribution.

The respective income shares of the richest and poorest 20 per cent help to explain this difference. In Brazil, the poorest 20 per cent account for 2.5 per cent of national income, compared to 9.2 per cent in Indonesia. In other words, Brazil has to grow at almost four times the rate of Indonesia to achieve the same rise in average income among the poorest 20 per cent. Similarly, Mexico has to grow at twice the rate of Vietnam to achieve similar income gains among the poorest 20 per cent.

Increasing the share of increments to growth captured by, say, the poorest 20 per cent is the central requirement for accelerating progress towards poverty reduction. The fact that poor people benefit from growth on a proportionate basis counts for little when extreme income inequalities result in exceptionally low levels of average income among the poor. As a minimum requirement, the aim should be to ensure that the poorest 20 per cent capture a larger share of any increment to growth than the non-poor, but even this may be a limited objective in situations of extreme inequality. **The broad target should be to ensure that the income share of the poorest 20 per cent increases to at least 10 per cent of national income. This would imply a radical shift in income distribution outcomes for a large number of countries, supported by an equally radical expansion of opportunity to participate in markets on more equitable terms.**

The evidence

Contrary to the claims made by Dollar and Kraay, there is substantial evidence that current patterns of growth are reinforcing, rather than reducing, existing inequalities in income. This is true across a large spectrum of countries:

- In India, home to almost half of those living on less than \$1 a day, the rate of poverty reduction has slowed in the 1990s, with the rural poor falling further behind, and the gap between richer and poorer states widening.
- In China, the number of poor increased by 2 million between 1997-1998, reversing a long-run trend. Widening income gaps between coastal and interior areas are largely responsible.
- In Vietnam, average income in the northern region increased by 31 per cent between 1993-1998 - less than half of the increase recorded in the south-east region. Poverty rates in the northern region are 59 per cent, compared to 8 per cent in the south-east.
- In Mexico, economic recovery has been associated with a widening income gap between rural populations in the poverty belt states of the South, and northern regions linked to the US economy. Between 1990-1996, the number of people in poverty increased by 11 million.

- In Eastern Europe and the Former Soviet Union historically unprecedented increases in inequality have reinforced the effects of slow growth, with the incidence of poverty increasing five-fold in the 1990s.
- In Latin America, the world's most unequal region, recent household survey evidence shows that inequality has increased in fifteen countries, including Peru, Brazil, Honduras and Nicaragua.
- In Britain, the proportion of the population with less than half average income trebled between 1979-1990, with the poorest 20-30 per cent failing to benefit from economic growth. Child poverty trebled in this period (see below).

There is clear evidence from current and past experience that distributional changes *do* impact on poverty. Once again, the experience of Latin America is instructive. During the lost decade of the 1980s, an additional 100 million people in the region fell below the poverty line. Economic recession was an important factor, but it was reinforced by adverse distributional changes. According to the Inter-American Development Bank, the deteriorating patterns of income distribution were responsible for half of the increase in poverty.

It is not just during periods of economic recession that distribution influences poverty reduction. Research into growth periods under structural adjustment programmes has shown that worsening inequality acts as a brake on poverty reduction. Growth periods during the 1980s and 1990s in Kenya, Tanzania and Ghana were characterised by widening income gaps between rich and poor, between urban and rural areas, and between marginal and commercial rural areas. The point in all of these cases is not that growth has failed to reduce poverty, it is that adverse distributional shifts have weakened the effects of growth on poverty reduction. The key policy priority is to understand what measures are needed to enable poor people to participate more equitably in markets. Simplistic assertions to the effect that growth is ultimately good for everyone are not a helpful starting point.

Income distribution and the 2015 targets

At the Social Summit in 1995, the world's governments committed themselves to the international development target of halving income poverty. It is no longer realistically possible to meet this target without a radical pro-poor shift in distributional patterns. The 'by growth alone' strategy advocated by Dollar and Kraay is not an option for governments seriously committed to the 2015 targets. Indeed, the high profile given to *Growth is good for the poor* by the World Bank raises serious questions about the institution's role as a poverty reduction agency.

The record on poverty reduction speaks for itself. The annualised rate of poverty reduction required between 1990-2015 to achieve the 2015 target is 2 per cent. Only East Asia has achieved this rate (Table 1). Sub-Saharan Africa poses particularly grave cause for concern, since the annual rate of poverty reduction has been less than one-sixth of that required. But South Asia and Latin America are also reducing poverty respectively at just over and just under half of the required rate.

Assuming that current growth and income distribution patterns broadly continue, the World Bank projects a small increase in the absolute number of poor over the next ten years. But even this depressing projection obscures the full extent of the problem facing some regions. The number of poor in Sub-Saharan Africa is projected to grow by 116 million. Meanwhile, the number of poor in Latin America will rise by 52 million, or 60 per cent.

It is of course theoretically possible to meet the 2015 target through increased growth without any change in income distribution. For sub-Saharan Africa, this would imply growth rates of 4-5 per cent per capita over the next fifteen years – wildly in excess of even the most optimistic projections. However, combining a lower growth rate with an increased income share for the poor reduces the rate of growth required to more realistic levels. Doubling the share of national income captured by the poorest 20 per cent in Latin America would imply a shift in income distribution of around 4 per cent of GDP and would lead to significant reductions in poverty at current growth rates.

While redistribution can increase the efficiency of growth as an engine for poverty reduction, any trade-off between growth and distribution would have potentially damaging implications for the poor. To take the extreme case, if an improvement in income distribution was associated with a return to zero growth, any short-term benefits for the poor would rapidly be lost. But if distribution can be improved without slowing growth, this presents a 'win-win' scenario for poverty reduction. As early drafts of the World Development Report have argued, there is growing evidence of a positive relationship between growth and equity. Improved distributional outcomes are associated not just with higher growth, but also with more stable growth. There are good reasons why redistribution might act as a catalyst of growth. In particular, it can play an important role in removing poverty-related barriers to investment and productivity, enabling poor people to take advantage of market opportunities. Whether or not trade-offs happen in practice will depend on the precise mix of policies applied, but there is no necessary reason to assume a negative outcome.

However, at extreme levels of inequality the trade-offs are more illusory than real. High levels of inequality in land-holdings are associated with low levels of efficiency, for example. Similarly, extreme inequalities in access to productive assets, marketing infrastructure, health and education stifles innovation and restricts opportunities for the development of markets. Seeking to build growth on the foundations of extreme inequality is not just socially unjust, it is also inefficient. **In this respect, the Dollar and Kraay model is not just bad for the poor, it is bad for growth.**

Some lessons from the North

In many respects, the development perspective outlined in *Growth is good for the poor* can be traced to heyday of free market 'trickle down' economics in the Reagan-Thatcher era. Rising poverty in the midst of growing prosperity, widening wealth gaps between rich and poor, social dislocation, and a shameful increases in child poverty were among the hallmarks of this era.

- During the 1990s the United States experienced economic expansion with low inflation and a soaring stock market. Per capita incomes rose at almost 2 per cent a year. Yet by the end of the decade, 19 per cent of the nation's children were living in households with incomes below the poverty line, roughly the same as in 1990. With the second highest per capita GDP in the OECD, the US was second to bottom of the OECD league for child poverty – one place above Mexico. The reason: rapidly increasing income inequality. In 1985, the richest 5 per cent of Americans received 16 per cent of national income, the same share as the poorest 40 per cent. By the mid-1990s, the poorest 40 per cent received 14 per cent and the richest 5 per cent received 20 per cent.
- The UK followed a similar trajectory in the 1980s and first half of the 1990s. Between 1979-1992 the poorest 20-30 per cent of the population failed to benefit from economic growth, reversing over a decade of declining inequality. The proportion of the population living on less than half the average income trebled, to over 20 per cent. The widening wage gaps between rich and poor and tax reductions on high incomes were the primary motor behind this trend, with inequalities widening more rapidly than in any other OECD country except New Zealand. The legacy is readily apparent today. Between 1979 and the mid-1990s, the child poverty rate tripled to 20 per cent – the fastest increase in child poverty recorded in any OECD country. Today, Britain is fourth from bottom of the OECD child poverty league.

The experiences of the US and the UK are directly relevant to the current debate on growth and poverty reduction. During the fifteen years up to the mid-1990s, both countries achieved high growth with a strong policy focus on low inflation and a commitment to greater openness. Distribution was regarded as being irrelevant to poverty reduction, with increased inequality seen as an acceptable price to pay for higher growth. It was assumed – wrongly in the event - that this growth would ultimately 'trickle down' to the poor. This is the model held up today as a prescription for poverty reduction in developing countries by Dollar and Kraay.

It should be stressed that the poverty indicator for the US and the UK is a 'relative' one based on the number of households living on 50 per cent or less of the national median income, rather than the absolute \$1 a day indicator. This relative poverty reflects the distribution of opportunity within countries and the ethical values that underpin economic policies. The British Government's commitment to eradicate child poverty by 2020, is in fact a commitment to achieve more equitable growth, with the poorest 20 per cent of households capturing a bigger share of the economic cake. Various policies have been put in place to contribute to this goal, including minimum wage legislation, the working families tax credit, a 'sure start' programme to reduce educational under-achievement, and special provisions for 0-4 year-old children at most risk from poverty. Whatever the strengths and weaknesses of these interventions, their concern with equity places them at odds with the approach advocated by Dollar and Kraay.

Standard macro-economic policies and globalisation are best for poverty reduction

Much of the Dollar and Kraay report is spent making a case for free markets, purportedly on the basis of data on the relationship between growth and distribution. Trade liberalisation, capital market liberalisation and economic globalisation are deemed to be inherently good. Dollar and

Kraay are unable to find “any evidence of a significant negative impact of openness to international trade on incomes of the poor,” and they therefore jump in characteristic style to the conclusion that “globalisation is good for the poor.” After reviewing a range of potential factors influencing growth and distribution, they claim that standard macro-economic policies, with an emphasis on low inflation and private property, are ‘super-pro poor’. Public investment in health and education is presented as being only marginally relevant for growth and income distribution.

Part of the problem with the positive picture presented by Dollar and Kraay is that it contrasts so starkly with the experience of poor people in a large range of countries. There is a gulf between their assertions and the real experiences of many countries. In the Philippines, the liberalisation of agricultural markets left desperately poor producers in the island of Mindanao facing increased competition from subsidised imports from the United States. Producers in southern Mexico have faced similar problems. In Tanzania, the benefits of coffee market liberalisation have been unequally shared between richer and poorer coffee growing areas. In Zambia, maize market liberalisation undermined the position of producers in the most marginal areas. In China and Vietnam, increased openness has widened income gaps between regions, and between rich and poor. One recent World Bank report, cited in current drafts of the World Development Report, estimated that the benefits associated with trade liberalisation have been captured by the wealthiest 20 per cent, with the poorest 40 per cent becoming poorer.

The real issue here is not one of free trade versus protectionism. There are strong efficiency grounds for opening markets, especially in the importation of capital and intermediate goods. But the extravagant claims made about the benefits of openness in this area for poverty reduction are not warranted. Poor people are often excluded from market opportunities by a lack of productive assets, weak infrastructure, poor education and ill-health. **The degree to which trade liberalisation benefits the poor will depend in part on the extent to which government addresses these problems. But experience clearly demonstrates that the benefits are not automatic.** In fact, whether for growth or poverty reduction, openness *per se* is less significant than the complementary policies for managing growth that are developed by governments.

In the case of capital market liberalisation, Dollar and Kraay’s claims are even less tenable, not least because their data does not extend to the period of financial crisis in East Asia. The liberalisation of capital markets in a context of weak financial regulation and volatile global markets contributed to a major recession in the region, with large-scale increases in poverty. The social costs have been enormous. In Thailand, the health budget has been cut by one-third. In Indonesia, the poverty rate increased by almost 50 per cent, with another 10 million people falling below the poverty line.

On the subject of education, Dollar and Kraay’s findings run counter to those from a wide body of research, not to mention the views expressed by poor people themselves in participatory poverty assessments. Not surprisingly, there is clear evidence that the poorest households in Latin America have less education. In Mexico, the poorest 10 per cent of households receive on average two years of education, compared to 12 years for the wealthiest 10 per cent. According to the Inter-American Development Bank, education differences are the single biggest factor in explaining income inequality in the region. In Brazil and Mexico, workers with six years of education earn almost twice as much as workers with no education. Evidence from a large group

of countries in the region suggests that returns to education are rising as demand for skilled labour, linked to education, increases. As in other regions – and in developed countries - inequalities in education are reinforcing income inequalities. Moreover, in almost all developing countries lack of education is a passport to low-income and poverty. Several studies using household data on education, poverty and income distribution provide grounds for questioning the results of the Dollar and Kraay study. For instance, panel data covering 2,678 Vietnamese households over the period 1993-98 found that the higher the level of education attained at the start of the period, the faster the subsequent income growth. On average, the expenditure levels of those with no education declined, while they increased for those with primary and secondary education. In Vietnam, the poverty rate in households headed by someone with no education is 68 per cent. In households headed by someone with a secondary education the figure falls to 41 per cent.

Making markets work for the poor

For policy makers concerned with poverty reduction, the real challenge is that of making markets work for the poor. There is no blueprint. But there are some rules. Markets will not work for the poor where exclusion from educational opportunity or poor health restricts ability to generate income, or to raise productivity and wages. Similarly, market-reforms can create opportunities, but poor producers cannot take advantage of opportunities if they lack access to land, credit, skills, good health or to marketing infrastructure. The issue of power in the market place is also important. People do not enter markets as equals – and market outcomes reflect power relations. State intervention can compensate for unequal power relations, for instance by setting minimum employment and wage standards.

Achieving the patterns of growth with equity needed to meet the 2015 poverty reduction targets is not just about taxing growth and transferring income to the poor in the form of social welfare provision. Such transfers can play an important role in compensating for income inequality, as they have in several OECD countries. But for poor countries poverty reduction and enhanced equity requires a production-based approach. That is, the poor need to be provided with opportunities to produce and invest their way out of poverty, rather than to await the trickle down of wealth. This implies government commitment to the redistribution of opportunity through the transfer of assets, the prioritisation of the poor in public spending provision, and the management of market liberalisation to protect the livelihoods of vulnerable producers.

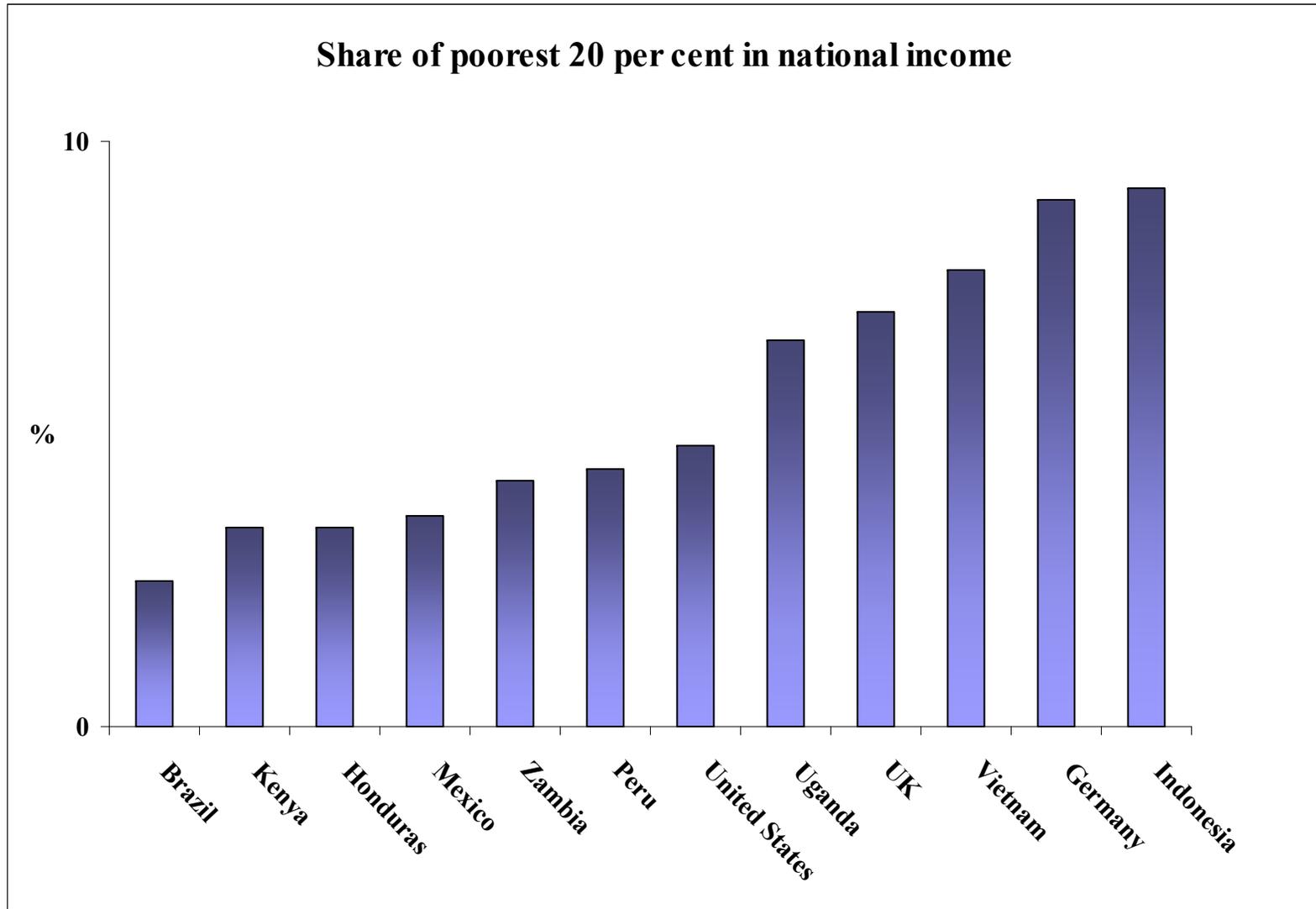
None of this is to argue against the primacy of growth as an engine for poverty reduction. But growth without equity is a prescription for deepening social divisions, the continuation of mass poverty and – ultimately – economic inefficiency. This is the model of the future offered by Dollar and Kraay. It is a model that deserves to be returned to museum of failed economics.

For further reading please see the following Oxfam Insight Publications:
Economic Growth with Equity: Lessons from East Asia, Kevin Watkins, 1998.
Social Investment and Economic Growth: A strategy to eradicate poverty, Patrick Watt, 2000

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Regional poverty indicators

	Number of poor (millions)		Headcount index		Required rate of poverty reduction to meet 2015 target	Actual rate of poverty reduction 1990-1998
	1990	1998	1990	1998		
East Asia	452	278	27.6	15.3	2	2.40
Latin America	74	78	16.8	15.6	2	0.15
South Asia	495	522	44.0	40.0	2	0.50
Sub-Saharan Africa	242	290	47.7	46.3	2	0.17
Total all developing and transition economies	1.276	1.190	29	24	2	0.62



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