

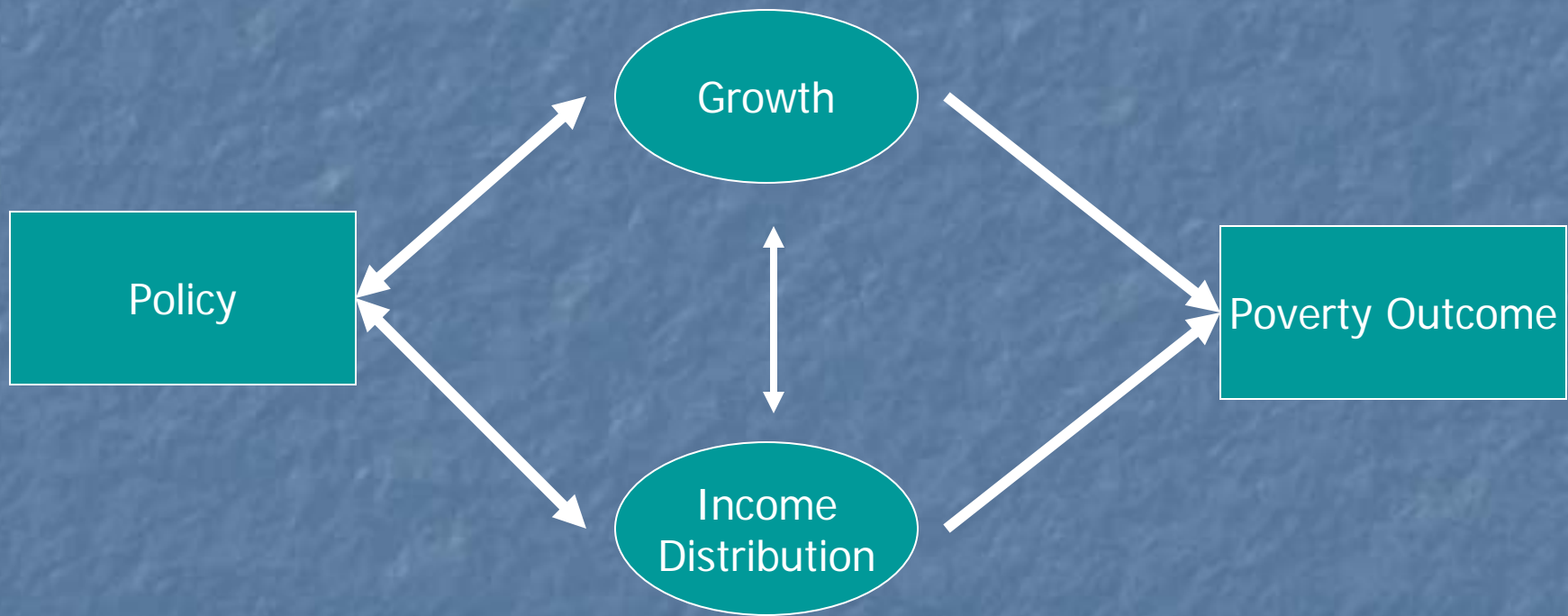
*Pro poor growth: A review of
what we know
(...and of what we don't)*

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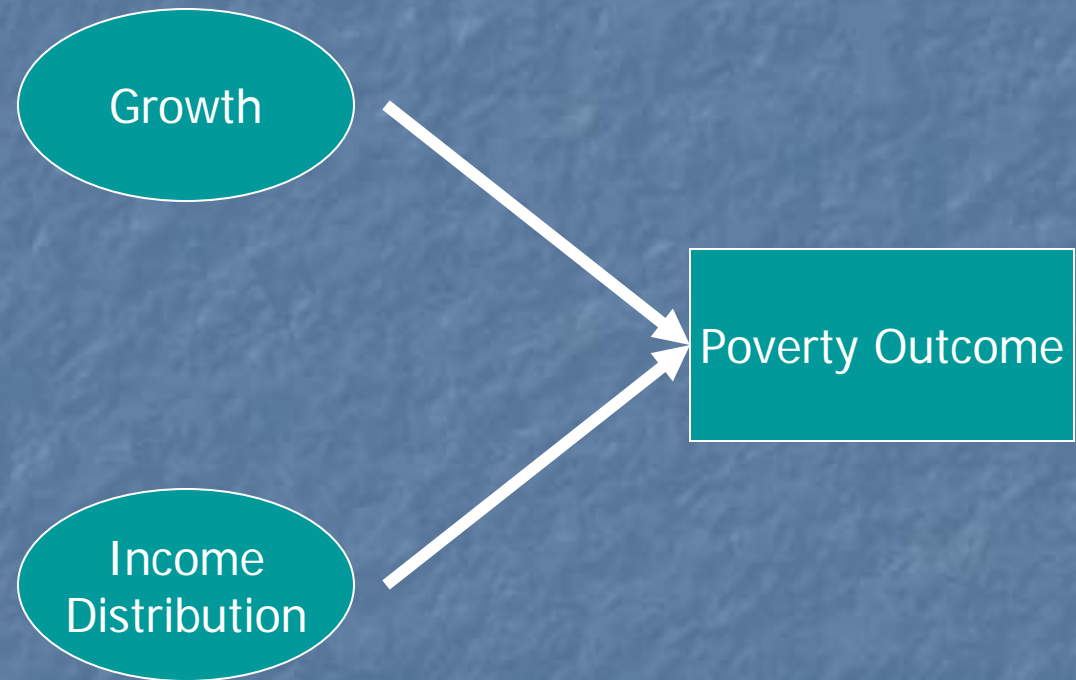
Plan of the presentation

- 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?

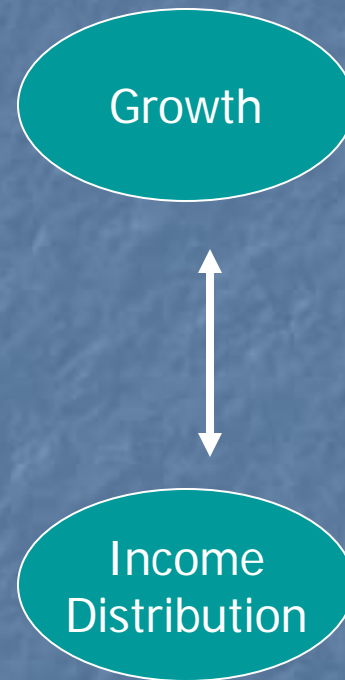
From policies to poverty...



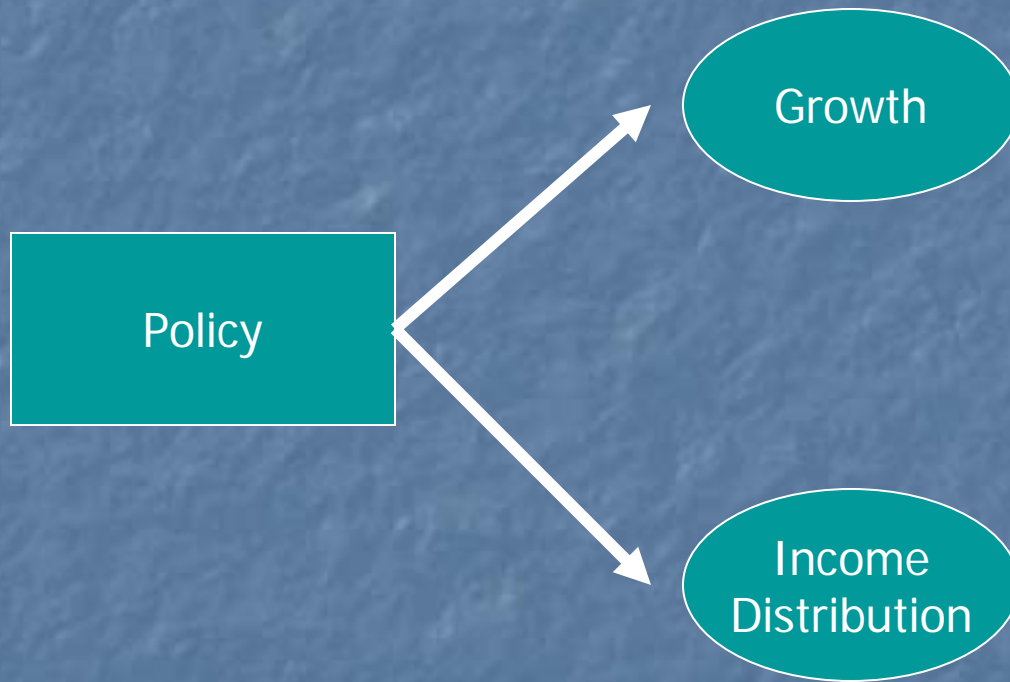
Some papers focus on the growth & distribution - poverty relationship



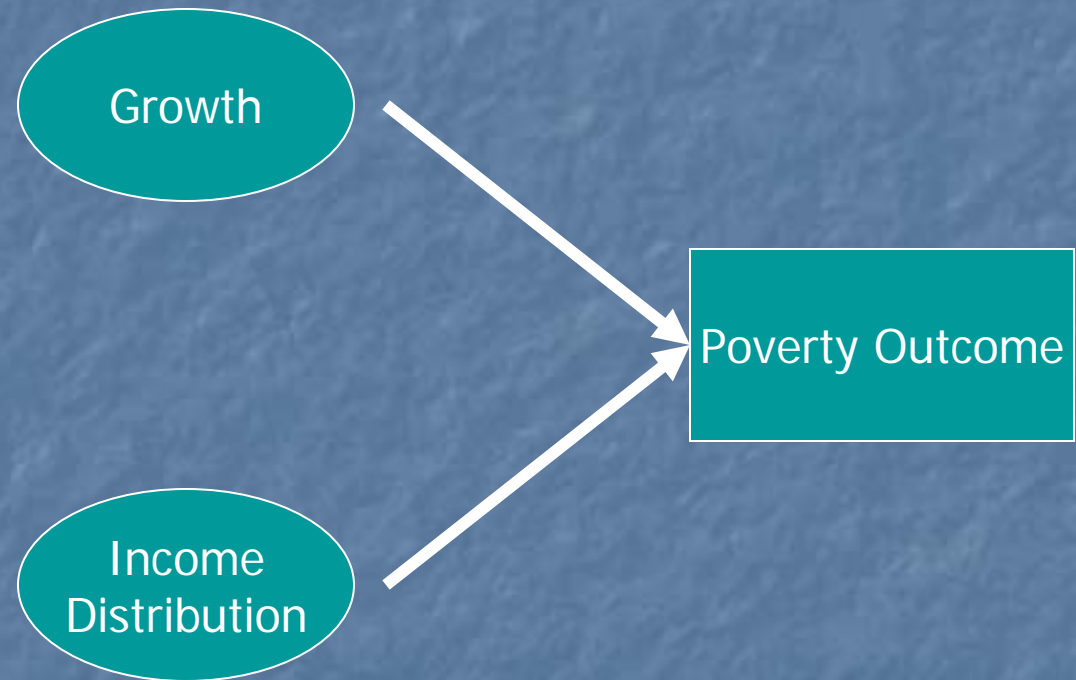
Others on the growth - inequality relationship



Finally, others on the impact of policies on growth and inequality



Poverty, growth and inequality



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 pc 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 (i.e. in the elasticity) 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:
 - $\text{Changes in (HC) poverty} = k(1 - \text{Gini}) * \text{growth}$
- 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.

Do initial conditions matter?

- So far..
 - Growth matters (Kraay)
 - Inequality matters (Ravallion)
- But do each of them matter in some countries more than in others?
 - To answer this we assume that income follows a log-normal distribution (Bourguignon (M 02) finds that -at least for P0- this approximation seems to be extremely precise)
 - This assumption permits identifying precisely the contribution of growth and distributional change for poverty reduction as a function of level of development and initial inequality.

The sensitivity of poverty to growth (under log-normality)

	Growth		Elasticity	
PL^a / Gini	0.3	0.4	0.5	0.6
0.16	-6.2	-3.3	-2	-1.2
0.33	-4	-2.2	-1.3	-0.9
0.5	-2.8	-1.6	-1	-0.7
0.66	-2.1	-1.2	-0.8	-0.5
0.9	-1.4	-0.9	-0.6	-0.4
1.1	-1	-0.7	-0.5	-0.4
	Inequality		Elasticity	
PL^a / Gini	0.3	0.4	0.5	0.6
0.16	12.9	7.7	5.3	4
0.33	5.2	3.3	2.4	2
0.5	2.5	1.7	1.4	1.2
0.66	1.2	0.9	0.8	0.8
0.9	0.4	0.4	0.4	0.4
1.1	0.1	0.1	0.2	0.3

The importance of growth for poverty reduction

Poverty Line	Gini			
	0.3	0.4	0.5	0.6
0.16	0.19	0.16	0.12	0.08
0.33	0.37	0.31	0.23	0.17
0.5	0.56	0.47	0.34	0.25
0.66	0.75	0.64	0.5	0.28
0.9	0.92	0.84	0.69	0.5
1.1	0.99	0.98	0.86	0.64

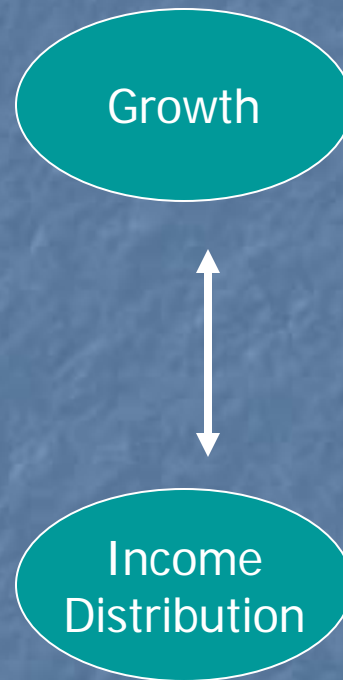
Some simulations...

Scenario 1^b				
PL^a / Gini	0.3	0.4	0.5	0.6
16	-5.7	-2.2	-0.7	0.4
33	-6.8	-3.3	-1.5	-0.7
50	-5.9	-3.1	-1.6	-0.9
66	-5.1	-2.7	-1.6	-0.7
90	-3.8	-2.3	-1.4	-0.8
110	-2.9	-2	-1.3	-0.9
Scenario 2^b				
	0.3	0.4	0.5	0.6
16	-12.4	-6.6	-4	-2.4
33	-8	-4.4	-2.6	-1.8
50	-5.6	-3.2	-2	-1.4
66	-4.2	-2.4	-1.6	-1
90	-2.8	-1.8	-1.2	-0.8
110	-2	-1.4	-1	-0.8
Difference				
	0.3	0.4	0.5	0.6
16	-6.7	-4.4	-3.3	-2.8
33	-1.2	-1.1	-1.1	-1.1
50	0.3	-0.1	-0.4	-0.5
66	0.9	0.3	0	-0.3
90	1	0.5	0.2	0
110	0.9	0.6	0.3	0.1

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



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.

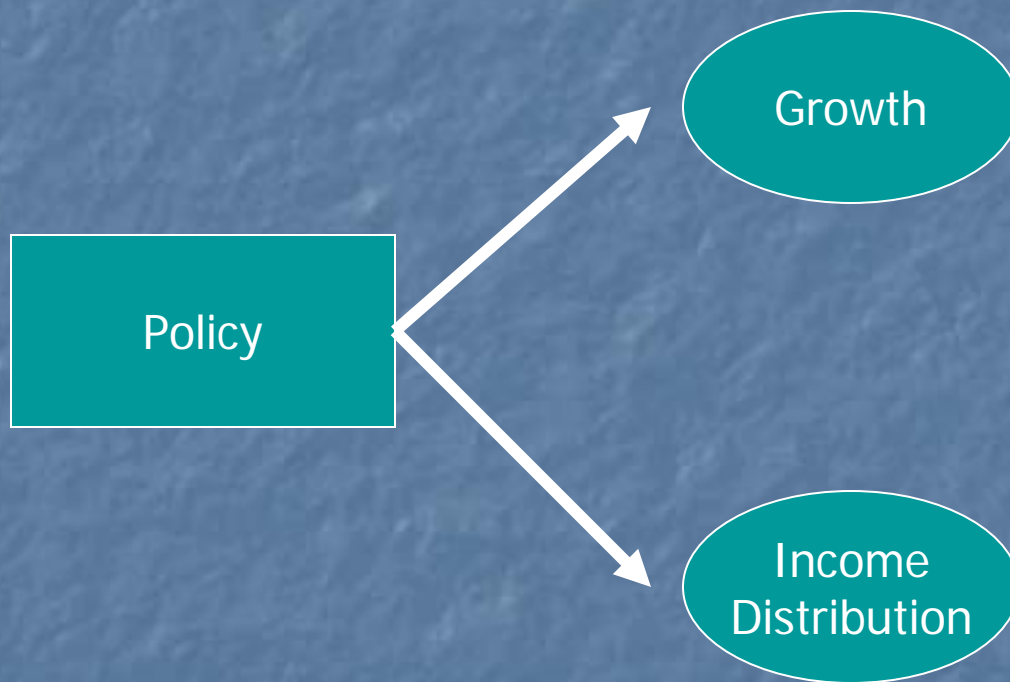
The relationship between growth and income distribution

- 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



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. Focus 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

	B(2000)	D&K(2000)	L&Z(2002)	K(2003)	L&S(2003)	L(2004)
Better Education	+		+		+	+
More Trade	-	+	0	0	-	-
More Financial. Devel.		-	+		0	-
Less Government Spending		+	-	0		-
Better Rule of Law	+	+		0		
Lower Inflation		+	+		+	+

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.
 - The level of development and the level of inequality of a given country should be taken into account when designing poverty reduction strategies.
 - Better education and lower inflation are typically associated with lower poverty.
- 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.
 - 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.

