



HIGHLIGHTS OF USAID WORKSHOP:
PROMOTING ECONOMIC GROWTH IN A NEW ERA
JUNE 28 – JULY 2 2004

Pro-Poor Economic Growth Interventions

The concept of “pro-poor growth” has recently attracted considerable attention and controversy. The purpose of this session was to introduce a working definition of pro-poor growth and to review the available empirical evidence on how to achieve it.

Aart Kraay, a Senior Economist at the World Bank, presented new cross-country research linking changes in poverty with growth and changes in relative incomes, to identify the relative contributions of each to poverty reduction. Recent discussions of “pro-poor” growth have defined this term in two distinctly different ways. One definition counts growth as pro-poor only when the pattern of growth in relative incomes is poverty-reducing – i.e., only when inequality falls. A second defines growth as pro-poor to the extent that *the poverty measure of interest* falls. To illustrate that the second definition is more useful, Kraay cited two recent country experiences: in Indonesia 1996-99, distribution shifted in favor of the poor, but headcount poverty grew markedly as the overall economy shrank; meanwhile, in China rapid overall growth during 1990-98 led to historically unprecedented reduction in headcount poverty, despite some loss in the share of income earned by the poor. The first definition would count the Indonesian case as one of “pro-poor growth,” but not that of China. The second definition avoids this kind of perverse classification. Still, the choice of a particular poverty measure determines *whose* income growth is counted toward poverty reduction: for example, the headcount measure is highly sensitive to income growth among those initially just below the poverty line, while insensitive to growth affecting those either above or significantly below that line.

Kraay then introduced a method for breaking down changes in poverty rates into three distinct components: (i) growth in average incomes; (ii) sensitivity of poverty to growth; and (iii) changes in the relative incomes of different groups. Through cross-country analysis, one can use this decomposition to assess the contribution of each component to observed changes in poverty. The available data suggest that, in the medium-to long-run, most poverty reduction results from growth in average incomes, with most of the remainder due to poverty-reducing patterns of growth in relative incomes. Ultimately, the value-added from adding the “pro-poor” prefix to growth really depends on the extent to which we can identify policies and institutions that affect poverty through the second and third components – a matter where the cross-country evidence has so far provided little guidance.

Humberto Lopez, also a Senior Economist at the World Bank, followed with a presentation of what we know (and what we don’t) about pro-poor growth. The theoretical and empirical literature on the links among growth, income distribution, and poverty reduction is vast, but some of these links are much better understood than others. For example, we know that economic growth reduces poverty, and that growth does not significantly affect income distribution. Therefore, standard growth-enhancing policies should be at the center of poverty reduction strategies.

Although growth is fundamental for poverty reduction, income distribution makes a difference as well. For example, the impact of a given growth rate on poverty reduction will be smaller, the more unequal a country's distribution of income. Likewise, growth accompanied by progressive distributional change reduces poverty more rapidly than growth alone. The available evidence suggests that in low-income countries, distributional change alone has limited potential to achieve poverty reduction; in contrast, redistribution may be effective in richer countries. Finally, the most effective set of policies for reducing poverty in very poor *and* very unequal countries remains a conundrum that the literature has yet to address.

In contrast to these areas of (relative) agreement, other key issues remain much less clear. In particular, published research has reached diametrically opposite conclusions on whether greater inequality promotes growth, retards it, or has no impact. Similar disagreement surrounds the question of how policies affect inequality. The evidence consistently shows that more and better-distributed education and lower inflation are associated with lower inequality. The links between inequality and other factors – including openness, financial development, government spending, and the rule of law – remains highly ambiguous.

During Q&A, one Workshop participant pointed to the challenge of working in dualistic societies (e.g., Guatemala) where the minority represents the poorest segment of the population. One participant recommended that future research explore the *finite* changes in income and other factors to complement the existing research on the effects of infinitesimal changes. Finally, another expressed interest in seeing more country-specific research on the relationships between poverty, growth and inequality.