Pro-Poor Growth

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There is considerable evidence that economic growth is pro-poor in the sense that the fraction of a country's population who fall below the poverty line and the extent of this shortfall are both correlated with the growth in average incomes. Various cross-country studies of developing countries have estimated growth elasticities of poverty reduction to be in the range of −2 to −3 when the poverty line is set at US$1 a day. That is, a 1% increase in average incomes is typically associated with a 2 to 3% drop in the fraction of households who fall below the poverty line.

But for some countries, the contribution of economic growth to poverty reduction is much worse. For example, a recent study of Brazil by Francisco Ferreira, Phillippe Leite, and Martin Ravallion of the World Bank found that from 1985 to 2004, on average a 1% increase in per capita gross domestic product (GDP) reduces poverty by only 1.09% using 1996 prices to measure purchasing power. Coupled with an extremely low growth in per capita GDP of 0.5%, it is not surprising that progress in reducing poverty in Brazil was slow over this period. More recently, Brazilian poverty has been falling at a more rapid rate.

Over a long period of time, even modest gains can have a significant impact on poverty reduction. Using 2005 prices to make intertemporal comparisons, Martin Ravallion has found that the percentage of the Brazilian population below a poverty line set at US$1.25 a day fell from 17.1% to 7.8% from 1981 to 2005 and from 31.1% to 18.3% using US$2 a day as the poverty line, which is closer to the official Brazilian poverty line of approximately US$3 a day. (The gains are more modest if the official poverty line is used.) These figures can be contrasted with those of China and India, which, like Brazil, are countries with very large populations and substantial poverty. Using the US$1.25 a day poverty line, the percentage of the population in poverty over this period fell from 84.0% to 16.3% in China and from 59.8% to 41.6% in India. Using this poverty line, Brazil's average annual proportionate rate of poverty reduction (the rate obtained by subtracting the population growth rate from the growth rate in the number of poor) of 3.2% looks impressive compared to India's 1.5%, but pales in comparison to China's 6.6%. Impressive as the Chinese performance has been, it must be borne in mind that China started this period with the vast majority of its population in poverty.

It is important to investigate the factors that account for differential success in poverty reduction, both across countries and across time within a country. Simply looking at averages over a twenty or twenty-five year period can obscure significant variations in the rate at which the incidence of poverty has changed during this period, and understanding the reasons for these variations is instructive. If the growth elasticity of poverty reduction remains constant over time, the rate of change in the incidence of poverty will simply track changes in the growth rate. Indeed, the incidence of poverty may even increase if growth is negative, as was the case in Brazil from the mid 1980s to the early 1990s. But this elasticity may also vary over time, possibly resulting in

significant gains in poverty reduction even in periods of economic stagnation. For the most part, the gains in such periods are due to reductions in income inequality.

It is useful to distinguish the role that changes in governmental policy have had on poverty reduction from other factors. All three of the countries mentioned earlier have implemented major changes in policy in the past three decades, which have either directly or indirectly contributed to poverty reduction. For example, in Brazil, during the 1990s, the benefits of trade liberalization and macroeconomic polices aimed at controlling inflation (notably the 1994 Real Plan) began to have a significant impact on poverty. However, it has been the expansion of public pensions and direct forms of social assistance such as the *Bolsa Família* program (and its predecessors) that have had the most significant impacts on poverty reduction.

In addition to changes in government policy, a number of other factors influence the magnitude of the growth elasticity of poverty reduction, including how growth is spread across sectors of the economy and regions of the country, the extent to which the population is concentrated in urban areas, the health status and education levels of workers, the extent of unionization, investments in infrastructure (roads, port facilities, communication networks, etc.), the state of technical know-how, and so on. For example, in the case of Brazil, the Ferreira-Leite-Ravallion study found that growth in the service sector contributed more to poverty reduction than growth in either the agricultural or industrial sectors, but that after trade liberalization, growth in the latter sectors became more poverty-reducing. Nevertheless, in the absence of any change in government policies, these factors only account for a relatively small fraction of the progress that has been made in reducing poverty.

Trade liberalization and macroeconomic stabilization polices tend to operate indirectly by promoting growth or by helping to maintain the real value of the incomes of the poor. In the case of Brazil, Francisco Ferreira, Phillippe Leite, and Matthew Wai-Poi have found that trade liberalization has helped the poor, with the induced changes in employment levels across sectors and across type of employment (formal or not, self-employed or not) being the channel through which trade liberalization has had the greatest impact on poverty reduction. In the case of China, pre-reform trade distortions were so extensive that its massive trade liberalization programs dramatically increased the growth rate of GDP, which in turn helped contribute to the rapid decrease in the fraction of its population in poverty.

Inflation contributes to the incidence and extent of poverty because the poor are the least able to protect themselves against the erosion in the purchasing powers of their incomes caused by rising prices. The taming of massive hyperinflations in Latin America has helped keep chronic poverty from getting worse. Inflation has a second, less obvious impact on poverty that operates through changes in relative prices. If the prices of goods and services that form a relatively large part of the budgets of the poor rise more rapidly than the prices of other goods, then the poor will be more adversely affected than the rest of the population. Empirical evidence presented by Hyun Son and Nanak Kakwani has shown that inflation in Brazil has been anti-poor in this sense from 1999 to 2006, but not

if we restrict attention to the last couple of years in their sample. As one might expect, they have found that increases in the prices of food, clothing, and housing have a greater impact on the poor, with a 1% increase in the prices of these goods increasing the fraction of the population in poverty by 0.42%, 0.11%, and 0.63%, respectively.

A number of developing countries have expanded their public pension and social assistance programs in the past two decades. These initiatives have been major contributors to the fight against poverty and they have done much to reduce overall inequality. The Ferreira-Leite-Ravallion study estimates that the poverty rate in Brazil would have been about 5 percentage points higher in 2004 had Federal government spending for social assistance and public pensions not increased.

While pension reforms, such as those associated with the Benefício de Prestação Continuada (BPC) program in Brazil, result in a permanent drop in the incidence of poverty among the elderly and disabled, perhaps the policy innovation that has the most potential for making sustained reductions in poverty a reality is the recent adoption of conditional cash transfer programs by an increasing number of jurisdictions. Conditional cash transfer programs are targeted towards poor families with children. They operate by applying some form of means test to determine eligibility, but make the payments conditional on their compliance with a number of conditions aimed at improving the health and education status of the children. The precise conditions vary from program to program but include school attendance requirements, health checkups, a regime of vaccinations, and pre-and post-natal counseling for mothers.

As recently as 1997, there were only three conditional cash transfer programs in operation, in Bangladesh, Brazil, and Mexico. Today, there are dozens. Some of these programs extend their reach to large segments of the population. As of June 2006, benefits from Brazil's *Bolsa Família* program were being received by 11 million households (roughly 20% of the population), whereas as of October 2008, Mexico's *Opportunidades* program was providing benefits to 5 million households (roughly 18% of the population).

The cash transfers have an immediate effect in reducing poverty, but this effect may pale in comparison with the potential long-term benefits. One of the main reasons for making the transfers conditional on human capital investments in health and education is to try and break the vicious cycle in which poor families are unable to afford good health care and education for their children, with the consequence that when the children become adults, they either do not have the skills or are not healthy enough to obtain an income that would lift them out of poverty.

It is too early to evaluate the success of these human capital investments in attenuating the intergeneration transmission of poverty. An encouraging sign is the high compliance rates with the conditions of the transfers. However, as noted in a recent analysis of conditional cash transfer programs by a team at the World Bank under the direction of Ariel Fiszbein and Norbert Schady, these conditions typically do not incorporate performance goals. To the extent that the health and educational services received by the

targeted populations are of poor quality, these programs will need to be supplemented by complementary programs aimed at improving the quality of these services if the hoped for long-term benefits are to be realized.

Some additional support for the effectiveness of conditional cash transfer programs for reducing poverty is provided by a study prepared for the Brookings Institution by Ricardo Barros, Mirela de Carvalho, Samuel Franco, and Rosane Mendonça. They compared the impact of raising the minimum wage in Brazil by 10% with using an equivalent amount of resources for an expansion of the *Bolsa Família* program. Because the value of both BPC pensions and contribution-based pension and social security payments are linked to the minimum wage, with the latter accounting for 95% of all public transfers, changing the minimum wage affects a substantial proportion of the population. It was found that the poorest 10% of the population would see only a 1 to 2% increase in their incomes from the minimum wage increase (the poorest 5% would see their incomes fall), whereas the incomes of the poorest 10% would increase by 17 to 18% if the same resources were instead devoted to the *Bolsa Família* program.

Promising as conditional transfer programs are, the cost of the programs may well be out of reach for the poorest nations of the world. There are many ways in which a country's fiscal capacity to implement redistributive polices may be measured. Martin Ravallion has suggested that we measure this capacity by how much it would be necessary to increase the marginal tax rate of those who are not poor by US standards in order to raise everybody below the poverty line up to this threshold. While for many countries this rate would exceed 100%, for Brazil in 2005, it would only have been necessary to raise the marginal tax rate of the 'rich' by 1% to eliminate poverty using a poverty line of US$1 per day and 4% if the poverty line was instead set at US$2 a day. Viewed from this perspective, Brazil can well afford an expansion of its public pension and social assistance programs so as make further progress in eliminating poverty from its borders.

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