

Growth and Poverty Reduction: What Are the Real Questions?

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August 2000

Should governments pursue economic growth first and foremost, or should they focus on poverty reduction? The recent debate on these questions has generated more heat than light, because it has become embroiled in a wider, political debate on globalization and the role of World Bank/IMF conditionality. As an empirical matter, it is clear that growth and poverty reduction go largely hand in hand. The real questions in this debate should be: What are the policies that yield these rewards, and would a poverty focus facilitate their adoption?

Let us begin, however, with the easier questions.

Is growth good for the poor? Generally yes. All developing countries that have experienced sustained high growth over the last few decades have reduced their absolute poverty levels.

In principle, one can imagine cases where an economy registers high growth on average, but the households at the bottom of the income distribution scale make few gains. For this to happen, however, income distribution needs to deteriorate significantly during growth. This is an unlikely outcome because the available evidence suggests that measures of income distribution (such as the Gini coefficient) tend to be quite stable over time within countries.

To the extent that measures of income distribution vary, the changes do not seem to bear any systematic relationship to economic growth. In some countries (such as Taiwan, Bangladesh, and Egypt) growth has been accompanied with an improvement in Gini coefficients; in others (such as Chile, China, and Poland), Gini coefficients have gone the other way. This suggests that the poverty-reduction payoff from growth depends in part on the specific circumstances and policies in each country.

Is poverty reduction good for growth? Again, generally yes. It is hard to think of cases where absolute poverty levels have declined significantly without accompanying high growth rates.

Just as one can imagine growth occurring without any poverty reduction, in theory one can imagine a strategy of poverty reduction that relies exclusively on redistribution from the rich or the middle classes. But as an empirical matter, one would be hard pressed to find real-world instances of this. As I discuss below, policies that are effective in increasing the incomes of the poor--such as investments in primary education, rural infrastructure, health, and nutrition--are also policies that enhance the productive capacity of the economy in aggregate. This is another fact that is reflected in the observed stability of income distribution measures over time.

What does a high correlation between growth and the incomes of the poor tell us? For reasons just discussed, practically nothing. All that such a correlation demonstrates is that income distribution tends to be stable and rather unresponsive to policy changes.

¹ This article has been prepared for publication in Finance & Development. I am grateful to Rob Jensen for helpful discussions and comments.

A strong correlation between economic growth and poverty reduction is compatible with both of the following arguments:

- a) all that matters is economic growth, and only policies that are targeted on growth can generate poverty reduction;
- b) only policies that are successful in reducing poverty can yield higher growth in aggregate.

As such, the observed correlation between growth and poverty reduction is consistent with arguments that span the entire spectrum of views on the growth-poverty debate.

The operational question of interest, therefore, is not whether growth is good for poverty reduction, or vice versa. These questions tell us nothing of interest as far as policy is concerned. The real issue regarding priorities is whether the well-being of the poor should enter as a separate determinant of policy choices, in addition to the usual focus on macroeconomic stability, microeconomic efficiency, and institutional quality.

Should economic reform strategies have a poverty focus? Yes. There are at least three reasons for this.

First, most people, including presumably democratically elected governments, would place a greater welfare weight on the well-being of the poor than on that of the rich. The economy's growth rate is not a sufficient statistic for welfare evaluations not only because it ignores the level of income, but also because it disregards its distribution. A policy that increases the income of the poor by one rupee can be worthwhile at the margin even if it costs the rest of society more than a rupee. From this perspective, it can be entirely rational and proper for a government to select, among two competing growth strategies, the one that has greater potential payoff for the poor even if the aggregate growth impact is less assured.

Second, and even if the welfare of the poor does not receive extra weight, interventions targeted at the poor may well be the most effective way of raising average incomes. There is a simple reason for this. Poverty, it is natural to assume, is associated with market imperfections and incompleteness. The poor remain poor because they cannot borrow against future earnings to invest in education, skills, new crops, and entrepreneurial activities. They are cut off from economic activity because many collective goods (such as property rights, public safety, and infrastructure) are under-provided. They lack information about market opportunities. It is a standard tenet of economic theory that raising real average incomes requires interventions targeted at closing gaps between private and social costs. There will be a preponderance of such opportunities where there is a preponderance of poverty.

Finally, a poverty focus is also warranted from the perspective of a broader, capabilities-oriented approach to development. An exclusive emphasis on consumption or income levels constitutes too narrow an approach to development. As Amartya Sen has emphasized, the overarching goal of development is to maximize people's capabilities--that is, their ability to lead the kind of life they value. Here it is probably the obstacles facing the poor that are the greatest, and therefore the most deserving of urgent policy attention.

Do priorities matter? Yes, a whole lot. Policy makers make choices all the time. The lens through which they perceive development makes a big difference to the outcomes. Keeping poverty in sight ensures that priorities are not distorted.

Consider some illustrative tradeoffs.

- Fiscal policy. How should a government resolve the tradeoff between higher spending on poverty-related projects (rural infrastructure, say) and the need for tight fiscal policies? Should it incur the risk of financial market disapproval as the price of better irrigation? How should it allocate its educational budget? Should more be spent on building primary schools in rural areas or on training bank auditors and accountants?
- Market liberalization. Should the government maintain price controls on rice, the main staple for the poor, even if that distorts resource allocation in the economy? Should it remove capital controls on the balance of payments, even if that means that fiscal resources will be tied up in holding additional foreign reserves (resources that could otherwise have been used toward a social fund)?
- Institutional reform. How should the government design its anti-corruption strategy? Should it target the large-scale corruption that foreign investors complain about, or the petty corruption in the police and judicial system that the ordinary citizen suffers from? Should legal reform focus on the trade and investment side, or the domestic side? Whose property rights should receive priority, that of peasants or of foreign patent holders? Should land reform be pursued, even if it threatens politically powerful groups?

As these examples illustrate, even the standard, growth-oriented desiderata of macroeconomic stability, microeconomic efficiency, and institutional reform leave considerable room for maneuver in practice. Governments can utilize this room to better or worse effect. A poverty focus helps ensure that the relevant tradeoffs are considered explicitly.

How much do we know about policy impacts? Not nearly enough. We have some evidence that land reforms, appropriately targeted price reforms, and certain types of health and education expenditures benefit the poor, but the range of our uncertainty is large. It is one thing to say that development strategies should have a poverty focus, yet another to decipher what the relevant policies would be.

But this is not a strike against poverty-oriented programs, since the same problem plagues growth-oriented programs as well. The uncomfortable reality is that our knowledge about the kinds of policies that stimulate growth is quite limited. We know that large fiscal and macroeconomic imbalances are bad for growth. We also know that "good" institutions are important--although we have very little idea about how countries can acquire them. And, despite a voluminous literature on the subject, we know next to nothing about the kind of trade policies that are most conducive to growth.

The policies that promote growth are probably not that different from those that target the poor directly, for reasons discussed previously. These policies are likely to vary considerably depending on institutional context, making it difficult to generate robust generalizations. The debate on growth versus poverty reduction is a meaningless debate that diverts attention from the questions that should be our real focus: what works, how, and under what circumstances?