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Pro-poor growth and development

Linking economic growth and poverty reduction

The pursuit of pro-poor growth – sometimes called 'shared' or 'inclusive' growth – has been central to development thinking and practice in the 2000s. It reflects two concerns that emerged in the 1990s: one, that rates of growth in developing countries had to increase if they were ever to narrow the gap with the industrialised countries; and two, that poverty had to be reduced – a goal given concrete expression in the Millennium Development Goals (MDGs).

A lively debate has ensued over the definition of pro-poor growth. Growth is clearly pro-poor when it raises the incomes of the poor. There is less clarity on how much the income of the poor needs to rise for growth to be defined as pro-poor, and how this increase should be measured. These are issues of considerable debate. Some favour a relative measure, which states that growth is only pro-poor when the incomes of the poor rise faster than those of the better-off. Others argue for an absolute measure, looking only at whether the economic conditions of the poor are improving. A more demanding absolute measure is that the poor should see their incomes rising at a substantial rate – for example by enough to hit the first MDG target, which aims to halve the proportion of persons living in poverty between 1990 and 2015.

This Briefing Paper provides an introduction to pro-poor growth. It reviews the concepts of growth, poverty reduction, inequality, and democracy and accountability in the pro-poor growth context. It also discusses the policy implications of a pro-poor growth approach and tools that can be used to direct such strategies.

Key concepts in the pro-poor growth debate

Growth. Growth can play a key role in reducing poverty. For example, rapid economic growth has helped greatly to reduce poverty in East Asia, where the proportion of people living in extreme poverty fell from 33% in 1990 to 9.9% in 2004, and in South-East Asia, where the proportion fell from 41% to 29.5% over the same period. Conversely, in sub-Saharan Africa, where economic growth has been slow overall, the proportion of people living in extreme poverty has fallen only slightly, from 47% in 1990 to 41% in 2004.

Growth spurts are a common global phenomenon. What is not so common in the developing world, however, is countries' ability to sustain episodes of growth. Policies and institutions play a central role in enabling sustained growth. Indeed, the secret to sustaining growth seems to lie in getting the institutions and policies – or 'the rules of the game' – right. Essentially, sustaining growth requires increasing incentives to invest and increasing the use and productivity of capital and labour across the economy through appropriate policies and institutions. It requires facilitation of the factors that contribute to growth, which include macroeconomic stability, institutions that are underpinned by good governance, and a favourable investment climate that ensures secure property rights and efficient markets.

Headloading matooke (bananas) for market in remote rural Uganda

Key points

- Economic growth is usually necessary for poverty reduction, but is far from sufficient
- Poverty reduction through growth depends on access to markets
- Blueprints for growth and poverty reduction do not exist – each country needs detailed and specific analysis

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Box 1: Uganda: Increasing poverty despite economic growth

- During the 1990s, growth in Uganda was accompanied by falling rates of poverty, but, since 2000, economic growth has not reduced poverty. Despite increases in average real expenditure per capita, the poverty headcount in Uganda went up between 1999 and 2003.
- Not only are the numbers of poor rising, but the poor are also getting poorer. Spending by those at the bottom of the income distribution curve has fallen, as has consumption of items such as meat, fish and salt that are sensitive to poverty. Wages are also down.
- The causes seem to lie in a: slow-down of agricultural growth; a fall in food prices between 2001 and 2002, that hit Uganda's poor, most of whom are net food producers; and perhaps also reduced cooperation within households, as more individualised consumption norms spread, especially among men.
- Uganda's Chronic Poverty Research Centre suggests the following responses: social protection to reduce the vulnerability of the poor and enable them to keep participating in markets; the improvement of education retention rates by school feeding and post-primary education scholarships for the children of chronically poor households; the introduction of legislation to strengthen women's rights to land, assets and inheritance; and the support of smallholder agriculture.

Sources: Bird and Shepherd (2006) and Chronic Poverty Research Centre – Uganda (2005).

While there may be widespread agreement about these broad principles, the precise ways to achieve the conditions for growth are elusive. For example, while institutions are increasingly accepted as the cornerstone of growth, what matters is not so much the form of the institution as the way it functions, and this in turn, is highly specific to the context. Property rights in China and Russia in the 1990s are a case in point. In the former, rights have been ambiguous and ill-defined, and without formal legal backing; yet this has proved no deterrent to both domestic and foreign investors, who trusted that their investments would not be expropriated. In Russia, rights were clearly defined in law, but many would-be investors were not reassured. In both cases, what mattered was the informal ways that property rights were respected.

Moreover, as economies develop, the drivers of economic growth may change. Michael Porter (see Porter, Sachs and McArthur, 2001) has proposed a three-stage model: early growth depends on putting unused and underused factors of production (such as labour, and for farming, land) to work; later the challenge is to use factors more efficiently; and finally growth depends largely on innovation. Different issues arise at each stage, and countries that fail to recognise the changing nature of the challenges they face and the correspondingly different requirements for institutions and policies can find their growth stalling.

Understanding growth, and ways to make it pro-poor, is not easy. A World Bank (2004) review concluded that its own understanding of growth, was 'partial and incomplete'. This is not surprising given that development implies transformations of society with sharp breaks from past trends, behaviours and institutions, and the resulting processes entail considerable uncertainty. It seems, then, that in looking for ways to stimulate economic growth, there is no substitute for careful analysis of particular national contexts. As Sala-i-Martin has observed (Snowdon, 2006), each country needs to develop its own market-supporting institutions. Countries and regions develop economically with different, and often surprising, sets of rules and institutions. For example, the growth take-offs of the UK, Japan, the 'Asian Tigers' and China have been quite different, and many economists could not have imagined that the Chinese model of capitalism would have worked.

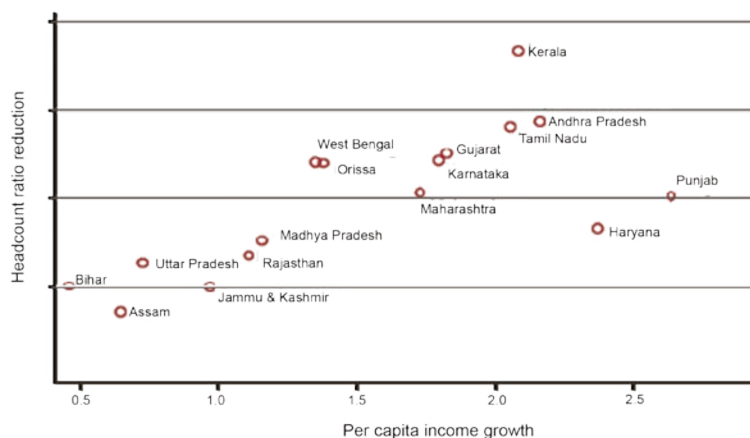
Poverty reduction. Economic growth by itself is only weakly correlated with poverty reduction. For example, Ravallion (2004) found that a 1% increase in per capita incomes can reduce income poverty by as much as 4% or by less than 1%, depending on the country as well as the time period. Clearly the pattern of growth matters as well as the pace.

The variable impact of growth on poverty reduction is illustrated in Figure 1, showing economic growth and poverty in Indian states. Although it seems that faster growth is associated with falling rates of poverty, there are significant outliers, with Haryana and Punjab growing quickly but having relatively little success in reducing poverty, while slower growing Andhra Pradesh and Kerala achieved more poverty reduction.

This leads us to ask: why does growth not always transmit its benefits to the poor? In a market economy, the answers lie in the degree of access that the poor have to markets and the terms on which they participate in such markets. This can be broken down into the following elements:

- Lack of physical access – some people are effectively unable to take advantage of opportunities owing to the costs of reaching the market;
- Market failures – particularly in the cases of finance, land, and labour, such failures mean that

Figure 1: Poverty reduction and income growth in Indian states, 1960-2000



Source: Besley et al. in International Policy Center (2007)

the poor cannot obtain the resources needed to invest and innovate;

- Lack of human capital of the poor – low levels of basic education and vocational skills, and higher levels of ill-health, often leave the poor in no position to get better-paid jobs; and
- Exclusion – discrimination on grounds of race and ethnicity, language, religion, caste, and gender can mean people are excluded from jobs and public services.

In addition, the vulnerability of the poor to a range of hazards makes it too risky for them to invest, innovate, specialise and otherwise take up economic opportunities. Indeed, shocks to the vulnerable poor are a major reason for poverty, depriving them of assets and preventing them from working.

Inequality. Inequality can be a problem in itself, given its potential to undermine the confidence of the poor and to fuel political discontent. But it may also reduce growth through credit market imperfections that exclude the poor, or from a political economy in which policy distortions arise from the lobbying of the rich. Inequality is usually associated with a low elasticity of growth to poverty reduction. This arises when inequality of opportunity is embedded in society, so that the poor are denied the assets by which they might build their livelihoods, and are disadvantaged – indeed, in some cases face outright discrimination – in markets. Not only do the poor suffer, but so too does the economy as a whole, since the working poor are unable to contribute substantially.

A particular concern is gender inequality: women receive less education than men in much of Africa and Asia, have to provide the majority of childcare, and often confront barriers in labour markets. Similarly, in many developing countries, significant differences in the provision of education and health services to rural areas compared to the cities mean that rural people are at a disadvantage.

Inequality also often has a regional dimension, as can be seen for India in Figure 1.

Policy implications

Promoting pro-poor growth is not a matter of reading off policies from a blueprint. Broad principles that may facilitate pro-poor growth can be identified, however.

Economic growth depends on incentives to invest and raise productivity, which in turn require: a stable macro-economy; institutions that allocate property rights, lower transaction costs, and permit organised production in companies and collectives; and 'good-enough' governance that makes policy predictable, reins in the worst excesses of rent-seeking and corruption, and delivers public goods and services.

Poverty reduction requires: providing physical access to markets – especially in the case of lagging regions; remedying failures in markets relating to factors such as credit that make it difficult for people to obtain the resources needed to invest and innovate; investing in the health and education of the entire population, and especially of women, those living in rural and remote areas, and groups that suffer from discrimination; and also countering discrimination, especially in access to public services and jobs.

Investing in health and education, and countering discrimination, can also address issues of inequality of opportunity. Redistributive policies such as social protection – transfers of income or goods to households on the basis of their income and family situation – can reduce inequality and also contribute to economic growth. Through social protection, vulnerability can be reduced, enabling risk-averse households to take advantage of opportunities such as investment or crop diversification, which generate growth and can be an exit route out of poverty.

What can be done for lagging regions – often remote – and frequently with poor natural resources, that have high rates of poverty? One strategy is to correct any systematic disadvantages such regions suffer in health, education and other public services. Another is to improve access to such areas to stimulate farms and enterprises, by making it cheaper to get to distant markets and by reducing the costs of imported goods. Better access, of course, may encourage out-migration, but this can have significant welfare-enhancing impacts for poor households.

Together these measures for growth and poverty reduction should be self-reinforcing and do much to ensure that growth is pro-poor. But should policy be more ambitious in trying to direct the pattern and location of growth? Should there be, for example, active measures to encourage investment in sectors and regions where the poor tend to work and live?

Whilst this might seem sensible, it is less evident how this may be done, beyond making sure that that such sectors and regions are not disadvantaged by distorted patterns of public spending and by market failures. Indeed, the limited capacity of the public sector in some less developed countries may not allow such ambition without loss of focus and dilution of effort.

More radically, should poverty be alleviated by large-scale transfers of income from the haves to the have-nots? Even when politically possible, there are few if any cases where this has produced a sustained reduction in poverty. Instead history suggests that the substantial reduction in poverty seen in most OECD countries during the twentieth century can be attributed to long-term economic growth with modest transfers of income. More radical redistribution, it is feared, will reduce incentives to invest, innovate and indeed to work, thus dampening economic growth.

Policy-making

Policy-makers need to find the right combination and sequencing of these economic and social poli-

Box 2: Analytical tools to help inform pro-poor policy

- **Growth diagnostics**, proposed by Hausmann, Rodrik & Velasco, can help identify the limiting factors for economic growth, based on the proposition that low investment and entrepreneurship can be attributed either to funds being too expensive, or to perceived returns to investment being too low. For each of these two main causes, there are contributing factors, so that the tool presents the analyst with a cascading series of issues to investigate that should highlight the key factors impeding growth.
- **Growth incidence curves** show the rate of growth of income by percentile across the distribution for a given period, based on data from household surveys. These can powerfully demonstrate patterns of growth and their varying effects on the poor.
- **Integrated Economic Analysis**, developed by the Swedish International Development Cooperation Agency (SIDA), brings together analyses of labour markets, the business environment and the macro-economy to illuminate the constraints to economic growth and poverty reduction.
- **Poverty Impact Assessment (PIA)**, promoted by the DAC Network on Poverty Reduction (POVNET), is a simplified form of Poverty & Social Impact Assessment focussing on the transmission from policy to impacts on the poor.
- **Participatory Poverty Analysis (PPA)** uses qualitative data to improve understanding of the processes driving and maintaining poverty and to capture a range of poor people's perspectives. PPA can give poor people a voice and contribute to their empowerment. The results of PPA have increasingly contributed to debates for second-generation poverty-reduction strategies.

cies to facilitate pro-poor growth. In the short term, with limited resources, trade-offs may be apparent. But many of the measures are complementary and a broad approach could be more effective than a narrow one.

How closely should strategies target poor people or focus on general conditions? There is no clear answer to this – the nature of the policy will largely determine whether a universal or targeted approach should be adopted. As the principles outlined indicate, most of the measures for economic growth apply generally, while social protection and countering discrimination will usually be targeted to particular cases and issues. Application of these principles demands that strategies are tailored to local circumstances to ensure that they are context-specific.

Democracy and accountability. Giving the majority, and particularly the poor, a stronger voice in policy-making promises to lead both to better policy-making as well to demands on the state for accountability, with consequent pressure for more effective and efficient public services. That said, how the poor can gain more representation and power is a difficult question: formal democracy and decentralisation can help, but may not be sufficient.

While representation of the poor might be desirable in the early stages of development, it may not be feasible or even necessary for reducing poverty. Recent development success stories are notable for gains to the poor resulting from the initiatives of enlightened elites, with China being a prominent example. Indeed, the road to better governance is long, difficult and so deeply embedded in local contexts and sequences that it is difficult to stipulate what steps should be taken on the basis of general principles. As with the case of economic growth and poverty reduction, it seems that in trying to improve governance there is no substitute for detailed case-based analysis.

A final point: if pro-poor growth cannot be generated using a blueprint, and if adapting principles to local circumstances is crucial, then given the complexity of how economies and societies work it is unlikely that any strategy, however well planned, will be entirely successful. Therefore, it is important that policy-makers monitor outcomes in growth, poverty reduction, equality and governance, and are prepared to modify their policies as lessons are learned. China, for example, did not set the conditions for its growth with the reforms of 1978-79 alone: these were adjusted and complemented by further measures in subsequent policy-making.

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