

# Poverty In Focus

International Poverty Centre

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Analysing and achieving  
**Pro-Poor Growth**

# FROM THE EDITOR

*Poverty in Focus* is a regular publication of the **International Poverty Centre (IPC)**. Its purpose is to present the results of research on poverty and inequality in the developing world.

IPC is a joint project between the United Nations Development Programme and Brazil to promote South-South Cooperation on applied poverty research. It specialises in analysing poverty and inequality and offering research-based policy recommendations on how to reduce them. IPC is directly linked to the Poverty Group of the Bureau for Development Policy, UNDP and the Brazilian Government's Institute for Applied Economic Research (Ipea).

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**Front page:** Photo by Manish Mandlik, Thane, Maharashtra, India: "Rice Harvest" Photo # 475485, Stock.XCHNG, <http://www.sxc.hu/index.phtml>. The photo illustrates that pro-poor growth has to be based on enhancing the productivity of poor women and men in sectors and areas where the poor make a living, such as in the rural villages of India. As shown in the table on page 18, the state of Maharashtra is characterised by high growth, but low poverty elasticity. It is the state where the financial and industrial centre of Mumbai (ex-Bombay) is located, where most of its economic growth is generated. Thus it also illustrates that economic growth in the urban modern sector is not necessarily pro-poor.

**Editor's note:** The sources of graphs and tables are the reference publications at the end of each article concerned. Thanks for permission to use this material to Stephan Klasen, University of Göttingen; Janet Stotsky, IMF; Palgrave-Macmillan; Swedish International Development Cooperation Agency (Sida); ILO; German Institute of Global and Areas Studies (GIGA); Blackwell Publishing; Africa Economic Research Consortium (AERC); and the University of Connecticut. And thanks not least to all the authors contributing their intellectual products without any monetary remuneration.

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**T**he reduction of income poverty is largely associated with long-term economic growth. There seems to be a broad consensus among analysts and policy makers that per capita income growth is a major element of sustainable poverty reduction. However, similar rates of growth can have very different impact on income poverty under different conditions, varying in time and space.

Poor women and men are not just beneficiaries but primary creators of growth. The extent of poverty reduction depends on the degree to which the poor participate in the growth process and share in its proceeds, i.e. on inequality in the asset and income distribution. Thus, both the pace and pattern of growth matter for poverty reduction.

The distinction between pro-poor growth and general economic growth is crucial for policy analysis and for formulating poverty reduction strategies. Yet, there is no consensus about how to define and measure pro-poor growth. The International Poverty Centre (IPC) initiated a debate on this issue among researchers in 2004-05 in a series of One-pagers, summarised in Number 6: [Pro-poor growth: finding the Holy Grail](#), available on the website.

This issue of IPC's journal *Poverty in Focus* is not so much about the definition of pro-poor growth as about analytical and policy approaches, and results. The authors spell out and apply different definitions and measures in discussing various policy-related aspects of pro-poor growth and summarising research results. It is clear that much more pro-poor growth, whatever the definition, is needed in most countries if the first Millennium Development Goal is to be achieved.

*Hyun Son* reports on a recent IPC study, which analyses growth performance during the period 1984-2001 in 80 countries and especially the extent of pro-poor growth of 237 growth spells, using a fairly tough definition.

*Stephan Klasen* shows that gender inequality, especially in education and employment, has a negative impact on overall economic growth and notably on poverty reduction.

*Andy McKay* presents growth incidence curves as a useful graphical tool for observing and analysing the changes in poverty that the distribution and growth patterns imply.

*Louise Cord* summarises a recent collaborative research project with country studies, which confirm the strong correlation between economic growth and poverty reduction.

*Susanna Lundström* and *Per Ronnäs* outline a method for integrated pro-poor growth analysis of employment, the macroeconomy and the business environment.

*Aziz R. Khan* discusses recent international research on how the incomes of the poor depend on the nature and extent of employment that economic growth generates.

*Esther Ishengoma* and *Robert Kappel* explore the challenges of formalising informal firms, which is hugely important for improving the employment conditions of poor people.

*Timothy Besley et al.* identify the main policy origins of the very different growth and poverty experiences across India's states and indicate reforms for more pro-poor growth.

*John Farrington* and *Mark Robinson* analyse the serious challenges that Asian countries face in seeking to sustain the rapid growth and poverty reduction achieved so far on the road to achieving MDGs by 2015.

*Germano Mwabu* and *Erik Thorbecke* review a collaborative study by African economic researchers on the broad elements of development strategies based on pro-poor growth.

*Nanak Kakwani et al.* reveal how Brazil managed to reduce poverty without growth in per capita incomes by implementing pro-poor policies that reduced inequality.

*Mwangi S. Kimenyi* proposes 10 Commandments of Pro Poor Growth. A basic notion is that policies must be designed to stimulate growth in those sectors and areas, in which poor people earn their living.

This issue of *Poverty in Focus* is intended to illuminate the state-of-the art regarding the policy implications of the relationship between economic growth and income poverty reduction. We hope you will find it instructive and useful.

*Dag Ehrenpreis*

# Global Estimates of Pro-Poor Growth

by Hyun H. Son,  
International Poverty Centre

**The economic** growth performance of developing countries differs a lot, both over time and across countries. There are large variations not only in growth rates but also in the impact on poverty per unit of growth—the elasticity of poverty with respect to mean growth of income or consumption. This article is intended to illuminate the empirical interrelation between growth performance, poverty reduction and changes in inequality.

A recent Working Paper from the International Poverty Centre, IPC, presents global estimates of growth and its pro-poorness on the basis of cross-country analysis of 237 growth spells in 80 low- and middle-income developing countries during the period 1984-2001, spanning two successive household surveys for a given country.

The study defined growth as pro-poor if poor households increase income (or consumption, whichever measure is available for a given country) proportionally more than the non-poor, i.e. households above the poverty line. When growth is negative, i.e. in a recession, it is called pro-poor if the income decrease is proportionally less, on average, for poor households than for the non-poor ones.

Further, a new measure of pro-poor growth was defined in order to adjust the observed mean growth rates of income (or consumption) for distributional changes. Thus, if inequality increases over a period, then the pro-poor growth rate will be lower than the observed growth rate of the mean income or consumption, and vice versa. This new measure of pro-poor growth captures gains and losses in the income (or consumption) of the poor, relative to the observed average

growth rates, due to changes in inequality. The gains imply pro-poor growth, the losses anti-poor growth.

The proposed pro-poor growth rate can be calculated if statistical data are available on the mean income or consumption as well as the distribution by decile for the period between any two household surveys. The World Bank's cross-country data provide this information and thus the proposed methodology was applied to globally assess the rates of growth and its pro-poorness across the developing countries. Some of the empirical findings are summarised here in the two tables.

Table 1 shows that of all the 237 growth spells under observation, 106 had a negative growth rate of per capita consumption, i.e. not much less than half (44.7 percent). For the remaining 131 growth spells where the per capita growth rates were positive, growth was pro-poor only in 55 cases (23.2 percent) and anti-poor in 76 cases (32.1 percent). These findings suggest thus that global growth processes have generally not been pro-poor as here defined.

Then, the study broke down the 237 growth spells into various country classifications as defined in the World

**A recent IPC study analyses global growth rates and their extent of pro-poorness.**

**A new method to measure pro-poor growth is presented and used on available data.**

**Negative per capita growth is quite frequent, while far too few growth spells are both positive and pro-poor.**

**There is a large variation across regions and country categories.**

**Some factors behind these outcomes are also analysed.**

**Table 1**  
**Growth performance in 80 countries, 1984-2001**

	Positive growth	Negative growth	All growth spells
Pro-poor	55 (23.2%)	53 (22.4%)	108 (45.6%)
Anti-poor	76 (32.1%)	53 (22.4%)	129 (54.4%)
Total spells	131 (55.3%)	106 (44.7%)	237 (100%)

Development Indicators. The results are summarized in Table 2.

In East Asia and the Pacific, growth rates were positive in 74.3 percent of the spells, but only in 17.1 percent of the spells was growth both positive and pro-poor. This suggests that in this region, poverty reduction was due mainly to high rates of actual growth, rather than to growth being pro-poor when considering its distribution.

Low-income countries, heavily indebted countries and sub-Saharan Africa—the largely overlapping country groupings with the highest incidence of poverty—had a lower than average frequency of growth spells that were both positive and pro-poor: around 20 percent. The highest such frequency was in the Middle East and Northern Africa region, and in the low middle-income countries.

In Latin America and the Caribbean as well as South Asia, about 30 percent of the spells were both positive and pro-poor, while the latter region had the lowest frequency of both negative and anti-poor spells, less than 6 percent.

The worst-performing region was East Europe and Central Asia, which went through a transition period in the 1990s. Growth was positive only in one-third of the spells in the region, and both positive and pro-poor in only 12.3 percent of the observed spells, i.e. in less than one in eight. Growth was negative in two thirds of the spells, and in addition anti-poor in rather close to half of the spells (45.6 percent).

Which factors determine growth patterns, whether positive or negative in the mean, and whether pro-poor or anti-poor? The study focused on macroeconomic, structural and institutional determinants such as inflation, openness to trade, share of agriculture in GDP, and the rule of law. The strength of the association between each of these factors and growth patterns was statistically tested.

In recent years, policy makers have placed increased emphasis on price stability. Monetary policy has been geared toward the achievement of low and stable inflation. When inflation is

**Table 2**  
Summary results by various country groupings

Country groupings	Positive growth			Negative growth		
	Pro-poor	Anti-poor	Total	Pro-poor	Anti-poor	Total
<b>Low-income countries</b>	<b>20.8</b>	<b>33.3</b>	<b>54.2</b>	<b>27.8</b>	<b>18.1</b>	<b>45.8</b>
<b>Low middle-income</b>	<b>26.7</b>	<b>31.4</b>	<b>58.1</b>	<b>19.0</b>	<b>22.9</b>	<b>41.9</b>
<b>Upper middle-income</b>	<b>21.7</b>	<b>35.0</b>	<b>56.7</b>	<b>21.7</b>	<b>21.7</b>	<b>43.3</b>
<b>Heavily-indebted poor countries, HIPC</b>	<b>18.6</b>	<b>27.1</b>	<b>45.8</b>	<b>32.2</b>	<b>22.0</b>	<b>54.2</b>
East Asia & Pacific	17.1	57.1	74.3	17.1	8.6	<b>25.7</b>
East Europe & Central Asia	12.3	21.1	33.3	21.1	45.6	<b>66.7</b>
Latin America & Caribbean	30.4	29.1	59.5	24.1	16.5	<b>40.5</b>
Middle East and North Africa	35.7	14.3	50.0	28.6	21.4	<b>50.0</b>
South Asia	29.4	52.9	82.4	11.8	5.9	<b>17.6</b>
Sub-Saharan Africa	20.0	34.3	54.3	31.4	14.3	45.7
<b>All countries</b>	<b>23.2</b>	<b>32.1</b>	<b>55.3</b>	<b>22.4</b>	<b>22.4</b>	<b>44.7</b>

high and unpredictable, businesses and households are expected to perform poorly, and vice versa. The study found a statistically insignificant relationship between inflation and rates of mean growth, but a highly significant negative relationship between inflation and pro-poor growth. Thus, lower inflation is associated with pro-poor growth, and vice versa.

Openness to international trade was measured by exports plus imports relative to GDP. Contrary to conventional wisdom, the study found that low levels of trade openness were significantly associated with positive growth and high level of trade openness with negative growth; the statistical relationship with the pro-poorness of growth was insignificant.

Regarding the share of agriculture in GDP, the study found an overall insignificant relationship with positive growth, but a positive relationship where the

agricultural share of GDP ranges between 20-30 percent. The results indicate an insignificant association between the share of agriculture and pro-poor or anti-poor growth.

The rule of law was not found to have any statistical significant association with either mean growth rates or pro-poor growth.

It should be kept in mind that conclusions emerging from cross-country analysis must be interpreted with care. They indicate only the average picture across a large number of countries. Individual country experiences may be quite different. Hence, the policy conclusions emerging from cross-country analysis should only be used as a reference for further analysis in individual countries. ■

Son, Hyun H. and Nanak Kakwani (2006) *Global Estimates of Pro-Poor Growth*, IPC Working Paper series No. 31, IPC, Brazil. <http://www.undp-povertycentre.org/pub/IPCWorkingPaper31.pdf>

## The Unbalanced Distribution of Global Economic Growth

Between 1981 and 2001, world GDP (PPP in 1993 prices) increased by \$18.7 billion. Of this, only \$786 billion, or 4.2 percent, went to poverty reduction as defined by the \$2-a-day poverty line—slightly *less* than the share of the poor in GDP at the beginning of the period—even though the poor represented the majority of the world population. Poverty reduction based on the \$1-a-day poverty line was even smaller, at \$278 billion—just 1.5 percent of GDP.

To put it another way, of every \$100 of growth in income per person in the world between 1981 and 2001, just \$1.30 contributed to reducing poverty as measured by the \$1-a-day line and a further \$2.80 to reducing poverty between \$1-a-day and \$2-a-day lines. The remaining \$95.90 went to the rest of the world population above the \$2-a-day line.

Redistributing just 1 percent of the income of the richest 20 percent of the world's population to the poorest 20 percent would benefit the latter as much as distributionally equal growth of around 20 percent. Even expanding the target group to the poorest 50 percent of the world's population—equivalent to a poverty line of around \$2.50 per day at 1993 prices—and the source group to 25 percent (roughly the level at which the well-being literature indicates that further increases in income cease to raise well-being), a 1 percent redistribution is equivalent to economic growth of 7.4 percent. This is more than four times the average 1.7 percent per capita growth rate of global GDP (in PPP terms) since 1981.

**D. Woodward and A. Simms: *Growth is failing the Poor: The Unbalanced Distribution of Global Economic Growth*. UN-DESA Working Paper No. 20, March 2006.**

# Pro-Poor Growth and Gender Inequality: Insights from new research

Stephan Klasen,  
University of Göttingen

**Pro-poor growth**, i.e. rates and patterns of economic growth that are associated with significant increases in the incomes of the poor, is central to reducing absolute income poverty and thus to reach the first Millennium Development Goal. Pro-poor growth will be particularly high in environments of high economic growth associated with pro-poor distributional change. Given the existing literature on the impact of gender inequality on growth, and on various well-being outcomes at the household level, the recently completed international research project on Operationalizing Pro-Poor Growth (OPPG) included an analysis of whether and to what extent reduced gender inequality can contribute to pro-poor growth.

An analysis of the impact of gender inequality on pro-poor growth has to deal with the problem that income poverty is defined and measured at the household level and cannot easily be

attributed to individual members for conceptual and practical reasons. As a result, intra-household gender inequalities will not be captured; and policies that help reduce such inequalities will not have an impact on measured poverty beyond their effect on total incomes.

From a well-being perspective, such an income-based approach will not be very helpful in investigating the inequality of the gender distribution of the benefits from growth and poverty reduction.

In poor countries, many women and older girl children are engaged in non-market production that is not captured in the standard income concept used in household surveys. They nevertheless produce valuable outcomes, such as better health, education, and nutrition of their families and children. Neither their contribution nor the outcome of their contribution is directly visible in an

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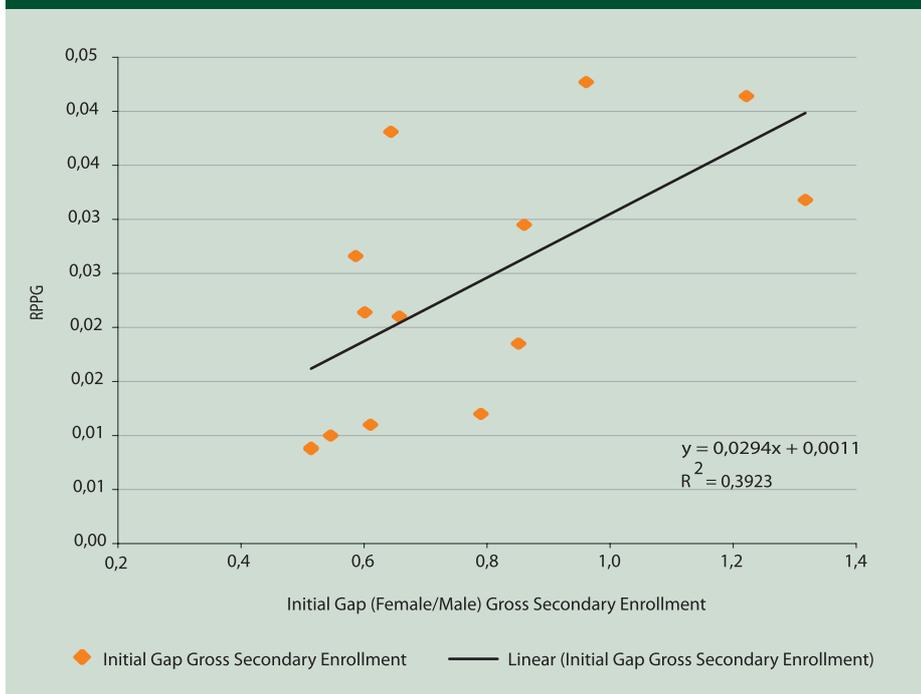
**Research shows that gender inequality in education and employment has a negative impact on economic growth.**

**This is an issue in all countries but there is large regional variation in the gender inequality aspects that are most harmful to pro-poor growth.**

**Gender inequality impacts much more on growth rates than on overall income inequality.**

**Country-specific policies are needed for promoting pro-poor growth through reducing gender inequality.**

### Rate of pro-poor growth and gender inequality in school enrollment



income-based concept of pro-poor growth. It will only show up indirectly in our income-based measures if the outcomes of their household production lead to increases in earned incomes.

Thus, a narrow lens focusing only on income poverty neglects very important contributions of women to non-income well-being outcomes of household members. However, this brief summary article about pro-poor growth in the income dimension has to use such a lens.

Both theoretical and empirical research indicates a negative impact on overall economic growth of gender inequality in education and also in employment opportunities. It is much less clear, however, whether and how gender inequality affects inequality between households across the income distribution. That depends on whether gender gaps and their impact on incomes are larger within poor or rich households, and this varies a lot with country-specific circumstances.

The 14 country case studies<sup>1</sup> in the OPPG work clearly illustrate the large regional differences regarding which aspects of gender inequality impose critical constraints on pro-poor growth.

In most of Sub-Saharan Africa, high fertility and gender inequality in education remain the key constraints to women's access to formal sector employment and to their productivity in the informal and agricultural sectors where they are main participants.

Also, significant gender gaps in access to productive assets and inputs into agriculture, viz. land, fertilizer and modern technologies, seriously limit pro-poor growth. In addition, poor access

to water, fuel and markets cause serious time poverty, further reducing women's economic capabilities. And AIDS places an extra time burden on women in the affected countries.

In South Asia as well as North Africa, fertility decline is well under way, but large gender gaps in education in some parts and employment opportunities virtually everywhere remain central constraints for pro-poor growth. However, in Bangladesh, Southern India, and Tunisia much lower gender gaps in education, combined with labour-intensive export-oriented growth strategies, have enabled women to make important contributions to pro-poor growth while also enhancing their incomes and bargaining power.

In Latin America, low fertility and low gender gaps in education have created a favourable environment for women to contribute to pro-poor growth. But they are held back by significant barriers and discrimination in the labour market and are often crowded into informal sectors.

In East Asia, the pro-poor growth success is in considerable part due to the contribution of women in agriculture as well as export-oriented growth strategies. Low fertility and low gender gaps in education and employment were helpful factors. The central remaining barrier is continuing gender discrimination in the labour market, both in pay and career advancement.

### Gender and macroeconomy

Gender inequality within households suggests that the bargaining power of the different family members influence consumption and saving behavior and other economic variables of choice to the household. If these differences are systematic and pervasive enough, they may also lead to differences in macroeconomic outcomes. One key finding is that women tend to devote a larger share of household resources to activities that are necessities to the household and that foster the growth of their children's capabilities. Some evidence also suggests that women are more oriented toward productive saving and investment behavior, though they are less likely to take financial risks. Further evidence indicates that women's political empowerment leads to support for a larger role for public insurance. Altogether, these differences suggest that policies that give women greater control over household decisions can strengthen aggregate economic growth while at the same time moderate macroeconomic instability.

**Janet Stotsky: *Gender and Its Relevance to Macroeconomic Policy: A Survey.* IMF Working Paper, WP/06/233.**

## Gender and growth issues in case study countries

Region	Countries include	Growth-relevant gender issues	Differences within region	Trends in priority gender issues
Sub-Saharan Africa	Burkina Faso, Ghana, Senegal, Uganda, Zambia	High fertility, significant gender gaps in education, low levels of female education, low female share of formal employment, inequality in access to land and inputs, time poverty	Role of AIDS in imposing time burden on women and affecting human capital accumulation (Zambia, Uganda); Levels and gaps in education (lower in Uganda, Ghana); separate versus joint production in agriculture (West Africa versus Eastern and Southern Africa)	Little change in fertility (except Ghana) and in education levels, and slow reduction of gaps (except Uganda), burden of AIDS worsening (except Uganda), little change in access to land and inputs
South Asia and North Africa	Bangladesh, India, Tunisia	Moderate fertility, large gender gaps in education and employment, rising female employment in manufacturing/services	Higher female education and expansion of female employment (Bangladesh and Tunisia)	Strong fertility decline, sharp expansion of education, quick reduction of gaps (except India), large expansion in female employment (exception India)
Latin America	Bolivia, Brazil, El Salvador	Moderate fertility, low gender gaps in education, high female labour force participation, but unequal access to formal sector	Important role of women in export production (El Salvador)	Strong fertility decline, further expansion of education, large expansion of female employment
East Asia	Vietnam, Indonesia	Low fertility, low gender gaps in education, large female participation in export industries, large pay gaps	Role of transition on employment opportunities of women (Vietnam)	Rapid expansion of female education and employment in manufacturing (including exports) and services; slight reduction in gender pay gaps
Transition Countries	Romania	Low fertility, no gender gaps in education, high female labour force participation	Depth of economic crisis affects female employment changes	Decline in female employment and relative pay

In transition countries, women have historically contributed strongly to growth through high education and labour market participation. The challenge here is to ensure that these gains for women are protected in the transition process where in many countries gender gaps in education and employment are re-emerging, to the cost of women as well as the entire societies. Similarly, opportunities to combine work with family are strongly curtailed, further undermining women's previous strong roles in the labour market.

This very cursory summary suggests that gender inequality is an issue in all countries but the nature, extent, and effect of gender inequality differs greatly by region. It is probably fair to say that in most of Sub-Saharan Africa and South Asia the high potential contribution of women to poor-poor growth is particularly constrained while in East Asia, the important contribution of women can be nicely demonstrated.

The central importance of reducing the gender gaps in education is also demonstrated in the diagram, which shows the correlation between the rate of pro-poor growth in the 14 OPPG case study countries, i.e. the average rate of income growth of households below the poverty line, and initial gender gaps in secondary education. The diagram clearly suggests that pro-poor growth is higher in countries where gender gaps in secondary education are lower, although no straight causality can be inferred through this cross-country correlation.

Other cross-country correlation diagrams for the group of 14 OPPG countries are shown in the book chapter under reference below. They demonstrate the correlation between the rate of pro-poor growth and, respectively, initial fertility rates and the annual increase in female labour force participation rates. They show similar although somewhat less robust patterns of correlations.

Further analyses reveal that the impact of gender inequality on pro-poor growth is mostly a result of the effect of gender inequality on economic growth rates, and not so much of the effect of gender inequality on income inequality. Thus addressing gender inequality will promote pro-poor growth by accelerating overall economic growth. Which types of gender inequality matter the most for promoting growth depends on the region and country. This calls for region/country-specific policies for promoting pro-poor growth through reducing gender inequality. ■

Klasen, S. "Pro-Poor growth and gender inequality." In Menkhoff, L. (Ed.) *Pro-Poor Growth: Policy and Evidence*. Berlin: Duncker & Humblot (2006), 151-179. [http://wiwi.uni-goettingen.de/vwlseminar/working\\_papers/ibero/DB151.pdf](http://wiwi.uni-goettingen.de/vwlseminar/working_papers/ibero/DB151.pdf)

1. Burkina Faso, Ghana, Senegal, Uganda, Zambia; Tunisia; Bangladesh, India; Bolivia, Brazil, El Salvador; Vietnam, Indonesia; and Romania.

by Andy McKay,  
University of Sussex

# Analysing the Distributional Pattern of Growth

**Pro-poor growth is a function of the pattern as well as the pace of growth.**

**Distributional changes need to be analysed to inform policy responses to ensure that growth reduces poverty more efficiently.**

**Growth incidence curves provide a useful graphical tool for observing growth and distribution together.**

**Some typical curves based on new data are shown and interpreted in several distributional dimensions.**

**There is** widespread agreement that economic growth plays a very important role in poverty reduction. The recent experience of China provides an emphatic example of this, while many other examples, often in Sub-Saharan Africa, show how difficult it is to achieve poverty reduction without growth. But its distributional pattern also matters. Where richer members of society capture the benefits of growth, its poverty reduction impact is limited or undermined.

From a pro-poor growth perspective, the key question then is whether poor women and men are able to participate in, or otherwise benefit from, economic growth. This may be through direct participation in productive activities, for example through increased real wages, new employment opportunities or increased returns in self-employment activities. The poor may also benefit indirectly from increased public spending or private transfers made possible by increased revenues from growth. The extent to which the poor share in this will depend on many factors including the pattern of growth, the nature of poverty (who/where/why), the institutional context and the policy environment.

To assess this, it is important to examine the income distribution. In policy and research circles, discussions on growth, poverty and inequality are often conducted separately, despite the fact that they are clearly interlinked. This is partly a data issue. Standard national accounts data typically enable a disaggregation of economic growth by productive sector, but not of the distribution of incomes among poor or non-poor income-earners, nor by region. Analysis of poverty and inequality is generally based on household surveys and other micro-level data sources. Where household survey data are

available at two points in time, policy analysts can assess the distributional pattern of growth by examining data on changes in household income or consumption over this period.

There are many different approaches to this, including through decomposition of changes in poverty into growth and distribution components. A useful graphical way of presenting such data to policy analysts is by means of a growth incidence curve, as illustrated for four countries in the diagram. The growth incidence curve (GIC) summarises how the different statistical percentiles of the income distribution fared over the period of time between the surveys: the rate of change in income or consumption across the population. The GICs are based on a comparison between survey data at two points in time, for example 1992 and 2003 in the case of Vietnam. The horizontal axis of the graph plots the population by percentile from the poorest 1 percent to the richest 1 percent. The vertical axis plots the annual change in income (or consumption) between these two points in time for each percentile.

The shape and position of the curve provides important visual insights about the distributional pattern of growth. It can also be used to assess the changes in poverty that the growth pattern implies. The shape of the GIC provides information about the distributional pattern of growth and thus about the implied change in inequality. Where the GIC is broadly upward sloping (Bangladesh and Vietnam here), this shows that consumption levels increased at faster rates for higher percentile groups compared to lower percentile groups. This implies that inequality increased over this period. Where the GIC is downward sloping (as in the case of Indonesia here) this implies that

inequality fell; the recession associated with the East Asian crisis over this period hit everyone, but the impact seems greater in the richer percentiles.

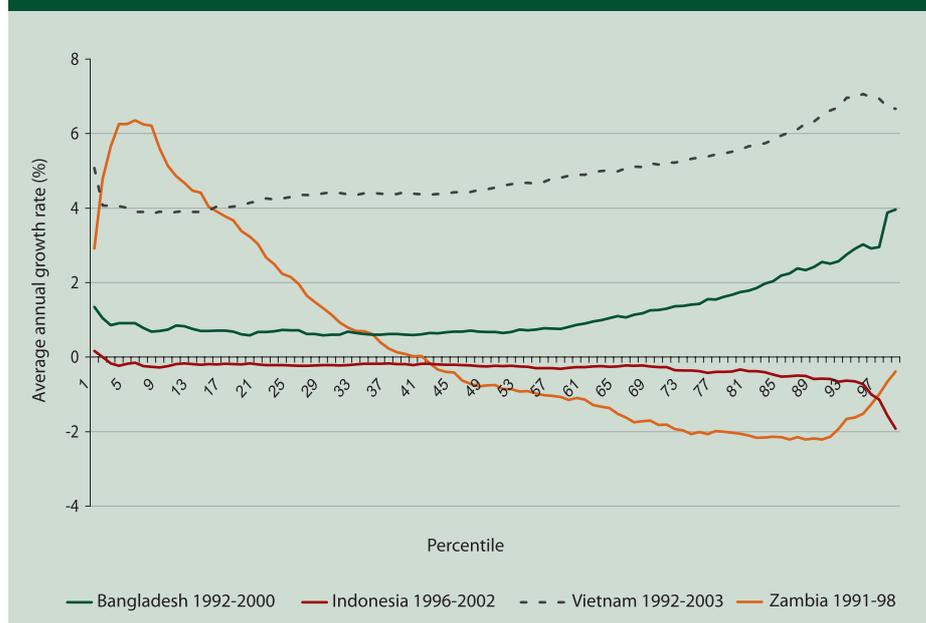
These examples also illustrate the difference between absolute and relative concepts of pro-poor growth. In Vietnam growth was pro-poor in an absolute sense, and poverty fell; but growth was not pro-poor in a relative sense. In Indonesia inequality fell (pro-poor change in a relative sense), but growth was negative and poverty increased. Thus, growth was not pro-poor in an absolute sense.

The position of the GIC also allows conclusions to be drawn about the change in poverty. Where the curve is always above the zero axis (as in the cases of Bangladesh and Vietnam here), this means that all absolute measures of poverty will have fallen over this period, whatever the poverty line set. The magnitude of the reduction still depends on where the poverty line is set, and the GICs provide a quick visual summary of how the magnitude of change would be different for example on the very poorest. Similarly in the case of Indonesia, headcount poverty rose over this period for any poverty line, but the magnitude of the rise would be less for lower poverty lines. When the GIC crosses the axis as in the case of Zambia, the conclusion about changes in poverty will depend on where the poverty line is set and on which poverty measure is selected.

Growth incidence curves thus provide a quick graphical summary of the distributional pattern of growth between two periods in time. They provide an important starting point for analysing what underlies the observed distributional pattern of growth, and hence for the formulation of policy reforms and poverty reduction strategies.

The same technique can be applied to subgroups of the population, and this can be very informative. Growth is often highly spatially differentiated within a country, and this may be very relevant to assessing the poverty reduction potential in growth. In the case of Ghana over the 1990s, national level data shows an upward sloping GIC

### Examples of Growth Incidence Curves



above the zero axis, i.e. poverty reduction with a modest increase in inequality.

But GICs for different localities in the country show a diversity of experience. In the rural areas of the country's forest zone, its main export producing area, growth was relatively fast throughout the distribution; but in the rural areas of the savannah in the north of the country (the poorest locality to begin with) the GIC was in fact below the zero axis between about the 10<sup>th</sup> and 65<sup>th</sup> percentile. In other words growth was highly spatially differentiated, and this was an important factor making growth less pro-poor than it would otherwise have been. This is important information for policy purposes in trying to achieve pro-poor growth: it is not sufficient to just consider the economic growth rate in aggregate.

Similarly the Zambia pattern in the above diagram reflects very different experiences in rural and urban areas of the country. Spatial differentials in growth are an important factor in many countries, and of particular relevance for pro-poor growth policies, especially if the lagging regions are poorer to begin with. Similar analysis for other subgroups – for example employment categories – can also be very informative, and directly related to key policy questions.

GICs are only a tool for presenting the distributional pattern of growth; but much of the value comes from seeking to understand the factors underlying the observed patterns. As a graphic tool though they have a number of advantages. In particular they are a convenient means of considering growth and distribution together; they do not depend on a specific poverty line; and they can enable a specific analytical and policy focus on the poor according to any relevant definition. The technique can also be applied to measures of non-income dimensions of wellbeing.

However, GICs do not provide information on household mobility along the income distribution because the composition of each percentile is not the same in different surveys. Understanding the processes by which some households improve their incomes while others are not able to is important for policy analysts interested in pro-poor growth, but this requires panel or longitudinal data, i.e. observing the same households at different points of time.

■  
Grimm, M., S. Klasen and A. McKay (eds.); *Determinants of Pro-Poor Growth: Analytic Issues and Findings from Country Cases*. Palgrave-Macmillan, 2007.

by Louise Cord,  
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# Promoting Pro-Poor Growth: Lessons from country experiences

**Recent country studies confirm the strong correlation between economic growth and poverty reduction.**

**The rates of pro-poor growth were almost all positive, but lower than GDP growth due to increasing inequality.**

**Poverty reduction strategies need to focus on job creation and growth in sectors and regions where the poor live and work.**

**This includes both agriculture and non-farm activities, and involves education, labour market policies and public investment.**

**While a broad** consensus has been reached on the respective roles of growth and inequality in reducing poverty, we still know little about the policies and strategies which enable poor households to participate in and benefit from growth. Recently completed studies of eight countries<sup>1</sup> that have been relatively successful in delivering pro-poor growth provide important insights. These studies integrate growth analytics with the micro analysis of household data to determine how country policies and conditions interact to reduce poverty and to spread the benefits of growth across different groups.

To what extent was growth associated with poverty reduction in the sample of countries? Not surprisingly, countries that experienced the strongest growth also had the greatest poverty reduction in the 1990s. The correlation between changes in poverty and in GDP per capita was negative and significant as seen in the lower part of the figure.

But to what degree did inequality hamper the poverty reducing impact of growth? Rising inequality over the 1990s offset the gains from growth in five of the fastest growing countries.<sup>2</sup> In Bangladesh rising inequality meant that poverty fell by only 9 percentage points between 1992 and 2000, instead of 16 percentage points if growth had been distribution-neutral. If inequality had not increased in Uganda between 1992 and 2002, the poverty rate would have 30 percent instead of 38 percent.

Comparing changes in the mean growth rate in consumption of the poor (RPPG, the rate of pro-poor growth) with changes in average consumption for the whole population provides a more precise measure of the impact of growth on the well-being of the poor

and non-poor. The upper part of the figure shows that the RPPG is positive for all countries except Indonesia, but less than the average growth rate in mean consumption, except Brazil. Thus, inequality between the poor and the non-poor rose on average among these countries.

These results underscore that growth, although extremely important, does not explain all the variation in poverty reduction. Initial inequality and changes in inequality are also important factors which can limit the extent to which the poor participate in and benefit from growth.

What insights do these eight countries provide for poverty reduction strategies? The specific policies adopted by the eight countries differed, as did the role of exogenous forces in affecting growth and hence poverty reduction. However, some common threads emerge.

The country studies underscore that a successful shared growth strategy needs to have, at its core, measures for sustained and rapid economic growth. These measures include macroeconomic stability, well-defined property rights, trade openness, a good investment climate, an attractive incentive framework, well-functioning factor markets, and broad access to infrastructure and education.

These cases also suggest that it is important to design policies which enable poor people to participate in and benefit from growth. This task requires a conscious and sustained effort on the part of governments to provide the basic conditions necessary for broad-based growth in the regions and sectors where the poor live and work.

Since labour is the most abundant asset of the poor, it is hardly surprising that

1. Bangladesh, Brazil, Ghana, India; Indonesia; Tunisia; Uganda and Vietnam.

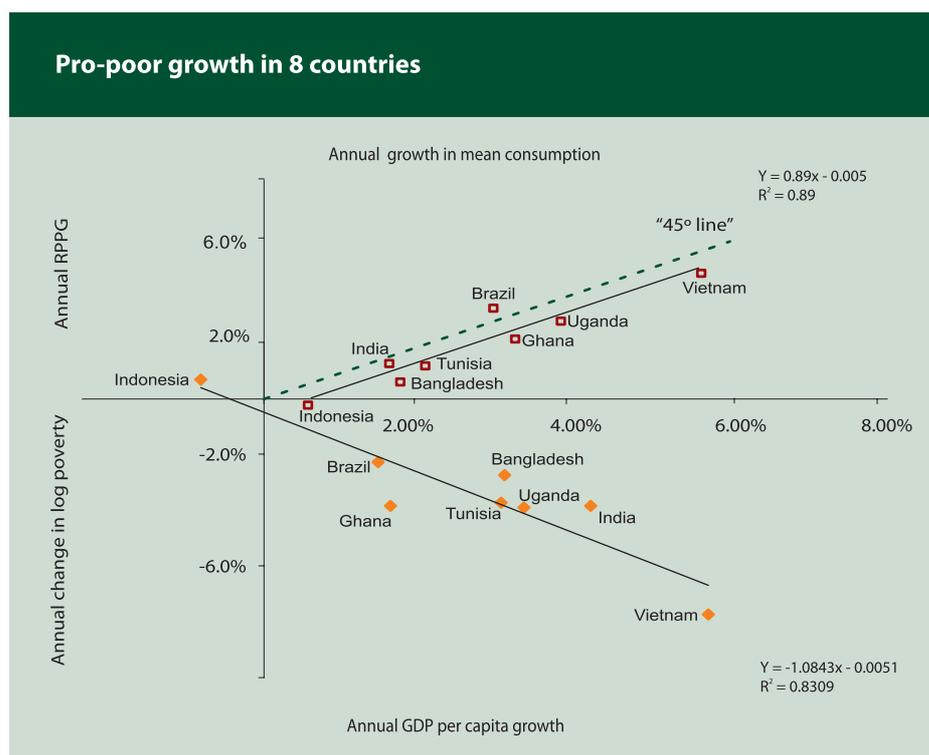
2. Bangladesh, Ghana, India, Uganda and Vietnam.

the most successful experiences with poverty reduction have occurred where policy has supported the creation of attractive jobs, accessible to poor households. Given the concentration of poor households in agriculture, this strategy rests in part on making agricultural activities more productive. Improved access to markets and technology, strengthened property rights, and better methods of risk management may each have a role to play.

But since growth in non-agricultural activities has tended to be much higher than in agriculture, a strategy of shared growth also rests on enabling the poor to take advantage of rural non-farm and urban employment opportunities. Improvements in the investment climate and infrastructure, expanded access to secondary education (particularly for girls), and reform of labour market regulations may all feature in such a strategy.

Are there particular country conditions which are prerequisites for shared growth? The case studies suggest that successful strategies can be forged even under initially unfavourable conditions. The experiences of Bangladesh, Indonesia, and Uganda testify that countries can achieve high rates of growth and poverty reduction even when faced with weak institutions, poor human development outcomes, and weak trading links and infrastructure assets. And impressive rates of poverty reduction and growth occurred under a variety of political regimes. But whether more or less democratic, the eight countries had in common a political leadership that was committed to achieving growth *and* poverty reduction. Indeed, even in the absence of democracy, poverty reduction largely occurred because the incentives of the political elite were aligned behind that goal.

The eight countries represent a diverse sample: the policies outlined above were implemented to various degrees in each of them; and because of different initial conditions and exogenous factors not all of the policies increased the ability of the poor to participate in growth to the same extent. Nonetheless, these cases share enough in common to underline certain core principles for achieving shared growth. In particular,



Notes: 1) RPPG = Rate of pro-poor growth, which is a different measure than the pro-poor growth rate in the articles on pages 3 and 24.

2) The x-axis in the upper part shows consumption, in the lower part GDP per capita. These are measured by different methods, hence the different horizontal positions of some countries.

three pillars – good macroeconomic and structural economic policies, political stability, and public investments in physical and human capital – were essential in facilitating private initiatives and investments among the non-poor and especially the poor. Political regimes and the quality of institutions also affected outcomes, but drawing conclusions about their impact on growth and poverty reduction is difficult, as many countries were innovative in overcoming their institutional weaknesses.

The experience of these eight countries in the 1990s underscores three challenges for analysts and policymakers as they seek to accelerate poverty reduction through broad-based growth. First, movement from agricultural to non-agricultural employment helped raise the incomes of poor households in many countries, but the more educated and better-connected workers were more successful in this regard. The effects of education and labour market policies on sectoral mobility are important areas for further research. Second, the impact of growth was uneven across regions within countries. Public investment strategies that can address sub-regional

growth and poverty are another important area for further analysis.

Third, country wide indicators of political regime often do not take into account the institutions which matter most for the poor. Sub-national and sectoral institutional indicators – including the share of land that is titled in rural and urban areas, the quality of local service delivery, and corruption and governance indicators which reflect regional variations – would help us to better understand the differentiated institutional fabric of developing countries, yielding important insights into how local and national conditions affect the impact of institutions on the poor.

These areas of future research promise to advance an important analytical agenda. The application of a pro-poor growth lens to development challenges can cast light on the economic and systemic constraints facing the poor and enhance the design of policies to ensure that they are among the principal participants in and beneficiaries of growth. ■

Timothy Besley and Louise J. Cord (eds): *Delivering on the Promise of Pro-Poor Growth*, New York: Palgrave, 2006.

by Susanna Lundström and Per Ronnås,  
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# Integrated Economic Analysis for Pro-Poor Growth

**Economic growth is the aggregate result of the efforts of all economic actors to increase their incomes.**

**For growth to reduce poverty efficiently the poor must be able to participate fully and on an equal basis in economic growth.**

**Employment is the key link between economic growth and income poverty reduction.**

**We need an integrated analysis of employment, the macroeconomy and the business environment in each country.**

**Income from work**, for wages or as self-employed, is crucial for the livelihoods of most people. Thus, employment is the key link between economic growth and income poverty reduction. The majority of all people who live in poverty are either unemployed or under-employed. They lack sufficient work or, more commonly, are trapped in employment of such low productivity that – even with long, hard hours – it pays too little to enable them to escape poverty.

Yet, employment and labour market analysis is seldom at the fore of economic analysis, if at all included. The creation of productive employment opportunities is still often seen as a side-effect rather than as an objective of economic growth. Despite the bulging literature on pro-poor growth (PPG), the scant regard paid to employment aspects in economic analysis also implies that the mechanisms translating economic growth into reduced poverty remain rather poorly understood.

The traditional analytical approach has been to focus on economic growth *per se*, as a necessary, albeit not sufficient, condition for reducing poverty. An alternative, and arguably more helpful approach is to view people living in poverty as creators of growth rather than as recipients of its benefits; i.e. as economic actors – whether self-employed producers or employees of a firm.

Economic growth is the aggregate result of the efforts of all economic actors to increase their incomes. Thus, it is not growth as such that reduces poverty, but people, including those living in poverty, who individually or collectively create growth and improve their material well-being in the process.

For growth to reduce poverty efficiently the poor need to be able to participate

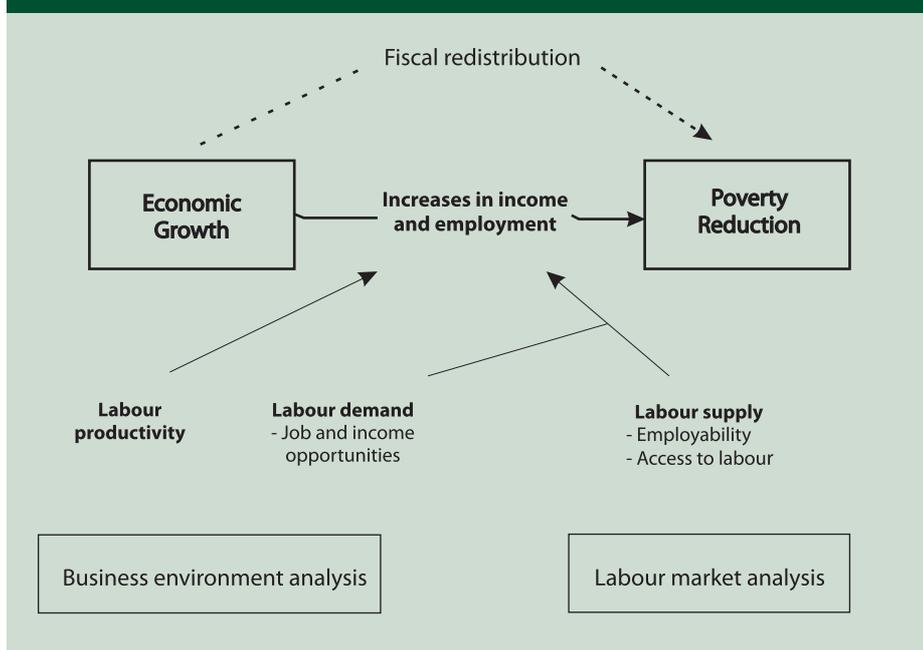
fully and on an equal basis in the economy. Enhancing employment and returns to labour by (i) strengthening the productive resources and capacity of the poor and (ii) creating opportunities for everyone to make full use of the productive resources at hand, is the main avenue for reducing income poverty and achieving pro-poor growth.

Productive employment thus becomes the natural entry point – as well as an indispensable integral part – of economic analysis that has poverty reduction as a key objective. Indeed, a more holistic approach to economic analysis, which puts employment, labour productivity and incomes in focus, is needed to sharpen the poverty focus.

We have developed an integrated economic analysis (IEA) approach, which aims to improve the understanding of the determinants of pro-poor growth at the country level, by integrating employment analysis, macroeconomic analysis and business environment analysis. This approach opens up for considerable synergies and has proven to have considerable merits. Based on an analysis of the context specific development dynamics, challenges and opportunities, it aims to identify the binding constraints on pro-poor growth with a view to facilitate informed prioritisation in policy-making.

The focus on the economic actors also makes it conceptually easier to incorporate cross-border labour migration into the analysis. The employment analysis covers all workers irrespective of whether they work within or outside the country, while the business environment analysis is supplemented by a migration climate analysis that follows the same logic as an investment climate analysis.

## Integrated Economic Analysis for Pro-Poor Growth



Traditional labour market analysis is less meaningful in developing countries where most of the labour force is self-employed, as it tends to assume that different actors account for the supply and demand for labour, viz. there are employees and employers. The IEA largely solves this problem by integrating the employment analysis with the business environment analysis. The latter is in practice, though often unwittingly, tantamount to an analysis of the demand side of employment (i.e. creation of jobs and income) – directly for the self-employed and indirectly for the wage employed. The self-employed are in fact more or less identical with the economic actors in a business environment analysis.

By integrating business environment analysis and macroeconomic analysis with the employment analysis, the demand for labour is not only assessed, but causes behind inadequate demand and low productivity/ income opportunities are also identified.

The business environment analyses is greatly enriched by being linked to employment analysis, as the latter provides information on the characteristics of the economic actors with regard to endowment with human resources

(education, skills), strengths and weaknesses etc. Such knowledge is crucial for assessing the particular needs of different economic actors – such as the poor and resource-weak, and the impact on these groups of deficiencies in the business environment.

Thus, it facilitates a sharper poverty focus in the business environment analysis by highlighting how deficiencies in the economic environment affect the smaller and weaker economic actors, i.e. the poor. Another major advantage of integrating employment and business environment analysis is that the dynamics of the informal economy become part and parcel of the analysis.

Linking macroeconomic analysis with labour market and business environment analysis brings several advantages. It makes it easier to identify structural causes of both macroeconomic vulnerability and of stability-related constraints on growth. It also helps shift the focus from short-term remedies for acute macroeconomic problems towards long-term macroeconomic stability, by addressing root causes of instability.

In the final stage of the IEA analysis, the findings and conclusions from the

employment, macroeconomic and business environment analyses are brought together with a view to identifying the binding constraints on enhancing employment, labour productivity and returns to labour i.e. the binding constraints on pro-poor growth.

The IEA approach captures not only growth constraints that are due to low productivity (technology, institutions, risk, etc) or low levels of input of production factors (land, labour, capital), but also those pertaining to low mobility of labour and poor and unequal access to economic and employment opportunities. Moreover, IEA aims at identifying a bundle of constraints rather than the binding constraint, and emphasises the need to *sequence* the relaxation of constraints. Finally, it is important to recognise the time lag between policy and impact; some constraints that are not immediately binding may need to be addressed now in order not to become binding later.

The IEA should be regarded as an integral part of country analytical work, which should draw on and complement existing economic analysis, and as a tool to identify knowledge gaps to inform future studies.

The broad integrated approach to economic analysis, its strong focus on the poor as economic actors and on aspects (employment, productivity and returns to labour) that have a direct impact on poverty, as well as the identification of binding constraints makes it well suited as an analytical tool generating knowledge for prioritisation of policies and as input into national poverty reduction strategy (PRS) processes. It can also be helpful in the identification of result indicators.

A methodological guideline based on the IEA approach, as well as several empirical country studies based on this approach, have recently been published by the Swedish International Development Cooperation Agency (Sida).

■ **Integrated Economic Analysis for Pro-Poor Growth. Sida Methods Document, Stockholm, September 2006.** [http://www.sida.se/shared/jsp/download.jsp?f=SIDA30631en\\_IEA\\_web.pdf&a=25631](http://www.sida.se/shared/jsp/download.jsp?f=SIDA30631en_IEA_web.pdf&a=25631)

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# Employment and Pro-Poor Growth

**The incomes of the poor depend on the nature and extent of employment that economic growth generates.**

**Slow employment growth has been a major correlate of slow poverty reduction in developing countries.**

**While East Asia is the best example of pro-poor growth in modern history, growth in China and India has been far less employment friendly.**

**Macroeconomic stabilization can reduce economic growth and damage its employment intensity.**

**The role of** employment in pro-poor growth has been increasingly emphasized in the analysis of development policy in recent years. The incomes of the poor largely depend on the nature and extent of employment that economic growth generates. But there is no automatic relationship between growth and employment and not all growth is equally employment intensive. This article focuses on the employment intensity of growth.

The bulk of the income of the poor comes from labour, even when they have some assets such as land that enables their labour to be used in productive activities. Thus, increased employment with improved rewards is key to poverty reduction. More specifically, growing incomes for the poor can come from increases in: (a) wage employment; (b) real wage; (c) self-employment time, productivity and output prices.

All these factors are associated with high rates of economic growth. But growth is not equally employment intensive everywhere. East Asia is the best example of pro-poor growth in modern history, characterized by a high employment intensity of growth, whereas the more recent rapid growth of China and India has been far less employment friendly.

Employment intensity of growth can be measured by the gross output elasticity of employment (GOEE), the ratio of growth in employment to growth in output. In a developing country this can be meaningfully measured only for industries and modern services. For traditional agriculture and informal activities the measurement of GOEE can often be misleading due to variations in the degree of underemployment in these sectors of residual employment category.

The central elements of East Asia's remarkable success in poverty reduction have been their very high rates of growth and the high GOEEs of the fast-growth sectors: industries and modern services. The growth in employment and its remuneration, as well as a shift in its composition towards higher productivity sectors, were the principal forces behind the dramatic reduction in poverty.

Recent economic growth rates in China and, lately, India have exceeded those of East Asia at its peak. But the success of these countries in poverty reduction can not be said to be nearly as remarkable as that in East Asia. One critical feature of growth in these countries that largely explains the difference is the low GOEE of their growth sectors.

Several sets of country studies by the International Labour Organization (ILO) and UNDP show that slow employment growth has been a major correlate of slow poverty reduction in developing countries. And almost without exception, slow employment growth was associated with low GOEE.

In Asia, manufacturing employment decreased in the 1990s, largely driven by China despite its extraordinarily rapid industrial growth. In other Asian countries, growth in manufacturing employment was slower than in the 1980s except in India, which however still had a very low absolute elasticity. This was an obstacle to the change in the composition of employment away from low-productivity agriculture in favour of higher-productivity industries.

In a new study<sup>1</sup> of eight Asian countries only one, Malaysia, had the right kind of long-term employment growth, while in China, India and post-Asian-crisis Indonesia and Thailand it has been low

and declining over time. In the two most rapidly growing economies, China and India, the problem has been a sharp fall in the GOEE, and in Indonesia and Thailand it was due to reductions both in the GOEE and in growth rates. In Cambodia, the Philippines and Sri Lanka it was by and large due to growth being too low and/or bypassing the large sectors where the poor eke out a living.

Why was industrial growth, including that in the most rapidly growing countries, so employment hostile? A major explanation is inherent in the nature of the transition from inward-looking, regulation-based, import-substituting industrialization (ISI) policy regimes to ones based on greater competition and integration with the global economy. While the incentive system in the latter is more employment friendly than in the former, the transition itself entails the laying off of vast numbers of workers inefficiently absorbed in the payroll, principally but not exclusively of state enterprises (the most prominent case being China).

A second source is a sharp sudden shift in the composition of incremental output in favour of activities with low labour intensity, either in response to such factors as opportunity thrown open by the global economy, e.g. India's rapid IT-led growth, or due to loss of competitiveness in some labour-intensive exports. An example of the latter is reduction in access to credit for small labour-intensive enterprises in a period of macroeconomic contraction.

The transition away from ISI regimes is indeed desirable and a change in the composition of incremental demand for exports is by itself nothing to be preempted. But appropriate and timely transitional measures of sufficient magnitude – increased employment in public works, retraining of laid-off workers, a more transparent system of unemployment insurance, and the prevention of the erosion of competitiveness in labour-intensive industries – should have been implemented to offset their negative impact on employment growth.

Employment performance is powerfully influenced by macroeconomic policies. In five of the seven Asian countries

### Employment-friendly growth: a success story

In South Korea in the 1970s, a phase roughly comparable to China's growth in the 1990s and India's at the present time, the GOEE for manufacturing was approximately 0.7. With an annual growth rate of the fast-growing non-agricultural sectors exceeding 12 percent, employment in those sectors increased by more than 8 percent per year, soon making these sectors absorb the underemployed workers in agriculture and other traditional activities. This led to an increase in real wages at roughly the same rate as per capita GDP growth, and a trend reduction in absolute employment in agriculture.

in difficulty (see above), higher economic growth would help overcome the problem. Far too often disproportionate macroeconomic stabilization has reduced economic growth to rates that simply are too low to permit adequately high rates of employment growth even when employment intensities are high and intact. But macroeconomic contraction can also damage the employment intensity itself through its asymmetrical impact on enterprises differing in factor intensity.

Employment hostility of industrial growth has contributed to the slowing and even a reversal in the so-called Lewis transition – reduction in absolute employment in agriculture – that is the hallmark of all successful cases of growth. In East Asia this transition took place early and rapidly: in South Korea agriculture's share of employment fell from nearly a half in 1970 to about a sixth in 1990 and the absolute fall in agricultural employment started right at the beginning of the period.

China, with a faster rate growth between 1980 and 2000 than what Korea achieved during the above two decades had a far slower fall in agriculture's share of employment, from 69 percent to 46 percent. Absolute employment in agriculture started falling after 1991, but this trend was reversed after 1996, due largely to a negative growth in industrial employment. The resulting rise in the gap between agriculture's share of employment and its share of GDP led to a further worsening of the already large gap between rural and urban areas in terms of output per worker and income per person.

Since most of the poor are rural residents, this was detrimental to the welfare of the poor.

Another study<sup>2</sup> of ten Asian countries shows a recent *increase* in agriculture's *share* of total employment in five: Armenia, Kyrgyz Republic, Mongolia, Indonesia, and Cambodia. This was because industries and related modern activities failed to absorb labour and, in several of these cases, the absolute number of workers employed by these sectors declined. Agriculture in these and most other low-income countries needs a smaller share of national employment and a larger share of national capital in order to boost productivity and reduce the gap in living standard and poverty between agriculture and the rest of the economy.

Many countries further exacerbate the problem of rural and overall poverty by adopting policies and/or failing to offset changes that result in an adverse movement in agriculture's terms of trade. China after the early 1980s and Vietnam in the late 1990s are examples of a decline in agriculture's terms of trade slowing down the rate of rural and overall poverty reduction.

The problem of low GOEE in the high-growth sectors underlines the importance of expanding the scope of self-employment for the poor by improving their access to credit, technology, market and, above all, human capital which not only increases the productivity of self-employment but also the productivity and earnings of the wage-employed.

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2. Khan, A. R., 2005, *Growth, Employment and Poverty: An Analysis of the Vital Nexus based on some Recent UNDP and ILO/SIDA Studies, Issues in Employment and Poverty Discussion Paper 19*, ILO, Geneva.

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# Formalising Informal Firms: What can be done?

**The informal sector plays an important role for poor women and men in developing countries.**

**But the views differ on its contribution to poverty reduction and alleviation.**

**Poverty forces people to engage in it and this is a dimension of living in poverty.**

**Formalising informal firms is a challenge for improving the employment conditions of poor people.**

**The important** economic role of the informal sector (IS) in developing countries has drawn the attention of both researchers and policy makers. The IS links formal sub-sectors to consumers, and it supplies many low and middle income employees of the formal sector with goods and services. The IS accounts for around half of urban employment in Sub-Saharan Africa (SSA), and about one quarter of urban jobs in Latin America, while this share varied widely across Asia: 10-65 percent.

Informal sector wage employment is less frequent than self-employment, which accounts for 70 percent of IS jobs in SSA and about 60 percent in the other developing regions. However, self-employment is sometimes referred to as a community of the poor or non-dynamic part of the IS. This has triggered concerns among policy makers and in the ILO regarding the status of the IS and its relation to poverty.

The IS jobs have poor working conditions and thus do not contribute much to poverty reduction. IS workers are poorly remunerated and underemployed, and they lack social protection; their rights are less respected, and they are excluded from social dialogue and decision making. The situation is even worse for female informal workers, who earn much less on average than male informal workers.

IS workers run a high risk of injury and other health hazards, while lacking protection or safety nets to help them and their families survive on a reduced or cutoff income. Thus, it can be inferred that poverty forces people to engage in the IS and working in the IS is a dimension of living in poverty.

On the other hand, studies indicate that in the absence of informal incomes, a majority of formal sector households would have fallen deeper into poverty. This indicates a significant role for the IS in alleviating poverty, reducing its depth and severity. How, then, can the contribution of the IS develop from this role of just alleviating poverty to an exit strategy for sustainably reducing it through underpinning pro-poor growth?

The expansion of the IS and the deteriorating employment situation in many developing countries in SSA, Latin America and the Caribbean are associated with low GDP growth rates. Many of these countries have also faced high population growth rates and increasing numbers of job-seekers particularly among the youth. However, an increase in the economic growth rate of a country does not automatically result in the movement of workers from the IS to the formal sector. Despite high GDP growth rates, some East Asian countries have faced an increase in unemployment. Economic growth reduces the size of the IS only to the extent that it is pro-poor, i.e. accompanied by improvements in formal employment levels and income distribution.

There are several factors holding back the growth of informal enterprises. Some of the most important obstacles facing an informal sector firm are: limited human and working capital, poor location, obsolete technology, limited access to markets and to financial and business support services, complex and burdensome government regulations, lack of economic infrastructure and a poor supply of public services.

A firm's decision to operate formally or informally depends on several matters. Firms tend to formalise as the enterprise grows. Younger firms may choose not to participate in some societal institutions due to the uncertainty surrounding their future. While manufacturing sector firms employ a relatively high number of paid workers and tend to comply with labour regulations, IS resale sector firms commonly utilise more unpaid workers.

Given the current business environment in developing countries, the opportunity costs of informality seem to be much lower than the cost of operating formally. Even small and medium enterprises (SMEs) with a higher degree of formality still face the same obstacles as their informal competitors. On the other hand, the cost of operating completely formally is very high for medium-size firms. This discourages SMEs to grow and increase their degree of formality.

Due to inefficient and poor property right enforcement coupled with corruption, most transactions among formal enterprises are coordinated by informal networks. Irrespective of their formality, SMEs and large manufacturing firms have limited access to long-term loans. In sum, total formality may mean having to close the operations of the firm unless the business environment is improved.

The quest for formalising enterprises needs to be addressed from various different angles, viz. reducing entry and operating formal costs, increasing the incentives for SMEs to operate formally, reducing obstacles to their growth, and searching for inexpensive approaches through which to enforce compliance with government regulations. This can be achieved by undertaking the following measures.

The reduction of entry costs can be accomplished by having a one stop-shop for registration, decreasing registration procedures, and increasing the effectiveness and efficiency of offices involved in the registration process. Following the approach of the Shanghai Municipal Government, the one-stop-shop can be organised at

different levels namely local, municipal/district, regional and national. At local level it may need to facilitate the registration process by providing enterprises with all the information, helping them to meet all the registration requirements; while the hostile behaviour of government officials towards informal enterprises should be repressed.

The national tax system needs to be well structured, clear and transparent. Local levies may be transformed into fees for the use of community resources in order to encourage the efficient provision of local public services and accountability. Measures aimed at enhancing accountability need to be taken.

Property right registration and contract enforcement mechanisms which incorporate informal, popular rules need to be introduced. Ways to link multilateral private governance structures and the formal judicial system may have to be found to simplify the process, increase its effectiveness and efficiency and improve its reach to all business operators.

Dual labour regulations and safety nets are often important for enabling informal enterprises to meet part of their labour contributions while staying in business and offering employment. It would be necessary to introduce dual safety nets for this purpose, whereby informal enterprises pay a certain percentage and the rest is covered by governments. Such schemes need to be spelled out in poverty reduction strategies and social protection policies.

Informal enterprises may need to be sensitised to the need of improving employment and working conditions. This needs to be incorporated into training programs that target informal enterprises. NGOs, local public governance structures, informal labour associations in cooperation with local and global lead firms need to encourage fair trade labelling.

Following the South African approach, training concepts for informal enterprises need to be introduced in vocational training programs. Students

following these programs can be assigned to informal enterprises in order to conduct their practical tasks which would enable them to learn more as future entrepreneurs and facilitate the solving of problems faced by informal enterprises. The diversification of products offered by financial institutions may need to incorporate security insurance and the establishment of limited liability institutions to encourage high return-high risk investment. The provision of business and financial services needs to be very realistic and objectively evaluated.

Training programs designed for SMEs may need to incorporate modules focusing on improving worker capabilities. Employers should be encouraged to allow their employees to attend training courses which in turn may also increase their employment potential.

It is important to encourage the creation of informal-formal sector forward linkages. Measures to overcome exploitation need to be considered and implemented. Actors who add no value in the chain linking informal and formal firms need to be removed which can be done by facilitating the creation of direct links between value adding informal and formal enterprises.

The formalisation of informal enterprises can be viewed as an empowerment process and a central feature of poverty reduction strategies recognising the key concept of capability poverty, because it entails legal/official recognition of the living conditions of the poor and their sources of income. This can be possible if the voices of IS employers and employees are empowered. If IS actors participate in decision making and the formulation of policies and regulations they may in turn be motivated to comply with them. Increased formalisation requires incentives; the provision of public infrastructure services needs to be efficient, reliable and affordable.

■  
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# The Policy Origins of Poverty and Growth in India

**Identifying the policy origins of growth and poverty in India is key to informing the current debate and to shaping future policy.**

**Why are some states more efficient than others in reducing poverty through growth?**

**Six key policy areas have driven poverty and growth in India.**

**The policy performance of the Indian states varies a lot in these areas.**

**This largely explains the hugely different pro-poor growth outcomes.**

**One third of** the world's extremely poor people live in India. Its states have much policy autonomy, leading to hugely different outcomes within the same nation. We study the link between the heterogeneous patterns of policy, growth and poverty reduction over the years 1958-2000 across its 16 main states with more than 95 percent of the population.

The chart shows the cross-state disparity in poverty and growth experiences. Growth in Punjab was nearly 3 percent over the period; in Bihar, income per capita is about the same as in 1960 and the share of poor people has remained above 60 percent, while in Kerala poverty has fallen by three quarters from that same level.

Also, poverty reduction for any given growth level—the growth elasticity of poverty—varies a lot. The average elasticity for Indian states is -0.65, compared to -0.73 for 88 developing countries; average

growth reduces poverty less than proportionally. Thus, India's average elasticity is modest in international terms, but it varies a lot across states. Kerala and West Bengal had remarkable larger-than-one elasticities, as large as East Asia, while in some Indian states they are as low as those of Sub-Saharan Africa.

The table shows Indian states in four groups defined by poverty elasticity and growth rates. We rank these groups, first by their rates of poverty reduction, growth rates, and growth elasticity of poverty; and then by their performance along each of the six policy areas discussed below. The rankings across these policy areas are quite diverse. Only gender has the same ranking as poverty reduction and elasticity, and among the other areas, only voice/accountability and human capital have the same rankings.

It is difficult, yet informative, to summarise the diverse state experiences when lumped together into only four groups of states. We now turn to explaining the key policy areas and their importance for pro-poor growth.

(i) **Voice and accountability** in the context of public food distribution and calamity relief in India: mass media are important for ensuring effective government responses to the needs of vulnerable citizens. Regional newspapers—printed in the regional languages—report local events and their readership tends to comprise vulnerable populations who depend on action by state governments for protection. Higher newspaper circulation is associated with having a higher growth elasticity of poverty, a higher growth rate and higher overall poverty reduction experience.

## Ranking poverty reduction, growth, elasticity and policy

Indian states, 1958-2000

States	Group 1: high poverty elasticity, high growth	Group 2: high poverty elasticity, low growth	Group 3: low poverty elasticity, high growth	Group 4: low poverty elasticity, low growth	
Poverty reduction	1	2	3	4	
Growth rate	2	3	1	4	
Growth elasticity of poverty	1	1	3	4	
Policy areas	Voice and accountability	1	3	2	4
	Regulation	1	4	3	2
	Access to finance	2	3	1	4
	Human capital	1	3	2	4
	Property rights	2	1	3	4
	Gender	1	2	3	4

Notes: Group 1: Andhra Pradesh, Gujarat, Kerala, Punjab; Group 2: Orissa, West Bengal; Group 3: Haryana, Maharashtra, Tamil Nadu; Group 4: Assam, Bihar, Jammu & Kashmir, Karnataka, Madhya Pradesh, Rajasthan, Uttar Pradesh. Rankings are average based on state rankings as calculated from the average variable of interest over the period (1=highest).

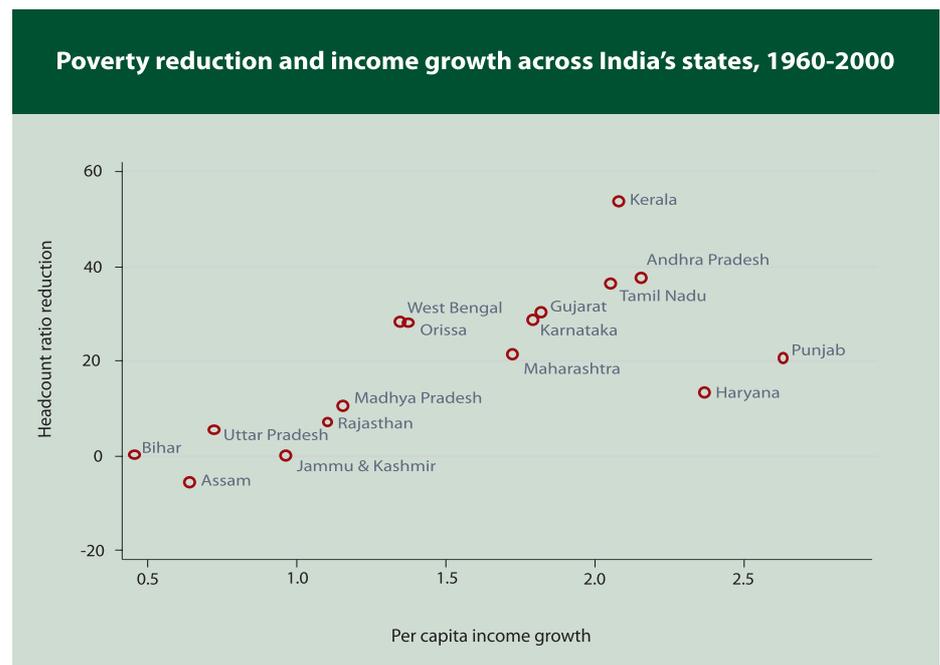
(ii) **Labour regulations** have been identified as an important element of the investment climate in India. We found that pro-worker regulation affects urban but not rural poverty. This reflects its adverse effects on the growth of manufacturing firms, which are mainly located in urban areas. States with more pro-worker labour regulations tend to have larger informal sectors. In the post-1991 liberalization period, industries located in pro-employer states performed better than those in pro-worker states.

The table shows that the ranks of pro-employer labour regulations tally with high poverty reduction and elasticity, but less with growth. But it is the only policy area with similar ranks also to the worst performing states, suggesting an ambiguous relationship with pro-poor growth.

(iii) **Access to finance** can enable people to exit poverty by facilitating small businesses and other non-agricultural activities. In India, a massive expansion of rural bank branches enhanced economic growth by promoting non-agricultural output. The branch expansion program led to a reduction in rural poverty and, indirectly, increased wages of agricultural labourers. Thus, the poorest of the poor in India might benefit from rural credit expansion even if they do not transact directly with banks. The table shows the rank association of credit per capita with economic growth, but not so much with poverty reduction and elasticity.

(iv) **Human capital** is a constraint on pro-poor growth in India, where average literacy rates are extremely low—63 percent for males and 36 percent for females—with large disparity across states. In Kerala, mass literacy has been achieved via a social movement to promote schooling, while Uttar Pradesh has poor schooling outcomes and endemic teacher absenteeism. Both male and female secondary enrollment rates enhance income growth, but the impact is larger from increasing female than male human capital.

The table shows human capital rankings as closely related with poverty reduction and elasticity, and only slightly less with growth. This suggests that human capital



is key for increasing pro-poor growth. More, better schools with improved governance and accountability will be needed, e.g. promoting parental and community involvement, changing the incentives facing teachers and students, and involving non-state actors and NGOs in providing education.

(v) **Land reforms** to increase security of tenure and abolish intermediaries have been central for reducing rural poverty. Moderate reforms which improve the property rights and bargaining power of tenants and marginal farmers have had significant effects on rural poverty, whereas attempts to directly redistribute land had no effect as they tended to be blocked or evaded by powerful landed elites. However, there appears to be a trade-off with growth in agriculture output, as tenancy reforms are also negatively associated with the growth of real agricultural output per capita. The table shows that land reforms are associated with, in descending order, elasticity, poverty reduction and growth.

(vi) **Gender inequality** in literacy in India is amongst the highest in developing countries, and the participation of women in productive sectors is relatively low. Female labour participation was lower in 1991 (20 percent) than in 1901-1951. The ratios of female-to-male managers and workers as well as female literacy are

positively correlated with per capita real output in India's states. Gender inequality in the access to labour markets acts as a brake on development, and the efficiency costs of such inequality are large. The table shows gender as the only policy area with identical rankings as poverty reduction and elasticity, while slightly less related to growth.

To conclude, there are grounds for optimism about future poverty reduction in India. First, the Indian economy is growing at an unprecedented rate, and historical experience suggests that this growth will lead to a widespread reduction in poverty. Second, the building blocks of sustained economic growth and poverty reduction are known.

The evidence from cross-state studies is consistent with basic messages from modern growth theory. Physical and human capital must be accumulated, institutional reforms that expand opportunities for households (and individuals) must be implemented, the business climate must be improved, the accountability of elected officials must be increased, and gender inequality reduced.

■  
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# Growth and Poverty in Asia: Prospects for achieving the MDGs

**Asia has grown rapidly over the past ten years, making good progress towards the MDGs.**

**Further rapid progress is likely but by no means assured. It is threatened by a wide range of factors.**

**Asian countries face serious challenges to sustaining both growth and poverty reduction.**

**Concerted policy action in response to these challenges will be required to realize the dream of eradicating poverty within a generation.**

**Asia has made** good progress towards the Millennium Development Goals (MDGs). Economic growth has been exceptionally rapid, with several countries achieving GDP increases of over 6 percent annually over the last 20 years. This has had a dramatic effect on poverty rates, which fell from 32 percent of a growing population in 1990 to 22 percent in 2000, offering the prospect of eradicating poverty within a generation. Yet, Asia's large population size means that the region currently contains more than two thirds of the world's poor, and there is general recognition that growth is a necessary but not sufficient condition for poverty reduction.

Growth is largely export-led, with high rates of foreign and domestic investment. In East and South East Asia, the policy focus has been largely on growth, with important policy initiatives towards liberalisation, stability, the promotion of private investment, infrastructure and skill development. In South Asia, the proportion of public expenditure for service delivery and social protection is currently larger than in E and SE Asia, while direct growth promotion has also been important.

Success in growth and poverty reduction is not guaranteed: it can be threatened by a wide range of factors, including changes in international trade and investment climates, slowing of the global economy, or rapid rises in the prices of primary commodities (especially energy).

Nearer to home, environmental degradation, outmoded institutional arrangements, weak governance and infrastructure deficiencies may be constraining development. There is substantial scope for improvements in managing internal migration and urban expansion, and in accelerating the rate of

inclusion of certain regions and population segments not only in the benefits of growth, but also in programmes of basic service delivery (especially in health and education) and in social protection. There is also scope for improving transparency and accountability in the making and implementation of public policy.

The kinds of challenge that growth and development face in a rapidly-changing Asia mean that "business as usual" policies are unlikely to generate optimal combinations of growth and poverty reduction. Recent studies indicate that, in the approach to 2015:

- Asia will continue to experience strong economic growth led by a vibrant commercial sector, with a growing share of global GNP, exports and imports.
- There will be continuing strong progress towards the reduction of income poverty, though performance against many other indicators will be mixed.
- There is likely to be a worsening of environmental indicators, with increasing air pollution, reduced groundwater availability, reduced availability of cultivable land (and/or reductions in its quality), reduced forest cover, and continued illegal logging. Some, such as air and water pollution, and management of shared water, have cross-border implications.
- Continuing strong flows of internal migration into the cities will reverse the current average 60:40 ratio of rural to urban population in many countries, though with wide variation in the extent to which such migration is harnessed for growth and poverty reduction.
- Broader participation in political and economic decisions is likely, with

increasing numbers of civil society organizations, rising public consciousness of citizens' rights, and growing protest over such matters as corruption, environmental degradation and social exclusion.

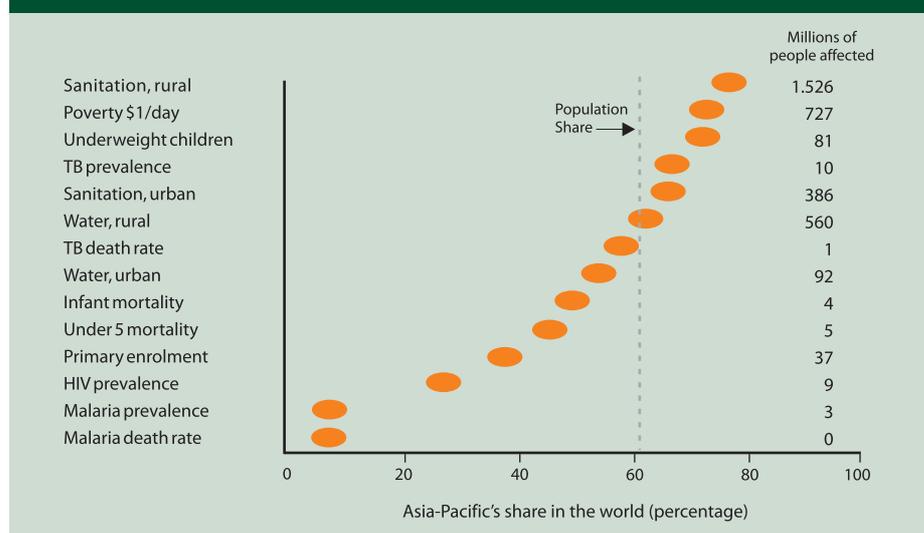
- Some reduction in long-entrenched discrimination against women and marginalized groups may occur as a result of this trend, but major disparities will remain in several countries.

The transition to predominantly urban-based activities represents a pervasive trend across Asia. This does not imply an absolute decline in, for example, the size of the agriculture sector, but a reduced share in GDP, exports and employment. The transition is well-advanced in most E and SE Asian countries and, less so, in S Asia but there are countries (Lao PDR, Cambodia, Burma) which are likely to remain predominantly agrarian until at least 2015. But this transition – with fundamental demographic change, extended life expectancy, reduced fertility rates, and at present a high ratio of working to non-working population – means that the challenges faced by Asian economies are becoming more intense, and in some cases, different from past experience.

This is due to the speed of these changes, the constraints on policy instruments accompanying the current phase of globalisation, and the way the benefits and risks of economic transition and deeper integration into the global economy are distributed. As a consequence, both rural and urban poor face new kinds of insecurities. At the same time, for emerging economies such as Vietnam and China, these rapid changes have coincided with a period during which the welfare provisions of state enterprises have diminished as they have downsized, often leaving fewer tools and resources in the hands of government to address these risks.

Achieving faster poverty reduction, especially towards non-income MDGs, is partly about fuller engagement with growth processes, and partly about higher and more effective public expenditure, better focused on crucial areas and groups. But it is also about the

## People living in social and economic poverty in Asia and the Pacific



Source: *Millennium Development Goals: Progress in Asia and the Pacific 2006*, ESCAP, UNDP and ADB, 2006. <http://www.mdgasiapacific.org>

more deeply embedded patterns of social discrimination in both society and public sector institutions which make it difficult to ensure that resources are used as intended.

In relation to the MDGs, incomes will continue to rise and the share of those with less than one dollar a day to fall to some 0.6 percent of the population of SE Asia in 2015, and to 6 percent in S Asia. But only around half the countries in the region are likely to be on-track against the target to halve hunger by 2015. Enrolment in basic education is rising but there is scope for improvement in quality and access, and girls' increasing participation in primary education is compromised by high dropout rates.

Most countries in the region face the challenge of reducing child mortality by around two thirds to meet this MDG, and rates of child and maternal mortality are higher for disadvantaged groups such as ethnic and religious minorities and lower castes. In terms of health criteria, progress has been mixed, with the continuing lack of effective prevention programmes against common diseases such as tuberculosis in many countries. New diseases such as SARS and avian flu present particular challenges. Overall HIV prevalence rates in the region are low, but rising, and the absolute numbers involved are very large. Access to

improved water sources and sanitation is increasing, albeit at a slow rate, and from a low baseline.

Asian countries have the opportunity to make continuing rapid progress, especially in comparison with other developing regions. But unless there is concerted policy attention to a common set of challenges across the region this potential may not be fully realized and the dream of poverty eradication within a generation will remain unfulfilled. Initiatives for addressing these challenges will be primarily driven by the political commitment of Asian governments to use increasing resources and expertise for this purpose. But there are emerging challenges that require new forms of partnership between governments in the region and with development agencies outside the region. Recognizing the implications of these challenges and identifying the best means of overcoming those lies at the heart of the development policy agenda in Asia over the coming decade.

John Farrington and Mark Robinson: "Introduction". *Development Policy Review*, Volume 24, Supplement 1, August 2006. Theme Issue: *Growth and Poverty in Asia: Where Next?* Publisher: Blackwell Publishing on behalf of the Overseas Development Institute. <http://www.blackwell-synergy.com/toc/dpr/24/s1>

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# Poverty, Inequality and Labour Markets in Sub-Saharan Africa

**Poverty has to be attacked through development strategies based on pro-poor growth.**

**African economic researchers worked together on the broad elements of such strategies.**

**African poverty is still mainly rural despite recent increases in urban poverty with high levels in some countries.**

**Key policy areas are: agriculture, human capital, vulnerability, market access, infrastructure and employment.**

**Like two sides** of the same coin, poverty reduction and growth are two dimensions of the same phenomenon. Scrutinizing poverty separately and independently from the overall growth process is clearly artificial. Poverty has to be attacked through an appropriate development strategy embedded in a pro-poor growth process. This article summarizes the key finding of African researchers on the broad elements of such strategies in Sub-Saharan Africa.

We jointly coordinated a collaborative thematic research project on “Poverty, Income Distribution and Labor Markets in Sub-Saharan Africa”, which started in 1997 under the auspices of the African Economic Research Consortium (AERC). Twelve national teams consisting of academics and government officials were selected and funded and each of the teams twinned with one of four collaborating universities (Cornell, Laval, Gothenburg and Copenhagen). The twinning feature provided African researchers with the necessary tools to complete successfully rigorous country case studies.

These studies focused on poverty assessment, profiles, and analyses of macroeconomic and sectoral policies to alleviate poverty within the context of economic growth – emphasizing the money-metric dimensions of poverty. Given the data intensive nature of the case studies, a two-year time horizon was envisaged for their completion. Thus, twelve country case studies were completed.<sup>1</sup>

There are two distinct ways of measuring poverty: a quantitative consumption-based money-metric approach and a qualitative approach, based on subjective perceptions of individuals. Every country team relied on the quantitative approach. Estimates of poverty incidence in the 12 country studies

ranged from one-third to two-thirds of their respective populations.

The Ethiopian research team also used a subjective method to complement the money-metric approach. The definition of subjective poverty is based on the perception of individuals about their wellbeing and attempts to relate the self-reported subjective welfare levels with observed income. Surprisingly, the poverty incidence estimates obtained under the quantitative, money-metric approach and under the subjective approach were strikingly close.

A poverty profile identifies the major household and environmental characteristics that are associated with poverty. The major correlates of poverty appearing in virtually all the country profiles are: labour force and occupational status, race, location (e.g., urban/rural, provincial or regional breakdown), education and health, size of household, gender (e.g., male- vs. female-headed household), age, dependency ratio, market orientation, ownership of land and assets, and marital status.

One of the most important contributions of the South African study was to show convincingly the close link between unemployment and poverty. Employment of adult labour market participants is the largest single contributor to household per capita income and household poverty avoidance.

All the studies found that the incidence of poverty was relatively greater in the rural areas than in urban areas. Indeed, because most of the African population is rural, African poverty is a rural phenomenon, despite the recent emergence of high urban poverty incidence in some countries.

1. Benin, Cameroon, Ethiopia, Ghana, Kenya, Madagascar, Mozambique, Nigeria, South Africa, Tanzania, Uganda and Zimbabwe.  
2. Cameroon, Mozambique, Ghana.

In general, the country reports find a strong negative correlation between education and poverty. But there were some unexpected results. In Ethiopia, returns to primary education – particularly in the rural areas – is close to zero but high at the secondary and tertiary levels. In some other African countries, notably South Africa and Kenya, rates of return to primary education have been estimated to be much lower than the returns to secondary and tertiary education.

A universal finding was that poverty per household member or per adult-equivalent increases with the size of the household. A key issue in this context is the extent to which economies of scale within a family play a role.

Most studies explored the impact of the gender of the head of the household on poverty incidence. Although male-headed households were found to suffer from less poverty than female-headed households, some countries<sup>2</sup> reported less poverty among female-headed households. Generally, age of household head and dependency ratio are found to be positively correlated with poverty.

The South African team found that domestic workers and farm workers are the most vulnerable groups in the labour market. Africans (Blacks) and women dominate both these groups completely. Further, labour markets are strongly segmented, with large informal markets affecting women and men differently. Spatial rigidities prevail, with urban work-seekers having access to rural jobs on average, if they so desired, while rural work-seekers typically do not possess the characteristics necessary to compete in the urban labour market. Also, labour markets appear to be stacked against new entrants, with the younger cohorts facing a much lower probability of finding jobs than older cohorts.

One of the few and most important instruments available to a government of a poor country in fighting poverty consists of public spending on social services. For example, in Mozambique about one-fourth of the central government's total spending was on education and health services and about

one-third on all social services combined including education and health. Given the relative magnitude of such expenditures, it is essential to determine how well targeted those services are towards the poor and how far they go in alleviating their plight.

For lower primary education the distribution of benefits is almost equal – the poor share equally in the benefits of lower primary education as the non-poor. On the other hand, secondary education benefits are distributed even more unequally than consumption. With regard to health services, the team found that the participation of infants and pregnant women in basic preventive health care is progressive (in the sense that the poor receive a larger proportion of the benefits than their share of total national income or consumption) and appears particularly progressive for infant vaccination. Hence access to preventive care helps to equalize the income distribution. Essentially, the same finding applies to visits to curative health services.

The Madagascar report also analysed the benefit incidence of public expenditures on education and health. Their findings were fairly similar to those from Mozambique. The distribution of primary education services was absolutely (per capita) progressive, while the secondary education benefit appears slightly regressive (in the sense that the poor receive a smaller proportion of the benefits than their share of total national income or consumption). Health expenditures on main and secondary hospitals benefit the rich slightly more than the poor, while public expenditures on other health care centres are relatively progressive.

In conclusion, five broad elements of a pro-poor growth strategy may be recommended for sub-Saharan African countries on the basis of the research emanating from this collaborative project:

1. Eliminate the discrimination against rural and agricultural development. Most of Africa is still in an early phase of development – what can be referred to as the pre-take-off phase. A lesson learned from those countries that were most successful in achieving both growth and equity throughout their development

history (e.g., East Asia) is that a continuous flow of resources should be provided to agriculture in the form of such elements as rural infrastructure, inputs, research and credit combined with appropriate institutions to increase this sector's productivity and potential capacity for contributing an even larger reverse flow to the rest of the economy.

Instead, the typical pattern in sub-Saharan Africa has been to exploit agriculture and tax and starve it early on, forcing it into stagnation and thereby "killing the goose before it had a chance to lay a golden egg". In general, a development strategy that promotes equitable growth should be designed and implemented as such, and should not be expected to emerge on its own through trickle-down effects.

2. Invest in human capital (education and health, including nutrition and sanitation) so as to improve human welfare directly. Making these services broadly available should be a key objective of development strategy.
3. Improve intra-household allocation of consumption. Some household members, particularly children, widows and the aged, may be deprived of basic needs even in non-poor households. Public policies, including safety nets, need to be designed to reduce the vulnerability of these groups.
4. Make markets and public infrastructure accessible. Access to all markets (labour, business assets, land, social capital, food, etc.) is associated with poverty reduction. Public programmes to improve access to markets and to social services, including security of property and persons, are important components of a pro-poor development strategy.
5. A number of reports emphasized the critical need to facilitate the creation of new jobs. Given the seriousness of overt unemployment and under-employment in Africa, any growth strategy should be centred on employment creation.

■  
Erik Thorbecke and Germano Mwanu ,  
*Research Contributions of the AERC Poverty Project*, AERC Research News, 2006.  
[http://www.aercafrica.org/documents/researchnews/cr3\\_thorbecke.asp](http://www.aercafrica.org/documents/researchnews/cr3_thorbecke.asp)

by Nanak Kakwani,\*  
Marcelo Neri\*\* and Hyun H. Son\*

# Pro-Poor Stagnation: The Brazilian paradox

**With policies that reduced inequality, Brazil since 2000 managed to reduce poverty without average income growth.**

**We analyse growth patterns, poverty and inequality, focusing on the role played by the labour market and social programmes.**

**Labour income has been highly pro-poor in recent years, due to increased productivity.**

**Non-labour income has been pro-poor for a decade due to cash transfers targeted at the poor, at low fiscal cost.**

**Brazil for a long time** topped both the inflation and inequality rankings in the world. After a steep rise in the 1960s, Brazilian income inequality remained stubbornly high between 1970 and 2000, but has since fallen. The proportions of Brazilians living in poverty fell from close to 30 percent in 1995 to about 26 percent in 2004, corresponding to an annual decrease of 1 percent, although per capita real income declined. This is sometimes referred to as the “Brazilian paradox”.

This article presents empirical research answers to such questions as: to what extent did Brazilian economic performance between 1995 and 2004 benefit the poor? And what were the respective contributions of labour and non-labour income to growth and reductions in poverty and inequality?

We define growth as pro-poor if its benefits accrue to the poor proportionally more than to the non-poor. The pattern of pro-poor growth can be defined by the growth in mean income in conjunction with changes in the distribution of income. Thus, poverty reduction is a result not merely of the growth in mean income, but also of changes in the distribution of total income growth among the poor and the non-poor. We calculate the impact of such changes through a “pro-poor growth rate” that captures the gains and losses to the poor in relation to mean income growth.

We analyse the association between growth patterns, poverty and inequality, focusing on the role played by the labour market and social programmes. While overall growth was sluggish, pro-poor growth was achieved through labour market performance and the expansion of targeted cash transfers. By calculating the “pro-poorness” of each of the factors

adding up to per capita income, the Brazilian paradox is explained.

The upper part of the table presents the growth rates of actual per capita income and its two components, non-labour and labour income, and for each of these the corresponding measure of the pro-poor growth rate (PPGR).

Growth in per capita household income adjusted for prices was pro-poor during the period 1995-2004. This was due to the pro-poorness of the non-labour income. By comparison, the labour income was found to be somewhat anti-poor (the pro-poor growth rate was -0.73) over the period. In the period 2001-04 (and especially in 2003-04), inequality was consistently falling when the growth of both labour and, in particular, non-labour incomes was strongly pro-poor.

Further, we examined the contribution of different types of non-labour revenue sources to the total growth of income, through a decomposition scheme of the impact of each source. Special attention was paid to incomes most directly affected by social policies, such as social security benefits and other non-labour income sources that include cash transfers from social programmes and capital income. The remaining sources of non-labour income such as rents and private transfers (remittances, donations, child maintenance support, etc.) are part of what is called non-social income.

Social security is the main component of social income in Brazil. Providing about 20 percent of all incomes, it is second only to labour earnings among all income sources. Social security had a slightly increasing impact on inequality during the period 1995-2004, while other non-labour income sources strongly

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## Poverty impact of growth rates

Explanatory factors	1995-2004	1995-2001	2001-2004	2003-2004
Per capita income growth rate	- 0.63	- 0.30	- 1.35	3.56
Per capita income, PPGR	0.73	0.10	3.07	14.11
Non-labour income, actual growth rate	2.64	3.69	1.02	4.48
Non-labour income, PPGR	6.30	5.20	9.14	9.18
Labour income growth rate	- 1.49	- 1.30	- 2.05	3.28
Labour income, PPGR	-0.73	-0.97	0.97	16.24
<i>Gains and losses in labour income growth:</i>				
• Labour force participation rate	-0.32	-0.29	-0.03	1.63
• Employment rate	-0.34	-0.48	0.11	1.56
• Hours of work per person employed	-0.17	-0.14	-0.29	0.87
• Productivity	1.58	1.23	3.23	8.90
- Years of schooling	0.97	0.46	2.43	3.05
- Relative rate of returns per school year	0.61	0.77	0.81	5.85
• Labour income	0.76	0.32	3.02	12.97

Note: PPGR = Pro-poor growth rate.

Source: PNAD, the annual national household survey of Brazil.

contributed to the fall in inequality during the same period.

These other non-labour income sources are very diverse, ranging from cash transfer programmes such as *Bolsa Familia* to capital incomes such as interest paid on government debt. The pro-poor aspects of these income items are very different, despite the fact that both are subject to public policy choices, and mostly mediated by the State as well. The favourable impact of these non-labour incomes on pro-poor growth and inequality is due to the targeting of cash transfers at the poorest households. The impact of cash transfers was strongly pro-poor and inequality-reducing throughout the period 1995-2004.

Comparing the impact on pro-poor income growth of different forms of income transfers, we found that each percentage point in the share of government transfers bought 20 times more pro-poor growth through "other non-labour income sources" than through social security benefits. Thus, these non-labour income sources have

played a dominant role in the pro-poor growth pattern, while making a minor contribution to total income growth and to public expenditures.

Turning to labour income growth, this is examined by decomposition analysis of four labour market components: the employment rate, hours of work, the labour force participation rate and productivity. The lower part of the table presents the results, explaining gains and losses in the poverty impact of labour income growth rates due to pro-poor and anti-poor growth patterns, reflected in the sign and rate of change.

Labour income became highly pro-poor in the 2001-04 period, when it contributed to gains in the pro-poor growth rate of 3.02 percent. In 2003-04, the gain in the pro-poor growth rate increased to nearly 13 percent, which suggests a large reduction in inequality.

Which are the major determinants of this very pro-poor outcome of the Brazilian labour market between 2003 and 2004? The table suggests that productivity was

the most important factor, contributing to the gains in the pro-poor growth rate of 8.9 percent.

Productivity, in turn, can be explained in terms of years of schooling and returns from schooling. The years of schooling factor was attributable to gains in the growth rate of about 3 percentage points. Yet there is no straight relationship between productivity and the years/level of schooling. If an expansion of schooling is accompanied by a reduction in returns from education, then productivity in the economy may even fall. This is exactly what has happened in Brazil. Average returns per year of schooling have been falling monotonically since 1996. This fall in educational returns has offset the increase in the average years of schooling. The fall in returns from schooling can be explained in terms of sluggish demand in the labour market.

Another factor that can impact productivity is variability in relative returns from education. All households do not enjoy the same rates of returns for the same level of schooling. Changes in relative returns over time also have effects on both growth rate in the mean income and income inequality. The table reveals that relative rates of returns from schooling became highly favourable to the poor, contributing to gains in the pro-poor growth rate of 5.85 percent points during 2003-04.

In conclusion, the recent Brazilian experience shows clearly that a country can have poverty reduction in the medium term even with slow or stagnant economic growth, with inequality concurrently falling. The falling inequality in Brazil is largely a result of the expansion of cash transfers targeted at the poor. A small share of government budgets devoted to cash transfer programmes has been highly pro-poor in a way that has improved poor people's standard of living.

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Kakwani, N., M. Neri, H. H. Son (2006), *Linkages between Pro-Poor Growth, Social Programmes and Labour Market: The Recent Brazilian Experience*, Working Paper No. 26, IPC, Brazil. <http://www.undp-povertycentre.org/newsletters/WorkingPaper26.pdf>

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# Ten Commandments of Pro-Poor Growth

**While growth is generally associated with reduction in poverty, most growth increases the incomes of the poor less than those of the non-poor.**

**Market reforms have mostly stimulated growth, but the impact on poverty has not been obvious, and country outcomes vary considerably.**

**Broad reform policies do not target the poor effectively but assume that income growth will trickle down to them.**

**Pro-poor policies must be designed to stimulate growth in sectors and areas where the poor earn their living.**

**There is now** a large volume of empirical studies on the relationship between economic growth and poverty reduction. The evidence reveals that growth is generally associated with reduction in the incidence of poverty. However, most growth spells are not pro-poor; they increase the incomes of the poor less, absolutely and proportionally, than those of the non-poor. The evidence on the determinants of growth shows that market reforms have mostly had a positive effect on growth. However, the impact on poverty has not been obvious, and country experiences vary considerably.

A possible reason for the failure of broad reform policies is that they do not target the poor effectively. It is assumed that effects of policies are effectively transmitted to the poor through markets that are well integrated and responsive to policies. If this were the case, broad policies can be expected to influence the activities of the poor. But a pro-poor policy must by design invigorate what the poor do much more than other activities.

Assume that a reform policy is introduced in an economy like in the table—say liberalization of prices. Except for subsistence fishing, the various sectors respond to varying degrees as reflected by the assumed adjustment coefficient (meaning percentage change in economic activity in response to the policy shock). Even if poverty was evenly distributed across the sectors, the ensuing growth would not be pro-poor. The rural subsistence agriculture and urban informal sectors may be only weakly linked to the formal sectors of the economy. Because of the fact that markets are not fully integrated, the impact of reform policies may not influence some of the markets.

I therefore propose the following principles for pro-poor reform policies:

## Principle 1

*Pro-poor reform policies must target activities which most poor are involved in, and because markets of the poor are generally not well integrated with other formal markets, pro-poor policies must influence markets of the poor directly and should not be based on assumed leakages from other sectors*

Past reforms have tended to focus on broad policies that improve the functioning of markets generally. Trade liberalization and deregulation of the domestic economy all improve on the efficiency of markets. But such reforms may have limited impact on the functioning of markets for the poor. Just because we liberalize trade does not necessarily imply that the rural agriculture markets operate more efficiently. Consequently, pro-poor reforms must focus on those constraints that hinder the poor from fully participating in markets. A poor farmer's main barrier may not even be production but taking goods to the markets. Markets for the poor can be significantly enhanced for example by simple improvements in rural access roads that make it possible for the farmers to engage in larger rural markets. Thus,

## Principle 2

*Pro-poor reform policies must focus on improving the functioning of markets where poor people participate.*

A good measure of a pro-poor growth reform must be one that results in increased utilization of what marketable asset the poor have in abundance—unskilled labour. Many reforms that have resulted in economic growth have mainly impacted on sectors that require skilled labour. In essence the reforms increase

## Evaluating impact of policy

Sector	Population involved in activity	Adjustment coefficient
Industrial	5	15
Small and micro enterprises	10	6
Commercial agriculture	5	20
Subsistence crop farming	55	2
Subsistence animal husbandry	15	1
Commercial fishing	5	10
Subsistence fishing	5	0

the wages of high income earners but neither the wages nor employment rates of low skill workers. The result is increased inequality without significant increases in the incomes of the poor. Pro-poor reforms must therefore target stimulation of those labour-absorbing activities. This calls for policies that raise labour intensive production in agriculture and industries. Hence the next principle:

### Principle 3

*Pro-poor reform policies should target low-skill, labour intensive economic activities.*

Due to weak market linkages, some markets might boom, but not others. Because most macro policies operate more directly in formal markets, growth cannot be pro-poor unless the impact of those markets is transmitted to other markets. And the poor may increase production but may not be able to reach those other markets (for example, a farmer who grows vegetables but is not able to access the wider urban markets). Thus, a way to increase the pro-pooriness of growth must seek to reduce the degree of market segmentation:

### Principle 4

*Pro-poor reform policies should seek to reduce market segmentation so that markets for the poor are better integrated in the economy. This means improving on the forward and backward linkages.*

Poverty is directly related to low productivity. Thus, even when the economy expands, increases in the earnings of the poor tend to lag those of skilled workers considerably. The poor start with very low or no skills at all, so that small investments that raise their capabilities can bring large increases in productivity that translates into pro-poor growth. Reform policies should therefore include targeted public expenditure to raise capabilities in health, education, skills training, etc. Improving the capabilities of the poor raises productivity and gives the poor tools that help them exploit economic opportunities.

### Principle 5

*Pro-poor growth strategy should ring-fence public expenditures for raising capabilities of the poor.*

Within the developing countries, there are many groups that operate outside the market. The general reforms that were discussed earlier would have absolutely no impact on these groups (adjustment coefficient = 0). Any pro-poor growth strategy must seek to bring these groups into the realm of markets which may require facilitation to create markets. These groups of poor can only benefit if there are specific policies that result in the evolution of markets.

### Principle 6

*Pro-poor growth policies should target those groups that operate outside the markets with the aim of creating markets.*

Pro-poor growth requires ensuring that the poor are protected from hunger. No policy will help the poor out of their state if they are exposed to the risk of starvation. Thus, there has to be a well focused policy that ensures that food is available to the poor—meaning improvements in production, distribution, storage, etc.

### Principle 7

*Pro-poor reforms should include a food security policy.*

One of the reasons that poor people tend to gain less from growth over time is their exposure to extreme risks—drought, floods, disease, etc. All these random events (and some not so random)

hit the poor hard resulting in severe livelihood shocks eroding any gains achieved from growth during normal times. This calls for early warning systems and appropriate safety nets.

### Principle 8

*A broad pro-poor growth reform strategy should include policy initiatives that protect vulnerable populations from large swings in welfare.*

Asset accumulation of poor people is a basic element of sustainable pro-poor growth. Land is a most important asset but there are also many other forms of assets that poor people need to accumulate. Policy should therefore focus on removing barriers that make it difficult for the poor to accumulate assets, such as the system of rights and market imperfections.

### Principle 9

*Pro-poor growth reforms should include policies that support accumulation of tradable assets by the poor.*

Finally, reforms for pro-poor growth must be founded on improved governance. In particular, the reforms must focus on those policies that make it possible for the poor to fully participate in the decision making process and be able to hold those in power accountable. This requires broad institutional reforms that increase the poor's voice and empowerment.

### Principle 10

*Pro-poor growth reforms must include institutional reforms that empower the poor through progressive diffusion of power.*

In conclusion, these 10 basic principles for pro-poor growth rely on a common sense approach, by building on what poor people actually do, where they live, what they can offer to the market, how they can increase their output, etc. These simple principles highlight the importance of thinking about the poor as people rather than mere numbers and getting a better understanding of the economy and the linkages within sectors and regions. ■

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