Poverty Reduction

Ortiz, Isabel

Initiative for Policy Dialogue, Columbia University

2007

Initiative *for* Policy Dialogue iPD

Poverty Reduction

By Isabel Ortiz

http://www2.gsb.columbia.edu/ipd/j_poverty.html

Poverty Trends and Measurements

More than 2.8 billion people, or around half the world's population, live below the international poverty line of US$2 a day. Of those, 1.2 billion people live in extreme poverty, surviving on less than $1 a day. Most of the poor are in Asia and Africa. The incidence of poverty is larger in women than men and higher in rural areas than in urban areas. Vulnerable groups such as the elderly, ethnic minorities, refugees or persons with disabilities are much more affected by poverty. Since 1990, the incidence of poverty has decreased, and the proportion of people living below the two dollar-a-day poverty line declined from 60% to 53% of the total world population. However, in absolute terms, poverty is not decreasing. Population growth remains high in developing countries, and many are born in poverty and destitution. Using World Bank's data, the number of poor people has actually increased since the late 1980s.

The definition and measurement of poverty is a highly political issue. Countries tend to hide the existence of large pockets of poverty as it makes them look underdeveloped and evidences public policy failures. Currently, different countries use different methodologies and are hard to compare - often they are based on the per capita expenditure necessary to attain 2000-2500 calories per day, plus a small allowance for non-food consumption. However, these measures do not adequately reflect other expenses necessary to cover basic needs - clothing, drinking water, housing, access to basic education and health, among others. This is the reason that United Nations institutions started using the one and two-dollar-a-day poverty lines; but these also have obvious flaws. If measurements based on a real minimum consumption basket were used, the number of people living in poverty would soar. There are many more poor people than appear registered in official statistics.

Many argue that poverty is not only income poverty. Poverty also has non-economic dimensions, like discrimination, exploitation, or fear. Other aspects should be considered, such as lack of control of resources, vulnerability to shocks, helplessness to violence and corruption, lack of voice in decision-making, powerlessness and social exclusion. As we expand the definition of poverty, the numbers of people affected by it increase.

Poverty should be distinguished from inequality. Inequality shows the distribution of income, consumption and other welfare indicators in society; in 2000, the richest 1 per cent of adults owned 40% of global assets, and the richest 10% of adults accounted for 85% of total world assets; in contrast, the bottom half of the world adult population owned barely 1% of global wealth. The comparison between what the rich and the poor possess raises serious questions on the adequacy of current development models (development for whom?) and generates feelings of injustice and political claims. This is why national estimates of inequality are even less reliable than those on poverty; income disparities are not at the core of national statistical data (for instance, Egypt and Indonesia are "officially" more equal societies than Australia or France). For these reasons, United Nations institutions have been working towards better monitoring of poverty and distribution data. Recent findings show that inequality has been growing in the late decades of the 20th century. Redressing global asymmetries is an urgent priority.

Poverty Reduction in Historical Perspective

Poverty is not a new phenomenon. Many descriptions of Europe in the 19th century describe living and working conditions similar to those seen today in developing countries. Charles Dickens' stories of children's misfortunes are analogous to the lives of many working children in contemporary Africa, Asia and Latin America. Friedrich Engels description of Manchester's river Irk industrial ghetto is similar to today's shanty-town scenes from Smoky Mountain in Manila or Nova Iguazu in Rio de Janeiro. What happened in developed countries, economic development accompanied of social development, can also happen in developing countries.

Let's take the example of the US in the 1930s. After the 1929 crash and the Depression, poverty was widespread, people migrated with little more to sell than their own labor, mafias were powerful and citizens powerless - once again, a similar situation to today's developing countries. After years of hardship, unemployment and crisis, the Roosevelt Administration embarked on the New Deal to revitalize the economy and support US citizens. It worked. The US entered a period of prosperity.

At the end of World War II, politicians from the advanced economies were determined that unemployment and economic crisis, which had provoked political crisis and resulted in Communism and Fascism, should never happen again. They accepted that full employment and macroeconomic stability should be the primary national policy objective, and the government got more involved in education, medical care, social and housing assistance, minimum retirement levels, employment policies, enforcement of labor laws and regulations. These programs were not new, they had been an essential part in the modernization programs of these wealthier societies at the early stages of their development. It worked again. Postwar policies allowed high productivity gains in the workforce, expanded domestic demand, and increased economic growth. The populations of Europe, Japan, North America, Australia and New Zealand experienced a prosperity unseen in history.

The lesson is that poverty can be reduced if governments are committed - and it can be reduced fast. However, Third World governments are rarely fully committed - poverty reduction is generally only one of many developmental objectives. A significant amount of developing countries are starved of capital, pressured by external debt, and have limited access to developed countries markets to export their products. Social policies, such as health, employment or pensions, have not been a priority; they have been largely neglected, or at best addressed with inadequate resources. Standard policy prescriptions provided by major development agencies ("the Washington Consensus") are often inadequate and ended causing poverty in the past. In many cases, public policy-making has been captured by some interest groups who benefit disproportionately from public policies, instead of ensuring development for the majority of the population. This is why the poverty reduction debate is highly politicized and ideological.

The Poverty, Inequality and Economic Growth Debate

Many argue that poverty reduction should not be a primary objective for developing countries and that economic growth should be the first priority. Eventually, the benefits of growth will "trickle down" to the poor. Further, academics like Simon Kuznets, the 1971 Nobel Prize laureate in economics, say inequality is necessary in the first stages of development of a country. These views are old but still influential in the development debate. Numerous governments today support what it has been called the "trickle down plus" approach (growth as a first priority, with some limited basic education, water supply and other social development projects).

From a development worker perspective, the debate appears rather sterile - a convenient way to postpone pro-poor policies. It seems obvious that poverty reduction needs economic growth to be sustainable. However, a fixation on growth rates is not enough, during the last decades there have been significant cases of "jobless growth" where the trickle-down effect does not occur, or occurs only marginally. Kuznets' theories have been widely contested. Evidence shows that highly unequal income distribution patterns are obstacles not only to poverty reduction but also to economic growth. By concentrating assets and wealth in the hands of few and maintaining high poverty levels, countries have limited domestic markets; in turn, low domestic demand depresses local enterprises, and keeps them from growing. Additionally, poor living conditions, and particularly malnutrition and poverty in children, damage health, cause death, reduce intelligence, and lower productivity and opportunities for future adults, a high tax to pay for a country. Equitable policies are an indispensable instrument for countries to raise productivity, maintain their international competitiveness, develop domestic markets and continued economic growth.

The **arguments for economic growth first** are:

- A country should save and invest in its first development stages; eventually, the benefits of growth will trickle down to the rest of society
- The rich save more; accordingly, if there are lower wages (higher inequality) there will be higher average savings, and thus faster growth
- Poverty and inequality keep the labor force cheap and thus encourage investment
- Attention should be given to limiting taxation on investors/higher income groups. This can limit available resources for poverty reduction or social development

The **arguments against economic growth first** are:

- Economic growth and poverty reduction should be promoted in parallel from early development stages, as part of the country's modernization strategy and the social contract between the government and citizens
- The quality of growth matters; macroeconomic variables are only aggregates, development requires more than GDP growth, emphasis has to be placed on the process of growth (i.e. employment, distributive aspects, good governance, correcting market imperfections. ensuring stability instead of volatility) with parallel investments in social development
- Inequality fosters distorted development patterns such as dependency on cheap labor (the so-called "race to the bottom," pushing salaries down to the level of the poorest competing country)
- Egalitarian distribution patterns encourage domestic demand and thus growth; greater effective demand (consumption ratios) of the lower income groups generates a larger domestic market
- Raising the incomes of the poor increases productivity of the workforce
- The greater the inequality the less the trickle-down effect given that powerful groups tend not let their privileges go, ultimately leading to political conflict
- The huge gap between rich and poor - 80% of world's population receiving only 11% of world's income - has become more worrying since the world is facing the threat of organized terrorism from groups based in some of the world's poorest countries.

National Poverty Reduction Policies at the Beginning of the 21st Century

Around three-quarters of the countries in the developing world have anti-poverty plans incorporated in their national planning. These, however, are often underbudgeted, have no target objectives or deadlines. In 1995, the international community set some specific targets, the Millennium Development Goals (MDGs), later endorsed by all countries at the United Nations 55th General Assembly (2000). They include halving hunger and extreme poverty by 2015, and improving a basic set of development indicators, such as achieving universal primary education, reducing infant mortality rates, improving maternal health, promoting gender equality and empowering women, combating HIV/AIDS and malaria, supporting environmental sustainability and consolidating development partnerships. The MDGs are ambitious but achievable provided governments' commitment. United Nations institutions, the OECD, bilateral donors and international NGOs, have all voiced support for the MDG targets.

In this context, the multilateral financial institutions (such as the World Bank and the regional development banks) changed their operational objectives from economic growth to poverty reduction - at least rhetorically. That has been a very important change, full of controversy - the old "growth versus poverty" debate reemerged and remains active in almost all country policy dialogues. Generally, a country needs to:

1. Diagnose obstacles to poverty reduction and design strategies to overcome them: The first stage consists of understanding why poverty exists in a particular country, agreeing on a poverty measure, reviewing the obstacles to reduce poverty. National Development Strategies, and where applicable, Poverty Reduction Strategies (PRS), are drafted identifying medium- and long-term targets to reduce poverty.

2. Prioritize policies for poverty reduction: Poverty reduction is not achieved by charity-type safety nets alone. Poverty reduction requires structural changes at the economic, political and social levels.

(a) Promoting employment-generating growth: That means promoting quality, non-volatile growth that supports employment, with attention to distributive aspects and good governance. It requires adequate macroeconomic policies, employment should be a primary objective and not to be "crowed out" by a narrow focus on inflation control and fiscal discipline. Some are tolerant to moderate rates of inflation given the positive effects of an expansive monetary and fiscal policy on aggregate demand. Macroeconomic policies must also ensure that public expenditures in the social sectors are maintained at satisfactory levels. Additionally, an adequate exchange rate policy combined with industrial policy stimulates output and employment growth. Fiscal, monetary, and exchange rate policies should be consistent with employment-generating growth and public investment strategies. Both private and public sector enterprises can be an engine of growth and employment; for them to contribute to poverty reduction, an enabling environment and effective regulatory framework should be enforced to promote competition, enforce fair practices and standards, and ensure that essential goods and services are affordable and reach the poor.

(b) Equitable sector policies that provide opportunities, assets and incomes to the poor: This is, public policies in any sector ? from agriculture to energy? that are progressive and benefit all. For instance, sector policies that enable the poor to build, buy or have access to natural assets (land, property, natural resources), finance (credit), and access social services (education, health, social protection). Many public policies in developing countries had very limited coverage and ended benefiting the wealthy. Incidence benefit analyses developed around the world for a variety of public policies evidence that, generally, the following public investments are equitable:

• Education and health: Expanding coverage of free primary and secondary services
• Infrastructure: rural electrification, affordable water and sanitation, rural roads, affordable public transport systems
• Social Protection: Social security/welfare programs, especially non-contributory social pensions
• Labour: Decent work agenda, active and passive labour market policies
• Inclusive finance: development banks, rural banks, microfinance
• Decentralization, if good governance at the local level, attending to equalizing redistributing formulas securing transfers between regions
• Rural development programs ensuring access to land, water, markets, livestock, credit for smallholders
• Urban development and housing focused on low-income areas

Alter alia, the following do not benefit the poor:

• Defense/military expenditures
• Health: Urban hospitals far from urban marginal areas, specialized clinics (cardiology etc.)
• Infrastructure: Large infrastructure projects—dams, motorways, airports
• Social Protection: Private pensions
• Financial sector: Reform/rescue of banking system (transfers to large banks)

(c) Ensuring good governance by supporting efficient, accountable, transparent, and responsive public administrations, with a mandate and capacity for pro-poor interventions; ensuring legal systems that are equitable and accessible to the poor; enforcing law and order; building public

management free of political distortions with decentralized mechanisms for broad-based participation in the delivery of public services and efforts to minimize the likelihood of these services being captured by local elites; promoting progressive tax systems and adequate allocations for social services; fighting nepotism and corruption.

(d) Empowering the poor and excluded groups by enhancing their capacity to influence the institutions that affect their lives and strengthening their participation in political and economic processes. Organizing the poor and excluded groups to fight for their rights was a critical factor in promoting social progress in developed countries - social development would have not happened without the fight of unions and civil rights groups. Empowerment and social mobilization are intrinsically linked to the broader agenda of good governance, transparency, and accountability of the government to its citizens.

(e) Fighting Exclusion and Gender Disparities. The increasing feminization of poverty is now a well-recognized trend. The gender division of labor and responsibilities for household welfare translate in non-paid work and lack of opportunities. Gender disparities frequently result in gender based inequality in access and control of resources and discrimination against women's basic rights, e.g. education, employment, inheritance, registration. To reduce poverty and to advance the status of half the world's population, support must be provided to the development of gender-sensitive policies and programs. Other excluded groups (e.g. caste, ethnic groups) require specific affirmative policies.

3. Adequate funding: Policies need to be accompanied of adequate funding. Most governments and public institutions (including international organizations) claim they do a lot for the poor – the issue is how much? Their real priorities are reflected in the budgets. Who benefits most from public expenditures? Is spending reaching the poor? Or is spending centered on sustaining administrative structures, vested interests?

4. The political economy of reform: National administrations are usually not opposed to poverty reduction but find themselves in situations in which powerful ministries or vested interest groups fight for privileges and unjustified shares of the budget, collapsing resources for poverty reduction. A good stakeholder analysis of the winners and losers of reform may facilitate the process, by making the trade-offs transparent; public expenditure reviews are also useful tools to bring transparency and rationality to decision making. Successful programs are normally those that are supported by the serious political commitment of the country's leadership, and agreed on by national political coalitions.

But More Is Needed to Reduce Poverty: Redistribution, International Policies

Critics of this agenda say it does not go far enough. The agenda, generally supported by UN agencies and the progressive wings of the development banks, is a necessary but not sufficient condition for fast poverty reduction. For instance, more can be added on redistribution policies. Redistribution is essential because the benefits of growth do not naturally reach all in society, it is a legitimate goal of public policy, to balance the tendency of the market to concentrate resources. Redistribution needs to happen at two levels, nationally and internationally – let's remember that the richest 2% owns 50% of world's wealth. Jeffrey Sachs, Director of the UN Millennium Project, notes that poverty could be eradicated with only one per cent of the combined GDP of OECD countries. Redistribution may be achieved through domestic taxation, increased development aid and new proposed international sources such as taxes on short-term speculative financial transactions, on arms trade, pollution and others.

Further, the agenda focuses on national domestic topics, but is very limited on external issues at the international level, such as debt relief, impacts of global finance, and lack of access to markets, among others. Critic NGOs, think-tanks and experts inside UN agencies are campaigning for social and economic alternatives, a new system of global governance to ensure that national and international public policy-making is coherent and benefits all world citizens. Of the several proposals, there is consensus that effective poverty reduction will require international action to:

(i) Resolve the problem of Third World debt:Despitedebt reduction attempts, many developing countries remain highly indebted and their scarce funds have to be used for debt repayment instead than for poverty reduction - NGOs like Jubilee 2000 have been fighting for a cancellation of all debt in poorest nations.

(ii) Manage international finance and corporations:Continual shocks and instabilities in today's financial markets have led critics to talk about a "global casino" and the need to regulate it through a new financial architecture that supports development, fights short-term speculative capital flows, tax evasion and money laundering. There is a need to establish and enforce better principles of public accountability and protect citizens/consumers from possible corporate irresponsibility

***(iii) Reform international trade*,** Current trade arrangements are not free and non discriminatory as is claimed. In fact, the EU, US and Japanese subsidize their own producers, including the agricultural sector - agriculture is one of the few economic activities that poor countries can develop to reduce poverty. Instead, in the name of "efficiency" and "free markets", developing countries are told to open-up and liberalize their economies - as a result, domestic producers cannot compete with the subsidized, higher quality products from developed countries and close down, generating further unemployment and poverty. Abandoning this double moral ("Do as I tell you, not as I do") and uncritical implementation of market-fundamentalist policies is essential to reduce poverty. Current trade policies should be replaced for a system of "fair" trade which favors poorer regions, ensuring that developing countries are given a role in the world economy.

Things to Watch Out For - Distinguishing Between Rhetoric and Practice

• Where are budgetary allocations going? Is spending pro-poor? (applicable to government or any institution - i.e. ministry, international organization). Is spending centered on sustaining administrative structures, vested interests?
• Are key sectoral programs (agriculture, infrastructure, education, health, pensions, etc) working to reduce poverty? Who benefits? What are the major obstacles to the poor to participate in economic activities and benefit from development?
• How are government revenues collected? Is a progressive tax system enforced?
• Are corruption and crime disrupting investment and civil activities? Do all citizens have equal access to justice, security and services? Is the government effectively fighting discriminatory practices against gender, caste, race, or religious beliefs? Are communities organized and are aware of mechanisms to protect them from abuse?
• What have been the social impacts of recent economic policies? (impacts on labor and employment, impacts on prices of essential goods and services, impacts on gender and vulnerable populations)
• How is progress measured - How is the poverty line calculated and have there been any changes in the methodology?

Conclusion: Understanding Poverty on a Global Scale

The latest thinking on poverty reduction focuses on the need to understand poverty on a global scale.

Firstly, because poverty is re-emerging in developed economies, poverty is no longer a Third World phenomenon. Two decades of neoliberal policies have eroded the living conditions of citizens in the West. The end of the post-war boom in the 1970s made Organization for Economic Cooperation and Development (OECD) policy makers abandon Keynesian approaches and replace them with supply-side policies, under the correct assumption that growth would be helped if companies sharpened their competitive edge. But global demand continued stagnating leading to a squeeze of corporate profits, shakeout of labor, slow down of growth of fixed investment and thus a decrease in demand for capital. This generated pressure on lowering wages and making labor markets more flexible which increased income inequality. Gross public sector debt became as high as 70% of national income in OECD countries, and this made policy-makers to further curtail social expenditures and privatize social services. Paradoxically, most of these savings went to support private sector companies in the public effort to generate growth (tax breaks, incentives, bailouts, etc), so the average citizen has experienced a significant decrease in welfare, while growth has remained low, unemployment and public debt high, because these neoliberal short-term policies do not address the long-term structural causes of the problem: overproduction and global excess capacity in a context of weak effective demand.

Secondly, it is necessary to think globally because some of the causes of poverty in developing countries are due to international policies that governments cannot influence (for instance, lack of access to developed countries' markets). Reducing poverty will require a concerted international effort. Additionally, developing countries were forced to adopt the same orthodox model applied to developed economies - the so-called "Washington Consensus" polices (structural adjustments, reducing controls on capital and trade, curving public expenditures, privatization). This led to maintaining or deepening social deprivation, instead of investing in human capital as part of national development strategies, to the point that the 1980s-2000s have been called "the lost decades".

The new century starts with profound changes. Globalization is shifting trade, investment and technology, changing values; it is also generating economic interdependence and vulnerability to economic shocks and downturns. If no equitable policies are in place, countries may experience mounting unemployment, poverty, marginalization and political conflict, given that populations pay the short-term costs of crisis. For globalization to be accepted, it will require better management, a "New Deal" for both developed and developing countries, in which the benefits of globalization are shared by all - instead of few. Further, the reduction of poverty at a global scale will boost global demand and productivity. Thus the reduction of poverty may not only alleviate human suffering, a goal in itself, but also have a primary role to sustain growth and well-functioning markets.