## Slide 1

# *Globalization and Poor People: The Debate and Evidence*

### *Martin Ravallion*

1

## Slide 2

### *One side of the debate:*

**"Growth really does help the poor: in fact it raises their incomes by about as much as it raises the incomes of everybody else. . globalization raises incomes, and the poor participate fully."** (*The Economist*, May 2000)

**"Evidence suggests that no one has lost out to globalization in an absolute sense."**

**"Growth is sufficient. Period"**

(Surjit Bhalla, *Imagine There's No Country*, Institute for International Economics, Washington DC)

2

## Slide 3

### *The opposing view:*

**"There is plenty of evidence that current patterns of growth and globalization are widening income disparities and hence acting as a brake on poverty reduction."** (Justin Forsyth, Oxfam UK., *The Economist*, June 20, 2000.)

**"Globalization policies have contributed to increased poverty, increased inequality between and within nations"** (International Forum for Globalization.)

***Who is right?***

3

## Slide 4

### *Outline*

1. ***Concepts:*** *sources of confusion in the globalization debate*
2. ***Data and measurement:*** *alternative approaches and the World Bank's preferred methods*
3. ***Evidence*** *from cross-country comparisons*
4. ***Evidence*** *from India*
5. ***Conclusions*** *for policy*

4

## Slide 5

# *1. Concepts: Confusions galore in the globalization debate*

### *"inequality"*
### *"poverty"*

5

## Slide 6

### *Relative vs. absolute inequality*

- *Relative inequality is about ratios; absolute inequality is about differences.*
- *"Distribution-neutral growth:"*
  - *Date 1: two incomes $1,000 and $10,000 per year*
  - *Date 2: these rise to $2,000 and $20,000*
  - *Ratio is unchanged but the rich can buy twice as much as before from the income gains in state B*
- *One is not right and the other wrong. Indeed, 40% of participants in experiments view inequality in absolute terms.*

6

**"*Distribution-neutrality*" does <u>not</u> mean that incomes of the poor rise** *"by about as much as everybody else"*

- Given existing inequality, the rich will capture a much larger share of the gains from growth than the poor.

- The income gain to the richest 10% in India will be 4 times higher than the gain to the poorest 20%; 15+ times higher in South Africa.

7

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**Distribution-neutrality on average does <u>not</u> mean that distribution is unchanging**
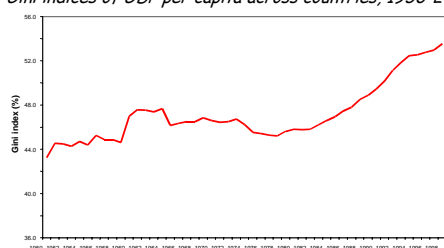
- *Large fluctuations in measured inequality even when no long-run trend*
- *Some of this is measurement error; noise in inequality data*
- *But even seemingly small changes in a Gini index (say) can mean large welfare changes for the poor*
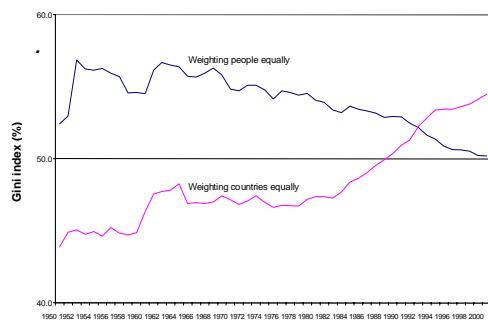
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**"Divergence" vs. "rising inequality"**

***Fact 1*:** *Poor countries have tended to have lower growth rates over last 30 years or so*

*Gini indices of GDP per capita across countries, 1950-2000*



9

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***Fact 2*:** *The between-country component of global inequality has been falling*



10

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**Should we weight countries equally or people equally?**

- <u>Macro literature</u> on growth and distributional empirics: countries weighted equally
- <u>Micro literature</u> on inequality and poverty: people weighted equally
  - Does country identity matter to welfare?
  - Robustness: Growth in <u>India</u> and (especially) <u>China</u> has been a strong factor in falling between-country inequality

11

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**"Vertical" vs. "horizontal" inequality**
*"Evidence suggests that no one has lost out to globalization in an absolute sense."*

- *Finding no change in aggregate inequality or poverty is perfectly consistent with their being large numbers of losers, and gainers, at every level of living, i.e., "horizontal" impacts*
- *There is now ample evidence of <u>churning</u>: gainers and losers at all levels*
  - *Russia 1996-98: poverty rate rose 2%; but 18% fell into poverty, with 16% escaping poverty*
  - *China and Morocco: trade reform has little aggregate impact on poverty and inequality but large variance in impacts at <u>given</u> income*

12

## "Relative poverty" vs. "absolute poverty"

**Relative poverty**
- *Poverty line rises with average income*
- *Extreme case: poverty line is proportional to the mean (e.g., Eurostat)*
- *Then distribution-neutral growth leaves poverty unchanged even when incomes of the poor have risen*

**Absolute poverty**
- *Poverty line is fixed in real terms*
- *But at what level?*
- *And how do we assure that its real value is constant?*

13

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## 2. Data and measurement

14

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## How do we measure these concepts?

- *Almost invariably we use representative household surveys*
  - *Random samples, national sample frames*
  - *Questionnaires (often huge!)*
  - *Distributions of income or consumption*
  - *Summary measures of inequality and poverty*
  - *e.g. Gini index for inequality; headcount index for poverty*
- *Each of these steps has its pitfalls, and large literature on the problems*
- *Supplementary data on prices and other welfare indicators*

15

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## Poverty and inequality measures from household surveys: Critique 1

- *Some observers prefer anecdotal evidence to quantitative data*
- *Lower inequality in Indonesia than Australia:*
  **"You can check that out by going to the capital city and driving in from the airport. You can see it ain't so."** *(James Galbraith)*
- *Thankfully, most observers would not find a drive from the airport more persuasive than a well-designed nationally-representative sample survey (as in both Australia and Indonesia).*
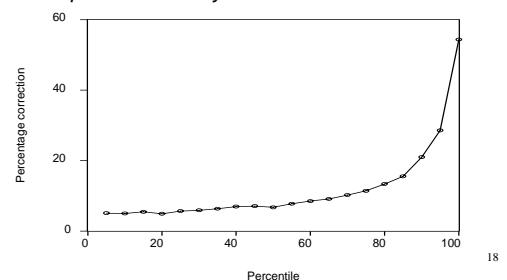
16

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## Poverty and inequality measures from household surveys: Critique 2

- *Some observers prefer to base poverty measures on the national accounts, assuming that the surveys get inequality right (Bhalla, Salla-i-Martin)*
- *But there is no basis for believing that this gives more accurate estimates.*
- *Indeed, there are reasons to suspect that this method gives severely biased estimates, which overstate the rate of poverty reduction*
- *Survey under-reporting is unlikely to be distribution-neutral*

17

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## Survey under-reporting is unlikely to be distribution-neutral: U.S. example

*Estimates of the percentage adjustments to mean household income needed to allow for selective compliance in surveys.*
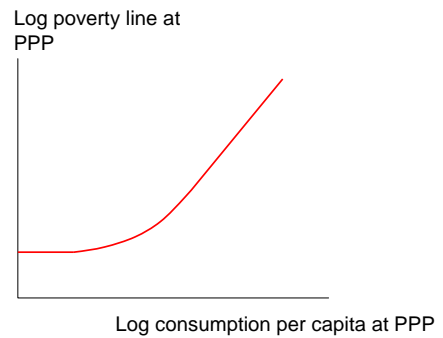


18

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## The World Bank's methods:
## Setting an international poverty line

- *Different people naturally have different ideas of what "poverty" means.*
- *This is true between countries as well as within a given country.*
  - *Amongst poor countries, there is very little income gradient across countries in their poverty lines — absolute consumption needs dominate.*
  - *But the gradient rises as incomes rise.*

19

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Log poverty line at PPP
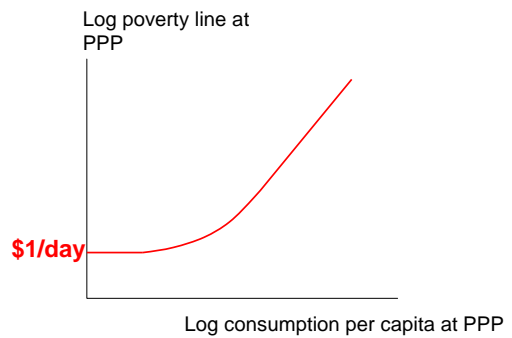


Log consumption per capita at PPP

20

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## "$1/day"

- *For global poverty monitoring, the World Bank has taken the position that to measure absolute consumption poverty on a consistent basis across countries one must use a common poverty line.*

  ***But whose poverty line should it be?***

- *In the 1990 WDR, the Bank chose to measure global poverty by the standards of what poverty means in the poorest countries, which gave the "$1/day" line.*

21

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Log poverty line at PPP



**$1/day**

Log consumption per capita at PPP

22

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## Purchasing Power Parities

- *International poverty line is converted back to local currency at the base date (1985 originally; 1993 now) using PPP rates for consumption.*

- *Continuing concerns about quality of PPP's*
  - *Incomplete ICP participation*
  - *Differences in quality of goods*
  - *Relevance to poverty*

23

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## Taking "$1/day" to the surveys

- *Poverty line in 1993 local currency is updated using local CPI*
- *All estimates are our own, from primary data (unit record/specially designed tabulations).*
- *Consistent methods across countries and time.*
- *Obvious comparability problems are eliminated*
- *However, there are comparability problems galore that can't be readily fixed (Income vs. consumption; recall periods; valuation)*
- *National accounts growth rates to "line up"*

24

## What surveys qualify?

- *Must be nationally representative*
- *Must allow construction of a comprehensive consumption or income aggregate (including consumption or income from own production)*
- *Must be possible to construct a correctly weighted distribution, as best we know*

25

## Survey data

- *Huge increase in country coverage:*
  - *WDR 1990: 22 surveys, 22 countries (65% of pop.)*
  - *Now: 500 surveys, 100 countries (93%)*
  - *>1 survey for all but 20 countries*
- *Substantial effort by the Bank into expanding household surveys, both quantity and access*
- *Efforts at country level to improve data quality*
- *Still notable regional differences*
  - *Improved coverage in Africa, but weak comparability over time*
  - *Improved coverage in MENA, but lags in access*
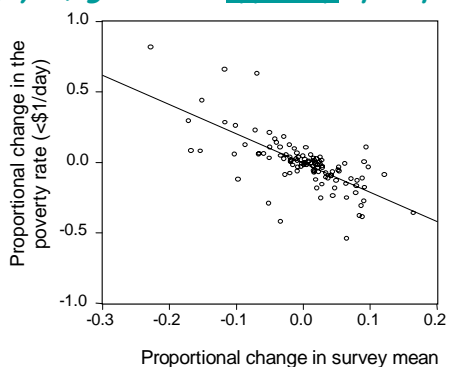
26

## 3. Evidence from cross-country comparisons

27

## Changes in relative inequality are uncorrelated with growth and/or greater openness

*1. Across 120 spells (between two surveys), virtually zero correlation between **changes in inequality** (the log Gini index) and **economic growth** (change in the log of the survey mean or PCE).*

*2. No correlation between inequality and greater openness to trade across 50 countries (n=100), with controls for schooling, financial development, urbanization, black-market premium,....*
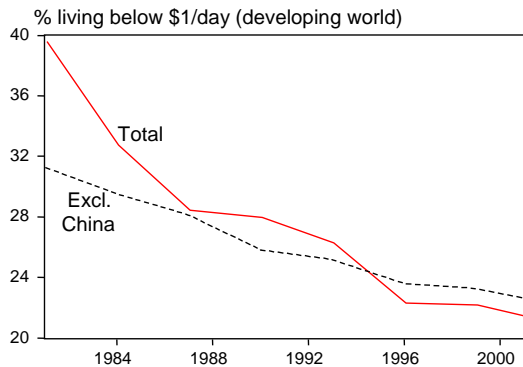
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## So, yes, growth is typically "pro-poor"

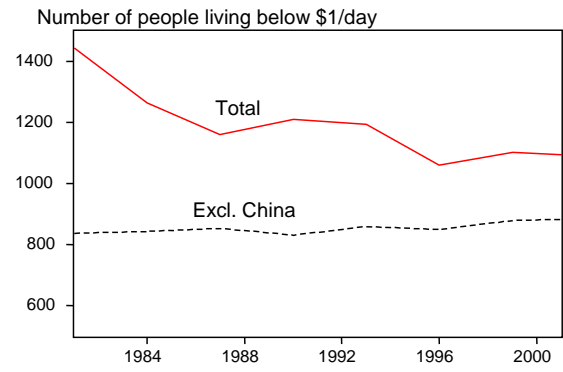

29

## What then has been happening to poverty in the aggregate?

- *With aggregate economic growth in the developing world as a whole since 1980 we have seen aggregate poverty fall.*
  - *"$/day" poverty rate has fallen from around 40% in 1981 to 21% in 2001*
  - *Number of poor has declined by 350 million*
- *However, much less sign of progress if one excludes China*

30

## $1/day poverty rate

% living below $1/day (developing world)



## Number of poor by $1/day standard

Number of people living below $1/day



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### The extent to which growth is pro-poor has varied enormously between countries and over time

- A **1%** rate of growth will bring anything from a modest drop in the poverty rate of **0.6%** to a more dramatic **3.5%** annual decline (95% CI).

- There have been plenty of cases of rising inequality during spells of growth. Indeed, inequality increases about half the time.

33

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### Diverse impacts on poverty coexist with aggregate distribution neutrality

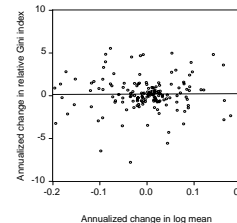| | | What is happening to average household income between the surveys? | |
|---|---|---|---|
| | | Falling | Rising |
| **What is happening to relative inequality?*** | Rising | **16% of spells** Poverty is rising at a median rate of 14.3% per year | **30% of spells** Poverty is falling at a median rate of 1.3% per year |
| * Relative Gini index | Falling | **26% of spells** Poverty is rising at a median rate of 1.7% per year | **27% of spells** Poverty is falling at a median rate of 9.6% per year |

34

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### But look at what has been happening to absolute inequality

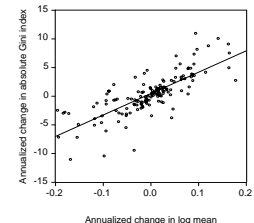| | | What is happening to average household income between the surveys? | |
|---|---|---|---|
| | | Falling | Rising |
| **What is happening to absolute inequality?*** | Rising | **4% of spells** Poverty is rising at a median rate of 7.3% per year | **52% of spells** Poverty is falling at a median rate of 6.2% per year |
| * Absolute Gini index | Falling | **38% of spells** Poverty is rising at a median rate of 6.0% per year | **7% of spells** Poverty is falling at a median rate of 5.9% per year |

35

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*Relative Gini*     *Absolute Gini*

36

## High inequality is an impediment to pro-poor growth
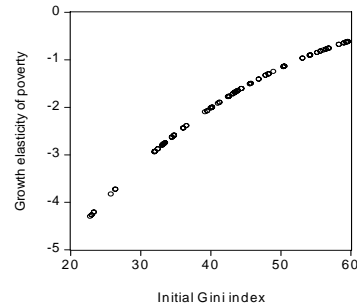
- It is not the rate of growth that matters, but the distribution-corrected rate of growth

  ***Rate of poverty reduction = [constant x (1 - inequality)ᵏ] x growth rate***

  – The constant term is negative and **k** is a parameter not less than one.
  – The term in square brackets is the growth elasticity of poverty.

37

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## Growth elasticity of poverty as a function of the initial Gini index



38

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## Rate of poverty reduction with a 2% rate of growth in per capita income and a headcount index of 40%

- <u>Low-inequality country</u> (Gini=0.30): the headcount index will be halved in **11 years.**

- <u>High inequality country</u> (Gini=0.60): it will then take **57 years** to halve the initial poverty rate.

39

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## Growth and inequality: a trade-off?

- No convincing evidence of an aggregate trade-off from cross-country comparisons
- If anything high initial inequality brings <u>lower</u> subsequent growth
- Consistent with recent theoretical work
  – More poor people means more credit-constrained people and hence lower investment and growth
  – High inequality also makes it harder to achieve efficiency-promoting economic reforms that require trust and cooperation
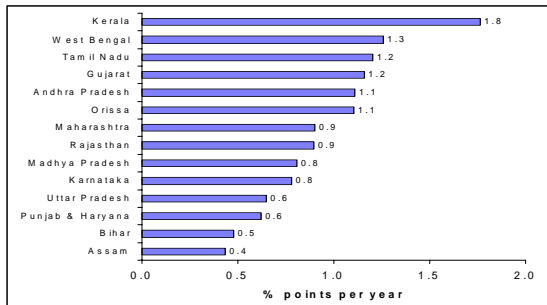
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## Growth and human development

- Strong correlation between social indicators and mean income
- But this is largely attributable to the impact of growth on absolute poverty
- The correlation with the mean is greatly reduced when one controls for poverty incidence
- It is not so much economic growth that drives human development but income poverty reduction

41

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## 4. Evidence: Growth and poverty in India

42

## Trend rates of poverty reduction by state (1970-2000)



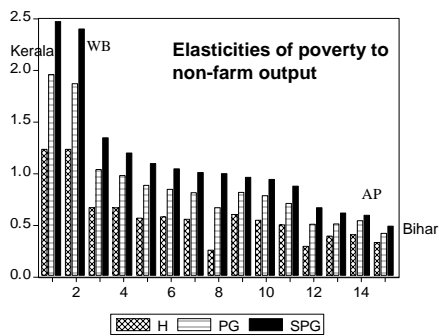| State | % points per year |
|---|---|
| Kerala | 1.8 |
| West Bengal | 1.3 |
| Tamil Nadu | 1.2 |
| Gujarat | 1.2 |
| Andhra Pradesh | 1.1 |
| Orissa | 1.1 |
| Maharashtra | 0.9 |
| Rajasthan | 0.9 |
| Madhya Pradesh | 0.8 |
| Karnataka | 0.8 |
| Uttar Pradesh | 0.6 |
| Punjab & Haryana | 0.6 |
| Bihar | 0.5 |
| Assam | 0.4 |

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## Why has poverty fallen so much faster in some states than others?

- *Higher average <u>farm yields</u>, higher <u>public spending on development</u>, higher <u>non-farm output</u> and <u>lower inflation</u> were all poverty reducing in India*
- *Agricultural growth, development spending and inflation had similar effects across states*
- *However, the response of poverty to <u>non-farm output</u> growth in India varied significantly between states.*

44

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## India: Elasticities of poverty to non-farm economic growth



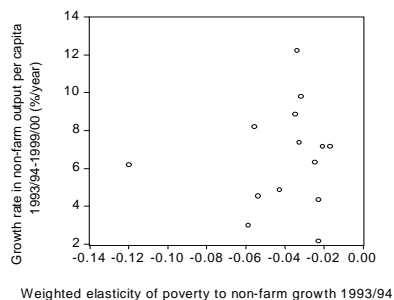**Elasticities of poverty to non-farm output**

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## Higher growth rate in India in the 1990s but the rate of poverty reduction is no higher

- *The poverty impact of higher aggregate growth in the 1990s has been dulled by its sectoral and geographic composition*

- *The growth has not happened where it would have the greatest impact on poverty*

46

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## Non-farm growth did not happen where it would have had the most impact on poverty



Weighted elasticity of poverty to non-farm growth 1993/94

47

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## Initial conditions matter to the impact of growth on poverty

- *Low farm productivity, low rural living standards relative to urban areas and poor basic education all inhibited the prospects of the poor participating in growth of India's <u>non-farm</u> sector.*
- *Rural and human resource development appear to be strongly synergistic with poverty reduction though an expanding non-farm economy.*

48

## 5. Conclusions:
## Policy implications for attacking poverty

49

## "Growth is sufficient" misses the point

- *Heterogeneity in the impact of growth on poverty holds clues as to what else needs to be done*
- *Combining:*
  - *growth-promoting economic reforms with*
  - *the right social-sector programs and policies to help the poor participate fully in the opportunities unleashed by growth*
  *will achieve more rapid poverty reduction.*

50

## How to achieve more pro-poor growth?

- *Develop human and physical assets of poor*
- *Help make markets work better for the poor, especially for credit and labor*
- *Removing biases against the poor in public spending, taxation, trade and regulation*
- *Promote agriculture and rural development; invest in local public goods in poor areas*
- *Provide an effective safety net; short term palliative or key instrument for long-term poverty reduction?*

51

## Monitoring and evaluation

- *Sensitivity to country context is crucial for assessing what mix of policies is pro-poor.*
- *Continuous monitoring of progress and evaluation of specific policies/programs is a crucial input to effective domestic and international efforts against poverty*

52