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Economic Growth, Inequality and Poverty Reduction: Does Pro-Poor Growth Matter?

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The impact of economic growth upon the poor in developing countries is complex and contentious. Does growth benefit all in a society, and how does it affect inequality and vulnerability? Paul Collier declares his position regarding these debates in *The Bottom Billion* by championing growth as the route out of poverty. This emphasis is welcome, especially as growth has been downplayed in debates about development in favour of human development for two decades. But growth alone is not the answer – it has to be sustainable and inclusive to deliver the best outcomes. Today's challenge is to generate sustainable growth.

Is growth the central concern?

Taking countries as the unit of observation (as Collier does), raising their average income clearly is of critical importance. This strong focus on growth is welcome. The central importance of economic growth has been much neglected in development discussions during the last 20 years, with a much stronger emphasis in policy discussions on human development and other outcomes. A rebalancing is very much needed, and this especially matters in the countries of the Bottom Billion. Collier is right that sustained growth matters.

Collier on growth, poverty and inequality

The arguments in *The Bottom Billion* can be reduced to two key positions:
- Growth matters and has been neglected. Growth should be our central concern.
- Growth is generally good for poor people. The quantity of growth (or lack of it) is the problem – not the quality of growth.

The whole approach of the book is based on a national level focus; it therefore says relatively little about what happens within countries. The poverty, inequality and growth nexus is only directly addressed, and then briefly, in the first chapter.

In sum, Collier does 'not share the discomfort about growth' felt by many people caring about development, he argues that the problem of the Bottom Billion is that 'they have not had any growth', rather than the 'wrong type of growth' and he claims that 'growth usually does benefit ordinary people' (Collier 2007: 11). His diagnosis is clear: 'The failure of the growth process in these societies simply has to be our core concern, and curing it the core challenge of development' (*ibid.*).

In other work, notably his review of the *World Development Report 2006* on inequality, Collier suggests that development policy has been distracted by poverty and inequality from a key focus on raising incomes for societies as a whole (Collier : 2006). Policymakers should worry about growth first and have faith that, generally, poverty reduction will follow.

> Growth by itself is not necessarily sufficient. It needs to be sustainable, sustained and inclusive.

That said, growth by itself is not necessarily sufficient. It needs to be sustainable, sustained and inclusive. There is a risk that current commodity-based growth in many countries in Africa is none of these. When growth is unsustainable a country is enjoying current consumption at the expense of future generations. And the highly volatile growth history in fragile states and sub-Saharan Africa in general has created a major cost to these countries.

Our comment, though, focuses particularly on the importance of ensuring that growth in the countries of the Bottom Billion is broadly inclusive and delivers on outcomes that people value. It is by no means self-evident that this is always the case. Growth is clearly not an end in itself, but rather a means to other ends. Growth definitely does supply essential resources for the attainment of these ends, through both private and public channels, if the benefits of growth can be sufficiently widely shared.

To echo Sen (1999), income is *only* an 'instrumental' freedom (i.e. it helps to achieve other 'constitutive' freedoms such as being healthy or being well-fed). The key question then is how growth relates to these ultimate ends. If we consider that ultimate ends are concerned with human development, reduction of vulnerability, participation, psychological well-being etc., then we need to understand how the growth process interacts with these. There are serious gaps in knowledge on these questions.

The distributional pattern of growth is also likely to be of particular importance for its sustainability, especially in the environment of a fragile state or in a country where inequality levels are already quite high (as for many Bottom Billion countries for which this information is available).

In sum, growth is very important, but we also need to be concerned with the nature of that growth. We cannot just assume that growth will usually translate into broad-based improvements in ultimate outcomes.

The quantity and quality of growth

The conventional wisdom is that growth is the most important and maybe the easiest driver of poverty reduction. But small reductions in inequality can also be important (Kalwij and Verschoor 2007; Ravallion 2001). While it has been strongly asserted that on average growth is matched by proportionate reductions in poverty, more recent evidence challenges this view, suggesting rather that the incomes of the poorest may increase less than proportionately with growth. Variation in the responsiveness of poverty to growth is wide, not only across countries but also across measures of poverty. Growth has even been accompanied by *increases* in poverty in some instances in sub-Saharan Africa, Russia and Eastern Europe. Various factors influence the magnitude of the growth elasticity of poverty, including initial inequality, the distributional pattern of growth, the composition of public expenditure, the role of labour markets, etc. Governments can intervene on each to reduce poverty, and in South and East Asia this is part of the explanation for success (Besley and Cord 2007; Grimm *et al.* 2007).

It is also important, though, to understand the relationship of growth to key ultimate outcomes, an issue on which there is still relatively little evidence. Human development indicators such as education and health are generally positively related to growth but often less strongly, or over a longer time horizon, than income poverty (Gross *et al.* 2005). For instance, mortality rates are correlated with income levels of countries, but income levels are far from being the only factor influencing recent improvements in life expectancy; other factors include public health care systems, nutrition and immunisation programmes and maternal education levels, any of which might or might not improve independently of growth.

Improvement in living conditions is

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further about improving economic security. The high levels of vulnerability that many face will tend to mean that the poor are less likely to engage in risk-taking (and potentially more profitable) activities, and this acts as a poverty trap. Also, many of the poor live in more remote areas, or are members of long-term disadvantaged groups, that tend to be both less well served by public policy and further removed from growth opportunities. Assets matter too. A low level of assets – including and maybe especially human capital – limit the scope for their participation in growth. In that important sense, poverty is likely to be bad for future growth. Broad-based growth is therefore more likely to be sustained growth.

Making the poor benefit from growth

Policy actions can help to reduce these problems over the longer term. But the fact remains that growth is often likely to be unequal. What can policymakers do to redistribute the benefits of growth? Here are three important options:

• Redistributive and transformative public expenditures to break the intergenerational transmission of poverty

Policy can redistribute the benefits of growth through pro-poor public expenditure. Growth is a major potential source of government revenue to finance public expenditure, which can be designed to be explicitly pro-poor, for example through broad-based expenditure on education and health. This provides an important opportunity for the benefits of growth to be more widely shared, and in a manner which is not likely to have major disincentive effects that would crowd out future growth. On the contrary, increased spending on education, nutrition and health, as well as key items such as infrastructure, is likely to be an important basis for future growth. As part of this, investment in young children and their families, via nutrition, health or education programmes for example, in order to break the widespread intergenerational transmission of poverty, potentially offers very high returns. It remains, though, always a major challenge to make sure that public spending is not captured by the rich.

• Increasing the rate of job creation from growth

It is also important that growth is associated with significant job creation to provide opportunities to people to benefit from higher education levels and move out of agriculture. But the record of employment creation with growth has been very weak in many countries.

How can policy increase the job creation from growth? Increased levels of private sector investment is one important part of the story, and that is likely to require substantial financial sector development. There is also potential for job creation through more informal channels by reducing formal entry requirements and rules on informal sector trading, as well as investment in small-scale infrastructure.

• Broad-based sectoral growth, particularly supporting food crop agriculture

Job creation may not benefit the poorest directly. Therefore, it is highly desirable to have a pattern of growth which is broad-based in terms of its coverage of sectors, regions or population, including the agricultural sector if that is the sector in which the poor are disproportionately represented.

Investment in market development, research, infrastructure and value added processing activities may all be important. Fast agricultural growth may also form a basis for transformative growth with the sectoral composition of growth shifting towards manufacturing and services.

Investment in social protection (measures to reduce vulnerability to poverty) can also potentially play a major role by reducing the vulnerability of small farmers and the poor in general.

> Policy can redistribute the benefits of growth through pro-poor public expenditure.

Further Reading

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Credits

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