

Chapter 4

Shifting Wealth and Poverty Reduction

Since 1990, the number of poor people living on less than one dollar-a-day has declined by nearly half a billion. High growth in the converging countries played a major role in this decline, though poverty also fell in a number of poor and struggling countries. In fact, improvements in health and education were largely independent of growth. The pace and pattern of growth as well as initial country conditions matter for how much growth turns into social development. The technological and structural changes underpinning shifting wealth are often accompanied by increases in within-country inequality. While high inequality can limit poverty reduction, the good news is that today an increasing number of countries actually have the resources to address distributional challenges and foster social development.

Introduction

Shifting wealth means a radical change in the geographical distribution of growth and, if sustained, will eventually transform the pattern of differences in income per capita across the globe. The previous chapters of this report have documented the sometimes dramatic reshaping of the world economy that shifting wealth has brought in its wake. This chapter looks at how this has translated into social outcomes in the developing world and what lessons can be learned for the future.

The average standard of living in middle-income countries has risen to a level that brings with it new concerns about inequality and relative, rather than absolute, poverty. As they grow, economies can afford greater investment in public goods and social development, and can introduce or reinforce redistributive policies. Making the change in mindset that may be needed to do this requires a measured but firm policy stance; some countries unfortunately have lagged behind.

This chapter first examines the differences across countries in the degree to which growth has helped poverty reduction. It then looks at the evolution of inequality across the groups of countries defined by the four-speed world classification presented in Chapter 1. In many cases, fast growth has been accompanied by increased inequality, further complicating the challenge of poverty reduction. The chapter further looks at efforts to make growth pro-poor and goes on to argue that, measured in relative terms, poverty remains a significant obstacle even in converging countries that have successfully reduced absolute poverty. Ultimately, higher levels of inequality could end up undermining continued growth and thereby the sustainability of the shift.

An important reduction in absolute income poverty

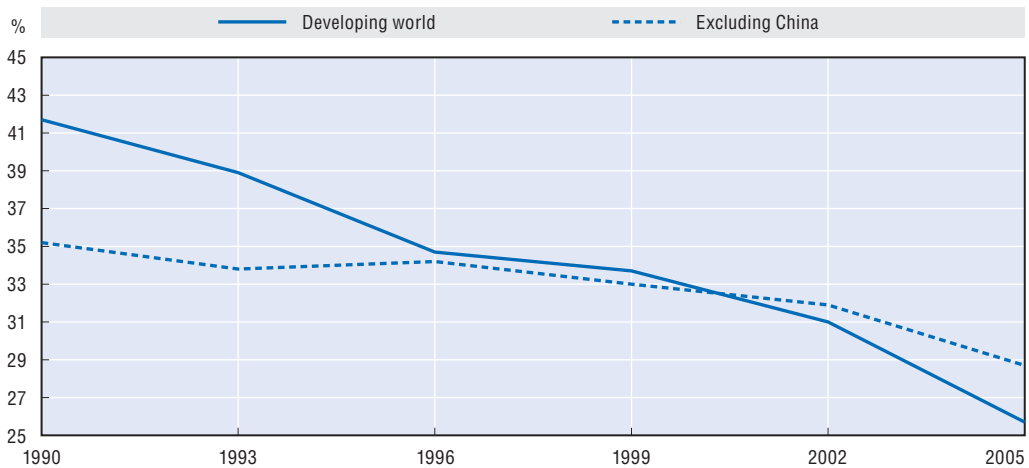
Aggregate economic performance improved significantly in the developing world between the 1990s and 2000s, and over the same period average poverty rates decreased ever faster (Figure 4.1). China's success was responsible for much of this.

Poverty in China stood at 84% of the population in 1981, but had dropped to 16% by 2005.¹ Excluding China, the picture is more mixed. Poverty in India – home to a sixth of the world's population – fell fairly steadily from 60% to 42% over the same period (Ravallion, 2009). This is certainly a worthwhile improvement, but will not be fast enough to eradicate poverty in a lifetime. During the 1990s the rate of poverty reduction in the rest of the developing world did not change dramatically and remained at a level insufficient to meet the Millennium Development Goal of halving poverty by 2015 (Chen and Ravallion, 2008). There has, however, been some improvement since the early 2000s.


The impact of growth on poverty has been unequal across countries

Growth in gross domestic product (GDP) is widely acknowledged to play an important role in poverty reduction (Dollar and Kraay, 2002; Ravallion, 2001). Figure 4.2 plots change in poverty against per capita growth for converging, struggling and poor countries in all

Figure 4.1. Headcount poverty rates
% of population living under USD 1.25 2005 PPP



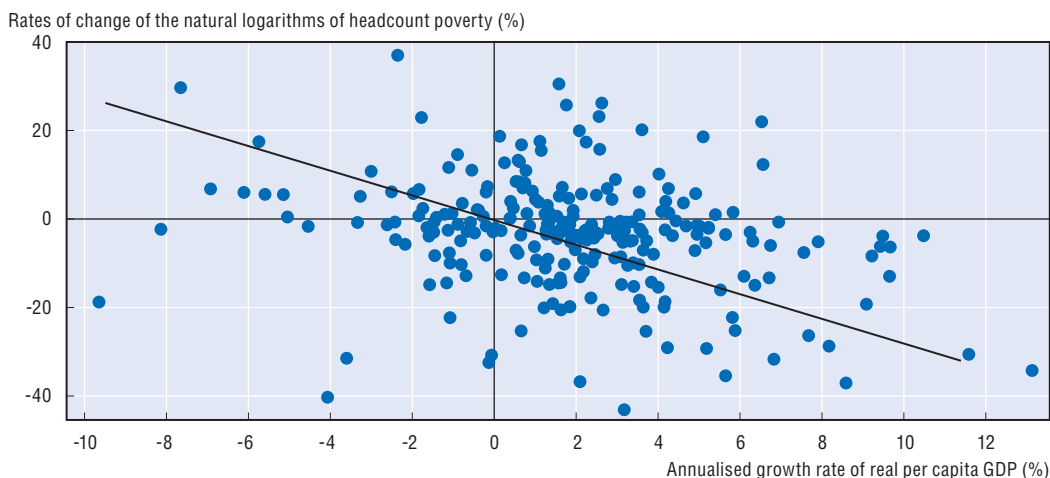
Source: Chen and Ravallion (2008).

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periods for which data is available. It demonstrates that growth and the speed of poverty reduction are strongly correlated: a 1% rise in real per capita GDP corresponds, on average, to a 1.1% reduction in the absolute poverty rate.²

Despite the strong association between growth and poverty reduction, Figure 4.2 also suggests that growth in per capita output explains a relatively small part of the differences in poverty reduction across countries.³ While growth has led to substantial poverty reduction overall, there are wide differences across countries in the sensitivity of poverty to growth. Chapter 1 documented differences in the pace of growth among developing

Figure 4.2. Poverty and growth – a strong relationship, but much unexplained variation



Note: Data covers 1990-2007. The figure presents the rates of change of the natural logarithms of headcount poverty (measured at USD 1.25 PPP per day) and real GDP per capita for all countries other than high-income countries. Plot points represent country-period observations. Most countries have multiple observations. The fitted line is weighted by the size of intervals in the observed spells so that countries carry equal weight when the period covered is identical.

Source: Based on World Bank (2009b).

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countries since 1990. Did the countries that grew faster manage to turn that growth into more rapid poverty reduction?


The sensitivity of poverty to growth differs across countries

Table 4.1 shows annualised changes in poverty and real per capita output growth for 24 developing countries, as well as the implied growth elasticity of poverty reduction over a 10-year period.⁴ On average, an increase of 1 percentage point in the long-term growth rate increases the rate of poverty reduction by around 0.7 of a percentage point.⁵ Overall, though, while fast-growing countries have achieved substantial poverty reduction, they were not the best performers.

Table 4.1. **Poverty reduction and growth for selected countries (1995-2005)**

	Annual change in poverty	Annual change in real GDP per capita	Total growth elasticity of poverty reduction (mid-1990s to mid-2000s)
	(dollar-a-day headcount index)		
	% per year	% per year	
	1995-2005	1995-2005	
<i>Convergers in the 1990s and 2000s</i>			
China	-9.2	7.9	-1.2
Dominican Republic	-1.8	3.2	-0.6
Cambodia	-1.9	5.2	-0.4
<i>Convergers in the 2000s (only)</i>			
Costa Rica	-12.2	2.6	-4.6
Ecuador	-4.4	1.6	-2.8
Ethiopia*	-4.4	2.6	-1.7
Honduras	-2.2	1.7	-1.3
Uganda*	-2.5	2.7	-0.9
Bangladesh*	-2.0	3.5	-0.6
Panama	-1.7	2.8	-0.6
Nigeria*	-0.8	1.8	-0.4
India*	-1.6	4.7	-0.3
Peru	-0.5	1.9	-0.3
Mongolia*	1.7	3.3	0.5
Georgia*	12.2	7.0	1.7
Colombia	3.2	1.2	2.7
<i>Struggling</i>			
Brazil	-3.0	1.0	-3.1
El Salvador	-1.4	2.1	-0.7
Paraguay	-3.1	-0.9	3.5
<i>Poor</i>			
Senegal	-4.8	1.6	-2.9
Mali	-4.3	2.8	-1.6
Nepal	-2.7	1.7	-1.6
Zambia	0.4	0.6	0.7
Niger	-1.6	-0.2	7.9

Notes: Growth rates are annualised rates of change in between the start and the end of the period. Data are within one year of the start (1995) and end (2005) of the period for each country. All struggling and poor countries in the table remained in the same group over the two decades. Among the convergers from the last decade, an asterisk (*) indicates the country was classified as "Poor" in the 1990s, while the others were classified as struggling in the 1990s. Source: Authors' calculations based on World Bank (2009a, 2009b).

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Among the convergers, the growth elasticity of poverty reduction in China is -1.2 , while that for both the Dominican Republic and Cambodia is below the -0.7 average. For India, the corresponding figure is only -0.3 . Converging countries, by and large, exhibit modest elasticities while a number of countries with slower growth performance display higher poverty reduction elasticities. Costa Rica (-4.6) and Brazil (-3.1) are notable examples. Ferreira *et al.* (2009) identify the expansion of federal social protection in Brazil as the single most important factor driving poverty reduction in the country over 1985-2004, a period which was characterised by disappointing growth.

Growth alone does not secure other human development goals

Social development cannot be measured solely through incomes or analysed through the narrow lens of income poverty. The links between growth performance and social development are all the more complex once non-income forms of poverty are considered. Indeed, by some measures of non-income poverty – for example infant mortality – converging countries were not the star performers.

Both the United Nations Millennium Declaration and the literature on pro-poor growth (see for example OECD, 2006; Besley and Cord, 2007) emphasise the multidimensionality of poverty. Pro-poor growth in income dimensions does not guarantee that improvements in non-income dimensions will also disproportionately benefit the poor. Until recently, the degree to which growth was pro-poor was measured exclusively by its incidence in income (or consumption) poverty, following measurement techniques proposed by Ravallion and Chen (2003), or using the average elasticities approach adopted in Table 4.1. Grosse *et al.* (2008) extended this methodology to non-income poverty, using indicators for education, health and nutrition. Looking at Bolivian data, they concluded growth in Bolivia was pro-poor between 1989 and 1998, in the sense that both the income poor and those deprived in terms of education, health and nutrition outcomes experienced a faster than average improvement in their well-being from growth.⁶

Bourguignon *et al.* (2008) found that the countries with the best growth performance are often off-track in terms of the achievement of the Millennium Development Goals (MDGs). They found the correlation between growth and non income-related MDGs, to be zero. Non-income dimensions of human development are also important for determining future growth, in particular by enhancing human capital.⁷

Using infant mortality rates as an example, Table 4.2 demonstrates that economic performance alone is not sufficient to secure the achievement of other human development goals. Certainly, sub-Saharan Africa, which has many poor and struggling countries, performed relatively badly. However, the best performing region is not Asia (which had by far the best growth performance), but Latin America. Strong results in terms of human development and poverty reduction are clearly contingent on the right set of social policies being in place and executed efficiently.

Table 4.3 shows absolute changes in child mortality rates and life expectancy, two major human development indicators, using the categories of the four-speed world. Affluent countries start with high absolute levels of achievement in these indicators so it is unsurprising that they are not the leading performers in terms of absolute change. More unexpectedly, the performance of poor countries outpaces all the other groups in the reduction of infant mortality rates. Given the sharp deterioration in life expectancy in a number of poor countries as a result of the HIV pandemic and civil conflicts, improvements

Table 4.2. **Under-5 infant mortality rates by region (per 1 000 live births)**

Region/country grouping	1990	2008	% change over period
Sub-Saharan Africa	108	86	-20
Middle East and North Africa	57	33	-42
South Asia	88	57	-35
East Asia and Pacific	41	22	-46
Latin America and Caribbean	42	19	-55
Central and Eastern Europe and the CIS	42	20	-52
<i>Industrialised countries</i>	<i>8</i>	<i>5</i>	<i>-38</i>
<i>Developing countries</i>	<i>68</i>	<i>49</i>	<i>-28</i>
<i>Least developed countries</i>	<i>113</i>	<i>82</i>	<i>-27</i>
World	62	45	-27

Source: UNICEF (2010).


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in life expectancy are also notable. Moreover, among converging and struggling countries, progress in these two human development indicators was actually faster in the slow growing 1990s compared to the 2000s, again suggesting that economic growth alone is certainly not a sufficient condition for human development.

Table 4.3. **Human development in a four-speed world**

	Average reduction in Infant mortality rate (per 1 000 live births)		
	1990s	2000s	1990-2007
Affluent	-3.1	-1.3	-4.7
Converging	-10.1	-8.2	-18.2
Struggling	-9.1	-6.0	-17.6
Poor	-13.4	-11.8	-24.7
	Average reduction in child (five-year) mortality rate (per 1 000 live births)		
	1990s	2000s	1990-2007
Affluent	-3.9	-1.7	-6.2
Converging	-15.4	-12.3	-27.0
Struggling	-12.3	-8.6	-25.6
Poor	-22.5	-21.1	-42.7
	Average increase in life expectancy at birth (years)		
	1990s	2000s	1990-2007
Affluent	2.3	1.8	4.0
Converging	3.1	1.6	3.9
Struggling	1.6	1.1	2.5
Poor	1.2	2.4	3.9

Source: Authors' calculations based on World Bank (2009b).

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Inequality, growth and poverty reduction

The diversity in the responsiveness of poverty reduction to growth is partly related to distributional issues. It has been argued that growth on average and across countries is distribution neutral (Ravallion, 2001; Dollar and Kraay, 2002). In other words, a given

percentage increase in mean income raises the income of the rich and the poor by the same percentage. However, this still implies that the rich capture a much larger share of the absolute growth in income than do the poor. The poor gain less – and poverty reduction will be weaker – the more unequally income is distributed (see Box 4.1).

Box 4.1. **Inequality can limit the impact of growth on poverty**

Between the mid-1990s and 2005, GDP per capita in Mali and Uganda grew at comparable rates – around 2.75%. But over that same period absolute poverty in Mali decreased from 86% of the population to 51%, while in Uganda it fell less rapidly from 64% to 52%.

Two key factors explain this difference. First, the degree to which GDP growth translated into household-expenditure growth was much higher in Mali: expenditure per capita grew at a rate of 6%, about double the rate observed in Uganda. Second, the distribution of benefits from growth was dramatically different in the two countries. While in Mali the Gini coefficient dropped from 0.53 to 0.39, in Uganda the same measure of inequality increased from 0.38 to 0.43. In other words, the relatively well-off in Uganda benefited disproportionately from growth.

Fosu (2010) argues that inequality and changes in inequality play a major role in explaining differences in growth elasticities of poverty reduction across countries. Greater inequality reduces the amount by which a given level of growth will reduce poverty. Increases in inequality generally lead to increases in poverty (for a given level of growth). Following this argument, if Uganda had grown at the same rate but maintained its level of inequality it would have reduced poverty by an extra 10 percentage points. If it had gone on to achieve a fall in inequality comparable to that in Mali, poverty would have fallen to 32% by 2005 – a full 20 percentage points lower than observed.

Source: Fosu (2010).

The unequal distribution of peoples' standards of living irrespective of the country in which they live is referred to as "global inequality". Between two-thirds and three-quarters of global inequality can be attributed to inequality between countries.⁸ This "between" dimension corresponds to differences in average incomes between countries, roughly measured by GDP per capita. As shown in Chapter 1, an extended period of increases in inequality between countries has reversed over the past decade thanks to the improved growth performance of the developing world.

At the same time, inequality in incomes or consumption *within* many countries has increased steadily since 1990. Has the rise in within-country inequality come as the price of success? In a recent report, the International Labour Organisation found that over 1990-2005, income inequality rose in more than two-thirds of the 85 countries it sampled (ILO, 2008), a trend which continued until at least the mid-2000s according to studies using more recent data.⁹ These increases in inequality are worrying because they threaten to reduce the impact of growth on poverty and because they also call into question the sustainability of growth itself.

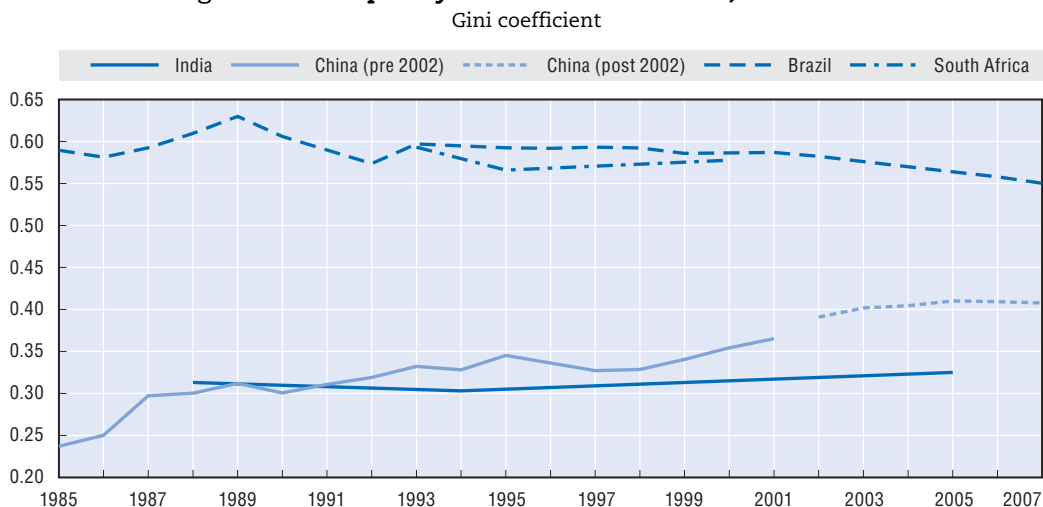
Did growth contribute to rising inequality within countries?

The global evolution of within-country inequality is heavily influenced by increasing inequality in the Asian giants, given their weight in the world population. Figure 4.3 contrasts rising inequality in two converging countries, China and India, with falling


inequality in two struggling countries, Brazil and South Africa. Though the two large converging countries saw inequality increase, it rose from lower levels. In contrast, the two large struggling countries experienced declines in inequality, but from extremely high initial levels.

Of the four countries, China exhibited the most striking change. Inequality in China rose dramatically between 1990 and 2005 (Figure 4.3). The Gini coefficient rose from 0.30 to over 0.40 in that period – taking inequality in China from close to the OECD average of 0.31 to a level shared by the most unequal of OECD countries (OECD, 2008a).¹⁰ Since 2005, the rise in income inequality in China appears to have come to a halt. In fact, using measures of inequality that give more weight to lower incomes, inequality has in fact decreased since 2005, especially in rural areas.¹¹

Figure 4.3. **Inequality in selected countries, 1985-2007**



Note: Gini coefficients for income (Brazil) or per capita expenditure (India, China, South Africa).

Source: Based on Topalova (2008) for India, OECD (2010) for China and World Bank (2009a) for Brazil and South Africa.
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China was not the only country to witness a marked increase in inequality. For example, Székely (2003) found that across comparable survey data, inequality did not decrease significantly in any country in Latin America during the 1990s, and increased strongly in Argentina, Bolivia, El Salvador and Nicaragua. Inequality also increased among countries transitioning from centrally planned socialist economies. Overall, the majority of emerging and developing countries witnessed increases in inequality in the 1990s. The position is summarised in Table 4.4.¹²

Since 2000, inequality has risen in a number of countries, but, for the majority, the trend moderated and inequality remained constant or changed only a little. A substantial number (more than half of the countries for which distribution data are available) experienced moderate falls in inequality. They include a number of Latin American countries for which differences in outcome in the 2000s are not explained solely by improvements in their external environment (Cornia, 2009).

Table 4.4. **Changes in the Gini coefficient in the 1990s and 2000s**

Change in inequality	Number of countries	
	Early to end 1990s	Early 2000s to latest
Large decrease	11	6
Moderate decrease	11	18
No significant change	19	16
Moderate increase	25	13
Large increase	7	9
Number of economies with data	73	62

Note: Economies are only considered if there is data at the beginning and the end of a period for the same measure of living standards (consumption or income). For some countries, inequality data refer to urban or rural areas only. For a given country the periods assessed in the two decades depend on data availability. “Large” refers to changes greater than 1 percentage point per annum in either direction, “moderate” refers to changes between 0.2 and 1 percentage point per annum, “no significant change” refers to variations smaller than 0.2 percentage points per annum.

Source: Authors calculations based on World Bank (2009a).

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Shifting wealth, labour markets and inequality

Accelerated globalisation brought about profound changes in the global labour market (see Chapters 1 and 2). Are these changes linked to the increases in inequality in the 1990s and the 2000s? Most existing analysis concentrates on inequality in advanced countries, particularly in the United States, although some observers stress that the mechanisms and implications would differ for developing countries (e.g. Kohl, 2003). Two arguments share centre stage.

The first rests on international competition between unskilled workers, mediated through trade in goods. If trade liberalisation equalises relative wages of unskilled workers worldwide, unskilled wages in less developed countries should rise, while unskilled wages in rich countries decline.¹³ As early as 1995, Freeman (1995) was asking the question whether US wages for low-skilled workers were being set in Beijing because of the rising competition faced by US manufacturers from Chinese imports. But while inequality has grown in developed countries (OECD, 2008a), wage differentials actually increased during the period in a number of emerging and developing economies (Kohl, 2003).

The second argument rests on skill-biased technological change (see, for example, Krugman [2000]). It says that technological change, and above all the revolution in information technology, has led to an increase in demand for skilled workers relative to their unskilled peers who as a result have seen their relative wages fall.¹⁴

Whatever the merits of these two theories in the advanced-country context¹⁵ their relevance to developing countries will differ greatly across countries. The relevance of each will depend on a country’s economic structure and level of development. International competition between unskilled workers, for example, will matter more where unskilled workers earn more than their counterparts in other developing and emerging countries because of local market conditions. Note too that this relationship is not static: the point at which global competition bites will depend on the future upgrading of international – especially Chinese – industry and the skill composition of trade.¹⁶ An empirical analysis of the links between globalisation and inequality found that trade globalisation and export growth since 1990 have tended to decrease inequality in most countries, while financial globalisation and technological progress have both tended in the opposite direction (IMF, 2007).

Moreover, domestic factors are also at play in the link between growth and inequality. The duality of labour markets, particularly those of the Asian giants, is a case in point. In both India and China there is substantial inequality in incomes between rural and urban workers. Dual-economy models along the line of Lewis (1954) have been used to represent the Chinese labour market (for example by Cai *et al.* [2009]). Kuznets (1955) posited that inequality increases over time while a country is developing and, after a certain average income is attained, inequality begins to decrease. The mechanics underpinning increasing inequality in Kuznets's hypothesis may be at play in the large converging countries. As structural transformation brings workers from the lower-inequality lower-productivity agricultural hinterland to the urban manufacturing sector, aggregate inequality first increases with development before eventually falling.¹⁷ The extent to which this will prove to be case in the large converging countries remains an open question.

New challenges to making growth benefit the poor

Taking initial conditions into account, there is wide room for policy to influence how growth affects poor households. Even when growth remains modest, countries with adequate financial and administrative capacity can reduce poverty through redistribution. Public action is also important as a tool against non-income forms of deprivation through the provision of key public goods, such as health care, education, water, sanitation, and other services. Policies that target inequality directly can similarly advance further poverty reduction. At the same time, the countries that have successfully decreased absolute poverty face new challenges of fostering social inclusion.

This section looks first briefly at how growth can be made pro-poor by focusing on the sectors where growth affects poor people most, such as agriculture. It then looks at the emerging need for converging countries to pay attention to relative deprivation in addition to absolute poverty.

Making growth pro-poor

Pro-poor growth is a pace and pattern of growth that “enhances the ability of poor women and men to participate in, contribute to and benefit from growth” (OECD, 2006). Many of the factors that determine whether growth is indeed pro-poor and benefits the poor disproportionately depend heavily on the country context – just like the determinants of growth itself. Nevertheless, a substantial body of country studies allows for the identification of a number of general principles for pro-poor growth.¹⁸

One view of the key mechanisms of pro-poor growth builds on the general principle that growth needs to happen in regions and sectors where poor people are (or to which they have access) and utilise the production factors the poor possess (Klasen, 2007). In most countries, this requires growth in the agricultural sector and in rural areas as well as growth that is labour-intensive, but this depends on factor and skill endowments and their distribution, as well as the external environment.

The importance of the sectoral composition of growth is one of the recurring elements of the literature on pro-poor growth. Growth in agriculture is found to be more pro-poor than non-agricultural growth in a wide range of country studies, including ones covering China, Ghana, Uganda and Viet Nam.¹⁹ Cross-country studies and policy reviews confirm this finding (see OECD, 2006). The importance of agriculture in this regard can be attributed to three distinct characteristics. First, even though it represents a shrinking share of value

added in the great majority of countries, large numbers of people still depend on agriculture for their livelihoods – 67% of the labour force in sub-Saharan Africa and some 60% in India, for instance. Second, agricultural growth directly uses the labour and the land of the poor. Third, agricultural growth is linked to non-agricultural growth through a number of channels – including the stabilisation of food prices and the freeing-up of labour for non-agricultural activities. In the story of China’s success in fighting poverty, it is notable that most rapid poverty reduction occurred during the period of rural and agricultural-market reforms, associated with the creation of markets for production in excess of government-set quotas from 1980 onwards (Ravallion and Chen, 2007).

Notwithstanding this importance, agriculture need not be the sole engine of poverty reduction. Growth in services was found to have a higher elasticity of poverty reduction in India (Ravallion and Datt, 1996) and Brazil (Ferreira *et al.*, 2009). More generally, understanding the factors that can allow poor households to take advantage of non-agricultural jobs in rural areas and other opportunities in urban areas is critical for pro-poor growth.

In turn, the capacity of the poor to take advantage of new opportunities depends critically on their skills and access to complementary assets. The better educated are also better placed to take the best non-agricultural jobs; unequal distributions of educational attainment not only restrict average growth by limiting the level of human capital, they also constrain poverty reduction and limit the poverty-reducing effect of growth in the future. In Uganda, access to secondary education by the poor declined throughout the 1990s and the early 2000s, while it increased for children in the top income quintile, leading to greater welfare inequality and thereby limited poverty reduction, despite a favourable external environment (Besley and Cord, 2007).

Policies can counter inequality, and a regional analysis confirms that policies that reduce inequality can greatly foster poverty reduction. An examination of the links between poverty and income growth in Latin America during the past decade showed that, although per capita household income growth accounts for 83% of the variation in poverty reduction in the region, the remaining variation is significantly related to reductions in inequality (OECD, 2009).²⁰

Moreover, co-ordinated falls in poverty and inequality are driven by policy to a substantial extent. During the recovery from its 2001-02 economic crisis, poverty in Argentina decreased from almost 10% of the population to fewer than 3% in the space of four years, while inequality as measured by the Gini coefficient fell from a high of 0.52 to 0.48.²¹ Only about a fifth of this change in poverty is explained by growth levels. A number of redistributive policies were put in place including cash transfers, job-creation initiatives and subsidies both explicit and implicit (through price controls). These policies, it seems, made a dent in inequality – although their sustainability has since been called into question by the crisis (see OECD, 2009).

This conclusion is significant for the future direction of policy. According to the Commission on Growth and Development (2008), growth is the main route to poverty reduction in very poor countries. But as a country develops redistribution becomes increasingly important. This means redistribution will have to become an increasingly important motivator of policy if momentum in poverty reduction is to be maintained.

From absolute poverty to relative deprivation

As average incomes grow and absolute poverty declines, the number of people whose existence is threatened by a lack of resources diminishes. However while fewer people face life-threatening poverty, they still may face extraordinary challenges to take advantage of the benefits that economic growth brings to their societies. Indeed, for those at the bottom end of the income distribution, gaping differences in standards of living are merely a new form of deprivation, one which brings its own challenges along with the new-found prosperity.

Yet international comparisons of poverty have long treated affluent and developing countries differently. Under the emerging configuration of the world economy, as developing countries succeed in reducing and ultimately eradicating absolute poverty, this distinction becomes increasingly questionable. When poverty is measured by relative deprivation rather than the threat to subsistence, the challenge of social development calls for determined action to foster social inclusion.

Poverty in many affluent countries of the world is defined by incomes that are unacceptably low by the standards of that society – even though they might be high by others' standards and may be a long way from life-threatening. Affluent countries (that is most OECD member countries) focus therefore on relative poverty lines and define poverty in terms of consumption or income below a given proportion of the mean or median (see for example OECD [2008a]). Relative poverty lines capture changes in social needs and their costs across countries and over time, since they change as the society itself changes. The World Bank's well-known "dollar-a-day" poverty line, on the other hand, sets an absolute standard based on a uniform minimum level of daily consumption or income needed for subsistence (the current USD 1.25 PPP per day international benchmark). This absolute measure is the one which tends to be used to measure progress on global poverty reduction in developing countries. When absolute poverty is high and per capita expenditure is clustered around the absolute poverty line (that is most people are at near subsistence levels), the two measures will provide similar information. They will tend to diverge as incomes rise for large enough subsets of the population.

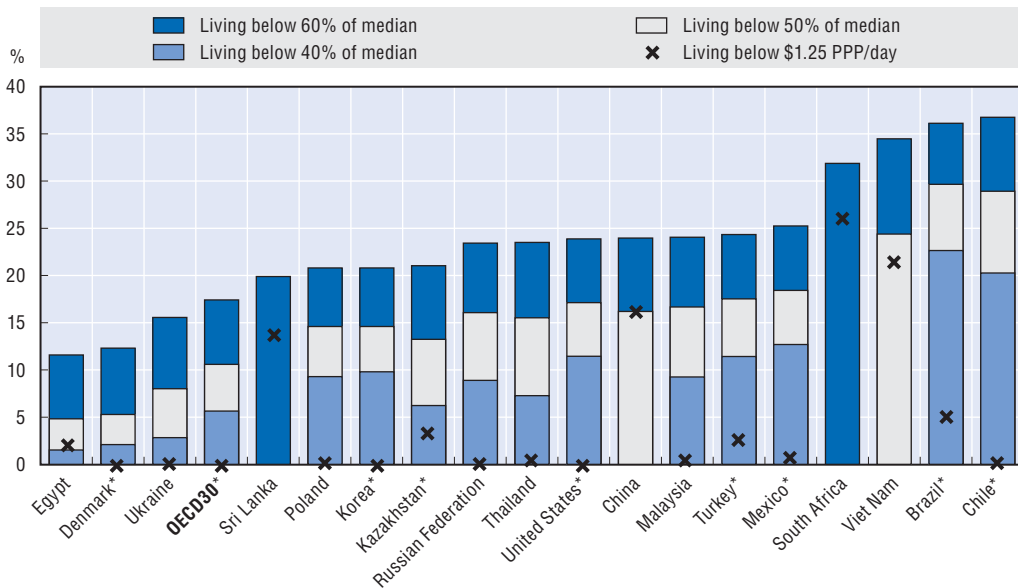
Given the decline in absolute poverty over the last two decades, the two poverty measures have indeed diverged in a number of countries, particularly among members of the converging group of the four-speed world. It is increasingly relevant to look at poverty in these countries through a relative lens, to complement the information derived from absolute poverty measures. In much the same way that shifting wealth raises concerns about inequality in countries with strong growth, notable reductions in absolute poverty levels prompt questions about the evolution of relative poverty.

As these countries turn increasingly from ensuring the survival of their people to fostering their social inclusion, comparisons of relative poverty outcomes with OECD countries become increasingly fruitful. These comparisons are all the more interesting given the wide variation in relative poverty within the group of OECD member countries (see OECD [2008a]). Figure 4.4 displays measures of relative poverty for selected emerging and developing countries that have achieved significant reduction in absolute poverty, and compares them on the same measures with a variety of OECD members.

To ease comparison, and since there is no single common relative poverty line, data at three different relative poverty lines are presented. These are set at 40%, 50% and 60% of the median income in each country. To be sure, in some of the developing countries


Figure 4.4. **Relative poverty rates for selected OECD and non-OECD countries**

Share of population, mid-2000s



Note: A cross (x) indicates use of income, rather than consumption data. Relative poverty is not reported in cases where the relevant poverty line would fall below the absolute poverty line of USD 1.25 PPP a day (2005 international dollars). These are the 50% line for Sri Lanka and South Africa, and the 40% line for China, Sri Lanka, South Africa and Viet Nam.²²

Source: Based on OECD (2008b) and World Bank (2009a).

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included in the data, absolute poverty remains significant, despite the recent decreases, and relative poverty is not reported for any poverty line which would fall below the international absolute-poverty line (and would therefore be below subsistence levels).

Brazil, Viet Nam, South Africa, Malaysia and China have successfully reduced absolute poverty but still face relative poverty levels much higher than the OECD average. The task confronting these countries is the difficult one of fostering social inclusion. Significantly, however, economic development in these countries is at a stage where redistribution becomes a viable tool in the policy armoury. Increasing wealth also means that governments can increasingly afford to address the social needs of their citizens directly. Where this is the case social objectives and policies should evolve accordingly and reflect the new-found capacity of the economy to secure greater social cohesion.

Conclusion

The rapid growth since 2000 (at least until the crisis) and the shifting wealth that has accompanied it have important implications for poverty reduction and social development. Growth can be seen as a rising tide, but though it has lifted many boats, not all have risen by the same amount. Strong growth is necessary to reduce poverty and deprivation sustainably in poor countries and can substantially contribute to reducing poverty in middle-income ones. However, the actual contribution of growth to poverty reduction varies tremendously across countries.

Moreover, the shift in wealth that has resulted from rapid growth in China and other developing countries has brought with it increased inequality. This matters because of its

direct impact on social cohesion. Increased inequality also reduces the poverty impact of future growth. Inequality has no single cause and many factors are highly country-specific. Ultimately, higher levels of inequality could end up undermining continued growth and thereby the sustainability of the shift.²³ Policy makers should pay attention to the evolution of income inequality, both for its own sake and because it influences the poverty dividend of growth. Social policy can limit inequality in outcomes today. But macroeconomic stabilisation and education can level the playing field over the longer term and offer possibilities for the poor to take advantage of future opportunities.

Policy makers can make a difference by seeking a pro-poor dimension to policy. This requires not only the right economic policy (focusing on growth in sectors and regions where the poor are concentrated), but also the right social policy. For social development to match pace with output growth, deliberate and determined interventions are necessary to make growth pro-poor and to establish social policies that protect and promote the productivity and earning potential of citizens. Through substantial income growth in populous countries and by spurring convergence elsewhere in the developing world, shifting wealth has dramatically increased the number of the world's people living in middle-income countries. These countries have acquired the potential to put in place social policies that foster human development and social cohesion.

Notes

1. This refers to absolute poverty measured by the international poverty line of USD 1.25 PPP (purchasing-power parity) per day.
2. The growth elasticity of poverty reduction derived from the regression line in Figure 4.2 is -1.12 . Allowing for the fact that the figure uses GDP per capita rather than mean per capita consumption expenditure, this exercise updates earlier findings (Ravallion, 2001) with results of a similar magnitude.
3. Per capita GDP growth explains just under 10% of the variation in poverty reduction across countries and periods. This is partly due to the inclusion of short spells, longer data series are considered in the following section.
4. In order to allow comparison over identical 10-year periods in the face of relatively sparse poverty data, the period used is 1995-2005. This 10-year period does not perfectly overlap that used in Chapter 1's four-speed world, but countries are nonetheless presented according to their place in that classification in the 1990s and the 2000s.
5. The average elasticity for all countries in Table 4.1 is -0.76 , and -0.71 if outliers are excluded.
6. Grosse *et al.* (2008) find evidence of mildly pro-poor income growth in the relative sense (the growth rate of income was larger for the poorer percentiles) but not in the in strong absolute sense (which would require average income increases to be positive and larger for poorer than for richer percentiles). Non-income poor with the lowest health, education and nutrition outcomes in 1989 achieved larger relative improvements in those same indicators. However, the social outcomes of the income poor did not grow at the same correspondingly rapid pace.
7. In aggregate studies, human development and economic growth are found to mutually reinforce each other (see, for example, Ranis and Stewart, 2007), a finding which is broadly consistent with endogenous growth theory. See Jolly and Mehrotra (2000), and Stewart and Cornia (1995).
8. See the review by Anand and Segal (2008) and individual studies by Sala-i-Martin (2006) and Milanovic (2002). Milanovic attributes 88% of global inequality to between-country inequality.
9. See also Pinkovskiy and Sala-i-Martin (2009). Given that primary data for distribution analysis are collected relatively infrequently, further extensions rely on material assumptions regarding the behaviour of inequality in a number of countries.
10. This increase in inequality in China is related to increased incomes for people already well-off relative to Chinese average incomes. Since more people in China are thereby brought closer to the modal world income, the two effects balance out to some degree in calculations of global

inequality. For this reason, the evolution of the global distribution of income is the subject of an intense and as yet unsettled debate. See Anand and Segal (2008) and Pinkovskiy and Sala-i-Martin (2009) for recent contributions.

11. The OECD *Economic Survey of China* (2010) presents the evolution of the Atkinson inequality index over the period 1985-2007.
12. It should be noted that there are substantial differences in how different countries performed depending on whether measurement is of income or expenditure inequality. Moreover, the availability of recent distribution data is somewhat biased towards middle-income countries meaning that recent trends should be seen as only indicative.
13. Standard trade theory – based on the Stolper-Samuelson theorem and its prediction of factor-price equalisation – suggests that trade liberalisation should lead to the global equalisation of the relative wages of unskilled workers. This would mean narrowing wage differentials between unskilled and skilled workers in less-developed countries (unskilled wages rise, other things being equal) while increasing wage inequality in developed countries (unskilled wages fall).
14. Since the trade and foreign direct investment are themselves vehicles of technology diffusion, these two arguments are difficult to disentangle empirically.
15. The extent to which either fits the available evidence has been questioned (Card and DiNardo, 2002; Goos and Manning, 2007).
16. See Chapter 5 for more discussion on technological upgrading and skill composition.
17. See McKinley (2009) for a recent exposition of Kuznets's hypothesis in the context of the pro-poor growth debate.
18. See, for example, Besley and Cord (2007) and OECD (2006).
19. For China, see Ravallion and Chen (2007); for Ghana, Uganda and Viet Nam, see Besley and Cord (2007).
20. Indeed, the simple correlation between poverty reduction and falls in inequality once average income growth is controlled for is about 0.5.
21. The Gini coefficient lies between zero and one. Zero represents perfect equality (all individuals have the same income/consumption) and one perfect inequality (all income is concentrated in the hands of one person). As illustrated in Figure 4.3 and Table 4.4, changes in inequality of 1 percentage point per annum or more are large and infrequent events.
22. When looking at absolute and relative poverty statistics together, a critical issue is how to interpret relative poverty when it falls below absolute poverty (so that people who are absolutely poor are not necessarily considered relatively poor). Given that the international USD 1.25 PPP a day poverty line will be tantamount to physical subsistence minima for a number of emerging countries, we have chosen not to report relative poverty for cases where it falls below dollar-a-day poverty. This is consistent with recent advances in poverty measurement (see Ravallion and Chen, 2009).
23. Although the facts are disputed (Jomo, 2006), there is an extended literature on how low levels of inequality were conducive to growth in East Asia (see World Bank, 1993). The inference from this literature is that strong economic growth is difficult to sustain in the context of high inequalities. In addition, Amsden (2001) suggests that countries with high income inequalities have had much less success at promoting national industries because of the difficulties in mobilising public support behind “national champions”.

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