Today's Golden Age of *Poverty Reduction*

BY SURJIT S. BHALLA

The story the World Bank and other agencies don't want you to know.

Have we just witnessed history? The last twenty years have been good for growth in the developing countries, and have been very good for poverty reduction—indeed, the best ever. More than a billion people have been moved out of poverty, defined according to the dollar a day measure. From about 1.3 billion poor in 1980, poverty in 2000 was close to 500 million. In no other period in history has the number of poor people declined, let alone declined by such historic proportions.

Calculations of poverty reduction go back to at least 1820, but calculations of the decline in the number of poor are unfair to history. Because of health improvements, life expectancy has improved enormously over the last two hundred years. This has enhanced population growth for all levels of income, poor and rich alike. With each succeeding generation, reductions in poverty have become more difficult. A better index, therefore, of historical performance is the fraction of people in poverty. Chart I compares the pace of poverty reduction since 1820. The share of population in absolute poverty has declined at a rate of approximately 4 percentage points every twenty years for the 130-year period, 1820 to1950. Between 1950 and 1980, the pace increased to a rate of 14 per-

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centage points for each twenty years. But the golden age for the poor has been the period post-1980. During this age, the record is of an astonishingly large 20 percentage point plus decline.

What happened? In large part, Asia, the continent given up for "dead" by most economists, came alive. (Gunnar Myrdal won a Nobel prize for his pessimistic work on Asian poverty, *Asian Drama: An Inquiry into the Poverty of Nations*.) More accurately, the two population giants, India and China, reversed course on economic policy. The China conversion story is well known. Not as well known is the fact that until about 1980, the Indian policy regime was as "controlled" as China. So both economies changed at approximately the same time (1978–1980); both started to open up, reduce tariffs, and embrace markets. The rest is history. In 1980, the poverty head count ratio in India and China was 50 and 60 percent, respectively. By 2000, the poverty ratios in both economies were in the range 10

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to 25 percent. The number of people moved out of poverty in these two countries alone was about a billion. This is history—an upliftment of 20 percent of the developing world's population. That is approximately the entire population share of the two other continents where poor people reside, Latin America and sub-Saharan Africa.

What has made this possible? Though detractors remain, there were at least three important developments in the world economy: first, more than 1.5 billion individuals in the developing world witnessed an increase in political liberties, as measured by Freedom House. This means that governments today have a lesser chance of survival if they pursue anti-growth policies. For some time now, the confusing "Confucian" hypothesis has prevailed in the world, positing that East Asian economies such as Korea and China grew fast because they had able dictatorships (an oxymoron). This correlation conveniently ignores the fact that most African and Latin American countries also had dictatorships and have not grown particularly fast. Political liberties enhance growth prospects because they limit the tenure of bad governments.

The second important development has been in terms of reversing ostrich-like closed tendencies. Tariff rates in developing economies are less than a third of the levels prevailing in 1980, and the absolute level of such tariffs today is less than 10 percent. This means that industrialists have to earn profits the old-fashioned way—by being efficient. Less chances for bribery of politicians and bureaucrats means better allocation of resources. Low tariffs means pressure from international and domestic consumers for higher efficiency and lower prices that lead to higher growth. How bad was it before and how much has policy changed? Well, the magnitude of change can be appreciated from the fact that as late as 1991, India proudly announced that the peak tariff rate had been reduced to 180 percent!

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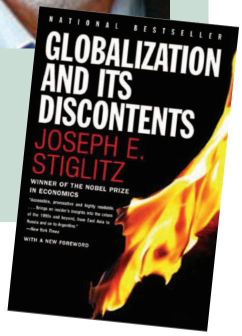
Got It Wrong

According to the World Bank, the number of poor in the world barely budged between 1.2 billion in 1990 and 1.1 billion in 2001. This deemed lack of poverty reduction has been the mantra (see **Joseph Stiglitz**'s book, *Globalization and Its Discontents*), and the cause has been variously but mostly attributed to "capitalistic growth" models. History shows these conclusions as false.

—S. Bhalla



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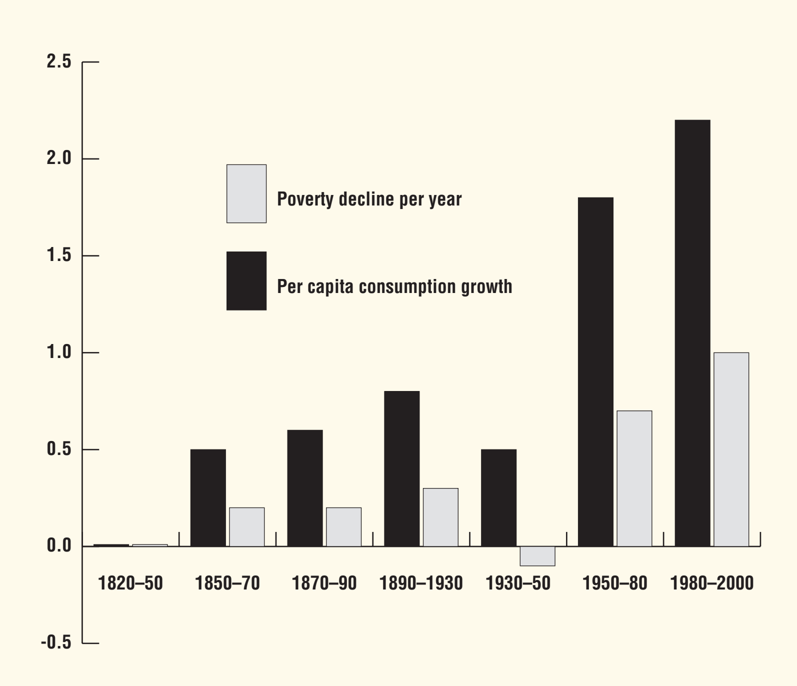
The increased efficiency in production leads to increased trade, which in turn leads to faster growth, and the cycle continues. This is the third happy happening in poor countries. The share of trade in developing economies expanded; this share (fraction of GDP accounted for by exports and imports) was 20 percent in 1960, 30 percent in 1980 and 53 percent in 2000.

It is believed that history would have been even better if somehow the poor countries had been able to control population growth. This belief no longer reflects the recent transformation. A centuries-old phenomenon, associated with all countries, is that with development, fertility rates (number of children ever born per woman) decline, and labor force participation of women increases, and both fuel each other. This is indeed what has happened in China, India, and most poor countries. The fertility rate in India and Bangladesh is today less than three, and in China and Iran less than two. The population growth rate in India today is close to 1.4 percent annually. The new story in the world today is not population growth, but the great fertility decline. It is coming soon to your favorite poor country.

WHAT'S WRONG WITH MARKETS?

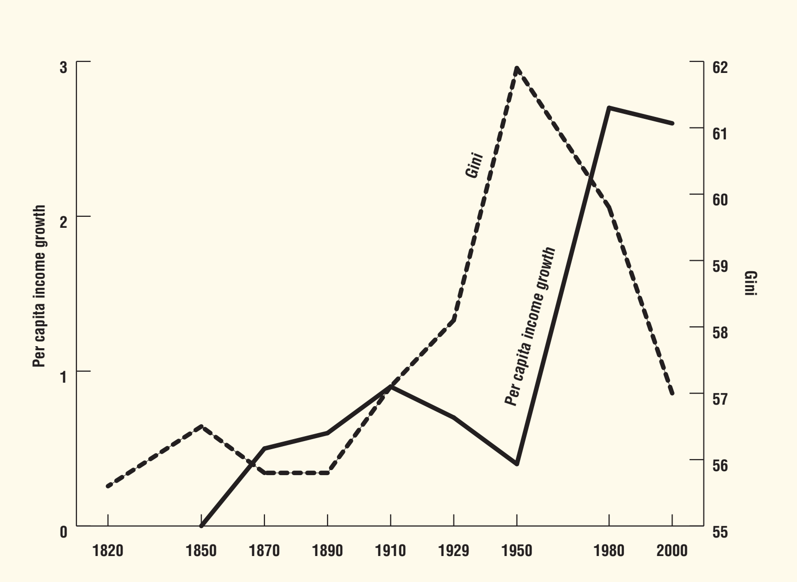
The "practice" of markets has been the major factor behind historical rates of

1 Consumption Growth and the Pace of Poverty Reduction



Note: The figures represent annual averages.

2 Developing World: Inequality and Per Capita Income Growth



Note: The Gini represents the level of inequality in the designated years; per capita growth is average annual growth between two periods.

poverty reduction. But the practice of capitalism and/or enhancement of markets is widely considered a four-letter word (according to those professing political correctness).

The basic complaint against capitalism or "markets" is that while it can and does generate extra growth, it does leave a lot to be desired in terms of inequality. The much-too-often-heard and erroneous refrain is that under capitalism, the rich get richer and the poor get poorer. But like the invisible hand, this deemed politically correct adversity is nowhere to be seen. Indeed, the data are consistent with the alternate explanation—growth is good for poverty reduction. An old truism, but somewhat surprisingly, one that needs to be emphasized every second day.

Just last year, the two leading development institutions in the world came out with reports on the importance of inequality change for reduction of poverty. The presumption, and conclusion, was that inequality deterioration had led to considerable welfare loss for the poor, i.e., if inequality had not worsened, world poverty would have been reduced more. The first part of the statement is wrong—developing (and all) world income inequality not only has improved over the last twenty years, but done so for the first time ever (Chart 2). Over the long 130-year period from 1820 to 1980, developing world inequality increased (consumption inequality peaks in 1980); only in the last twenty years has it shown some decline. Not incoincidentally, inequality started declining when average per capita growth in the poorest countries (such as India and China) started exceeding average growth in the rich countries around 1980.

Yet another (and more heuristic) indicator of inequality change is the excess growth experienced by the bottom 40 percent of the population. When this "excess" growth is negative, inequality has worsened. For example, between 1950 and 1980, average per capita consumption growth in developing economies was 1.8 percent annually; the bottom 40 percent had an average growth rate of 1.6 percent per year. So excess growth for this group was –0.2 percent per year (Chart 3). But

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globalization during the 1980–2000 period (the one severely criticized for worsening inequality) actually shows the poor reflecting a higher growth than average: 3.1 percent annually versus 2.2 percent, an excess growth of 0.9 percent per year.

Fast poverty reduction and improving inequality is not the news one obtains from a cursory perusal of major international newspapers, or the outpourings of international organizations dedicated to the removal of absolute poverty. The chorus: poverty reduction, especially in the last twenty years, has been a failure. Indeed, according to the World Bank, the number of poor in the world barely budged between 1.2 billion in 1990 and 1.1 billion in 2001. This deemed lack of poverty reduction has been the mantra (see Joseph Stiglitz's book, *Globalization and Its Discontents*), and the cause has been variously but mostly attributed to "capitalistic growth" models. History shows these conclusions as false. In my view, poverty reduction has been of such gargantuan proportions (as indicated in Chart 1) that it is time for the world to think about relative poverty. Most of the present poor, and future poor, are relatively poor. This fact should be recognized, and the absolute poverty line, currently at $1.08 1993 purchasing power parity dollars per capita per day, needs to be raised to about $2 (2005 PPP) dollars a day.

Given this historical and miraculous improvement for the world's poor, the question remains: Why isn't this one of the biggest stories of our time? There are several reasons, some good, some perverse, for this disconnect between rock band political correctness and economic reality. It could be argued that by constantly downplaying the success in poverty reduction, the poor of the world would actually gain more resources to redress their poverty. Extended, this argument means that agencies such as the World Bank can actually lobby the rich governments to give more money for poverty alleviation.

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The average sub-Saharan/Latin America per capita growth (two continents that witnessed near zero growth for the long two decades 1981 to 2002) since 2002 has been over 2.5 percent annually.

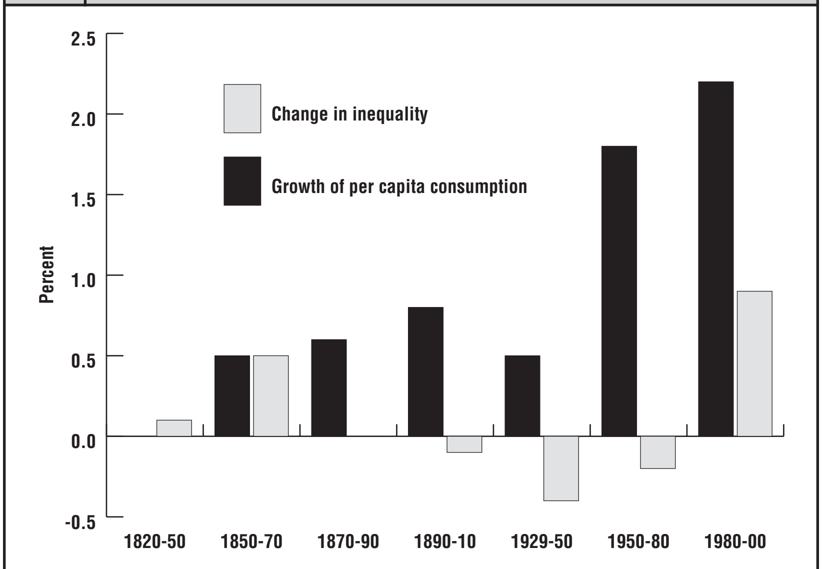
Extended further, the assumption is that aid monies will be "correctly" allocated to the needy in poor countries. Even if all this is done, the extra money gained due to drawing attention to the world's poor by downplaying poverty achievements has still not reached the poor. That involves the assumption that developing country governments will actually deliver money meant for the poor to the poor. Anybody who buys this sequence of probabilities is "knowledge-proof" about the political reality in the developing world. There maybe such buyers of snake oil in rich countries, but developing country practitioners know better. As far back as 1985, the then-Indian Prime Minister Rajiv Gandhi announced that only 15 percent of every rupee meant for the poor ever reached the poor; the reality has only worsened since then.

THE PRESENT AND FUTURE

The last few years have been witness to a resurgence in world growth; and both Latin America and sub-Saharan Africa have shared in it. The average sub-Saharan/Latin America per capita growth (two continents that witnessed near zero growth for the long two decades 1981 to 2002) since 2002 has been over 2.5 percent annually; for Asian (and eastern European economies), the growth has been in excess of 6 percent annually! For developed economies the growth has been close to 2 percent. Surely, this is the golden age for poverty reduction.

But such an age is not recognized by most analysts and most definitely not by international organizations like the World Bank and United Nations. The question does arise: was the growth made possible by state interventions or by the "capitalistic market"? Phrased differently, what are the lessons for Africa from all of this history? Is it Communism that did it? Or was it dictatorship? Or was it enlightened state intervention as argued by some? In all of this heart-burning, let us also not forget about the "bad" globalization period—so "bad" that it has helped move close to a billion people out of poverty in the last twenty sweet years. The growth did it, not government intervention, benign or otherwise. And growth for the poor was helped by a decline in world inequality, as poor countries grew faster than rich countries. ◆

3 Inequality and Consumption



Note: Inequality change is the excess growth of the bottom 40 percent of the population relative to average growth.

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