

Reducing Poverty: Some Lessons from the Last Quarter Century

Joseph E. Stiglitz

Manchester

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Impressive Achievements, Major Failures, Many Ambiguities

- Major reductions in poverty in China

	1990	2005
Living under PPP \$1.25/day	673m	207.7m
Living under PPP \$2/day	970m	437.7m
Infant mortality rate (per 1,000 lives)	37	22
Access to improved sanitation facilities (% of population)	48	65

- Increases in poverty in Africa –
Unlikely to achieve MDG poverty target (29%) by 2015

	1990	2005	2015
Living under PPP \$1.25/day	297.5m	388.4m	356.4m
Living under PPP \$2/day	393.6m	556.7m	585.0m
Living under PPP \$1.25/day (% of population)	57.6%	50.9%	37.1%

*All data from World Bank, “Global Economic Prospect 2009” and the Millennium Development Goal database.

Impressive Achievements, Major Failures, Many Ambiguities

- Measurement problems
 - Apparent in assessment of India
 - Improvement in childhood nutrition (Children under 5 underweight decreased negligibly from 44.4% in 1999 to 43.5% in 2006 – WHO)
 - Debate on whether World Bank's poverty numbers are overestimated due to PPP measurement. (*Debates on the Measurement of Global Poverty* discusses this.)
 - Income only partially correlated with broader measure

Many Dimensions of Poverty

- Income
- Insecurity
- Voice

Central message of WDR 2000/2001:

Income can increase at the same time that insecurity increases

Many Dimensions of Poverty:

International Commission on the Measurement of Economic Performance and Social Progress

Central message: Measurement Matters

- GDP per capita, even disposable income per capita are not good measures of well-being (one of reasons why there are many MDG's)
 - With growing inequality, average income can increase while median income declines and poverty increases
 - Why we have to keep focus on poverty
 - Explains why trickle down economics doesn't work

Many Dimensions of Poverty:

International Commission on the Measurement of Economic Performance and Social Progress

- Income is not the only factor contributing to “well-being”
 - Importance of social-connectedness (Putnam)
 - Importance of employment
- Many problems in measuring income
 - GDP does not measure income of citizens in country
 - Especially important in open economies (and even more so in natural resource-based economies with foreign firms extracting oil and minerals)
 - Many sectors’ (government, health) output is measured by input
 - Transition to market economy imposes even greater challenges in measuring increases in standards of living
- Importance of sustainability
 - Should take into account depletion of natural resources and degradation of environment

Broader measures can give different views both on progress over time and comparisons across countries

Some Big Lessons

- Growth is necessary but not sufficient for long-term poverty reduction
 - Trickle down economics doesn't work
 - If growth is accompanied by an increase in inequality, poverty can even increase
- *Policies matter*
 - Some policies that were argued *for* (e.g. by Washington Consensus) did not promote sustained growth and may have increased inequality
 - Capital and financial market liberalization

Key Ingredients Missing from Old Models

- Learning
 - Including local and traditional knowledge
- Balanced role of markets and state
 - So governance matters
 - And strategies for improving performance of state
- Social capital
- Sustainability

Old Models

Old models (Washington consensus) focused on wrong things, made wrong assumptions:

- Markets by themselves would suffice
- The proposition that “price stability is necessary and (almost) sufficient for growth” is wrong
 - There are a few cases of high with moderate (or worse) inflation
 - There are many cases of low inflation without growth
 - Price stability pursued wrong way can be antithetical both to growth and *real* stability

Creating a Learning Society

- What separates developed from developing countries is not so much a gap in resources but a gap in knowledge
 - Old view: reduce disparity in capital (World Bank)
 - New view: reduce disparity in knowledge
 - Investments in technology
 - Investments in education (and not just primary education)
 - Promoting entrepreneurship
 - Can be conflicts between short-run efficient allocation and long-run growth (learning)
 - Exemplified by patent system
 - Justification for industrial policies (including trade policies) that distort short-run allocation of resources
 - The infant economy argument for protection, exchange rate management

The Importance of Local Knowledge

- Technologies, projects making use of local technology, and resources, taking into account local preferences and needs
- Importance of local finance, management
 - Challenge is to combine “global” and “local”
 - Applying global knowledge to local situation
 - Financial market liberalization often results in reduced flow of capital to local SMEs, with adverse effects on development

Governance Matters

- Successful development requires an important role for the state
 - Markets alone don't work
 - And government has to go beyond setting rules of game
 - Not only a restraining role (e.g. in financial sector regulation)
 - Not only a market enhancing role (e.g. through competition policy and providing credit to SMEs)
 - But also a catalytic and constructive role
 - Successful **development states**
 - But even in setting rules of game, “governance” matters
 - Wrong rules can lead to more inequality, higher instability, lower growth

Market Failures and Public Failures

- There are both market failures and public failures
 - Simplistic solutions of “privatization” failed
 - Particularly serious problems in the privatization process itself
 - And when it succeeded, it was often because of easing capital constraints imposed by poor budgeting/accounting frameworks (often imposed by IMF)
 - Important agenda of improving the performance of government (“reinventing government”)
 - Including reforms in political processes

The Endogeneity of Governance

- To a large extent, good governance is an endogenous variable
 - Some states are rent-seeking/predatory, others are wealth-creating
 - Affected by wealth, inequality
 - In societies marked by a high degree of inequality, state may serve to preserve inequality, more likely to be engaged in rent-seeking
 - With less confidence in state, state is likely to be smaller
 - Absence of “public goods”
 - Successful cases: Scandinavia

Social Capital Matters, Too

- Societal performance depends on more than just government and the private sector
- We may not know precisely how to build social capital, but there are policies that can undermine it, and other policies that can enhance it
 - Well designed micro-credit schemes can enhance social capital
 - Poorly managed globalization/urbanization strategies can undermine it

Importance of Sustainability

- Social, political, economic, and environmental sustainability
- Growth in U.S. focused on wrong variables
 - While GDP per capita was increasing, most individuals were worse off year after year
 - The environment was being degraded, resources depleted
 - “Social capital” undermined—increasing number in prison, with health problems (like obesity)
 - Growth numbers distorted by measurement problems
 - Real estate prices were “bubble prices”
 - And financial sector profits were fictional
 - Growth based on debt
 - In the end—growth was not sustainable
 - And it will take a long time to return to prosperity
- **MANY DEVELOPING COUNTRIES FACE ANALOGOUS PROBLEMS**
 - Especially those whose growth is resource-based

What *Doesn't* Work

Natural resource curse

- Particularly important in some countries with high poverty
- Rich countries with poor people
- Unless assets below the ground are reinvested as assets above the ground as they are depleted, the country is becoming poorer
- Face problems of
 - Instability
 - Rent seeking undermining good governance
 - Currency appreciation undermines development
 - Few “learning” spillovers

When Is Growth Anti-Poor?

- When it is accompanied by high unemployment
- High levels of *real* instability

Variety of policies contribute to high unemployment, volatility

– Sequencing, pacing critical

- Easier to destroy jobs than to create them
- Creating jobs requires new enterprises
- That implies access to capital, knowledge markets
 - It is not just financial market stability that is important but also *access*, availability of capital
 - FML, CML had the wrong focus, may have adverse effects

When Is Growth Anti-Poor?

- Growth that is accompanied by high **unemployment** is anti-poor
 - Unemployment has particularly large adverse effects when there is no safety net
 - High unemployment puts downward pressure on wages
 - Long-term effects—can have life-long effects
 - hysteresis
 - Unemployment destroys human capital
 - Education interrupted, malnutrition, long term health effects

When Is Growth Anti-Poor?

- Growth with *real instability* (booms and busts) is anti-poor
 - Ratchet effects—decrease in (real) wages in downturn not fully made up in upturn
 - Especially when monetary policy tightens at sight of an increase in wages

What Causes/Contributes to Real Instability, Persistent Unemployment?

- Financial and capital market liberalization
 - Exposing countries to vicissitudes of global financial market
- Inadequate financial market regulation
 - Major lesson of this Great Recession
 - Loss of efficiency from moderate inflation an order of magnitude smaller than loss of efficiency from financial market instability/malperformance
- Exchange rate volatility
 - Markets by themselves can be highly unstable and not self-correcting (in relevant time frame)
- Ambiguous effects of wage “flexibility”
 - Can contribute to greater volatility, through effects on aggregate demand
 - Many “rigidities” are market-based (efficiency wage theories)
 - Job protections may also reduce poverty impact of cyclical variability

Developmental Innovations

- Conditional cash transfers
- Micro-credit
- Improved cooking stoves—impact on health, climate change, environment, burdens on women in gathering women
- Oral rehydration therapy
- Social forestry

Developmental Innovations

- Micro-credit—when successful, more than just finance, a transfer of cash
 - Consumer loans could lead individuals to be more indebted, poorer
 - Most successful programs have had a broader developmental agenda (including promoting social capital)
 - Alternative (and more successful) approach to providing credit and promoting development than “legal entitlement” (DeSoto) approach

National and Global Agendas for Reducing Poverty

- Washington Consensus policies did not promote growth, and even when they did, growth was not equitably shared. Countries (like China, and others in East Asia) that pursued other strategies had more success
- We need to learn from successes and failures
 - Global policies
 - Global institutions
 - But national policies and institutions have to “adapt” to global context—even when that context is adverse

Improved Global Policies/Institutions for Promoting Stability

- Failure of IMF, FSB and the policies that they pushed
- Private markets do a poor job in transferring risk from poor countries to rich
- Need better systems of global risk management
- And a new global reserve system
 - Enhancing global aggregate demand
 - Promoting global stability
 - And more equitable than the current system

Improved Global Policies/Institutions for Promoting Growth

- A true development round
 - Agricultural policies particularly hard on poor
 - Escalating tariffs, agricultural subsidies, non-tariff barriers
- A development-oriented intellectual property regime
 - Access to knowledge is critical
 - Including knowledge related to climate change mitigation/adaptation
 - But also access to medicines
- A pro-development climate change policy
 - Recognizing that developing countries bear burden of global warming
 - Honoring past commitments (1992) concerning finance and technology transfer
- Bad governance of global institutions partially accounts for bad policies
 - And sets a bad example for “good governance”

Recognizing the “Right” Policies Is Not Enough

- **Example:** financial reforms in advanced industrial countries
 - Political power of large banks stymied effective reform
 - But some of same powers dominate/play large role in international financial institutions
 - And these same powers stymie the governance reforms that would undermine their political powers
- Interests, politics are critical

But Ideas Matter, Too

- Ideas about how to promote growth and reduce poverty have played an important role in shaping policies
 - Even when these ideas were wrong or incomplete
- Silver lining on cloud of global recession: new perspectives, new thinking on economic policy
 - Offers rare opportunity for reshaping policies