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The Poverty Paradox – And How to Address It

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Poverty alleviation is the cornerstone and mission of the development community. Yet perhaps the community's focus on low-income countries (LICs) has skewed a healthy and accurate evaluation of the effectiveness of its interventions. A careful analysis of the current data indicates that the majority of poverty is found within middle-income countries (MICs) and not in the LICs. Seemingly unaware of this, the policy of the development community is still aiming at promoting LICs to become MICs. Once having become a MIC, it is assumed that poverty reduction will be accommodated largely by the national growth policies, supported by non-grant funds, international financial institutions (IFIs) and the global financial market.

Poverty reduction is the main goal for most donors and international financial institutions (IFIs). Conventional wisdom says, not surprisingly, that this goal is best accomplished when poverty is reduced in the poorest countries, i.e. in low-income countries (LICs) with a GNI/capita of less than US$1,000. Countries having attained and sustained higher income levels – the so called middle-income countries (MICs) – are generally seen as targets for stronger trade relations and more mutually beneficial cooperation arrangements by bilateral donors. This is because poverty is expected to be addressed by the MIC governments themselves. In addition, IFIs are generally more active in MICs.

Where Do the Poor Live?

Interestingly, recent figures from the World Bank's PovcalNet that have been thoroughly analysed by the Institute of Development Studies (IDS), Overseas Development Institute (ODI) and other institutions show that 80 percent, or almost two billion people, of the world's poor – those living on less than US$2 per day – live in MICs.[1] Half of them live in China and India, and 25 percent in other major MICs such as Indonesia, Nigeria and Pakistan. When the threshold for poverty is lowered to US$1.25 per day – referred to as "extreme poverty" – the number of poor decreases from 2.4 to 1.2 billion . Again, the overwhelming majority, almost three quarters, live in MICs.

In a deeper analysis of the data, Kharas and Rogerson find that poverty is mostly concentrated in what they define as "fragile and conflict-affected states", be them either LICs or MICs. In 2011, this group was made up of 45 countries. Some 70 percent of the poor are found in five of these countries, namely Nigeria, the Democratic Republic of Congo, Bangladesh, Pakistan and Kenya. Moreover, Sumner shows that the overwhelming number of poor people live in lower MICs (average income between US$1,000 and 3,975). The figures clearly demonstrate that poverty, including extreme poverty, cannot be seen as an issue solely related to the poorest countries, which has been the prevailing conventional wisdom within the donor community.

Growth Without Poverty Reduction?

Since 2000, 28 countries have "graduated" to MIC status. The successful transformation of many LICs to MICs, along with strong growth in many MICs, has not eradicated poverty in MICs. Not only has the absolute number of extremely poor been falling less than one would expect, in growth economies like Angola, India and Nigeria the number has actually risen. Furthermore, when considering the two dollars per day poverty line, only two countries, China and Vietnam, have seen a substantial fall in poverty.[2] Taken together, this seems to imply that there is no trickle-down effect inherent in growth. Despite rapid growth, there are still large pockets of poverty in economies that often are regarded as growth wonders.

There are no simple or singular explanations as to why growth is not transformed into poverty alleviation across the population in these countries. Surely the lack of inclusiveness of economic growth policies has been one important parameter. Despite this, projections built on World Bank data assume that poverty eventually will fade away as growth continues. These forecasts predict a distinct fall in poverty in larger emerging market economies such as China, India and Indonesia. High poverty would then only remain in war-torn and fragile LICs, and in middle-income fragile and failed states (MIFFS), such as Iraq, Nigeria, Pakistan and Yemen. Other Arab Spring countries that might not succeed in achieving a stable society may also be grouped as MIFFS. Following the MIFFS definition, poverty would then to a large extent be seen as a product of political turmoil. This observation was also highlighted in the World Bank Development Report for 2011, with a focus on development and conflict resolution.

Middle-Income Trap

The projections are, however, quite uncertain and may not include political eventualities. It appears that some authoritarian and one-party states have been successful in breaking the low-income trap and accomplishing rapid economic growth through globalisation and market liberalisation. Recent examples of this seem to be Ethiopia and Rwanda. However, the lack of a subsequent political and economic liberalisation may in fact serve as a glass ceiling to further growth. The emerging discussion on middle-income traps may well bend the projections in another direction, leading to social and political unrest and to an expansion of the MIFFS category and the inclusion of populous countries such as China, Indonesia and Vietnam. Global poverty would then increase rather than fade away. In order to avoid becoming a victim of the middle-income trap, analysts suggest that major shifts are necessary in these countries. The present "invest and export" strategy would need to be shifted over to a domestic consumer-led economy, underpinned by the development of stronger social safety nets vis-à-vis labor, national health and pension reforms.

Challenges on Development Cooperation

Regardless of future growth trends, the paradox that poverty remains high even under regimes with strong economic growth has been largely overlooked in the general debate on poverty. This fact, no doubt, serves as a challenge to both donor communities and to IFIs and requires a review of current development cooperation policies. Some of the more pertinent policy recommendations are briefly discussed below:

1. The UN millennium development goals (MDGs) are to be reviewed by a high-level panel as part of the post-2015 development agenda, initiating its work in the fall of 2012. According to the MDG progress report for 2012 from the United Nations, it appears that the poverty goal of halving the population living on less than US$1.25 per day – the initial definition was US$1 per day – will be achieved by 2015. As this policy brief enumerates however, almost 2 billion people continue to live on less than US$2 per day, most of whom live in MICs. Moreover, the International Labour Organization's (ILO) contribution of measuring the poverty target in terms of earnings from employment rather than any type of income is a more sustainable measure, and should replace the original target. And if this earnings' target is used, the achievements of poverty reduction are less impressive. A more thorough analysis of the linkages between national growth and poverty reduction should therefore form a useful platform to the high-level panel's formulation of new poverty targets.

2. The weak link between national economic growth and poverty reduction has been addressed by academics as well as global institutions formulating the development agenda. Inclusive growth is on the agenda highlighted in the Asia Development Bank's forecast, Asia 2050.[3] Growth and inclusion do not need to be mutually exclusive. On the contrary, inclusive economic growth is necessary in order to maintain sustainable and resilient development. This means employment creation as well as access to public services. The experiences in Indonesia, supported by the ILO, of using employment diagnostics and employment targeting, are worth reviewing and mainstreaming, also with regard to the redefinition of the MDGs.

3. The fact that several fast-growing economies are either approaching or already suffering from the consequences of a middle-income trap may just as well have a political explanation rather than solely an economic one. The democratic

deficiency in these autocratically governed states means that the interest groups struggling for social justice and equality generally lack a voice in the socio-political dialogue. What these governments have not internalised as policy is that the impact on growth from an expanding and diversified consumer demand would be a welcome diversification to the current "invest and export" polices of these MICs . This would entail a rebalancing of the economic policy by creating a welfare state and moving away from focusing only on building wealth. The issue at hand is not so much how to design and develop affordable welfare programmes, but rather how to ensure growth that is sustainable and more equally shared by the population. Such policies would most likely also strengthen social capital and prevent social outbursts, particularly when combined with political liberalisation. Subsequent reforms of public administration, including economic and financial institutions, would lay the foundation for good governance. One can allude to Amartya Sen's conclusion that famine is easy to prevent in a democratic society and state that inclusive growth is best achieved under democratic rule.

4. The future of international development cooperation is multidimensional and involves much more than aid or even finance. As stated in the Swedish policy on Partners in Development, it involves trade, investment, migration, foreign relations, science and technology, etc. As global poverty reduction becomes increasingly successful, the two instruments of aid and finance are decreasing in importance in development cooperation. These issues have been analysed by ODI in the context of whether traditional aid agencies will survive until 2025 and, if so, how they must change.[4] The cost of closing the global poverty gap is, according to the ODI scenario, decreasing. This development, however, builds on the assumption that the MICs will be able to avoid the middle-income trap.

Implications for Swedish Development Cooperation

For a donor country such as Sweden, these findings have two major implications:

1. Sweden is providing development cooperation to both LICs and MICs. Generally speaking, the emphasis on poverty alleviation and support for growth policies receives less attention when a partner country has passed the threshold for an MIC, although it is still formally serving as the overall goal for all Swedish development cooperation. For instance, development cooperation with MICs such as China, Indonesia, Namibia, South Africa and Vietnam has in practice shifted emphasis from poverty alleviation to partner-driven cooperation arrangements. Additionally, it will, from 2014, be phased out of the framework of cooperation strategies that are being used to assess and suggest policy objectives on poverty alleviation, democracy and human rights. Surely this implies a lost opportunity to continue focusing on global poverty reduction and conduct bilateral dialogue on pro-poor growth policies and redistribution arrangements with these countries.

2. Considering Sweden's experience with social safety nets and the gradual build up of the welfare state, one can assume that MICs would be interested in learning from these policies in order to share the national income more equally and to build long-term conditions for social and economic growth. Demonstrating such policies as part of the bilateral dialogue would probably increase the appetite among these countries to adapt and apply some of these policies and systems. In fact, the new model on partner-driven cooperation arrangements with MICs could serve as a vehicle for the sharing of Swedish experiences in social and human development, be it health insurance, pension schemes, or other forms of social security focussing on strengthening human capital.

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Endnotes

1. Reported for example in the IDS Working Paper No. 393, "Where Do The World's Poor Live?" (2012) by A. Sumner, and in the ODI report "Horizon 2025: creative destruction in the aid industry" (2012) by H. Karas and A. Rogerson.

2. IDS, op cit, 10.

3. "Asia 2050: Realizing the Asian Century," (2011) Asian Development Bank.

4. H. Karas and A. Rogerson, "Horizon 2025: creative destruction in the aid industry" (2012) Overseas Development Institute.

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