



Escaping chronic poverty through economic growth



Workers at SAP in Burkina Faso, West Africa's only tyre factory for bicycles, which produces for domestic and export markets. While agriculture is central to many chronically poor people's livelihoods today, transformative growth – involving an expansion of manufacturing – is needed to eradicate chronic poverty. Photo: © Jan Banning/Panos Pictures (2004).

What is Chronic Poverty?

The distinguishing feature of chronic poverty is extended duration in absolute poverty. Therefore, chronically poor people always, or usually, live below a poverty line, which is normally defined in terms of a money indicator (e.g. consumption, income, etc.), but could also be defined in terms of wider or subjective aspects of deprivation. This is different from the transitorily poor, who move in and out of poverty, or only occasionally fall below the poverty line.

Key points

- Chronically poor people engage weakly, if at all, in economic growth, due to the multiple deprivations and adverse socioeconomic relationships they experience.
- Growth is necessary, but not sufficient, to tackle chronic poverty. The form that growth takes is critical. It is not enough to have growth solely in the sectors where poor people are most represented (e.g. agriculture). Substantial poverty reduction requires transformative growth and large-scale structural change.
- Even in highly unequal economies, growth can contribute to poverty reduction: but only if fiscal institutions are built to generate revenue, and focus on the poor and their needs.
- In framing economic policy, high priority must be given to the needs of poor people, and any policy must pass the test of poverty reduction. The linkages must be firm and the timescale reasonable.
- Economic growth can stimulate social change and new political spaces for articulating the voice of chronically poor people. This in turn can help to lay the ground for ending adverse incorporation.



Introduction

Tackling chronic poverty is the global priority for our generation. Between 320 and 443 million people are now trapped in poverty, and many of these people will remain in poverty for their entire lifetime. We are talking about a number roughly equivalent to the combined populations of the US and Japan.

The Chronic Poverty Report 2008-09 states that there are clear limits to the extent to which economic growth alone can tackle chronic poverty. Many Poverty Reduction Strategies (PRSs) lack an adequate conception of what it means to be chronically poor. They are therefore largely bereft of ideas on how to effectively connect chronically poor people to the growth process, and what to do for the chronically poor who are left out. In this Policy Brief, we discuss how chronically poor people participate in growth (or are excluded), and how different forms of growth connect to poverty. We highlight important policy levers, in relation to agriculture, urbanisation, social protection and fiscal reform.

The problem with growth

Chronically poor people engage weakly, if at all, in economic growth, due to their multiple deprivations and adverse socioeconomic relationships.

In principle, there are three links between higher economic growth and the eradication of chronic poverty. First, the link can be direct, if the chronically poor are farmers achieving higher output (following the successful adoption of a new seed technology, for example), or micro-entrepreneurs selling new products and services (resulting from investments financed from micro-loans, perhaps).

Second, the link can be less direct, but still clear, when chronically poor people exchange their labour for wages, by working for smallholders, large farmers, and manufacturers (both large and small). In all of these cases, chronically poor people are participating in the process of economic growth. They are sharing in society's increasing value-added, either as producers themselves, or as employees (frequently switching between, or integrating, farm-based, non-farm and labouring activities).

The third, and often ignored, relationship between growth and poverty is the fiscal link, whereby growth raises the revenue base and therefore the potential for pro-poor public spending.

In reality, these links are often constrained, and

the extent to which economic growth alone can tackle chronic poverty is limited. In a growing economy the chronically poor may fall behind the poor in general. In the worst cases, their situation may deteriorate. If, for instance, they have insecure tenure, they may lose their land to the more powerful, as its commercial value rises with economic growth.

Chronically poor people are actively engaged in different economies, but often on very weak terms. A number of poverty traps effectively lock them out of national growth processes (and the benefits of globalisation). Three traps are particularly inhibiting:

1. Insecurity

Chronically poor people are often coping with shocks and stresses, with few assets to buffer them. This means they are unable to invest in new income-earning strategies or long-term benefits, because of their immediate need to survive. For example, they may be unable to prioritise their children's education over work. This not only perpetuates chronic poverty across generations, but also reduces society's stock of human capital (and therefore growth itself). Chronically poor people often experience food deficits, with little prospect of raising output in response to new opportunities. Illness may also prevent them from participating effectively in a growing labour market.

2. Spatial disadvantage

Chronically poor people often live or work in disadvantaged areas. These may be remote from the best national markets; in areas of low agricultural productivity, ill served by transport and communications infrastructure; in precarious locations, with high levels of violence that restrict livelihoods; or with unhealthy living conditions, which impinge on their ability to work. These areas are often politically excluded and low on the policy agenda. Discrimination against people from certain neighbourhoods can be particularly detrimental to job seeking.

3. Poor work opportunities

Where there is limited economic growth, or where growth is concentrated in enclaves, work opportunities are restricted and people can be exploited. Work may enable survival, but the work itself can be demeaning, dangerous, and often does not permit longer term investments in people's futures. Modern slavery takes

Box 1: Poor working conditions

Eleven-year-old Bakyt, and his two brothers, work in a private coal mine, earning income to support their family. The brothers work in extremely small mine shafts, lugging sacks of coal out on their backs. Working in the mine is dangerous: the shafts have no supports and could collapse at any time. Due to their poor diet, hard work and poverty, the brothers and their sister are frequently sick. But working for 12 hours in the mine puts food on the table, which allows them and their disabled mother and grandmother to survive.

many forms, including bonded labour and the trafficking of women into prostitution. In the worst cases, people are too sick or physically impaired to work, or too infirm after a lifetime of backbreaking work. Less dramatically, many chronically poor people depend on work which is insecure, low paid, unhealthy and unsafe. They may have little scope to improve their situation (Box 1).

Globalisation is creating a world in which the poorest are exposed to new and perhaps greater levels of hazard – financial crisis, economic restructuring, increasing food prices and climate change. The current food price crisis provides a clear example of globalisation's 'unexpected effects' (Box 2). Global climate change is starting to undermine the viability of some rural livelihoods, often increasing variability in temperature and rainfall, with implications for urban areas too. Growth that decreases natural capital is not good for the poor; nor is it sustainable in the long run.

Transformative growth can work for chronically poor people

Growth solely in the sectors where poor people are most represented (e.g. agriculture), whilst necessary, is not enough. For example, Sub-Saharan Africa (SSA) is now seeing growth (above 5% annually since 2005), in contrast to the stagnation and decline of the recent past. Some of this is occurring within the smallholder sector, and is therefore beneficial to Africa's chronically poor. But there are long-standing constraints, such as institutional problems, and a high incidence of landlocked countries with inadequate infrastructure. These hold back the region's progress in achieving structural change. High world demand for SSA's minerals is the main driver

of growth. Investments in processing will add much needed value to the mineral sector. The benefit for chronically poor people, however, will almost entirely be indirect, through sharing in the proceeds of revenue generation.

Whether growth generates large-scale structural change has major implications for poverty. Take, for example, the cases of Ethiopia and Vietnam, where growth has been sustained over the last decade. Vietnam has experienced transformative growth – involving the creation of new export-manufacturing activities – whereas Ethiopia has not (agriculture's share of output is much the same as it was ten years ago). This shows up in the poverty outcomes. Evidence from an Ethiopian rural panel survey (from 1994 to 2004) indicates improving consumption levels (although with high variance, due to climatic factors) and a fall in poverty: 27% of households exited poverty while 13% entered poverty, contributing to an exit-to-entry ratio of 2.1. However, most people remain dependent on the vagaries of an agricultural livelihood, with little non-farm employment available (and high rates of urban underemployment). In contrast, the rural panel in Vietnam (2002-04) shows that 14.4% of households exited poverty while only 5.8% entered poverty, contributing to an exit-to-entry ratio of 2.5.

International trade has immense potential to transform economies and lift people out of poverty. This is especially true in very small countries (many of them African), where the size of the internal market limits growth through import-substitution (part of the success of the large economies of China and India). However, benefits from trade can exclude chronically poor people, such as those who live in regions where possibilities for export-crop farming are limited (as many do).

Globalisation is changing national (and local) prospects for growth. In contrast to Africa, much of Asia is already undergoing transformative growth. This involves fast structural change – including the creation of entirely new activities that push economies up the value-added chain (India's export of IT services, for example).

International trade is associated with foreign direct investment and technology transfer, when governments provide the right institutional environment. The mix of market mechanisms and state controls used to achieve this varies greatly across countries. **It is, however, imperative to build an effective system of public finance to fund investments in high-return infrastructure, human capital, and developmental institutions.** These factors all improve a country's chance of successfully integrating in the global economy.



Public policy to make growth work for chronically poor people

Measures are required to maximise inclusion in growth processes, and provide protection for those excluded. Transformative growth does not necessarily provide increased opportunities (directly or indirectly) for chronically poor people. Indeed, it can make things worse for them – through increasing inequality, restructuring labour markets, or forced displacement. Nevertheless, countries should aim for transformative growth. But when shifts in the sectoral composition of an economy harm chronically poor people, social protection policies that mitigate the adverse effects of growth on the chronically poor are vital (refer to Box 2 on rising food prices).

There is much promise in linking social protection more effectively to growth. This can be done by changing the character (and depth) of the market environment in which each country's industrial-policy strategy is framed. By definition, a market is a social institution in which 'money talks' – cash transfers to chronically poor people provide them with a market voice. That cash may create a market where none existed before – by making it profitable for entrepreneurs to invest in the production and supply of goods and services for which there was previously no effective demand. Cash transfers raise the level of aggregate demand, and they change the sectoral composition of demand towards the basic goods and services required by poor people.

Where opportunities for transformative growth are limited, growth in the sectors where poor people are most represented (such as agriculture) can be supported. Agriculture can be a strong motor for reducing chronic poverty, and plenty can be done to make agriculture work for chronically poor people.

Connectivity and infrastructure provide numerous benefits to rural households. CPRC research in rural Uganda found that improved roads had increased farm-gate prices for both crops and livestock (due to greater competition among traders), and had provided easier access to district markets. Horticulture had expanded rapidly – a needed replacement for declining coffee yields. Moreover, the non-farm rural economy (for example, brick making, vending, beer brewing and tailoring) had expanded, due to increased demand for goods and services associated with improved on-farm incomes. Young men were engaged in boda boda (motorcycle taxis) to link the village with urban centres, and the weekly market was thriving.

Box 2: Food prices, growth and chronic poverty

Since 2003, global food prices for major staple crops have been on the increase. Since 2006 these price rises have escalated rapidly, fuelled in part by oil price rises. This is mainly a result of growth, and consequent changing consumption patterns (more meat, vegetables, oil and fish), in China and other fast-growing developing countries, as well as changes in OECD demand, and policies on biofuels. Most analyses have concluded that prices will continue to rise in the medium term, even if not at the same pace, as the causes are structural.

Governments are keeping a close watch on food price inflation. It can be politically dangerous, especially for authoritarian states. Poor people in urban areas may resort to street protests if price increases are too great. Rural discontent can be a big worry for countries with large spatial inequalities (for example, China, where many rural people have not shared in the globalisation-driven economic boom). Food riots have already taken place in Indonesia and Pakistan. Some governments are stepping up price controls: China, Russia and Thailand have all capped basic food staples. Malaysia is planning to stockpile basic foods, while Venezuela is threatening to expropriate food companies that hoard. China, India, Egypt and Vietnam have all restricted rice exports, to boost domestic supply.

Chronically poor people have very few means to cope if price increases are too great. So even if production does rise eventually, the chronically poor could still suffer badly from rising food costs. Measures such as social protection and targeted nutrition interventions can help. Broad consumer food subsidies often benefit the rich more than the poor, since the rich consume more food.

Education can be linked to increased agricultural productivity, as well as enabling households to access non-agricultural activities – a likely route out of poverty. It also creates important ways out of rural poverty through facilitating successful migration to urban



areas, which can be an escape route from poverty. Those with higher educational levels move sooner, and have greater success in attaining reasonable employment.

Agricultural extension has been the conventional channel for disseminating information. CPRC country studies provide mixed evidence about its effectiveness, however. More effective ways of broadening access to information on job opportunities, on changing input and output markets, or on new farming or agro-processing enterprises and techniques, would offer improved opportunities to poor people in rural areas.

Strategic urbanisation can help to strengthen the contribution that economic growth can make to chronic poverty reduction. This requires policy makers to shift their framework, to consider a more dynamic national urban planning strategy. Such a strategy would link poor regions with economic potential to cities, promote the development of towns and cities in poor regions, and tackle the issue of social discrimination in urban labour markets.

Urbanisation can also have negative consequences. It can destroy livelihoods, and bring increased levels of economic inequality, which facilitate the concentration of political power. It can also have negative health and environmental effects, especially when it is not properly planned. Policy needs to manage and contain these harmful effects.

The politics of growth and revenue redistribution

Economic growth generates rapid social change, especially through urbanisation and migration, and these changes affect chronically poor people. Change can open up new political spaces, in which to organise and articulate voice. Trade unions and social movements are able to mobilise around vital issues, such as housing and displacement. This political voice can lay the ground for turning adverse incorporation into positive incorporation. This can be achieved through asset investment (and redistribution), greater accountability in public finances, and through the regulation of market economies in the public interest.

The challenge here is to address the underlying politics of inequality, and to achieve a more inclusive social compact between the state and its people. The resources generated by growth itself can provide an initial financial base from which to do this – but only if the institutions are built.

Domestic revenue must take centre stage for state-building. A country's tax base rises as growth brings increases in national income, market activity and trade (both domestic and international). This provides greater scope for collecting more public revenue, through indirect and direct taxes, as well as customs duties. Greater revenues can finance more pro-poor public spending. Examples include cash transfers to poor families (often encouraging greater school participation); greater provision of basic healthcare, sanitation and water infrastructure; and roads and communication systems that enhance existing livelihoods and generate new ones.

The fiscal link between growth and poverty is especially important when the main drivers of growth benefit few people directly. In Botswana, an effective social compact has been built, and the fiscal means consolidated, to redistribute the gains from high mineral revenues to the population. This has enabled growth to benefit wider sections of society, in a far more egalitarian way than would otherwise have been the case. Rising mineral revenues have allowed elites in states such as Angola and Equatorial Guinea to consolidate their rule. With little need to swap representation for taxation, they have mostly ignored the needs of large sections of the populace, which consequently remain impoverished.

The revenue base in many low-income countries remains highly volatile. This reflects the high variance in output when economies are relatively undiversified. **Donors can play an important role here, through providing stable and consistent aid flows for key social protection measures and social sector expenditures.** Moreover, broadening the tax base is desirable, to reduce overall revenue volatility. Broadening the VAT base, however, cannot be achieved without raising the tax burden on poor people.

There is a balance to be struck in mobilising more revenue, while not discouraging growth, or investment by poor people themselves. Simplifying the tax regime to make it institutionally compatible is important, although this may come at the cost of less progressivity. The income tax threshold should be high, in order to protect poor households. In Kenya, for example, the personal income tax threshold is four times the per capita income and has been consistently raised, relative to per capita income, to avoid overtaxing low-income earners. Ultimately, countries must create comprehensive income tax systems if they are to fund inclusive welfare regimes.



The Chronic Poverty Research Centre (CPRC) is an international partnership of universities, research institutes and NGOs, with the central aim of creating knowledge that contributes to both the speed and quality of poverty reduction, and a focus on assisting those who are trapped in poverty, particularly in sub-Saharan Africa and South Asia.

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This will also enable them to use tax credits and other mechanisms to target poor households.

There are success stories: Rwanda has successfully boosted its revenue–GDP ratio, for example. We need to know more about the political economy of such cases.

State–business relations in particular are central to promoting inclusive growth. They help to reduce market and coordination failures, ensure a more appropriate allocation of resources, and increase state credibility among capitalists. They also enable the state to guide and (where required) discipline capital, in line with broader developmental goals. Among chronically deprived countries there tends to be an absence of such relations.

Some steps towards enabling and building progressive state–business relations can be easily identified. Umbrella associations for private sector interests should be encouraged. They can draw together capitalist forces and provide a point of engagement for government. The inclusion of labour and civil society actors in such processes offers an important mechanism for controlling the potentially damaging forms of collusive behaviour that can emerge within state–business relations. (As the Asian crisis of the late 1990s revealed, there is a fine line between developmental statism and crony capitalism.) As growth builds the power of private capital, it is essential to develop state capacities to check capital's rent-seeking behaviour, and impose market discipline and competition.

Finally, **more can be done to include the interests of business and labour within**

key processes, such as Poverty Reduction Strategy (PRS) processes and the budget.

One example comes from Uganda, which in the late 1990s institutionalised two working groups at the apex of the budgetary process – the Private Sector Working Group and the Poverty Eradication Working Group. These vetted all proposals from sector working groups. This type of institutional innovation offers a practical way of incorporating interest groups into key political processes.

Conclusion

None of this is easy, and we do not pretend to offer a magic elixir for growth. In the history of development thinking there have been too many attempts to push one approach to growth, leading to cycles in fashion. Rather, we insist that in framing development policy, a high priority be given to the needs of poor people, and that any development policy must pass the test of poverty reduction. Thus, it is not enough to offer the general hope that a particular industrial policy will yield poverty reduction by raising growth. Instead the linkages must be firm, and the timescale reasonable.

Progressive social change is not a one way street. Globalisation has large (and often unpredictable) effects – including the present rise in global food prices – and progress towards chronic poverty reduction can therefore be all too easily reversed.

This policy brief was compiled by Ursula Grant

Further reading

This policy brief accompanies the **Chronic Poverty Report 2008-09: Escaping Poverty Traps**. It draws directly from the report, where full references can be found. Further reading includes:

Dercon, S., Hoddinott, J. and T. Woldehanna (2006). 'Growth and Poverty in Rural Ethiopia: Evidence from 15 Communities 1994-2004'. Chronic Poverty Report 2008-09 Background Paper. Manchester, UK: Chronic Poverty Research Centre (CPRC).

Grant, U. (2007). 'Urban Economic Growth and Chronic Poverty'. Chronic Poverty Report 2008-09 Background Paper. Manchester, UK: Chronic Poverty Research Centre (CPRC).

Underhill, G.R. D. and Zang, X. (2005). 'The Changing State-Market Condominium in East Asia: Rethinking the Political Underpinnings of Development', *New Political Economy*, 10(1), 1-24.

This policy brief is based on the Chronic Poverty Report 2008-09: Escaping Poverty Traps. For further information about the report, please visit www.chronicpoverty.org or contact cprc@manchester.ac.uk for a printed copy.