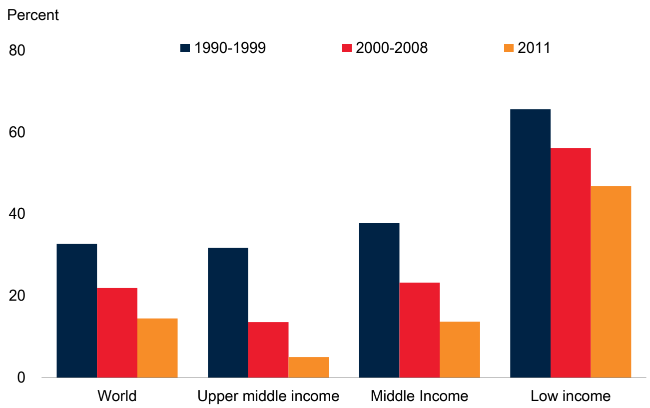
BOX 1.1 What does weak growth mean for poverty in the future?[1]

The Millennium Development Goal to halve extreme poverty was reached in 2010. Since then, the World Bank Group set a new goal, to reduce extreme poverty to below 3 percent by 2030. Under current growth projections, reaching this goal will be challenging. This increases the urgency of implementing growth-enhancing policies and structural reforms.

FIGURE B1.1.1 Evolution of global poverty, 1990–2011

Global poverty has fallen sharply since 2000.



Source: PovcalNet (2014).
Note: Simple average over the respective years. Poverty defined as share of population living on less than US $1.25 per day (in constant 2005 prices).

Global poverty has declined steeply over the past half century. The Millennium Development Goal of halving extreme poverty by 2015 was achieved ahead of schedule, as the share of the world's population living on less than $1.25 per day in constant 2005 prices declined from 36 percent in 1990 to 14.5 percent in 2011 (Figure B1.1.1). The reduction in poverty between 2000 and 2011 was aided by relatively high growth rates in developing economies, especially prior to the global financial crisis. Fast-growing Asian emerging markets—namely, China and, to a lesser extent, India—accounted for most of the decline in poverty.

Despite the rapid decline in poverty overall, it remains widespread. Almost half of the population of low-income countries still lives in extreme poverty. At the global level, more than one billion people, mostly in Sub-Saharan Africa and South Asia, are in extreme poverty. In April 2013, the World Bank set an ambitious new poverty target of reducing the share of people living in extreme poverty to 3 percent of the global population by 2030.[2]

Weaker growth in developing countries during the past three years raises questions about whether the significant decline in poverty achieved in recent decades can be repeated in the future. In 2012–14, growth in developing countries slowed to 4.5–4.9 percent, well below the average rate during the early 2000s, and is expected to rise only slowly, to about 5.4 percent by 2017. Moreover, the post-crisis slowdown in developing countries has been taking place in an environment of weak global growth.

In light of the fragile medium-term growth outlook, this box briefly examines the implications of various growth projections for the global poverty rate in 2030.

Why is growth so important for poverty reduction?

Growth is central to poverty reduction. Between 1970 and 2010, growth in average per capita income accounted for three-quarters of the income growth of the poor.[3] In particular, a significant part of poverty reduction was attributed to growth in labor income (Inchauste et al., 2014; Inchauste and Saavedra-Chanduvi, 2013). Increases in labor income are associated with a reduction in poverty through at least two channels. First, growth in the agricultural sector, the primary source of income for the poor, raises incomes more than growth in less labor-intensive sectors, in particular the natural resource sector. Second, the movement of labor from the low-productivity agriculture sector to the higher-productivity manufacturing and service sectors raises labor incomes, including of those of the poor (Kuznets 1955; Chenery, 1979; Ngai and Pissarides, 2008).

[1]The main author of this box is Vandana Chandra.

[2]The poverty goal is one of the World Bank's twin goals. The other goal is to promote shared prosperity by improving the living standards of the bottom 40 percent of the population in every country. The poverty target is 3 percent (as opposed to zero) in order to accommodate persistence due to exogenous shocks, such as conflict and drought, as well as the churning that occurs when vulnerable families fall back into extreme poverty. Basu (2013) presents a detailed discussion of the normative properties of these goals, their strengths and weaknesses, and their implications for policies.

[3]This finding is based on regressions of growth rates of the income of the poor on average income growth. The underlying data for the exercise is compiled from household surveys of 151 developed and developing countries. Despite the increase in inequality in some countries, growth was sufficiently strong to reduce poverty sharply. For example, in East Asia, poverty declined steeply as the incomes of the poor grew at 3.2 percent per year, close to growth of 3.4 percent in average incomes. In the early 1980s, East Asia was the poorest region in the world by headcount poverty rate and Sub-Saharan Africa the third poorest. By the early 1990s, Sub-Saharan Africa had swapped positions with East Asia (Dollar, Kleineberg and Kraay, 2013; Chen and Ravallion, 2007, 2013;, Ravallion, 2007, 2012).

BOX 1.1 *(continued)*

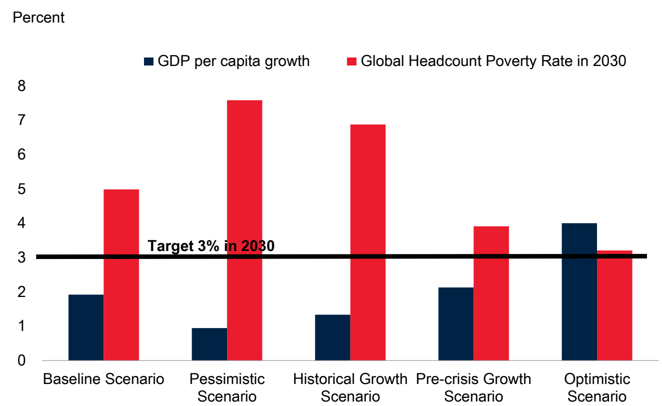
What do different growth projections imply for poverty?

A simple simulation exercise is conducted to study the implications of different growth projections for the percentage of the world's population who will live below the international poverty line of $1.25 a day in 2030.[4] The exercise begins by aligning each country's household survey-based mean per capita income or consumption expenditure for 2011 (reference year) and then applies per capita GDP growth rates to simulate country-specific poverty in 2030. The country-specific poverty rates are aggregated to derive regional estimates and the latter are aggregated to obtain global poverty estimates.[5] The five growth scenarios are as follows:

- Baseline scenario: Annual per capita growth rates for each country during 2015–17 are as projected in this report. For 2018–30, growth is assumed to remain at the 2015–17 average.
- Pessimistic scenario: Per capita growth rates during 2015-30 are 1.5 percentage points below those in the baseline scenario. This scenario illustrates the effect of a sustained slowdown in the global economy.
- Historical growth scenario: Throughout 2015–30, per capita growth rates are the long-run average of actual growth rates during 1991–2010.
- Pre-crisis growth scenario: Throughout 2015–30, per capita growth rates are the average of growth rates during 2003–08. This scenario illustrates the effect of a repeat of the exceptionally strong performance during the pre-crisis years.
- Optimistic scenario: Throughout 2015–30, per capita growth rates are assumed to be 4 percent per year, which would be unprecedented (Commission on Growth and Development, 2008).

FIGURE B1.1.2 Global poverty in 2030

Meeting the poverty target will be a challenge.



Sources: World Bank (2014ij) and Chapter 2.
Note: GDP per capita growth is the aggregate for the developing world. Global poverty estimates in the optimistic and historical scenarios are based on the growth assumptions in World Bank (2014j). The pre-crisis scenario is based on historical average growth between 2003 and 2008. Poverty estimates for the baseline and pessimistic scenarios are based on the per capita growth of household final consumption expenditure for 2011-2014 in World Bank (2014k) and per capita GDP growth projections in this report for 2015-2017. Population growth assumptions in all scenarios are based on the UN population growth projections.

Although forecasts of growth and corresponding projections of poverty rates are highly uncertain, the results of the scenarios elaborated here show the difficulty of achieving the 2030 poverty target of 3 percent. The target is met only in the optimistic scenario (Figure B1.1.2).[6] Under the baseline scenario, the global poverty rate will stand at 5.0 percent in 2030, while in the pessimistic scenario of persistent slow growth in developing economies it would fall to only 7.6 percent.[7] A significantly higher per capita growth rate in China and South Asia enables poverty to decline rapidly in the optimistic scenario. Given that South Asia has almost as many poor as Sub-Saharan Africa, higher growth in the former would make a large contribution to poverty reduction in the world.[8]

[4]These exercises closely follow those in World Bank (2014j, 2014k).

[5]The main assumptions underlying the scenarios are: (i) the distribution of consumption or income in each country remains unchanged throughout the projection period for all scenarios; (ii) the population growth rates are country-specific and based on the UN population growth projections, except in the optimistic scenario, in which population growth in each country is assumed to be equal to the world average population growth rate in order to keep between-country inequality unchanged; and (iii) growth rates are country specific and are based on either national-accounts-based per capita income/consumption expenditure growth projections or the historical mean of per capita household income/consumption expenditure, except for the optimistic scenario, as noted above. Some of the findings are quite sensitive to changes in these assumptions.

[6]For simplicity, all the scenarios here assume stable growth rates over the 2015–2030 period. In reality, variability in growth rates is more likely. If the assumption of each country's population growing at the world average is replaced by country-specific population growth, the poverty rate in the optimistic scenario declines to only 4.1 percent. The results reported here convey the same headline messages as World Bank (2014a). Minor differences between the results here and those in World Bank (2014a) stem from small variations in the household survey datasets. The findings here are also broadly consistent with Chandy, Ledlie and Penciakova (2013), Edward and Sumner (2013), and Bluhm, de Crombrugghe, and Szirmai (2014).

[7]The scenarios here assume that the distribution of income in each country does not change. However, if the incomes of the bottom 40 percent grow faster than the mean, it would be easier to achieve the World Bank's poverty goal by 2030 (Lakner, Negri, and Prydz, 2014).

BOX 1.1 ***(continued)***

Challenges beyond growth

High growth rates will be necessary for reducing poverty in the future, but poverty reduction will likely face two additional challenges. First, poverty reduction will need to be broader based than it has been in the past. Rapid growth in a single country, China, helped halve the number of extreme poor over 2000–2011. Going forward, slowing growth and a shrinking number of poor in China will reduce its contribution to global poverty reduction. Instead, the main drivers of poverty reduction should be Sub-Saharan Africa and South Asia, where most of the world's poor are now concentrated. Second, although Sub-Saharan Africa is expected to be among the fastest-growing developing regions, its growth is likely to be driven by the capital-intensive natural resource sector, limiting the scope for positive trickle-down effects to the labor incomes of the poor.

Poverty reduction: Role of policies

The growth scenarios presented here and the highlighted additional challenges indicate the importance of policies for improving the odds of achieving the 2030 poverty target. The fragile medium-term global outlook makes the implementation of growth-enhancing policies and structural reforms even more urgent. Adverse growth shocks—whether caused by domestic or external factors, drought, or conflict—can stall or reverse poverty reduction.

The experiences of countries with sustained progress in poverty reduction point to two equally important policy components. First, these countries implemented policies that promote the productive use of the poor's most abundant asset—labor. This calls for the wider adoption of policies aimed at harnessing market incentives, social and political institutions, infrastructure, and technology to better utilize the poor's labor. Second, countries that have been successful at reducing poverty designed policies to provide basic social services to the poor, including primary health care, family planning, nutrition, and primary education (World Bank, 1990). In addition to these two components, which support each other, a comprehensive strategy to alleviate poverty also requires well-designed social safety nets, which can help sustain poverty reduction and foster inclusive human development especially during economic downturns (World Bank, 2014k).

[8]The regional poverty projections indicate that the poverty outcomes associated with slow global growth will be worse for Sub-Saharan Africa. For example, in the optimistic scenario, the poverty rate for Sub-Saharan Africa is close to 18 percent by 2030, whereas it is about 34 percent in the pessimistic scenario.

remittances. Additional monetary policy accommodation and a gradual, though weak, recovery in the Euro Area would support strengthening growth in Central and Eastern Europe. In contrast, despite a gradual tilt toward increased ties to China, contraction in Russia, low commodity prices and an unfinished domestic reform agenda will hold back activity in CIS countries. In Turkey, despite robust exports and government spending, growth slowed somewhat in 2014 as election-related uncertainties and geopolitical tensions dampened confidence and policy tightening slowed credit growth. In 2015–16, growth is expected to gradually accelerate on the back of strengthening consumption growth, and lower oil prices will reduce current account deficits.

- *Latin America and the Caribbean:* Growth decelerated sharply in 2014, as a consequence of domestic difficulties and declining commodity prices. A number of the larger economies are currently grappling with low growth, high or rising inflation, and weak investor confidence. Over the next two years, negative terms of trade effects should taper off in commodity-exporting countries and domestic constraints should ease to some extent. But growth is expected to remain modest by pre-crisis standards. Productivity-enhancing reforms, and the extensive trade exposure to the United States, should support growth in Mexico. Prospects of a rapid rebound in Brazil, however, are constrained by an unfinished reform agenda and weak confidence. Since Brazil is a significant importer from the rest of the region, this may weigh on growth in neighboring countries. Macroeconomic imbalances and soft prices of key commodities dampen growth prospects in Argentina (compounded by the unresolved dispute with some bondholders) and República Bolivariana de Venezuela. Should República Bolivariana de Venezuela's preferential energy export arrangements with countries in the Caribbean, Central America and South America be altered, external financing needs could rise sharply in recipient countries and funding for some related social programs could be affected.

- *Middle East and North Africa:* The recovery is strengthening, in particular in oil-importing countries, but it remains fragile and uneven. Substantial official