A novel approach to assess the policy contributions of growth and redistribution to poverty reduction

Vanessa Hartmann ¹  Konstantin M. Wacker ²

¹University of Mainz & KfW Development Bank
²University of Groningen
Motivation: poverty reduction too slow to meet SDG 1

Sources: Lakner et al. (2020) (updated), PovcalNet, World Bank (2020)
Change in poverty headcount rate can be decomposed into income effect and distributional effect (Bourguignon, 2004):
Contribution of our paper to the literature

Problem: conventional poverty decomposition does not reflect policy efforts.

Example:

- Traditionally modest levels of inequality in *Ethiopia*. Maintaining inequality at that low level will require serious policy effort but does not contribute to poverty reduction in traditional decomposition.

- Traditionally high levels of inequality in *South Africa*. Reduction in inequality will be relatively easy to achieve and contribute to poverty reduction through distribution.

⇒ traditional poverty decomposition does not reflect ‘policy effort’
We propose to compare actual vs. *counterfactual* dynamics of:
- income
  - predicted by convergence regression (lower-income countries “catching up”)
- inequality
  - predicted by inequality convergence regression and relationship with income level (“Kuznets curve”)

and their contribution to poverty developments.

The difference between the two captures “true policy effort.”

We estimate those dynamics for 144 countries and perform our counterfactual analysis to 71 developing countries.
Example 1: Côte d’Ivoire (1985-2015)

- Started at low income level and comparably high inequality in 1985 (Gini index: 45.5).
- Further decline in real income level but reduction in inequality (Gini of 41.7 in 2015).
- Was policy in Côte d’Ivoire particularly redistributive to reduce poverty?
  - Traditional poverty decomposition would suggest so.
  - Our approach suggests: based on other countries’ experience, inequality should actually have declined more (to a Gini of 37.7)
  ⇒ Policy was not particularly distributive towards the poor.
Example 1: Poverty changes in Côte d’Ivoire (1985-2015)

- **Actual**: 6% income effect, 2% distribution effect, net change -4%
- **Predicted**: 8% income effect, 2% distribution effect, net change 4%
- **Difference**: 2% income effect, 4% distribution effect, net change -6%

- Outstanding ‘growth acceleration’ since early 2000s (see Moller and Wacker, 2017 WDevt).
- Traditional poverty decomposition would attribute most poverty reduction to growth.
- Our approach suggests: this growth was largely to be expected for an initially poor country, but policy was surprisingly redistributive towards the poor.
Example 2: Poverty changes in Ethiopia (1995-2010)

- **Actual**
  - Income effect: -1.5%
  - Distribution effect: -2.0%

- **Predicted**
  - Income effect: 0.0%
  - Distribution effect: 0.5%

- **Difference**
  - Income effect: 0.5%
  - Distribution effect: -0.5%
Additional findings in the paper

- Tradeoff between poverty reduction through growth vs. distribution? Not really, unless pushing redistribution too much.

- Few general patterns about successful poverty reduction but: shortfalls mostly driven by surging state fragility (e.g. Bhutan, Liberia, Tadschikistan).

Paper (and calculation tool for counterfactuals) available at: sites.google.com/rug.nl/kmwacker/home/research