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"Attacking Poverty in the 21st Century"

Poverty and Inequality

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"Through the United Nations we are working together to ensure that the global market benefits all of us, allowing the poor to lift themselves out of poverty."

(Kofi Annan, *UN Chronicle 1999/4)*

Introduction

I would like to start by making a few remarks about the very interesting presentation Ravi Kanbur just made on the forthcoming World Development Report. This is bound to be a most influential document, and I must say that I very much like, what I have seen so far in terms of both substance as well as the participatory manner in which the report is being compiled. This is the first time that the Bank is widely circulating a draft report ahead of publication -- and we are very fortunate to have here this première and maybe even some influence on the final version.

With 1.2 billion people living on less than one dollar a day, there is no question about the massive scale of the poverty challenge. Poverty remains widespread and deep. Ten years ago the World Bank's *World Development Report 1990* projected that the total number of poor would have fallen from 1.1 to 0.8 billion (1,125 to 825 million) between 1985 and 2000. Yet, the Bank's most recent figures for years both before and after the Asian crisis (1.2 billion) indicate that the original target was missed by a wide margin.

Eradication of poverty, therefore, has become the international community's No. 1 development objective, and rightly so. The overriding target – adopted in 1996 by the Development Assistance Committee of the OECD and endorsed by the international community – is to reduce the incidence of poverty in developing countries from 30 to 15 percent by the year 2015. This is widely thought to be achievable and indeed, an altogether commendable goal.

Mats Karlsson and Ravi Kanbur, both, have provided a powerful call to action, showing some ways forward in this struggle, as well. They demonstrated clearly that the issues to be tackled are very complex. Results can only be achieved when we work together, in a comprehensive fashion. Both speakers have rightly highlighted the importance of country-ownership, of partnership, long-term vision, focus on results and balance between social and structural issues.

The approach taken was refreshing, reflecting the growing consensus over the need for a multi-faceted, balanced and long-term approach. The quality and balance of the report illustrate clearly, that we have made major progress in understanding the problem. Still, I must say, there is some concern, some vague uneasiness, that we are *not yet there*. To solve a problem one must first be able to clearly describe and define the problem. We may not yet have reached that stage. My concerns focus on:

(1) the functioning of the trade-system, and
(2) the scanty attention for size and consequences of the growing inequalities within countries.

<u>The Trade –System</u>

My main concerns are with Chapter 8 – *"Making Markets Work for the Poor."* Not so much with the analysis *per se* but with the implications. A key finding, for example, is that *"on average reforms have been associated with the resumption of economic growth – not sufficient, however, to meet the poverty reduction targets."* That is a worrying finding – especially combined with your assessment that *"this (modest) positive effect is dampened by the fact that the impact of reforms on income distribution might have been unequalizing."*

This seems tantamount to an admission that the dominant approach of the last 20 years has been far from sufficient. I am reminded very much of Goran Hyden's prediction some two decades ago, when such reforms were being introduced, that there would be "*no shortcut to progress."* But it is the various implications of this assessment that are particularly important as we attempt to rethink development. The first of these is that for many countries, certain types of reforms will have to be rethought depending on local circumstances. This would seem to be the case particularly with financial liberalization, but also with trade liberalization as well. This would seem to be very contentious ground – particularly between the Bretton Woods Institutions – and I wonder if you could expand on it a bit.

What we – at least in the UN – are aiming at is to ensure that the global market benefits all of us, allowing the poor to lift themselves out of poverty (Kofi Annan).
Crucial is what globalization will look like for the developing world; what can be done to help developing countries – especially the poorest – make the most of the opportunities offered by the world trading system as it has evolved in recent years (Karlsson p. 6).

Appropriately structured and sequenced, trade liberalization *can be* an engine of development and poverty reduction.
However: If trade is to contribute all it can, to development and poverty reduction, the poorest countries must be able to participate more fully in its benefits. For these countries agricultural liberalization is crucial! (Karlsson, p.7).

How have we done? Apparently not so well. Ambassador Samuel Insanally of Guyana as the Chairman of the Group of 77, e.g. claimed in the period leading up to Seattle and Bangkok:

> "The accelerated pace of globalisation in this decade has certainly not produced equitable growth and development for all members of the international community."…
> "Developing nations must insist on *Special and Differential Treatment* in accordance with the GATT-agreements. We must see to it that the *unfinished business* of the Tokyo and Uruguay Rounds be concluded." and …
> "If there is to be a *Millennium Round*, it must be truly *development centred* and address the vital concerns of developing countries."
> (*Journal of the Group of 77*; vol. 12/3, 1999)

In Seattle, 2 December 1999, Nathan Shamuyarira, Minister of Industry and Commerce of Zimbabwe phrased the same complaints and ideas as follows:

> "WTO's Charter commits the trade body *to alleviate poverty and promote sustainable development*. Yet, it is an undisputed fact that the general experience of developing countries like Zimbabwe in the implementation of the Uruguay Round agreements has been disappointing. … In fact, the economic situations of our countries have in many cases deteriorated."
> (*Africa Recovery,* Vol. 13 No. 4, December 1999).

It seems to me that this is not only due to the fact that the agricultural trade liberalization is still so weak, by far not completed, or in the words of Jim Wolfensohn in Seattle:

> "It makes no sense to exhort poor countries to compete and pay their way in the world, while we deny them the means to do so by restricting their market access in areas such as agriculture."

Indeed, there is still a lot to be done in this direction. The "*level playing field*" is not yet organized to be level, to start with. However, that might still not be enough! Yes, we cannot turn back the clock on globalization. Yes, technological advances that have fueled it cannot be *uninvented*! (Karlsson p.6). But: geography and centuries of history can also not be *undone*, if that is at all deemed desirable. Under the title *"Knowing your place"* the *Economist* of March 1999 wrote: "Economists say they have rediscovered geography.

Geographers are interested to hear it. They did not know they had been away." And also: "at the frontier of research abstract economic modeling and the real world have moved dispiritingly far apart! A meeting of minds ought to be possible!

The "*level playing field"* was not created level, to begin with. Of course, this is not meant to re-introduce any kind of geographical determinism. But country-ownership in the multi-faceted approach of the Comprehensive Development Framework is meant to promote flexible ways to operate under very different conditions. These might include, however, such huge differences in positions and conditions that competition on the world markets becomes extremely difficult. In countries and e.g. in the European Union much attention goes to policies to favour development in economically weak/less favoured regions, almost without time-horizon. Such structural, balanced, generous policies are lacking at the global level. This situation becomes even worse because the world's population increase in the next thirty years is expected to be in those economically weak countries and international migration is strongly being controlled and reduced.

Why Inequality Within Countries?

Now in the rest of my remarks here, I want to focus on an issue highlighted in Ravi Kanbur's presentation and one of the key challenges Mats Karlsson mentioned in his conclusion - the issue of the increasing gap between the haves and the have-nots. My comments here draw on the findings of a recent project of the UNU's World Institute for Development Economics Research (WIDER) directed by Andrea Cornia.[1]

Let me observe first why we looked at inequality so closely. That is essentially because of the perception that inequities have risen at the global level. Ravi Kanbur has drawn attention to this issue - as did indeed the latest UNDP Human Development Report. From a policy perspective, however, we felt it was far more important to look at the issue of inequality *within countries*. Although actions at the global level can help - and more should be done - the key fact is that most policy decisions affecting inequality are still taken at the national level.

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1 Some of the key papers are:
(i) Giovanni Andrea Cornia 'Inequality and Poverty in the Era of Globalisation and Liberalisation' paper presented at the UNU Millennium Conference, Tokyo, 19 - 21 January 2000.
(ii) Anthony Atkinson, 'Increased Income Inequality and the Redistributive Impact of the Government Budget', paper prepared for the UNU/WIDER project.
(iii) Giovanni Andrea Cornia, 'Social Funds in Stabilisation and Adjustment Programmes,' Research for Action 48, UNU/WIDER.

The mainstream approach to reducing poverty in the past has tended to concentrate on accelerating rates of economic growth. As Mats Karlsson, already, said we will never have poverty reduction without economic growth. However: rapid growth is *a necessary, not a sufficient* condition for poverty reduction. To the Bretton Woods institutions in particular, rapid growth has long been seen as being achieved by a stringent focus on macroeconomic stability, the liberalization of domestic markets, privatization, the search for market solutions to the provision of public goods, and rapid external trade and financial liberalization. While the emphasis has been on faster growth, the World Bank and IMF, until recently, have been largely silent on inequality. They have argued that the long-term distribution of income within countries is basically stable - and that there is no clear association between inequality and growth.

Much of this debate, however, has been conducted without reference to adequate data, particularly from the last decade. In an effort to fill this knowledge gap, UNU/WIDER, together with the UNDP, compiled all available data on inequality trends into the World Income Inequality Database (WIID). Analysis of this new evidence has brought out some very interesting trends. In my brief remarks here, I want to draw attention to this new work - and particularly some of the preliminary implications it has for how we might attack poverty more effectively in the 21st century.

World Income Inequality Database (WIID)

The database contains all existing information on income equality within countries. It covers various income concepts, including gross and net income, as well as for earnings and expenditure. It is freely available, with the goal of facilitating further analysis and debate on inequality.

A few basic facts about the database:

* It covers 149 countries - 91 developing and 28 transitional economies.
* The time span for the data is from around 1950 to 1998.
* The database includes 4,596 observations.
* The data are drawn from the Deininger - Squire database of the World Bank and Central Statistical Offices around the world.

The Database[2] can be easily accessed or downloaded from the UNU/WIDER website at www.wider.unu.edu/wiid/wiid.htm.

[2] For further information on the WIID please contact the database manager Sampsa Kiiski at kiiski@wider.unu.edu

The Key Findings

It is probably too early for clear-cut conclusions from the WIID analysis. We ourselves have done a lot of looking at the evidence over the last few months. But we would particularly like researchers round the world to look at the data themselves.

Having said that, I would like to highlight four sets of issues where we think the finding are most interesting. I will then go into a little more detail for each of these.

(i) First - the evidence is clear that inequality has risen in most countries since the early - mid 1980s.

(ii) Second - our analyses indicate that the surge was triggered to a considerable extent by the rush to implement a set of economic policies in countries that did not have adequate institutional capacity.

(iii) Third - and this really cuts to the heart of this matter for this meeting: Rises in inequality not only weaken the impact growth has in reducing poverty - it can also depress the rate of growth itself. Unless inequality is addressed, it is going to be much more difficult if not impossible to achieve the DAC poverty targets.

(iv) Fourth - the policy measures implied by this work are that, in addition to measures to combat the traditional sources of inequality, it is essential to pay much more attention to the distribution of growth and wealth.

Inequality Has Surged

Over the last two decades, inequality has risen in 45 out of the 77 countries for which there was sufficient data. These 45 countries account for about 80 per cent of the population and about the same proportion of the GDP - PPP (the purchasing power parity) of the sample countries. Inequality fell in 16 countries - only 16 per cent of the sample and even less of its GDP - PPP.

There have been national and regional variations. There has been a universal - and often sharp - rise in inequity in the former Soviet block, where the number of people living in poverty jumped from 14 million in 1989 to 147 million in 1996. Inequality has gone up also - from already high levels - in most of Latin America and parts of Africa. China has also experienced a sharp increase in inequality in recent years. In addition, surges in income dispersion were observed in the vast majority of OECD countries as well as a number of South and East Asian countries - which in the past have been able to achieve "*growth with equity.*"

<u>What Caused the Increase?</u>

Making easy generalizations would not be appropriate - the situation in each nation depends on specific country circumstances and policy mixes. Nonetheless, there are some recurrent common factors associated with the recent rise in inequality.

Initially, it is important to note that although traditional causes of inequality - like land concentration, urban bias and inequality in education - explain most of the variation in cross-country inequities; they do not explain the recent surges within countries.

The UNU/WIDER project analyses indicate that, to an important extent, the rush to implement liberalization policies - particularly in the former socialist countries - in the absence of adequate regulatory capacity triggered the recent surges in inequality. Indeed, *trade liberalization has to be appropriately structured and sequenced*! Stabilization, structural adjustment and external openness are often helpful. But the extreme nature, scope and speed of the liberalization approach had a negative impact on distribution and - through that - on poverty alleviation, in particular in the former socialists countries.

In particular, the analyses highlighted the following impacts associated with some of the economic strategies pursued over the last ten to fifteen years:

- excessively deflationary programmes have in most cases reduced the wage share in total incomes and worsened the overall distribution of income. There is also evidence that countries have been encouraged to adopt policy packages to correct short-term economic distortions which have led to cuts in education expenditure. This is clearly a strategy that is putting the cart before the horse and not conducive to equitable long-term development;
- rapid financial liberalization has led to the formation of conspicuous financial rents, while the greater volatility it triggered depressed the labour share and worsened inequality. This finding, incidentally, seems to be supported by evidence cited in the draft World Development Report;
- in the former Soviet bloc in particular, but also in other countries, the focus on rapid privatization has given rise to an unprecedented concentration of wealth and income;
- the liberalization of labour markets has often led to a decline in minimum wages and unionization, to greater informalization of employment, and to wage differentials greater than suggested by differences in human capital;
- the erosion of the redistributiveness of the tax and transfer system reduced the ability of the state to influence the final distribution of income. Also, the new "*Social Funds*" launched to

moderate the impact of liberalization have generally had a negligable impact on curbing the rise of poverty and inequality triggered by policy reform.

The paradox is that the very policies intended to reduce poverty through increased growth may have led to increasing inequality - and thus actually made it more difficult to achieve the objective of reducing poverty.

International Poverty Targets Can Only be Met if Inequality is Reduced

Reducing poverty, of course, depends on the level and nature of growth; faster growth is necessary for many countries to meet the poverty targets. But growth alone does not guarantee poverty reduction. The level of inequality is also important because higher inequality significantly reduces the impact growth has in poverty alleviation. In addition, new evidence shows that very high inequality depresses the rate of growth.

The key policy lesson is that the poverty targets will not be met at the projected growth rates, given current levels of inequality. It is only through reducing levels of inequality that the projected levels of growth could reduce poverty to the extent necessary to meet the desired international levels. This is particularly the case in countries where such increases occurred from already high levels - or where the surge was very large. Most of the former Soviet bloc, much of Latin America, a number of African countries, and now China, have levels of inequality that will make it very difficult for growth to be translated into rapid poverty reduction.

It is also important to add at this point that reducing inequality is not only important for economic reasons; lessening it is also helpful to social cohesion and political stability. Recent UNU/WIDER work[3] coordinated by Wayne Nafziger and Frances Stewart among others, identifies inequality as one of the critical underlying factors that can lead to the sorts of humanitarian disasters which we have witnessed so frequently these last few years.

Priorities to Reduce Inequality (and Poverty)

These data demonstrate that to combat poverty will require a two-pronged strategy *to reduce inequality.*

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[3] Jeni Klugman, 1999, *Social and Economic Policies to Prevent Complex Humanitarian Emergencies. Lessons from Experience*, UNU/WIDER Policy Brief.

First, measures to reduce structural inequality are essential. Major land reform programmes (as in South Korea and Taiwan) have demonstrated their capability to sharply curtain inequality and trigger rapid growth. While reforms may require major political upheavals, inequality can also be reduced by improving access to common-pool land, more equitable agrarian contracts, and a reform of the land market. In addition, in low-income societies, promoting growth in agriculture and labour-intensive industry - that is sectors with a high labour absorption - is also a key priority. Higher public expenditures on health, education, basic infrastructure, and income transfers, as well as access to financial markets would also help, especially over the medium term.

But making economic strategies more distributionally favourable is a second essential ingredient in combating the rise in inequality. The priorities should be:

(i) *avoid severe adjustment policies* which have major impacts on the poor;

(ii) *include strong distributional* concerns in the design and regulation of privatization and domestic financial liberalization;

(iii) *enact policies to reduce the output volatility* caused by financial shocks, including capital controls; and, finally,

(iv) *implement policies to control wage inequities*.

Avoiding increases in levels of inequality is much easier than subsequently trying to reduce them. Prevention is still worth a good deal of cure. Such tactics would ensure that any growth would have a larger impact on improving the lives of the poor.

Conclusion

While we have made a lot of progress over the past decades, reducing poverty remains one of our toughest challenges. Vice President Karlsson concluded with a call for two things - and I too would like to end by essentially seconding him on these.

The first was to understand the scale and complexity of the challenge we are up against. As the Rector of the UNU - an organization devoted to understanding the key processes affecting the world, particularly developing countries - I could not agree more. The mission of the UNU is to help further understanding, *to find complex answers to complex challenges*. More and more, there is growing emphasis on the critical contribution knowledge might make in trying global crises - from poverty to bad governance to humanitarian emergencies. I certainly hope that today's meeting will contribute to that effort. The work of the *Global Development Network*, to which UNU is committed, is another major contributor. And I would like to take the opportunity to point out that he network's annual meeting will be taking place in Tokyo in December of this year.

There is also *a second key issue* - the need *to commit ourselves to working together*. This is the first time in recent years that we have co-organized a meeting in Japan with the World Bank. And I hope it is the first of many. But this partnership is also happening on a much greater scale around the world. We strongly support, for example, the *Comprehensive Development Framework* put forward by Jim Wolfensohn.

When people understand a course of action, and pull together toward achieving it, it is remarkable what can be achieved.

Thank you very much.

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