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Economic growth and the MDGs

Growth is important for the MDGs, but governments must focus on how the benefits are distributed

Key points

- The challenge for policy-makers is to maximise the impact of growth on human development
- What matters is how the opportunities presented by growth are distributed, and specific policies are needed to ensure that the poor gain their fair share
- Equitable distribution of the benefits of growth, in the form of progressive taxation and pro-poor public spending on health, education and social protection, is an essential part of how growth contributes to the MDGs

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As we approach the tenth anniversary of the Millennium Declaration, attention will focus on the strategies that governments can adopt to achieve the Millennium Development Goals (MDGs) by 2015. Economic growth needs a central place in this discussion.

The link between economic growth and achieving the MDGs is in how the opportunities created by growth, and the benefits from growth, support the human development of the poorest people. This briefing paper reviews the evidence on this issue, and outlines a forward-looking policy agenda on growth and distribution to support accelerated progress on the MDGs between now and 2015.

Progress on poverty requires the fair distribution of the benefits of growth.

Growth and the MDGs

The MDGs have been blamed for the relative neglect of how growth can contribute to human development outcomes. Paul Collier, an enthusiastic – and hugely influential – advocate of growth as the key route out of poverty, argued in his book, *The Bottom Billion*:

'Nowadays the talk is about poverty reduction and the other Millennium Development Goals, not about growth rates ... yet the central problem of the bottom billion is that they have not grown.'

Of course policy-makers – particularly in developing countries – have not forgotten growth. It remains central to poverty reduction strategies. But the emphasis on the MDGs focuses attention on the links between growth and human development, rather than on growth for its own sake.

The UN Secretary General's report for the UN Summit on the MDGs in September 2010, *Keeping the Promise*, frames the issue thus:

'Sustained and equitable growth based on dynamic structural economic change is necessary for making substantial progress in reducing poverty. It also enables faster progress towards the other Millennium Development Goals. While economic growth is necessary, it is not sufficient for progress on reducing poverty' (UN, 2010).

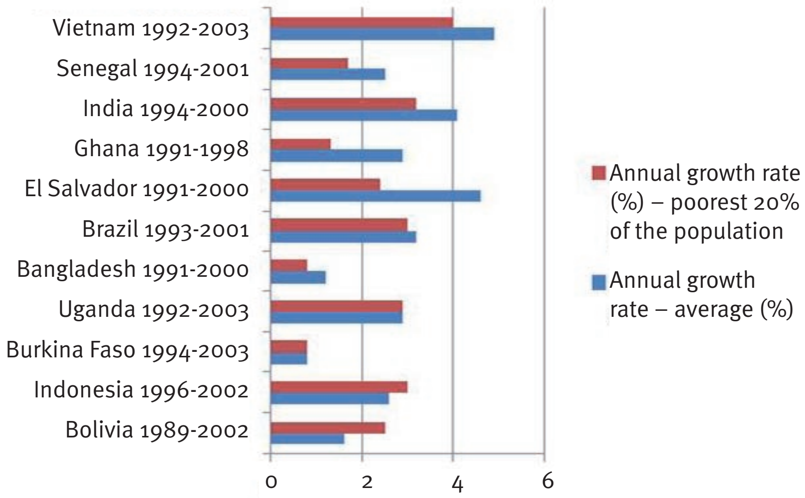
What does the evidence say about where and how growth has contributed to achieving the MDGs? What are the key mechanisms that can translate growth into MDG progress?

How important is growth to achieving the MDGs?

MDG1: Eradicate extreme poverty and hunger

High growth in China and India has been responsible for most of the global reduction in income poverty and, therefore, for most of the

Figure 1: Annual growth and the poorest 20%



Source: Grant (2005).

global progress on MDG1 since 2000. Cross-country studies confirm that, on average, growth tends to be positively correlated with improvements in the incomes of poor people overall (World Bank, 2005). Growth also tends to be positively correlated with improvements in food supply and protein and calorie intake (Haddad, 2003).

Averages, however, conceal how poor people benefit from growth relative to the whole population. As Figure 1 demonstrates, for example, the growth rate of the poorest 20% of the population tends to be lower than the average annual growth rate. This means that the poorest quintile are not benefiting from growth as much as the population on the whole.

Averages also conceal a huge variation in the impact of a given rate of growth on poverty and hunger. The impact of growth on poverty is mediated through inequality – it depends on both the initial rate of inequality in a country and the extent to which growth itself leads to increases or decreases in inequality. For example, at a growth rate of 2% per head, and a poverty headcount of 40%, a country with low inequality could halve poverty in ten years, while a country with high inequality, would take nearly 60 years to achieve the same reduction (Ravallion, 2007). This means that, at a given rate of growth, two more generations of children would have to grow up in poverty in countries with high inequality, compared to those living in countries with low inequality, if poverty reduction relied on growth alone. And in some cases ignoring inequality can lead to growth that actually goes together with worsening poverty – as in Uganda between 2000-2003, where GDP grew at 2.5% a year but, because of worsening inequality, poverty increased by 3.8% (Bourguignon et al., 2008).

The initial inequalities that determine who benefits from growth are not just about income. *Keeping the Promise* estimates that indigenous people comprise one third of the nearly one billion extremely poor rural people worldwide. Poverty among scheduled castes in India, including those once known as 'untouchables', is much higher than among the rest of the population. Increasing the opportunities for poor people to benefit from growth is not just a matter of, for example, increasing employment or access to credit at the aggregate level, but also of specific policies to overcome centuries of multiple and complex social, economic and political inequality. Policies to redress these multiple inequalities are an important part of increasing the poverty reducing impact of growth, and of forestalling widening inequalities that are putting poverty reduction further and further out of reach for some groups.

Policy-makers are faced with a difficult balancing act between encouraging growth on the one hand, and addressing existing inequalities, and not creating new ones, on the other. There are examples of success in ensuring that poor people have the assets and the opportunities to benefit from growth. The success of East Asian countries and a few others, such as Mauritius, in using industrial policy to encourage local industries and the expansion of low-skilled employment is well documented. In agriculture, Malawi's 'starter pack' programme, providing subsidised inputs to smallholder farmers, has been important both in boosting growth and in reducing inequality in rural areas.

Getting the balance right has proved surprisingly hard in some regions. For example, a joint report on MDG progress by the African Development Bank, African Union Commission and United Nations Economic Commission for Africa (2010) finds that despite recent strong and persistent economic growth in the region, the 'joblessness' of growth remains a major impediment to the achievement of employment-related MDGs. In part this is because, in many cases, government policy in this area does not itself create jobs or markets, but is about incentivising the private sector to behave in particular ways. Governments need a clear political mandate, effective institutions and strong technical skills to be able to influence the private sector in the way that some Asian governments have done.

The impact of growth on MDG1 need not only be through individual and household involvement in labour or agricultural markets. Redistribution of the benefits of growth, through social protection schemes, is also important – both to reduce poverty directly and to allow people to participate in markets. Social protection can both increase incomes in the short term and also contribute to higher incomes in the longer term by allowing poor people to build up both their assets and their level of health and education. Brazil's 'Bolsa Familia' social protection scheme, for example, has been one of the factors reducing inequality in that country, and has also led to improved access to credit for some poor people and improved educational and health outcomes for children.

It may also contribute to higher growth rates as the economic contribution of poor people increases, and as the existence of a safety net allows poor people to take more risks as they try to increase their productivity and diversify their incomes. In Mexico the 'PROGRESA' scheme is leading to improved income and assets even among households that do not receive transfers, but who are in areas where families do, suggesting a positive multiplier effect on growth.

Social protection can also insulate poor people from the worst effects of shocks and prevent shocks from leading to increases in poverty. Many millions of people are thought to have become poorer as a result of the food and financial crises of the last few years: the most recent global estimates are that as a result of the crises an additional 64 million people are living under $1.25 a day. This experience has brought social protection higher up the policy agenda, as a core part of achieving MDG1.

MDGs 2-7: education, gender, health and the environment

A recent review found the correlation between rates of GDP per capita growth and achievement of MDGs 2-7 to be 'practically zero' (Bourguignon et al., 2008). What does seem to matter is public services. A strong conclusion in the literature is that the provision of various public goods – health, education and social protection in particular – are positively linked to achieving the MDGs. So, unsurprisingly, free education is good for the education MDGs, the provision of midwives helps to reduce maternal mortality, immunisation helps to reduce child mortality and so on. There also seem to be positive links between different MDGs: education, for example, is positively linked to child nutrition. Social protection, though until now relatively neglected by donors and all but a few middle-income developing countries, is positively linked with MDG achievement across a number of different goals and targets.

At first glance it seems then that growth is less important than other considerations in achieving MDGs 2-7. But it is not that simple. The fact that the evidence is more ambiguous on the importance of growth to these targets does not mean that growth is irrelevant to their achievement. The focus on aid and the social sectors in the MDG debates has tended to obscure the fact that in the end, public goods are provided, in those countries that can afford it, by redistributing the benefits of growth within countries in the form of progressive taxation and public spending. Although different countries have very different capacities to fund social services through taxation, equitable distribution, in the form of a progressive taxation system and the effective provision of services that benefit the poor, is an important link between growth and the MDGs. Fast growing Asian countries, for example, have experienced a virtuous circle of increased growth leading to higher public expenditures on both primary and secondary education and higher enrolment rates, in turn stimulating further growth.

The central place of publicly funded programmes is highlighted by the results of recent randomised control trials, emphasising the extent to which even small charges on the users can discourage poor people from using public services. In Africa, raising the cost of anti-malarial bed nets from zero cost to $0.75 reduced demand by 75%; a small fee for deworming drugs led to an 80% reduction in treatment rates (Sumner, 2010). Achieving the MDGs requires services that are free for users and funded through taxation and aid revenues. *Keeping the Promise* stresses the importance of improving the fiscal space for governments to invest in social provision, including by reducing capital flight so that more of the benefits from growth, in the form of profits, remain within countries to be used for poverty reduction.

As with MDG1, any effect of growth and more government spending on MDGs 2-7 will be filtered through existing inequalities. *Keeping the Promise* describes how children from the poorest 20% of households make up more than 40% of children out of school in some countries. The use of public money to provide services has to be handled very deliberately if it is to reach poor people, and to some extent to compensate for existing inequalities, if the distribution of the benefits from growth is to play its full part in achieving the MDGs.

Growth, distribution and politics

An analysis of distribution inevitably brings politics centre-stage. The evidence on what works to achieve the various MDG targets highlights the importance of politics and social relationships. Unsurprisingly to anyone familiar with Amartya Sen's groundbreaking work on famines and democracy, expanding political rights and ending repression seems to help in progress towards MDG1 on hunger. The same study shows that women's rights are also part of the story of ending hunger. Recent randomised control trials also show that citizens' ability to hold providers to account at a local level has a significant impact on health outcomes such as child mortality and undernutrition (Sumner, 2010).

Politics is a key part of the story of providing public goods. Without pressure on national level leaders to first raise money from tax payers, who are likely to be more politically influential than the poor, and then allocate resources in particular ways to public goods that benefit the poor, and without pressure at the local level to maintain the quality of the services provided, distribution of the benefits of growth to support progress on the MDGs will not be effective. This a lesson familiar to all governments, in developing and developed countries alike, trying to get the maximum returns for funding public services out of general taxation. Equity is critical. A society that is very unequal is also likely to be one where the poor have less political power, and where governments are less likely to be prepared to redistribute the benefits of growth from the rich to the poor. It is also likely to be less stable, both politically and economically, and instability in any form will generally hit the poor hardest.

Policy recommendations

Growth is important to achieving the MDGs, but the mechanisms that link growth to human development outcomes vary across the different goals. The extent to which growth contributes to MDG1 depends mainly on the distribution of the opportunities that growth brings to individuals and households. For MDGs 2-7, the distribution of the benefits that growth produces, in the form of public spending, is key.

The particular strategy that best combines growth with equitable distribution will vary between countries. Much of this is about creating the political coalitions that ensure that policy-makers see reconciling the two as an important objective. Better data, which exposes inequalities and makes visible those who are being left behind by growth, is needed to create such political coalitions. Where policy-makers do want to tackle distribution, there are steps they can take to ensure that growth provides the maximum benefits for achieving the MDGs.

MDG1:

- **Increase the assets of the poorest people to enable them to be in a position to benefit from any new opportunities presented by growth.** Examples include land reform, access to secondary education and access to credit.
- **Redress existing inequalities in employment and other markets.** Examples include investment in transport infrastructure to address rural/urban inequality, incentives to the private sector to offer employment to particular groups, priority in public investment in education for the children of particularly disadvantaged groups and targeted programmes to improve agricultural productivity for the poorest.
- **Incentivise the private sector to promote growth that offers opportunities for poor people.** Examples include investment promotion policies or tax incentives for particular behaviour.
- **Develop social protection schemes that both protect incomes and enable poor people to build up skills and assets to improve their incomes.** Examples include cash transfers that are linked to school or health clinic attendance, schemes to protect incomes in case of business failure or climatic shocks and minimum wage policies.

MDGs 2-7:

- **Develop systems of redistributive social spending to support achievement of MDGs 2-7.** Examples include, on the revenue raising side, building up an efficient and effective progressive domestic tax system, and on the spending side, investing in publicly funded health and education services. This may include targeting scarce resources on particular groups to ensure that existing inequalities do not become a barrier to achieving particular targets.

Growth on its own is not the 'royal road' to the MDGs – the link between the two is distribution. The key is setting in train a political process that will lead governments and the private sector to distribute the assets, opportunities and benefits of growth more fairly, supporting human development outcomes and in turn, the achievement of the MDGs.

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