Poverty Reduction and Growth: Virtuous and Vicious Circles

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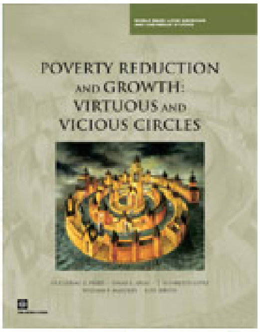
Latin America Needs to Cut Poverty to Boost Growth



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Latin American countries need to fight poverty more aggressively if they want to grow more and compete with China and other dynamic Asian economies, says a new World Bank report.

According to **Poverty Reduction and Growth: Virtuous and Vicious Circles**, while growth is key for poverty reduction, **poverty itself is hampering the achievement of high and sustained growth rates in Latin America**, which remains one of the most unequal regions in the world with close to a fourth of the population living on less than US $2.00 a day.

Resources

- Main figures from the report
- Audio and video interviews with the authors
- Transcription of the press briefing
- Authors'photos
- Join a live discussion with the authors on February 21: Submit your questions now
- Office of the Chief Economist for Latin America & the Caribbean

While China experienced annual per capita growth of about 8.5 percent between 1981 and 2000, reducing poverty by 42 percentage points, **Latin America's per capita GDP declined by 0.7 percent during the 1980s and increased by about 1.5 percent per year in the 1990s**, with no significant changes in poverty levels.

According to the study, prepared by World Bank economists Guillermo Perry, Omar Arias, Humberto Lopez, William Maloney and Luis Serven, a 10 percent drop in poverty levels, other things being equal, can increase economic growth by one percent. In turn, a 10 percent increase in poverty levels lowers the growth rate by one percent and reduces investment by up to eight percent of GDP, especially in countries with underdeveloped financial systems.

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Poor regions lacking infrastructure, for instance, fail to attract investment. Poor families, faced with substandard schools and high opportunity costs, under-invest in the education of their children. Poor countries, unable to moderate income disparities, find social tensions exacerbated that, in turn, make it difficult for a healthy business climate to flourish.

"In order to move from a vicious to a virtuous circle, we need to launch a broad-based attack on poverty that feeds back into higher growth that in turn reduces poverty," said Guillermo Perry, World Bank Chief Economist for Latin America and the Caribbean. *"Fighting poverty is not only good for the poor; it's also good business for the whole of society."*

The study notes that a pro-growth-poverty reduction strategy should aim to improve the quality of education, expand coverage at secondary and tertiary levels, and boost investment in infrastructure to benefit laggard regions and increase the access of the poor to public services.

In addition, such a strategy needs to extend access to credit and financial services, preserve macro-economic stability, and implement effective social policies, such as conditional cash-transfer programs that provide cash to poor families as long as they keep their children in school and take them to the doctor. Some examples are Bolsa Familia in Brazil, Oportunidades in Mexico, and Familias en Accion in Colombia.

The report notes that targeted poverty reduction strategies are particularly important to complement pro-growth policies like trade liberalization, which although essential for long-term growth and poverty reduction, can also have short-term negative effects on poverty and inequality.

"The benefits of trade can be greatly enhanced if countries complement their agreements with investments in areas such as education, infrastructure, and conditional transfers for poor regions and farm workers who may suffer in the transition," said Perry.

In order to pursue a pro-growth poverty reduction strategy, the study recommends that countries first improve the equity of their public expenditure programs, by targeting them to those who really need them rather than spending resources on subsidies for programs for the well-to-do, such as the consumption of energy, pensions, and public universities. In addition, countries need to improve the efficiency of their social policies and, in most cases, to increase tax collections through tax systems that minimize adverse effects on investment.

"Converting the state into an agent that promotes equality of opportunities and practices efficient redistribution is, perhaps, the most critical challenge Latin America faces in