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**POLICY RESPONSE TO POVERTY AND INEQUALITY IN THE DEVELOPING
WORLD: WHERE SHOULD THE PRIORITIES LIE?**

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**Policy Response to Poverty and Inequality in the Developing
World: Where Should the Priorities Lie?**¹

by Albert Berry

1. Introduction

By the most common measuring rods for economic progress (per capita income or purchasing power, satisfaction of basic needs) there has been a striking decline in the incidence of poverty in the Third World, and hence in the world as a whole, over the past half century for which fairly adequate data are available. With a constant poverty line of 200 1970 U.S. dollars², world poverty incidence fell from nearly half in 1950 to about a quarter in 1977 and on down to probably 10-13% in 1995, with the absolute number of poor falling by over 40%³. A considerable share of this advance has reflected the rapid growth and low level of inequality in China. When that country is excluded, incidence falls more slowly, from 36% in 1950 to 24% in 1977 and about 11-15% by 1995, while the absolute number of people in poverty falls modestly by perhaps 5-15% over the whole period with all or nearly all of this occurring since 1980. Defined by the higher poverty line of 1,000 1987 international dollars, the absolute level of poverty outside China showed a net increase over 1950-95, with this pattern emerging over the recent period 1980-1995 as well as before.

The decline in income poverty incidence in the non-socialist world has thus been fitful, uneven regionally, and threatened by changes of policy and context. Accordingly, there is a good deal of concern to find a secure recipe for the sort of "growth with equity" which would bring rapid and widespread poverty alleviation. Though there is considerable agreement, at least among economists, with respect to some of the elements of a good strategy to reduce it, other possible elements are more controversial, and there is nothing approaching consensus on the relative importance of the suggested components. This paper puts forward some views on what

¹ I thank Gerry Helleiner for valuable comments on an earlier draft. Remaining errors are my own.

² And with other country values converted to U.S. dollars at the purchasing power parity conversion rate.

³ Based on Berry et al (1983) and on Serieux and Berry (1999).

works, and emphasizes the need to base policy on a more serious analysis of human welfare than has been the case and to tighten the links between the definition of poverty and the policy response.

Any discussion of the alleviation of absolute poverty (when defined as purchasing power below some given absolute level) is necessarily also a discussion of growth. One may think of the rate of poverty alleviation as being determined jointly by the rate of growth of average income and changes in the distribution of income. If distribution improves, this contributes to poverty alleviation, so growth "accounts for" less than the whole of the improvement; otherwise it "accounts for" all or more than all of the alleviation which occurs. In this mechanistic sense the great bulk of the poverty alleviation which has occurred over the past half-century, perhaps all of it, is due to growth. Over the last decade or so, increases in inequality have become the norm in developing (as well as developed) countries; growth itself is, accordingly, a less secure route to absolute poverty alleviation than before, even though it has become the sole source thereof.

It is useful to distinguish the primary distribution of income--that which emerges from the functioning of the economy before any subsequent redistribution through taxes and transfers, and the secondary distribution which includes their effects. Taking this distinction into account, one may think of the challenge of poverty alleviation as involving (i) growth, (ii) the impacts of the particular growth pattern followed on primary distribution (sometimes positive and sometimes negative), and (iii) direct poverty redressal, whereby some form of redistribution takes place to alleviate part of the poverty implicit in the primary distribution of income; this may be through the state or through private channels, e.g. the extended family or the community.

If relative income or consumption is a key element of the basic definition of poverty--and authors like Easterlin (1974), Scitovsky (1976) and Hirsch (1976) have argued that relative consumption is the central determinant of well-being in industrial countries, then changes in distribution are likely to be the main source of changes in poverty incidence, where poverty is defined as a low level of self-defined well-being (see below). In either case, it is evident that the relationship between the two potential sources of poverty reduction--growth and improved equity, is important. Many early post-war development theorists emphasized that growth might well worsen income distribution over a period (Kuznets, 1955). Others, some who did not expect the early-stage worsening of distribution, and some who believed that it would not be sharp enough to prevent benefits reaching the poorer groups, believed in the "trickle down" theory whereby although growth is not designed particularly for the benefit of the poor, some of its fruits do nonetheless accrue to them. The record of the last half-century has basically confirmed the trickle down theory, at least in the sense that much poverty alleviation has been achieved, even

in countries which did not seem to concern themselves much with poverty alleviation. The experience of Taiwan shows just how complementary a very equitable distribution of income can be with very fast growth, even during the early phases (Ranis, 1978). Other countries, while making the point in a less spectacular way, have records which are consistent with it. The growth-distribution discussion has thus gradually moved to a fairly general acceptance that the two objectives are not likely to be in conflict in any systematic way unless a bad combination of policies has been chosen. The range of experiences on both the growth and the distribution fronts suggests that policy may matter a great deal, i.e. that not all of the variance of outcomes is due to differing exogenous circumstances.

Past errors in the interpretation of how development occurs have been at least matched by oversimplification in the matter of the definition of poverty. The concentration of economists on income-related measures of welfare may have been no more than a naive prejudice, on balance ill-supported by other more direct evidence. Specifically, when people in the industrial countries (where such surveys have been carried out with some frequency) are directly consulted about their happiness and its correlates, income seems to play a much smaller role than standard economic theory would suggest. It is moderately significant when the comparison is between people at different levels of the income hierarchy at a point of time but less so--some authors say virtually insignificant, as a factor in how average societal welfare changes over time, even when average incomes have risen considerably (Easterlin, 1974, 1995; Scitovsky, 1976; Oswald, 1997). Most such studies reveal that the strongest influence among economic variables comes from employment; people with jobs are much happier than those without them. Low inflation also makes people feel happier. The educated are happier than the uneducated, the self-employed than employees and the retired than the economically active. The ultimate meaning of all this evidence remains to be seen; in particular a deeper understanding of the small apparent role of income cries out for analysis.

The history of ideas about poverty and its relationship to growth, as well as many issues relating to poverty policy, are reviewed in Lipton and Ravallion (1995).

This is presumably due in part to unhappy people having trouble finding jobs but longitudinal studies by psychologists have demonstrated that this is not the only cause (Oswald, 1997, 1999).

Though rising average income does not appear to lead to anything like commensurate increases in average happiness, it is

One might plausibly guess that income would be a more significant determinant of self-reported happiness in lower income (developing) countries, and the available data do show this. Frank (1997, 1834) notes that "most careful studies find a clear time-series relationship between subjective well-being and absolute income at low levels of absolute income." Where most people lack minimally adequate shelter and nutrition, additional income yields significant and lasting improvements in subjective well-being (Diener and Diener, 1995). Reported satisfaction levels are significantly lower in extremely poor countries than in rich ones, and within countries the positive link between income and satisfaction is significant primarily at the lowest levels of relative income. "For individuals in the middle and upper portions of the income distribution, variations in income explain less than 2% of variation in reported satisfaction levels" (Frank, 1997, 1834-5, citing Diener and Diener, 1995). Having concluded that average satisfaction levels within a country are not significantly correlated with income over time, Frank puts great emphasis on relative status as a source of respect and a determinant of well-being.

The surprising (to many economists at least) findings on the relative unimportance of income as a determinant of societal welfare may be only one of several reasons for a reconsideration of the conceptual basis for poverty policy. The role of a sense of belonging to a community in human welfare is obvious at one level, but it remains to be factored into discussions of economic policy. The same may be said of "social capital" (the ability to work effectively with others). Participatory poverty assessments uncover some of the correlates of welfare and deprivation as experienced by the respondents. In his study in the Republic of Guinea Shaffer (1998) found that, although consumption data revealed no relative deprivation of women vis a vis men, two other dimensions which disproportionately affect women surfaced clearly--excessive work load and lack of decision-making authority/respect.

The combination of evidence to the effect that more income does make the individual better off than his counterparts with less income but that when everyone's income rises over time there is no comparable effect on average reported happiness is consistent with

true that there is a significant cross-section relationship between happiness and income. In the European data for 1975-86, 18.8% of the bottom quintile report being "very happy" compared with 28.4% for the top one, while 26.7% report being "not too happy" compared with 13.1% for the top quintile (Di Tella et al, 1996). Part of this correlation would be due to the higher unemployment rates of the lower income groups. Over time the happiness of the unemployed shows much more fluctuation than that of the employed, for reasons as yet unexplained.

the general notion that people's welfare depends on relative status, which in modern societies is affected by relative income and consuming power. Given such attitudes, deprivation--the reason one is interested in poverty as a problem, can be alleviated mainly by reducing the degree of income inequality. But, as many authors have emphasized, a more basic implication of such a situation is that the society is dysfunctional in the sense that, as long as it defines satisfaction in relative terms, there is no way to make everyone better off. The gain of the low income person who is now closer in status to those above him is a loss to the latter, who can no longer enjoy the feelings of superiority which gave him satisfaction before. A society whose attitudes are less individualistic and competitive and more positively community or society-oriented has the chance to benefit much more from economic advance. In short, the empirical evidence from the industrial countries suggests that attitudinal change may be more important than economic growth, and that without the former the latter may remain largely irrelevant. Although this is less true of the developing countries, to the extent that they replicate the attitudinal patterns of the rich countries it will become their problem too. A key objective of any society should be to reduce the "zero-sum" component of what gives people satisfaction.

What does the partial and in some ways puzzling evidence on the determinants of human welfare add up to, in terms of its practical implications for economic policy given current attitudes? Most striking is the ambiguous role of income. Taken literally, the results would seem to suggest that economic growth be severely downgraded in our thinking about poverty and welfare and that socio-economic policy should focus much more than it now does on employment (for those that want it), on employment conditions (including avoiding excessive work), on income distribution, on freedom from economic insecurity, on the importance of personal respect, and on sense of community. Whatever the ultimate meaning of the low weight attached to income, a plausible case can be made that most of the other identified correlates of self-declared happiness are associated with each other in a mutually supportive way. To begin with, a (or the) main direct source of high levels of income inequality is an inadequate demand for the labour of those with the least skills and this also tends to produce unemployment of the more chronic and socially costly type, together with economic insecurity and the anxiety which accompanies it. Income inequality is also associated with an unequal distribution of physical and human capital. These interconnected inequalities are a direct cause of lack of respect for those at the bottom of the pyramids of income, wealth, education, skills, etc. Diminishing the inequalities naturally reduces the number of people subjected to lack of respect from others, even if those others retain an income-wealth-education-related definition of status and respect; in fact when these variables do not constitute such a gulf among people the societal definition of the sources of respect are likely to change in a positive way. When differences among people are smaller, the

sense of community is also more developed and positive in its impacts.

Since the empirical evidence confirms the reasonable expectation that increases in average income have a more positive effect on societal welfare in low income than in high income countries, income remains an important target variable for policy. More of it is used to purchase necessities and less for the sort of luxuries which become the vehicle for competitive consumption; invidious comparisons are perhaps less central to people's thinking.

Three variables or groups of variables encapsulate most or all of the relevant information we have on which to base poverty policy: income, whose appropriate role is clearly less than that usually assigned to it but nevertheless important, especially in the poorest countries where the most severe poverty is found; the group of variables related to inequality (of income, of status, etc.); and the set of variables related to the social externalities of "community" feelings. It may be that the second and third categories are closely enough linked that most of the same steps would promote both. Given this, it is useful as a starting point to consider the list of main suggestions made with a view to raising growth, improving distribution or both, noting duly their likely impact on the "other" objectives of policy. How the third category of variables comes in will be treated in a more **ad hoc** way.

A frequently postulated recipe for healthy growth at present (e.g. as proposed by the World Bank and other international institutions) includes macroeconomic stability, a constrained but wisely chosen set of activities for government, a high level of savings and investment, rapid human capital accumulation, technological change, openness to trade and capital flows, other policies to increase the scope for markets as opposed to government discretion, and the strengthening of institutions in support of the effective pursuit of these policies. The components of such a package are interrelated with each other in various ways, with savings, human capital formation and technological change being appropriately thought of as proximate sources of growth, each calling for a series of supportive policy steps, while openness and prudent macroeconomic management are policy stances **per se**, whose expected benefits would show up through their impacts on the proximate growth sources. For present purposes we will not concern ourselves with this asymmetry.

The empirical support for the inclusion of the various elements of the currently popular policy package is more solid for some than for others. Both the likely impact on distribution and the predictability of that impact also vary markedly across these elements, as do their political and administrative feasibility. Some policy areas which may in fact be important to growth are not

presently on the commonly accepted list. Finally, some possibly important policies for distribution are naturally not on the "growth-oriented" list, but their growth implications need to be considered.

Since, especially over the longer run, growth is the main factor in alleviating absolute poverty measured in income terms, it follows that those policies adopted principally for their expected growth benefits may also be the main determinants of how distribution changes over time, with the policies adopted for their expected distributional benefits playing a lesser role. In practice, some of these latter policies may in fact worsen distribution, either because governments mainly controlled by the relatively well-off shy away from implementing policies in a way which will be progressive, and/or because there remains a good deal of guesswork as to the distributional impacts of many policies.

2. Growth and Distributional Implications of the Primarily "Growth-Oriented" Policies

There is no serious debate about the importance of physical capital formation, human capital accumulation and technological change as sources of growth. The only discussion revolves around their relative importance and how this varies by setting, and around how best each of them may be achieved. In the latter context such policies as fiscal and trade policy are naturally involved. The distributional implications of these three processes is more complicated and may depend very much on the details of the case.

1) Conservative Macroeconomic Policy.

Runaway inflation is accepted to be prejudicial to growth. Whether or under what range of circumstances low inflation (say single-digit) produces better growth results than low double-digit levels is much less clear. The current (strong) preference for quite low rates of inflation seems to be based primarily on conservative ideology (whose prediction may of course turn out to be right), and on the perception that high inflation is more problematic in the context of the high level of integration towards which the world is evolving. It does appear that hyperinflation has a negative impact on distribution, though this may be relatively short-lived and is in any case not a major determinant of inequality. It is also often argued that the "inflation tax" resulting from even intermediate levels of inflation is significantly regressive, in which case lax monetary policy is likely to be regressive as well. But the evidence is fragile and there is little theoretical reason to expect the effects to go one way or the other, unless there is a correlation between the looseness of monetary and fiscal policy and the distribution of net

benefits from them (taxes, government expenditures, access to credit). It is fairly widely believed that the low real interest rates which have tended to accompany high rates of inflation tend to produce a more concentrated distribution of credit than would rates closer to market levels (Fry, 1988, 163). Hypotheses on the distributional implications of loose vs tight fiscal policy are more varied, with nothing approaching consensus (Whitehead, 1996). Overall, while there is no well-grounded reason to believe that these policies have important direct effects on equity, the credit, tax and public expenditure patterns which go with them may matter a good deal, albeit in ways not yet well understood.

The major importance of having a job to the satisfaction of people, as revealed in the surveys cited above, imply that any policy package which leads to high unemployment (e.g. tight monetary-fiscal policy aimed at achieving payments balance) doubly problematic. Only if high current unemployment is necessary to assure low future unemployment is such a policy likely to be justified.

ii) Savings and Investment Policies.

High savings **and** their effective use are necessary conditions for really fast growth. Both the cross-country correlation between savings/investment rates and growth, and the fact that the fast growing countries of East Asia all underwent dramatic increases in their savings rates as part of the growth acceleration (World Bank, 1993) underline the priority status of this variable. Unfortunately there remains great ambiguity as to what factors help to raise savings in which sorts of countries. Low demographic burdens appear to have helped in East Asia (Bloom and Williamson, 1998); positive real interest rates and strong financial systems appear to raise financial savings (Mason, 1988) though whether they matter to total savings remains unclear (Masson et al, 1998, 497; Akyuz, 1995). Fast growth appears to contribute to high savings rates, so the major challenge may be to achieve that first burst of rapid growth.

If savings potential were in fact limited to the rich (say the capitalist class) then there would be a clear trade-off between fast growth and equitable distribution of income. This is not universally the case, as we know from the experience of countries like Taiwan, but it may be that the trade-off is absent only under somewhat limited conditions. It is no doubt better to achieve high savings from a narrow segment of the population than not to get them at all, especially when the objective is alleviation of poverty defined in absolute terms. Where savings are very concentrated among entrepreneurs, some of whom are not particularly rich, the scenario is more acceptable, since the distribution of consumption expenditures is considerably less unequal than that of income.

iii) Human Capital Accumulation

Though it is widely accepted that human capital accumulation is important to growth (Schultz, 1961), and the mechanisms linking the two have been studied from various perspectives, the understanding of the role of human capital in the growth process is only modestly greater than it was several decades ago. Mincerian regressions, long the most widely used testimony of the social payoff to education/training have been shown to be very sensitive to specification problems, especially to omitted variables bias and to aggregation bias (Rosenzweig, 1999; Schultz, 1989); credentialism, though its possible quantitative importance has been harder to demonstrate, also continues to cast doubts on the simpler Mincerian interpretation of earnings differentials and to suggest that they suffer from upward bias (Dore, 1976). On the other hand, positive externalities related to the process of imitable innovation, to skill acquisition from the more educated, and the like could be significant also, and would tend to produce a downward bias in the standard estimates. Hopefully the Mincerian regression estimates hopefully do give a very rough feel for social payoffs to education in many circumstances; an estimated 15% rate of return should probably be interpreted as meaning that the true rate is in the range 5-20%. A convergence between the Mincerian regression results and evidence from other methodologies would be needed to narrow the range of uncertainty. With practical training of various sorts (including the periodic over-career upgrading of skills) much under discussion now, and relevant in various ways to poverty alleviation, the fact that earnings function analysis has even more obvious difficulty sorting out its benefits than those of formal education is discouraging.

The Mincerian estimates have been a source of optimism not only for their generally medium to high estimates of the overall social returns to further human capital accumulation, but also for their indication that such returns are particularly high for primary education. This underpins the belief that raising the human capital of those towards the bottom of the educational and earnings profiles should be a useful anti-poverty tool, perhaps even the most important tool of all. But understanding remains limited on what steps will in fact narrow educational gaps (this requires, for example, an understanding of the response pattern from those on the

Estimates like that of Behrman and Deolalikar (1993) suggest the true effects of education on productivity might be as low as 40% of those implicit in the simple Mincerian regressions.

Pritchett (1996) puts the confusion in this area quite starkly. There has been too much simplistic analysis and too little worry about the manifold methodological problems.

upper side of the educational gaps) and on how the future of education-related earnings gaps may unfold. The empirical evidence linking human capital advances to better growth and distribution outcomes is too flimsy to provide a substitute for detailed understanding of what goes on inside what is still a "black box". It is quite possible, especially in light of the apparent importance of the skills which are complementary with computer literacy and the information revolution, and of the widely observed increases in earnings gaps by level of education over the last decade or so (Robbins, 1996), that the relative payoff to higher as opposed to lower levels of education has risen for the medium term. Keeping well trained people in the country is increasingly difficult to the extent that high-level migration gets easier in a context of globalization; the migration option may be one of the factors behind rising earnings gaps in developing countries (Bhagwati and Hamada, 1974). These considerations could mean that the optimal growth promotion strategy in the area of human capital is no longer likely to improve distribution or alleviate poverty even though at some point in the past this was the case.

As with most of the other instruments under discussion, the relationship between human capital and poverty is likely to be sensitive to how poverty is defined. This is tautologically the case if one uses a "basic needs" definition in which education figures importantly.

(iv) **Technological Change.**

There is no dispute about the importance of savings and investment as a source of growth. In contrast, there **is** a debate on which new technologies contribute to growth, with theory suggesting that overly modern or capital intensive ones may not do so, whereas "intermediate" or appropriate technologies are a surer bet. Empirical confirmation of this presumption is limited and for the most part indirect, however, and there is a major doubt as to whether the shelf of available appropriate technologies is very well stocked.

The distributional impacts of technological advance are also ambiguous. Simple theory suggests strongly that modern technology, in creating few jobs per unit of investment, will tend to worsen the distribution between capital and labour income and that where such technology is also skill-intensive it will also worsen the distribution between more skilled and less skilled workers. Partly because we do not have indicators of the rate or pattern of technological change (in contrast to human capital formation, savings, etc, where we do have useful measures), it has been difficult to get an empirical feel for the validity of these theoretical presumptions. Technological change can be a threat to equitable distribution and hence to poverty alleviation either

because of its factor bias (favouring capital or skilled labour in a way which is out of line with a particular economy's factor proportions) or because those in a position to adopt it are already better off (e.g. because larger) than those who are not so favourably placed. Certain changes in agriculture can produce a negative distributional impact through both factors, as where tractorization not only lowers costs on large farms in ways which smaller farms cannot replicate, but also displaces labour and pushes more workers onto the smaller farms. In other sectors also, the size and existing technologies of the firms which introduce new technologies are both relevant to the final impact of that adoption (James, 1998; Berry, 1998a).

Some aspects of the process of technological change are more exogenous to individual developing countries and even to the group as a whole than is the case of the other sources of growth discussed above. It is widely noted that about 97% of research and development expenditures occur in the industrialized countries of the North (World Bank 1999). Accordingly, it may be very hard for developing countries, especially if tightly tied into the world economic system, to buffer themselves against some of the negative effects from the pattern of ongoing technological change at the world level. Still, a good deal of the evolution of technological practices is affected by the internal context and policies. Though key breakthroughs in agricultural research usually come from outside the country, it is important for their effective adoption, and especially their adoption by smaller farmers, that such international research be complemented by local efforts (Evenson, 1975). In other sectors there are a number of policies which clearly contribute to the rate of technological improvement by smaller firms (Levy et al, 1999), improvements which are usually more favourable to employment than those adopted by larger counterparts.

(v) Outward-Orientation and other Pro-Market Policies

The proponents of freer trade, less government intervention and generally more market-friendly economic policies have argued that this sort of shift will raise the rate of growth not only through Heckscher-Ohlin efficiency effects (Feder, 1983) but also by contributing positively to domestic savings, to foreign savings (capital inflow) and to the rate of technological change as a result of greater contact with foreign sources, etc. (Rodrik, 1995, 2933-34). There is no doubt that each of these factors is frequently at work. On the other side of the ledger are the

The World Bank's somewhat belated recognition of this threat came in the early 1970s. A study of the results of (large) tractorization in Pakistan helped to produce it.

negative effects of instability in the capital inflows and outflows which have come with freer international capital movements, and a possibly negative effect on investment when freer markets lower the certainty about the payoff to certain investments. Also, to the extent that some degree of protection is justified by the presence of learning-by-doing effects as formalized in the "infant industry argument", the inability to protect may hinder countries from helping along nascent industries which could become competitive. Under what circumstances the positive effects of outward orientation will prevail remains to be seen. Since, with only a few exceptions, the shift to market friendly policies has not yet brought the developing countries an immediate or a large positive impact on growth, the case cannot be considered closed. It may be that those effects will ultimately be significantly positive as anticipated by the proponents, but that a longish gestation period is required for the benefits to fully manifest themselves, or it may be that the optimism was simply ill-founded. The level of analysis which provided the basis for the policy shift was far from exemplary. Nor does economic theory help much to clarify what trade policies are likely to work best in developing countries; too much depends on the assumptions fed into the theory. When investor risk-aversion is strong and learning-by-doing is important it is likely that infant industry protection will be necessary to induce some investments which contribute to growth. If developing countries were highly effective in the design and implementation of policy intervention, free trade would not likely be their first-best option; their frequent failure to apply infant industry protection in a way close to that contemplated in the theory makes substantially free trade look like a more attractive "second-best".

There is a strong possibility that outward oriented policies are the best way to go for small countries but less so for large ones. When Peru adopted import substituting industrialization strategies from the 1950s the results appear to have been much less favourable than those in Brazil, which between 1945 and 1980, under strong ISI policies, outgrew every other country in the world (Maddison and Associates, 1992). Growth by inducing MNCs to invest

For example, although much use was made of cross-country regressions showing a positive correlation between outward orientation and growth, relatively little attention was given to the fact that the presence of a positive impact on individual countries does not necessarily or generally imply a positive impact for the Third World as a whole--a classic example of the fallacy of composition. This issue is discussed in the context of primary exports by, among others, Maizels (1994) and in that of manufactures, by Faini et al (1992) and by UNCTAD (1996). An even graver flaw, because less obvious to the untrained eye, has been the carelessness evinced in the measurement of "outward orientation". Alternative measures, each with some apparent logic, are not well correlated with each other.

in labour intensive exports is much more relevant to the smaller countries than to the half dozen or so in which the bulk of the LDC's population lives.

The distributional implications of freer markets, including freer trade and international capital movements, are hotly debated. Positive Hecksher-Ohlin effects are expected by most proponents, based on (i) the idea that developing countries typically have a comparative advantage in labour-intensive goods and services so that freer trade should increase the relative demand for labour and hence improve the distribution of income, and (ii) that freer trade in many countries implies a stronger demand for agricultural products whose exports are indirectly discouraged by the ISI policies mainly designed to protect manufacturing. Prominent among the various counter-arguments is the empirical fact that the recent wave of globalization and liberalizing of trade and capital movements has coincided with increasing inequality in many developing countries (Berry and Stewart, 1997) as well as in the developed ones; this fact throws doubt on whether Hecksher-Ohlin effects are working strongly as predicted. For some regions (like Latin America) the explanation for their not doing so may be that these countries' comparative advantage at a world level does not in fact lie in unskilled labour-intensive goods and services, but rather in goods intensive in natural resources and/or relatively skilled labour. More generally, the fact that firms which engage heavily in international trade tend to be larger (industry held constant) than those which do not, and also tend to use more capital intensive and modern technologies, suggests that as the share of output which is traded internationally rises distribution will tend to worsen.

Putting together the still doubtful growth effects of freer trade with the negative distributional trends which have frequently coincided with the policy shift makes it evident that any presumption that freer markets would bring significant poverty alleviation should be put on hold. Perhaps a most likely outcome will be a small positive impact on growth together with a negative impact on distribution of medium scope, leaving a small net effect,

Various empirical studies have reached more positive judgments. Thus Londoño and Székely (1998) concluded on the basis of cross country regressions for Latin America that trade reform had produced a positive impact on distribution, while labour reform had had the opposite effect. Stallings and Peres (2000) found that both trade reform and tax reform had negative impacts on household distribution. Morley (2000) also found the impact of trade reforms to be negative. Though they estimated a positive effect from the reforms, Londoño and Székely concluded that the reforms alone would not bring marked improvements in inequality or poverty unless they have the effect of diminishing educational inequality and widening access to other productive assets.

possibly positive and possibly negative on the rate of alleviation of absolute poverty. But the range of possible effects is wide given our lack of understanding of the mechanisms involved and the rather confusing empirical record thus far. In a society which places substantial weight on relative income, the impact of this policy shift on poverty could be strongly negative if the distributional effect is significantly negative.

3. Distribution and Growth Implications of the Primarily "Distribution-Oriented" Policies.

As with the main components of the more growth-oriented policies, each of the distribution-oriented policies considered below may have significant growth impacts together with the effects on distribution for which they are more often implemented.

(i) Asset Redistribution Policies.

The most obvious way to improve income distribution through a redistribution of productive assets. In the case of human capital this can only be done gradually over the course of time since expropriation and immediate redistribution is not feasible. With physical assets such redistribution is possible, but seriously feasible only with land, i.e. via land reforms. That these can have a substantial and lasting effect on income distribution under favourable circumstances is clear. Taiwan is the most commonly cited case; it appears that inequality fell markedly at the time of the reform, undertaken when the country was still mainly agricultural (Kuo, 1983, 94-97). The subsequent trajectory has been an exceptionally positive one both in terms of growth and of distribution. It appears that the initial equality contributed to its own perpetuation by helping to produce a very equal distribution of educational opportunities, a dynamic growth of small enterprise, first in rural and then in urban areas, and an increased political voice for the representatives of small enterprise. But few countries have had significant agrarian reforms so the number of experiences is too small to permit a judgement on the range of circumstances under which the effects would be as positive as they appear to have been in Taiwan or Korea. It is also clear that only very unusual political conditions open the door for a major land reform to take place. It therefore appears destined not to be an important component of many poverty alleviation strategies, even though it may in principle be the most promising of all in many LDCs.

Recently some attention has been given to the potential of market-based land reforms, in which subsidies to help small farmers buy land replace expropriation as the means of land transfer. The economic logic of these reforms is promising (Deininger, ???)

although it seems unlikely that such approaches will in practice have more than a marginal impact on agrarian structure if applied without traditional confiscatory land reform. When complemented by such traditional reform, they may have greater value, partly through the "threat effect" which can make landlords more flexible in the face of expropriation. Removal of legal constraints on land subdivision is a minimal enabling device (Lipton, 1993, 651). Removal of subsidies favouring large farmers or their crops can be a valuable supportive device for credit or land laws to help the poor, and can be nudged along by the fiscal stringency faced by so many countries. Lower subsidies helped discourage the rich from subverting reforms in Northeast Brazil, though other positive steps were also taken there.

Forest dwellers in many countries have faced expulsion from their natural-resource bases as other actors, sometimes private lumber companies and sometimes the state, put pressure on them. In this sector, as in agriculture, good distribution and efficient production often go together, as demonstrated by the success of community managed forests (which produce a range of timber and non-timber products) in a number of the states of India (Kant, 1996) and elsewhere (Brightman, 1987). In 1988 the government of India finally gave up on its former policy of exclusion of such dwellers from forest management, in recognition of the failure of that policy on both output and distribution grounds (Kant and Berry, 1999).

(ii) Policy in Support of Smaller Firms: Small Farms, Microenterprise and Small-Medium Enterprise.

Much more feasible politically than asset redistribution policies (mainly land reform) are forms of support for the small firms in agriculture and outside which are the base of employment for the majority of the labour force in most developing countries. Such support, to the degree that it raises output and productivity in these firms, directly increases the incomes of many poorer people. Its other advantage comes from the fact that smaller firms, whatever the industry, tend to be more labour intensive than larger ones, so their presence raises the total demand for labour relative to what it would have been if their place were taken by larger firms. Though small enterprises often generate low incomes, their productivity level (output per unit of scarce inputs) is often high, albeit varied. Medium-sized firms frequently achieve the highest total factor productivity of all the size categories, and thereby contribute to high incomes and to growth (Ho, 1980). Small and medium enterprises (SMEs) contribute to a more equitable distribution since their factor proportions tend to be close to those of the economy as a whole.

Raising the productivity of small farms and of microenterprise

has an immediate effect on poverty. In the former case the sources of success are clear--the sort of improvements in crop varieties which defined the Green Revolution. In the case of non-agricultural microenterprise, much effort has been directed to improving credit access on the assumption that this will lead to higher productivity and hence incomes. A major challenge here is to assure the sustainability of the credit institutions; most experiments thus far have failed to pass this test (Santor, 1999). On the equally important question of whether their social benefit-cost ratio is adequate the evidence is harder to come by and thus far uncertain. If the available support programs turn out not to have strong potential to raise the collective productivity of microenterprise, then a dilemma will arise as to whether such support is a more or less effective way of alleviating some poverty than is targeted poverty alleviation involving transfers of one sort or another to the poor (see the next section).

If it is not feasible to achieve considerable productivity increases in very small enterprises the next most direct way to alleviate poverty is to encourage a rapid expansion of small-medium enterprise, which will eventually tighten up the labour market and create jobs for those currently lodged in the less productive microenterprise sector (Berry, 1998b). Depending on the country this impact on poverty may come very quickly or with some lag.

(iii) Direct Poverty-Redressal Policies

All societies have ways of alleviating the poverty of those with inadequate entitlements on the basis of their own efforts or opportunities. In developing countries most such mechanisms involve the family (including the extended family) or the community. Developing countries have been evolving targeting techniques over the last decade or so; the statistical record, while still ambiguous, is reasonably promising (Grosh, 1995) that, with further experimentation and refinement they may play an increasing role in poverty alleviation over the next few decades, in some countries at least.

Though it is clear in many cases that the credit recipients have done better than non-recipients, this leaves open the question of whether the gains of the former have been at the expense of losses of the latter, a not implausible scenario in cases like small scale retailing where the structure is one of monopolistic competition and the total market size may be quite constrained. A recent, impressive study of the main microfinance institutions in Bangladesh is that of Morduch (1998).

Ocampo (2001, 25) notes that in two of the three countries of Latin America where rural poverty reduction was most marked in the 1990s, Brazil and Chile (the other was Panama) the reduction

A number of higher income developing countries (several in Latin America, for example) are moving towards such developed country staples as unemployment insurance. These too will inevitably go through a period of experimentation before it becomes clear what role they can and should play.

4. Priorities May Vary Dramatically According to How Poverty is Defined

Social scientists other than economists (especially sociologists and psychologists) have long emphasised that people's feelings of deprivation are very much related to relative income/purchasing power and the feelings of inferiority which arise under those circumstances, especially in competitive societies where people are judged by their relative success. As noted above, there has been no general positive trend in income or expenditure distribution over the last half century and recently a disproportionate share of countries have suffered the opposite pattern. It follows that a poverty indicator which gives high enough weight to relative income will show little if any progress over time, especially during the last couple of decades. Thus the widely differing implications of alternative poverty indicators which have been suggested imply an urgent need for more serious attention to which of these are more meaningful and perhaps to the identification of some professionally defensible combination of them which would give appropriate attention to each of the determinants of deprivation and satisfaction as experienced by individuals. Most of the indicators used by economists are naive in their implicit assumptions about the sources of individual feelings of deprivation, but thus far little attempt has been made to incorporate anything subjective into the indicators compiled by international agencies and by most economic researchers.

One of the more notable complexities still to be effectively dealt with is the sorting out of intra-family inequalities and the way they may have been changing over time. If rising incomes, urbanization and other processes of development have typically brought with them advances in intra-family equality between the sexes, one would conclude that the correctly measured distribution of expenditure among persons has evolved more positively than the standard estimates, which assume away intra-family inequality. How the distribution of subjective welfare has evolved is less clear; if for example, women's expectations have evolved more rapidly than has their relative position, subjective welfare distribution might move in the opposite direction from that of expenditures.

was closely tied to an allocation of transfers and state subsidies targeted to the poorer sectors.

5. What Are the Best Bets?

The most effective policy instruments to alleviate poverty thus depend very much on how poverty is defined. The optimal package is easiest to define when absolute poverty, defined by income or expenditure per person, is the operative concept. In that case it is clear that growth is central, growth with equity desirable, and policies whose main objective is redistribution unlikely to play a large role. The most promising instruments are promotion of a high savings rate, preferably with widespread involvement of the population; investment in human capital, especially for those population groups who lag in that respect; technological change, with a serious attempt to keep the innovations within the realm of "appropriate technology"; and policy support for smaller production units. Population policy and asset redistribution may be among these key elements in some countries, institutional reform and monetary-fiscal policy in others. Whether generally market-friendly policies will play a positive or a negative role remains to be seen.

As the weight assigned to relative poverty (also defined by income or expenditures per person) and to employment conditions, respect, etc. increases and that to absolute poverty decreases, the relative promise of the various policies is altered, perhaps dramatically. When relative poverty is the dominant concern, support for smaller productive units and attempts to raise the human capital of the poor are probably the best policy options available in most countries; asset redistribution may be the best in some cases where feasible, and significant in others; population policy can be important, especially when complemented by strong gender policies in countries where inter-gender inequality is important. Savings and technology policy are question marks in this situation since there is no general presumption that they can improve distribution even if executed fairly carefully with that objective in mind. Market-friendly policies are an unlikely component of the package. These policies may be deleterious in another way; to the extent that they focus on market competition as the route to wealth, for individuals, firms, regions, etc. they may heighten people's awareness of their relative position and thereby make the deprivation of those performing less well in the market that much more acute.

Among many reviews of poverty reduction strategies are Shaffer's report to the United Nations (United Nations, 1998), Chatterjee's paper for the Asian Development Bank (Chatterjee (1995) and Lipton and Ravallion (1995)).

This is a very broad-brush discussion. Within the category of market-friendly reforms there are some which are quite likely to worsen income distribution and others which are quite likely to improve it.

Since almost all students of poverty would grant that, if income and expenditures are the relevant indicators, both absolute and relative positions affect welfare, we are left with the conclusion that the optimal package will be somewhere between the two just identified, closer to the first if absolute poverty is more important and closer to the second if relative poverty is more important.

The aspect of relative position which can most easily be taken into account in the measurement of change is relative income. But, as noted, an individual's welfare involves also the way he/she is treated by others and the related sense of social inferiority, the lack of access to psychological support, etc. Discriminatory treatment toward women, the aged, children or subordinated ethnic groups all figure importantly in the loss of welfare. Accordingly, measures of societal welfare should take these forms of inequality into account directly. While some societies have made progress in dealing with ethnic and gender inequality, the problems associated with age may have on balance become more severe as more people live to advanced ages and as family responsibility for that group diminishes.

The task of policy prescription is altered again and perhaps made more complex when poverty is defined in other, more subjective ways which allow for the benefits of feelings of community and feelings of security (not taken account of in the absolute or relative income figures, although well enough reflected in market behaviour of individuals--purchase of insurance, risk aversion in investment behaviour, etc.). Without some concrete feel for societal preferences as to what the good life is (and recognizing that such perceptions are themselves to some extent dependent on past and current experience) it is impossible to take strong positions on what good policy is. It is clear, though, that it might look rather different from what such policy would be when the indicators are objectively measurable income or expenditure.

Desire for security is not necessarily inconsistent with a need for adventure as well; societies need to search for good ways to reconcile these goals. If access to opportunities is more important to satisfaction than ex post success in economic terms, this too alters the way in which both overall economic performance and the degree of inequality in a society should be measured. Unfortunately the concrete policy implications of these plausible components of social welfare are at this time fuzzy, for lack of careful assessment of what they might imply in practical terms.

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