PRO-POOR ECONOMIC GROWTH RESEARCH STUDIES
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Selection Criteria for Pro-Poor Economic Growth Policies

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Selection Criteria for Pro-Poor Economic Growth Policies

by

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INTRODUCTION

This paper discusses pro-poor growth policies, reforms, and activities and distinguishes the economic, administrative, and political determinants of success in their identification and implementation. It complements this discussion with a brief review of some specific policy areas in which promising pro-poor policies or programs may be found, and an examination of the need for measurement to confirm that a policy or program is in fact achieving what is expected of it. It ends with a brief summary of the key elements of selection criteria and the ways in which other outputs of the Pro-Poor Economic Growth Research Studies Activity will provide a more concrete discussion of policy and program selection to complement these general principles.

The process of selecting pro-poor policies and programs must be based on a clear definition of poverty and on benefit-cost principles. This process benefits from:

- An understanding of the correlates of poverty;
- Recognition of the policies and programs that contribute most to poverty reduction; and
- Operational experience and lessons learned in the country or elsewhere, especially in similar countries.[1]

Both identification and quantification of benefits and costs are matters of degree. Although precision is normally out of the question when a government formulates and implements pro-poor policies or programs, rough approximation is typically feasible. The process should include pre-implementation attempts to estimate probable benefits and post-implementation analysis of realized benefits. Policy selection should be viewed as a process that goes beyond the initial decision to implement and includes later decisions on whether to continue or modify the policy. These later decisions, unlike initial ones, are informed by operational experience using data from field activities.

CONCEPTUAL ISSUES: DEFINING POVERTY AND PRO-POOR POLICIES

Defining Poverty and Poverty Reduction

There is no simple, generally accepted definition of poverty. The same, therefore, is true of poverty reduction and of pro-poor growth policies. The Pro-Poor Economic Growth Research Studies Activity adopts the widespread practice of defining people as "income poor" if per capita family income or expenditure falls below a certain level (the poverty line) and of taking into account not only the number of such people (the "head count") but also how far

[1] See Deliverable 4: "Poverty-Problem Country Typologies," 2002.

they are below the poverty line (the "poverty gap" between their income and the poverty line).[2]

We assume, without imposing specific parameters, that the severity of income poverty for any given family rises disproportionately to the poverty gap and that the extent of poverty should be measured as an aggregate "weighted income poverty gap." It thus reflects the situation of all people suffering this dimension of poverty and gives greater weight to those farther below the poverty line.

Another variable to consider is people's access to basic needs, including food, safe water and sanitation facilities, basic education and healthcare, and control of epidemic diseases. Because the public sector provides for some of these needs, income or purchasing power may not provide an accurate reading on which families will suffer from their lack and how large the deficit of these amenities will be. Accordingly, another way to define poverty is in terms of the lack of these basic needs—hence, "basic needs poverty." As with income poverty, lines have been drawn between inadequate and adequate supplies of these needs, and one can think in terms of "basic needs poverty gaps."

Income poverty and basic needs poverty are best seen as complementary measures allowing a richer understanding of a multifaceted phenomenon. Although there is a reasonably high cross-country correlation between income poverty and the most common definitions of basic needs poverty, that correlation is not so high as to imply that they are or should be viewed as substitute measures. For example, countries whose educational performance is high for their income levels tend to score better on basic needs indicators (in which primary education is usually given significant weight), as do countries where food prices are very low.

Except in unusual situations, therefore, it is necessary to think of poverty as a multifaceted phenomenon and of poverty reduction as the result either of a reduction in the income or purchasing power gap and/or a reduction in the gap (or gaps) of these basic needs.[3] Policies whose main impact is on the income of poorer families will be judged against the standard definition of poverty in terms of purchasing power; policies whose main impact is to improve access to relevant services usually provided by the state will be judged by how much they affect such access.

The measured extent of poverty reduction must reflect the definition (or definitions) used. If the extent of income poverty were measured simply by the head count, then the amount of poverty reduction would be the number of people shifted from below the poverty line to above it, but such a definition does not take into account the amount by which each person's

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[2] Foster et al. (1984) discuss the rationale for such a definition and some of the implications of its selection.

[3] In a country where all publicly provided "basic needs" are indeed available to everyone, the poverty line that is defined by the purchasing power needed to buy the rest of one's requirements in order not to be poor retains its relevance and simplicity. Where public services do not provide for all such needs, measurement becomes more complex. It might be possible to convert the minimum level of each of these needs into dollar terms and include the resulting values as part of the definition of the poverty line, but this process is both demanding and controversial. An intermediate situation arises when, although usually provided by the public sector, some of these basic needs are also purchasable privately. In that case, either private or public action can diminish a given basic needs' inadequacy.

income increased. Where the "poverty gap" defines the level of poverty, then the natural measure of poverty reduction is the dollar reduction in that poverty gap. This measure takes into account the amount by which previously poor people's incomes rise (up to the poverty line), but it does not allow for the fact that a dollar's worth of poverty reduction is presumably of greater social value the poorer the person is. Thus, the more appropriate measure of income poverty reduction, corresponding to the basic definition of income poverty that we employ here, the "weighted income poverty gap," reflects the amount of the increase in income of each poor person (whether raised above the poverty line or not) weighted (inversely) by his or her initial income level.

These associated definitions of poverty and of poverty reduction provide a conceptual umbrella for the Pro-Poor Economic Growth Research Studies Activity. Sometimes, the statistical information on incomes is not adequate to permit the use of the weighted income poverty gap but simply of the income poverty gap; in these cases, that will be the measure used. In other cases, only the head count will be available. In most cases, policy conclusions are unlikely to be significantly affected by these definitional choices around the measurement of income poverty. The extent to which indicators of basic needs should and will be used depends on their apparent role in feelings of deprivation and on their relationship with income poverty.

Even when basic needs are included as elements in the definition of poverty, it remains narrow relative to the many and varied determinants of the level of human welfare.[4] Any decision to restrict the number of components is ultimately a practical one; many recognized components are hard to measure, and others are controversial either in terms of the appropriateness of their inclusion or in terms of their relative importance. Perhaps the most frequent determinant of welfare excluded in the above definition is the individual's or family's "relative income" (or relative level of education, for example, in the context of basic needs). For the purposes of this study, we base the income poverty definition on absolute purchasing power of families relative to the cost of a basket of goods and services chosen to define the boundary between poor and non-poor. Accordingly, it does not treat a person's or family's relative income as a direct determinant of poverty or degree of poverty. To the extent that one wishes to incorporate relative income into one's definition of poverty, this can sometimes be attempted with the information available.[5]

Another weakness of the income poverty definition is its failure to allow for differences in consumption and welfare within the family unit. This limitation is usually imposed by the lack of statistical information. It constrains the amount of quantitative information that can be brought to bear on gender and age differences in poverty. But the fact that this information is

[4] For a discussion of issues surrounding the definition of poverty and their implications for poverty policy, see, among others, Callan and Nolan (1991) and Lipton and Ravallion (1993).

[5] Attempts to do so, however, confront a number of difficult conceptual and empirical problems. For example, it is not generally clear whether what matters more to the poor family is its income in relation to the society as a whole, to those with whom it has most direct contact, or to its own past income. The family may be sensitive to displays of conspicuous consumption by the rich but otherwise be less concerned with their income and wealth.

partial does not preclude analysis of such differentials as a factor in poverty where such data do exist.

Fortunately, many definitions of poverty tend to move together closely over time and identify the same people as poor. A given contributing factor to poverty often deserves special attention when its level is out of line with those of other factors—for example, when malnutrition is high even though incomes are relatively high. Such discrepancies among the component elements of poverty help identify which pro-poor policies may be the most needed and hence the most productive. In short, bearing in mind the various dimensions of poverty helps enrich the analysis and understanding of poverty and gives the policy maker a better chance of designing a good pro-poor policy package.

An important exception to the generalization that most indicators of poverty tend to move in parallel involves income poverty measured by absolute purchasing power (as here) and poverty measured by relative purchasing power. The former definition implies that poverty falls as long as absolute incomes are rising for those families below the poverty line, whereas according to the latter definition poverty falls only when the level of inequality decreases. This difference notwithstanding, the two involve the same relative ranking of people and hence identify the same people as being impoverished.

Defining the Successfulness of Pro-Poor Policy

We can view poverty reduction as a benefit that society as a whole can purchase—that is, there may be a cost to the rest of the society in achieving such a reduction. The relative attractiveness of different ways of lowering poverty therefore depends on their benefit-cost ratio. Thus, the central criterion for policy selection is the activity's potential to reduce poverty in relation to the cost of that reduction. It is useful to think of success as reflecting the marginal cost to the rest of society of a given amount of poverty reduction. Several broad principles help differentiate effective from less effective poverty programs.

First, in the most positive programs, there may be no net cost to the rest of society from the implementation of a pro-poor program.[6] In that case, it is in principle a straightforward decision to proceed with the program, at least up to the point (e.g., its level of coverage) at which this condition ceases to hold.

Second, in all programs, it is desirable to achieve designed poverty-reducing effects at the minimum possible cost to the rest of society. (In the case of programs where that net cost is negative—i.e., there are on balance benefits to the rest of society as well—the higher those benefits the better.)

Third, poverty reduction programs involve different types of costs. The simplest are the transfers from the rest of society to provide the resources for the program. There are often

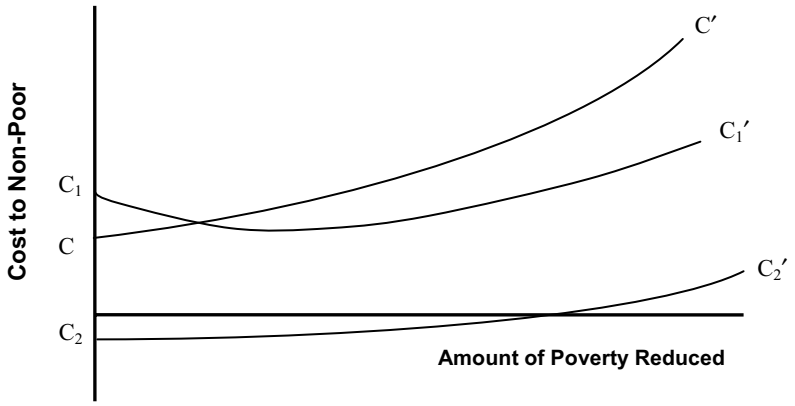
[6] Costs include direct (e.g., administrative costs) and indirect ones. When a pro-poor policy provides benefits to the rest of society as well as to the poor (perhaps the same sort of benefits or perhaps different ones), then its net cost to the rest of society can be zero or negative.

also indirect costs and benefits, such as deadweight loss in the collection of taxes to run a program and the unintended consequences of the program on the rest of society.

Fourth, in the case of programs that involve a net cost to the rest of society, policy makers must judge the acceptable costs to the rest of society to reduce poverty by a given amount. For example, society may accept the reduction of head count by one family as long as the cost does not exceed a certain level.

The economics of poverty programs can be illustrated with the use of a curve relating the cost to the rest of society to the amount of poverty reduction (see Figure 1), where poverty reduction is measured on the horizontal axis and the marginal cost of that reduction on the rest of society on the vertical axis. (The arguments are qualitatively the same regardless of the precise measure of poverty reduction that is used.) We can summarize the economics of many or most interventions in a marginal cost curve like CC′. The curve begins above the horizontal axis and rises, indicating that the more poverty reduction is pursued, the greater the marginal cost—logical because the program is likely to be better suited to some beneficiaries than to others, so that the average cost of getting to more beneficiaries will rise with the number of beneficiaries. There could, however, be a phase of decreasing marginal (and average) cost just as there tends to be in the economics of the producing firm (see curve C_1C_1'); this would reflect economies of scale in the use of this program up to a certain scale, after which rising costs settle in. In all of these respects, the issues parallel those of a firm's cost structure.

Figure 1



As noted above, some anti-poverty programs, however, may have no net costs to the rest of society at all—for example, policies that raise the welfare of the poor and simultaneously lower crime. In this case, the relevant marginal cost curve could be like C_2C_2', beginning below the horizontal axis. For policies that involve direct outlays, it is useful to distinguish the direct cost curve and the total cost curve, the difference between the two being the net externalities or indirect effects on the rest of society.

We can measure the amount of poverty reduction in terms of the number of people raised above the poverty line, the dollar reduction in the poverty gap, or the dollar equivalent reduction of the weighted poverty gap. In the simple case where it is the dollar reduction in the poverty gap, then a cost curve whose vertical coordinate is greater than its horizontal one has a greater cost to the rest of society than the benefits to the poor, measured in dollar terms. This would not necessarily mean it was a bad policy; in fact, as long as equality is viewed favorably, any program through which the poor can receive $100 of benefits at a cost of $100 (or less) to the rest of society would be a good one; it would involve redistribution with an

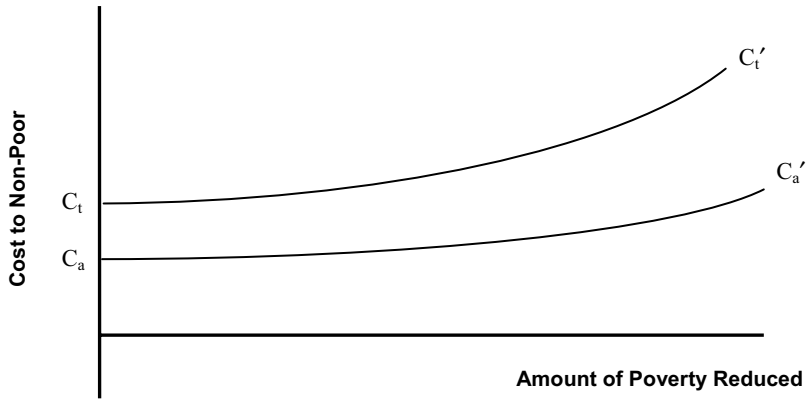
increase in the total size of the pie. When the size of the total pie shrinks, then redistribution has a cost in terms of total income.

A poverty reduction program is better the lower the cost for any level of poverty reduction and the more slowly that the cost curve rises. Those programs with rapidly rising cost curves, although they may be quite efficient (a high benefit-cost ratio) for small amounts of poverty reduction (if the cost curve starts low), do not have the potential for broad coverage.

Pro-poor programs have different types of costs, all of which are in principle summarized in the sort of cost curves shown in Figure 1. The simplest are the transfers from the rest of society to provide the resources for a poverty reduction program. There are often also indirect costs and benefits, such as deadweight loss in the collection of taxes to run a program, leakage of benefits to the non-poor, and unforeseen positive or negative outcomes on the rest of society. Precise identification of the cost curves is thus unlikely to be a simple matter.

Economic, Administrative, and Political Aspects of Successful Pro-Poor Policies

Figure 2



The basic criterion of policy selection (poverty reduction per unit of expenditure by the rest of society) can be thought of as incorporating or encapsulating in summary form all of the factors affecting a policy's success in reducing poverty. We can group such factors in various ways; one useful distinction focuses on economic, administrative, and political determinants. The actual cost of implementing a given anti-poverty program will be higher than the minimum theoretically possible level by an amount that depends on the administrative capacity of those implementing it, the efficiency of the tax system that raised the money to spend, the extent of cost-raising political opposition, and so on. In Figure 2, curve C_aC_a' portrays the minimum economic cost of poverty reduction. It assumes a high level of administrative efficiency and no costs resulting from political opposition. Where administrative efficiency is low or politically related costs are high, the actual cost curve may be much higher, as in curve C_tC_t'.

High economic and administrative costs have the effect of making a given poverty reduction policy less successful by lowering the benefit-cost ratio. Some costs related to the political process (and sometimes indistinguishable from administrative ones, as when incompetent but well-connected people attain public service posts, thereby raising administrative costs) also raise the cost of specific policies. Politics also may make a policy infeasible. Clearly, each of the three broad determinants of a policy's costs and feasibility—economic, administrative,

and political—must be kept in mind in policy selection since all have an impact on the policy's chances of success.

IDENTIFYING GOOD PRO-POOR POLICIES: WHAT TO LOOK FOR

Although the formal criterion for selecting pro-poor policies is simple—a good benefit-cost ratio as defined above[7]—it is important to lay out the practical criteria for identifying such policies in somewhat more detail. These criteria involve choosing promising policy areas and identifying determinants of policy efficiency. In both of these aspects of policy selection, much weight should be given to the prior record of that policy or ones like it, preferably in the same or similar countries but failing that in the wider context of developing countries as a whole. The ultimate test of any policy is the ex post evidence of its success. This prior record may be thought of as a third element of the selection criteria, in which case one would distinguish (1) choice of policy areas on conceptual grounds, (2) evidence of administrative efficiency, and (3) evidence from the prior record of similar policies.

The ex ante analysis of a potential pro-poor program involves, by definition, best guesses as to the costs associated with it. Later, after the program has been in existence for a period of time, it becomes possible to use actual evidence to get a better reading on the position of the cost curves.

Identifying Promising Pro-Poor Policies[8]

In practice, much poverty reduction occurs as a result of the growth of poor people's income, and a significant amount may occur through reduction in the cost or increase in the public provision of important needs. Thus, one promising category of policies includes those likely to raise the incomes of poorer people, such as programs to raise the productivity of small farms or increase the demand for unskilled labor. Another involves lowering the cost of basic needs. Increases in agricultural productivity in staple crops, especially if they involve small farmers, help hold down the price of food. Sites and services programs lower the cost of housing. Investments in water and sanitation infrastructure raise the welfare of the poor. These economic factors in pro-poor policy success underlie the "minimum cost" of reducing poverty when there is a high level of administrative capacity in implementation (see curve C_aC_a' in Figure 2).

Successful pro-poor policies and programs depend not only on the identification of promising areas but also on effective implementation, which depends upon administrative and political factors. For example, the program should be implemented by the level of government or nongovernmental institutions that can do so most effectively. Because the cost per unit of poverty reduction reflects the effectiveness of the program—i.e., the share of total benefits

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[7] A low "total cost per unit of poverty reduction" curve, as show in curve C_tC_t' in Figure 2.

[8] See Deliverable 12: "Recommended Policies, Reforms, and Activities that Support Pro-Poor Economic Growth" (forthcoming).

generated by the poverty program that get to the poor (and to the poorest)—this is another determinant of success. The transparency of poverty reduction programs is likely, under many circumstances, to contribute to their effectiveness. Accordingly, transparency is often a predictor of likely success.

In terms of efficiency of implementation, the likely degree of learning through practice should be taken into account; in some cases, efficiency may initially be low, but improvements may be rapid. Any decision should thus take into account the effect of the policy or program over the course of its life**.**

Finally, a given poverty reduction program is more attractive, other things equal, when it can be integrated well with other poverty reduction programs.

Confirming Success through Measurement

The ultimate test of all poverty reduction programs is ex post empirical evidence. Where not much evidence is available from relevant experience in the country or elsewhere, judgments must be appropriately qualified and tentative. As between two otherwise equally promising programs where the effects of one can be better predicted than those of the other, the former is preferable.

The initial decisions on a given poverty reduction program are not usually the last ones; later decisions involve whether the program should be retained or modified. At this point, full advantage can and should be taken of ex post assessments of success.

Gauging the effectiveness of a poverty reduction program always involves some degree of judgment. Policy makers must simultaneously take into account what relevant and credible theory suggests and what the evidence is with regard to the program's impact on the factors that cause poverty and on the level of poverty. The amount of judgment needed, however, decreases once actual evidence on the program accumulates.

MEASUREMENT ISSUES

The difficult part of assessing the poverty reduction potential of various programs lies mainly in the measurement of their effects on the poor and secondarily the measurement of indirect costs. (Measurement of direct costs is usually much easier.) Without a way of reasonably approximating the level of benefits, it is usually not possible to assess the merits of a potential pro-poor policy.[9] At least three types of information can help in judging the quantitative effects of poverty reduction efforts:

[9] In principle it is not necessary to know the size of benefits, only their existence, when costs are negative (i.e., when the rest of society benefits from the pro-poor program). Since, however, the direct costs of all programs are positive, it is only when the indirect costs are negative (i.e., are benefits rather than costs) that this situation arises. Indirect costs tend to be as hard to measure as benefits.

- Theory;
- Empirical evidence on the intermediate effects of the program; and
- Empirical evidence on the final effects on the level of poverty.

Theory is useful in deciding which policies are candidates for implementation. For example, an argument that raising formal sector wages well above the poverty line will increase poverty is based on a simple model of the labor market in which reduced employment in the formal sector increases the supply in the informal sector where wages are set by the market and thus pushes those wages down and raises poverty. Theory can sometimes even provide elements of the ex ante quantification of benefits that go into the cost curves on the basis of which a judgment is made as to whether to proceed with a given pro-poor policy. At that stage, empirical evidence from other countries or from previous experience in the same country complements theory. Theory, however, is always subject to error through oversimplification and other forms of mis-specification, and earlier positive experiences only provide a likelihood of success, since conditions differ from case to case.

The best demonstration of a program's poverty-reduction effects is likely to be a direct negative correlation between the level (or changes in the level) of the program and the level (or changes in the level) of poverty, other things held constant. The evidence may be of a cross-section or a time-series character or a combination of the two. Since simple correlation does not prove causation, strong evidence for the latter requires being able to sort out the effects of the program and the other factors at work that may affect the level of poverty. This is a task for econometrics. The hope of having credible evidence of this sort on the impact of a particular policy on poverty requires two conditions:

- The determinant has to be significant enough that its impact outweighs the statistical noise in the quantitative record; in other words, it cannot be a marginal determinant of poverty; and

- The other determinants of poverty have to be well enough understood and "specified" so that it is possible to distinguish their effects from those of the program itself.

When analysis of the relationship between the program and poverty does not provide adequate proof one way or the other about the program's value, it is often possible at least to ascertain whether one or more of the intermediate mechanisms that are hypothesized to connect the program to policy are working. Thus, since the effectiveness of food aid requires that many people actually receive the aid, measuring the number of recipients may be thought of as an intermediate piece of evidence, even if one has no direct evidence on its impact on the level of nutrition. Confirming that nutritional levels did rise will provide stronger evidence, since this will normally be a necessary condition for the policy to have been effective.

SUMMARY

The selection of pro-poor policies and programs must begin with a clear definition of poverty and be based on the identification and measurement of benefits and costs associated with policies or programs. Central to the process are a recognition of which types of policies and programs offer the best hope of reducing poverty and the use of evidence of their prior success. Both identification and quantification of benefits and costs are objectives that can only be partially met. Although we cannot expect to calculate benefits precisely before we initiate policies or programs, rough approximations are usually feasible. Later, we can analyze newly acquired data and better judge a particular program's payoff. Policy selection should be viewed as a process that goes beyond the initial decision to implement and includes later decisions on whether to continue or modify the policy.

The criteria outlined in this paper, along with evidence collected from forthcoming sector and country studies, will guide our selection of pro-poor economic growth policies, activities, and reforms. Other outputs of the Pro-Poor Economic Growth Research Studies Activity will elaborate on this paper's discussion and fine-tune the criteria presented herein. As this research program unfolds, we are aware that the complex and dynamic nature of the world makes it extremely difficult to recommend specific policies for unnamed countries and regions. This highlights the importance of well-defined and logical selection criteria. Recommendations made without this foundation would be problematic and could lead to worsening conditions for the poor.

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The goal of the USAID-funded Pro-Poor Economic Growth Research Studies and Guidance Manual Activity is to identify and disseminate policies, reforms, and activities that USAID decision makers can incorporate into their programs and that they can recommend to countries wishing to pursue strongly pro-poor, poverty-reducing, economic growth objectives.

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