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How Poverty Ends

The Many Paths to Progress—and Why They Might Not Continue

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For all the worries today about the explosion of inequality in rich countries, the last few decades have been remarkably good for the world's poor. Between 1980 and 2016, the average income of the bottom 50 percent of earners nearly doubled, as this group captured 12 percent of the growth in global GDP. The number of those living on less than $1.90 a day—the World Bank's threshold for "extreme poverty"—has dropped by more than half since 1990, from nearly two billion to around 700 million. Never before in human history have so many people been lifted out of poverty so quickly.

There have also been massive improvements in quality of life, even for those who remain poor. Since 1990, the global maternal mortality rate has been cut in half. So has the infant mortality rate, saving the lives of more than 100 million children. Today, except in those places experiencing major social disruption, nearly all children, boys and girls alike, have access to primary education. Even deaths from HIV/AIDS, an epidemic that once seemed hopeless, peaked soon after the turn of the millennium and have been declining ever since.

A great deal of the credit for these gains can go to economic growth. In addition to increasing people's income, steadily expanding GDPs have allowed governments (and others) to spend more on

schools, hospitals, medicines, and income transfers to the poor. Much of the decline in poverty happened in two large economies that have grown particularly fast, China and India. But now, as growth has begun to slow down in both countries, there are reasons to be anxious. Can China and India do anything to avoid stalling? And do these countries offer a sure recipe that other countries can imitate, so that they can lift millions of their people out of poverty?

Economists, ourselves included, have spent entire careers studying development and poverty, and the uncomfortable truth is that the field still doesn't have a good sense of why some economies expand and others don't. There is no clear formula for growth. If there is a common thread, it is that the fastest growth appears to come from reallocating poorly allocated resources—that is, putting capital and labor toward their most productive use. But eventually, the returns from that process diminish, at which point countries need to find a new strategy for combating poverty.

THE SEARCH FOR GROWTH

Although growth has been key to reducing poverty, "grow faster" or even "continue to grow fast" are more expressions of hope than actionable policy recommendations. During the 1980s and 1990s, economists spent a lot of time running cross-country growth regressions, a type of analysis aimed at predicting growth rates based on a number of variables. Researchers would plug in data—on education, investment, corruption, inequality, culture, distance to the sea, and so on—in an effort to discover which factors helped or hurt growth. The hope was to find a few levers that could be pulled to raise growth.

There were two problems with this search. First, as the economist William Easterly has shown, growth rates for the same country can change drastically from decade to decade without much apparent change in anything else. In the 1960s and 1970s, Brazil was a global front-runner in growth; starting around 1980, it essentially stopped growing for two decades (before growing again and then stopping again). In 1988, Robert Lucas, one of the founders of modern macroeconomics, published an article in which he wondered why India was such a laggard and wished it would become a fast grower, like Egypt or Indonesia. As fate would have it, India's economy was just beginning a 30-year period of fast growth, while Egypt's and Indonesia's were starting to fall behind. Bangladesh, widely derided as a basket case shortly after its founding in 1971, saw its economy grow at five percent or more for most years between 1990 and 2015, and in 2016, 2017, and 2018, Bangladesh's growth exceeded seven percent—making it among the 20 fastest-growing economies in the world. In all these cases, growth came or went without some obvious reason.

Second, at a more fundamental level, these efforts to discover what causes growth make little sense. Almost every variable for a given country is partly a product of something else. Take education, one factor positively correlated with growth. Education is partly a function of a government's effectiveness at running and funding schools. But a government that is good at doing that is probably good at other things, as well—say, building roads. If growth is higher in countries with better educational systems, should the schools that educate the workforce get credit, or the roads that make trade easier? Or is something else responsible? Further muddying the picture, it is likely that people feel more committed to educating their children when the economy is doing well—so perhaps growth causes education, and not just the other way around. Trying to tease out single factors that lead to growth is a fool's errand. So, by extension, is coming up with corresponding policy recommendations.

What, then, are policymakers left with? There are some things clearly worth avoiding: hyperinflation; extremely overvalued fixed exchange rates; communism in its Soviet, Maoist, or North Korean varieties; the kind of total government chokehold on private enterprise that India had in the 1970s, with state ownership of everything from shipyards to shoe factories. But this is not

particularly helpful advice today, given that hardly anyone is reaching for such extreme options anymore.

What most developing countries want to know is not whether they should nationalize all private industry overnight but whether they should emulate China's economic model. Although China is very much a market economy, the country's approach to capitalism differs greatly from the classic Anglo-Saxon model, characterized by low taxes and few regulations, and even from its European variant, with a greater role for the state. In China, the state, at both the national and local levels, plays an outsize role in the allocation of land, capital, and even labor. Other economies in East Asia have also deviated from the traditional capitalist model and experienced decades of high growth; consider Japan, South Korea, and Taiwan, all places where the government initially pursued an active industrial policy.

All these economies achieved spectacular success after pursuing unconventional policies. The question is whether they did so because of their choices or in spite of them. Did East Asia just luck out, or is there a lesson to be learned from its success? The economies there were also devastated by World War II, so the fast growth might in part have been a function of mere recovery. Moreover, what elements of the Chinese experience are countries supposed to emulate? Should they start with Deng Xiaoping's China, a dirt-poor economy with comparatively excellent education and health care and a very flat income distribution? Or with the Cultural Revolution, an attempt to wipe out the advantages of the elites and place everyone on an even playing field? Or with the preceding 4,000 years of Chinese history? Those who herald the experience of the East Asian economies to prove the virtue of one approach or the other are dreaming: there is no way to prove any such thing.

There simply is no accepted recipe for how to make poor countries achieve permanently high growth. Even the experts seem to have accepted this. In 2006, the World Bank asked the economist Michael Spence to lead a commission on economic growth. In its final report, the group recognized that there are no general principles for growth and that no two instances of economic expansion are quite alike. Easterly described their efforts in less charitable terms: "After two years of work by the commission of 21 world leaders and experts, an 11-member working group, 300 academic experts, 12 workshops, 13 consultations, and a budget of $4m, the experts' answer to the question of how to attain high growth was roughly: we do not know, but trust experts to figure it out."

THE LOW-HANGING FRUIT

Economists did learn something, however, from the back-and-forth about the sources of growth. In particular, they came to understand that transitions are an important yet underemphasized part of the growth story. One of the central tenets of traditional growth theory was that transitions were unimportant, because market forces ensured that resources were smoothly and speedily delivered to their most productive use. The most fertile plots of land should be farmed most intensively. The best workers should end up at the most profitable companies. Investors should entrust their capital to the most promising entrepreneurs.

But this assumption is often false. In a given economy, productive and nonproductive firms coexist, and resources do not always flow to their best use. This is particularly true in developing countries, where many markets, such as those for credit, land, or labor, function poorly. The problem is often not so much that talent, technology, and capital are not available but that the economy does not appear to put them to their best use. Some companies have more employees than they need, while others are unable to hire. Some firms use the latest technology, while others never do. Some entrepreneurs with great ideas may not be able to finance them, while others who are not particularly talented continue operating. This is what economists call "misallocation."

Resources do not always flow to their best use.

Misallocation saps growth, which means that reallocation can improve it. In recent years, economists have tried to quantify just how much growth could come from moving resources to their best uses. Chang-Tai Hsieh and Peter Klenow, for example, found that merely reallocating factors within certain industries, while holding capital and labor constant, could increase productivity in China by 30–50 percent and in India by 40–60 percent. If reallocation took place across a broader swath of the economy, the payoff would be even larger.

In other words, it is possible to spur growth just by reallocating existing resources to more appropriate uses. If a country starts off with its resources very poorly used, as did China before Deng or India in its days of extreme dirigisme, then the first benefits of reform may come from simply harnessing so many poorly used resources. There are many ways to improve allocation, from the moves away from collectivized agriculture that China made under Deng to the efforts India made in the 1990s to speed the resolution of debt disputes and thus make credit markets more efficient.

But the flip side to this is that at a certain point, the gains start to diminish. Many developing economies are now reaching this point. They and the rest of the world will have to come to terms with an uncomfortable truth: the era of breathtaking growth is likely coming to an end.

Consider China's trajectory. By now, the country has gotten rid of its most blatant forms of misallocation. Wisely, it plowed back the gains from the resulting growth in new investment, and as output grew, it sold that output abroad, benefiting from the world's seemingly endless hunger for exports. But that strategy has largely run its course, too: now that China is the largest exporter in the world, it cannot possibly continue to grow its exports much faster than the world economy is growing.

The era of breathtaking growth is likely coming to an end.

China might still eventually catch up with U.S. output in per capita terms, but its slowing growth means that it will take a long time. If Chinese growth falls to five percent per year, which is not implausible, and stays there, which is perhaps optimistic, and if U.S. growth continues to hover around 1.5 percent, then it will take at least 35 years for China to catch up with the United States in terms of per capita income. In the meantime, it makes sense for Chinese authorities to accept that fast growth is temporary, as they appear to be doing. In 2014, Chinese President Xi Jinping spoke about adjusting to "the new normal" of slower growth. Many interpreted this to mean that although the days of double-digit annual growth were behind it, the Chinese economy would still expand at seven percent per year for the foreseeable future. But even that may be too optimistic. The International Monetary Fund projects that China's growth will fall to 5.5 percent by 2024.

A similar story is playing out in India. Beginning around 2002, the country's manufacturing sector saw sharp improvements in resource allocation. Plants swiftly upgraded their technology, and capital increasingly flowed to the best firms within each industry. Because the improvements appeared to be unrelated to any change in policy, some economists spoke of "India's mysterious manufacturing miracle." But it was no miracle—just a modest improvement from a dismal starting point. One can imagine various explanations for the upswing. Perhaps there was a generational shift, as control of companies passed from parents to their children, many of whom had been educated abroad and were often more ambitious and savvier about technology and world markets. Or perhaps it was the effect of the accumulation of modest profits, which eventually made it possible to pay for the shift to bigger and better plants. Regardless of the precise cause, India's economic rise is best understood as the result of correcting misallocation: the type of growth that can come from picking low-hanging fruit.

That kind of growth cannot go on forever. As the economy sheds its worst plants and firms, the space for further improvement naturally shrinks. Today, India seems to be facing the prospect of a steep deceleration. The International Monetary Fund, the Asian Development Bank, and the

Organization for Economic Cooperation and Development have all downgraded their growth estimates for India for 2019–20 to around six percent. Others have suggested that India's economy may have already slowed: Arvind Subramanian, New Delhi's chief economic adviser from 2014 to 2018, has argued that official estimates have overstated the country's growth by as much as 2.5 percentage points in recent years. Growth in India could recover, but at some point, it will slow for good. Indeed, it is possible that India could get stuck in the dreaded "middle-income trap," whereby fast-growing economies start to stall. It would not be alone: according to the World Bank, of 101 middle-income economies in 1960, only 13 had become high income by 2008.

Unfortunately, just as economists don't know much about how to make growth happen, they know very little about why some countries, such as Mexico, get stuck in the middle-income trap and why some, such as South Korea, don't. **One very real danger is that in trying to hold on to fast growth, countries facing sharply slowing growth will veer toward policies that hurt the poor now in the name of future growth. In a bid to preserve growth, many countries have interpreted the prescription to be business friendly as a license to enact all kinds of anti-poor, pro-rich policies, such as tax cuts for the rich and bailouts for corporations.**

Such was the thinking in the United States under President Ronald Reagan and in the United Kingdom under Prime Minister Margaret Thatcher. If the experience of those two countries is any guide, however, asking the poor to tighten their belts in the hope that giveaways to the rich will eventually trickle down does nothing for growth and even less for the poor: in both, growth hardly picked up at all, but inequality skyrocketed. Globally, the one group that did even better than the poorest 50 percent between 1980 and 2016 was the top one percent—the rich in the already rich countries, plus an increasing number of superrich in the developing world—who captured an astounding 27 percent of total growth during that time. The 49 percent of people below them, which includes almost everybody in the United States and Europe, lost out, and their incomes stagnated throughout that period.

The explosion of inequality in economies that are no longer growing is bad news for future growth. The political backlash leads to the election of populist leaders touting miracle solutions that rarely work—and often lead to Venezuela-style disasters. In rich countries, the consequences are already visible, from the rising trade barriers in the United States to the mayhem of Brexit in the United Kingdom. Even the International Monetary Fund, once a bastion of growth-first orthodoxy, has come to recognize that sacrificing the poor to promote growth is bad policy. It now requires its country teams to take inequality into consideration when giving advice.

EYES ON THE PRIZE

Growth is likely to slow, at least in China and India, and there may be very little that anyone can do about it. It may well pick up in other countries, but no one can forecast where or why. The good news is that even in the absence of growth, there are ways to improve other indicators of progress. What policymakers need to remember is that GDP is a means to an end, not an end in itself. It is a useful means, no doubt, especially when it creates jobs or raises wages or increases budgets so that the government can redistribute more. But the ultimate goal remains improving quality of life, especially for those who are the worst off.

Quality of life means more than just consumption. Although better lives are indeed partly about being able to consume more, most human beings, even the very poor, care about more than that. **They want to feel worthy and respected, keep their parents healthy, educate their children, have their voices heard, and follow their dreams.** A higher GDP may help the poor achieve many of those things, but it is only one way of doing so, and it is not always the best one. In fact, quality of life varies enormously between countries with similar income levels: for example, Sri Lanka has more or less the same GDP per capita as Guatemala but far lower maternal, infant, and child mortality rates.

Such disparities should not be so surprising. Looking back, it is clear that many of the important successes of the last few decades were the result not of economic growth but of a direct focus on improving particular outcomes, even in countries that were and have remained very poor. The under-five mortality rate, for example, has fallen drastically across the world, even in some very poor countries whose economies have not grown particularly fast. **Credit goes mostly to policymakers' focus on newborn care, vaccination, and malaria prevention. The same approach can and should be applied to any of the other factors that improve quality of life, be it education, skills, entrepreneurship, or health. The focus should be identifying the key problems and figuring out how to solve them.**

This is patient work: spending money by itself does not necessarily deliver real education or good health. But unlike with growth, experts actually know how to make progress. One big advantage of focusing on clearly defined interventions is that these policies have measurable objectives and therefore can be directly evaluated. Researchers can experiment with them, abandon the ones that don't work, and improve the ones that do. This is what we have spent a good part of our careers doing and what hundreds of researchers and policymakers now routinely do with the help of such organizations as the Abdul Latif Jameel Poverty Action Lab, or J-PAL (the network we started at MIT), and Innovations for Poverty Action, a group founded by the economist Dean Karlan.

So although no one knows how to transform Kenya into South Korea, thanks to the work of Jessica Cohen and Pascaline Dupas, we do know, for example, that the massive distribution of free insecticide-treated bed nets is the most effective way to fight malaria. In a series of randomized trials, these researchers found that charging people for bed nets, which was once thought to make the nets more likely to be used, in fact decreased their use—evidence that eventually convinced major development organizations to abandon fees. Between 2014 and 2016, a total of 582 million insecticide-treated mosquito nets were delivered globally. Of these, 75 percent were given out through mass distribution campaigns of free bed nets, saving tens of millions of lives.

BEYOND GROWTH

The bottom line is that the true ingredients of persistent economic growth remain mysterious. But there is much that can be done to get rid of the most egregious sources of waste in poor countries' economies and of suffering among their people. Children who die of preventable diseases, schools where teachers do not show up, court systems that take forever to adjudicate cases—all no doubt undercut productivity and make life miserable. Fixes to such problems may not propel countries to permanently faster growth, but they could dramatically improve the welfare of their citizens.

Moreover, although no one knows when the growth locomotive will start in a given country, if and when it does, the poor will be more likely to hop on the train if they are in decent health, can read and write, and can think beyond their immediate circumstances. It may not be an accident that many of the winners of globalization have been communist countries that invested heavily in the human capital of their populations for ideological reasons (such as China and Vietnam) or places that pursued similar policies because they were threatened by communism (such as South Korea and Taiwan).

The best bet, therefore, for a developing country such as India is to attempt to raise living standards with the resources it already has: **investing in education and health care, improving the functioning of the courts and banks, and building better roads and more livable cities**. The same logic holds for policymakers in rich countries, who should invest directly in raising living standards in poorer countries. In the absence of a magic potion for development, the best way to profoundly transform millions of lives is not to try in vain to boost growth. It is to focus squarely on the thing that growth is supposed to improve: the well-being of the poor.