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Indonesia Development Forum 2017

Fighting Inequality for Better Growth

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Measures and Policies for Fighting Poverty and Inequality

Martin Ravallion
Georgetown University

Messages of this lecture

Most of the developing world, including Indonesia, has made good overall progress in reducing the incidence of **absolute poverty**.

But there are continuing challenges in addressing **inequality** and **relative poverty**, and in assuring that **none are left behind**.

The policies exist and there is experience to draw on. What is often missing is the **political will** and the **administrative capability** for effective implementation.

Road map

- *Why do we care?*
 - The ethical and economic arguments for why we need to worry about inequality and poverty.
- *How are we doing?*
 - Short histories of overall progress against inequality and poverty. Are the poorest left behind?
- *How can we do better?*
 - Objectives and constraints; policy options; recommendations for thinking about better policies.

Why do we care about inequality?

Why do we care about inequality? Ethics

Ethical concerns about:

- **fairness of processes**, such as unfair trades
- **unequal opportunities in life**, esp. from conditions of birth
- unequal **outcomes** in life; utilitarian objections; and/or implications for the next generation
- objectionable **specific inequities** (ethnic, gender, geographic) especially if due to **discrimination**.

Why do we care? Costs of inequality

- High inequality threatens prospects for future economic growth, and dampens the impact of growth on poverty.
 - Credit constraints facing the poor and middle class.
 - Political impediments to reform and public good provision.
 - Social costs of higher crime, weaker social cohesion.
- Countries starting out with high inequality have a **harder time growing their economy**, and a harder time assuring that their growth is **pro-poor**.

Debates about inequality and development

- **Unevenness in growth processes** => higher inequality emerges, as some poor people take up new opportunities, leaving others behind at least initially (Lewis, Kuznets).
- One view: “Poverty trumps inequality.” If the poorest are also making good progress then rising inequality is acceptable (Rawls).
- Another view raises concerns about high inequality even when poverty is falling
 - Re-emergence of **high-end inequality**; high returns to **rentiers** and their idle children (Piketty; Stiglitz). New Gilded Age.
 - Concerns that this will undermine (economically and politically) overall social progress, including for poor people.

Some inequalities matter more

- **Inequalities of opportunity** perpetuate poverty across generations and are especially damaging to the economy.
- Inequalities in outcomes today can lead to future inequalities of opportunity.
- **Absolute inequality** matters more to many people. Which has more inequality in your view?
 - State A: (1, 2, 3)
 - State B: (2, 4, 6) **Rising absolute inequality**
- Roughly **half** the students asked this say that State B has higher inequality. Yet (relative) inequality measures (such as Gini index) say that there is no difference.
- Perceptions on the ground often differ to the numbers quoted by economists and statisticians!

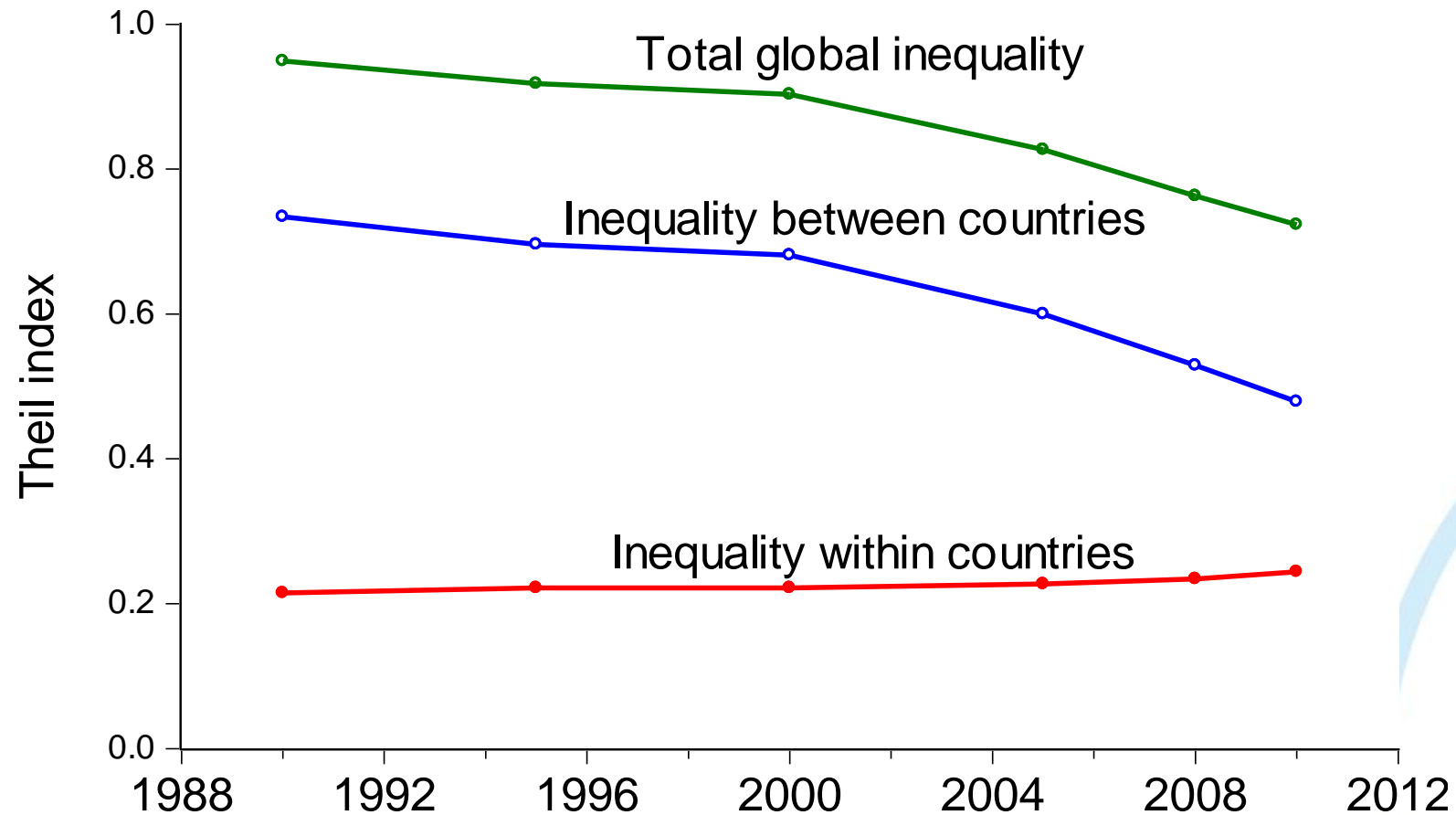
How are we doing?

A (super) short history of inequality and poverty

Falling global inequality in the new Millennium

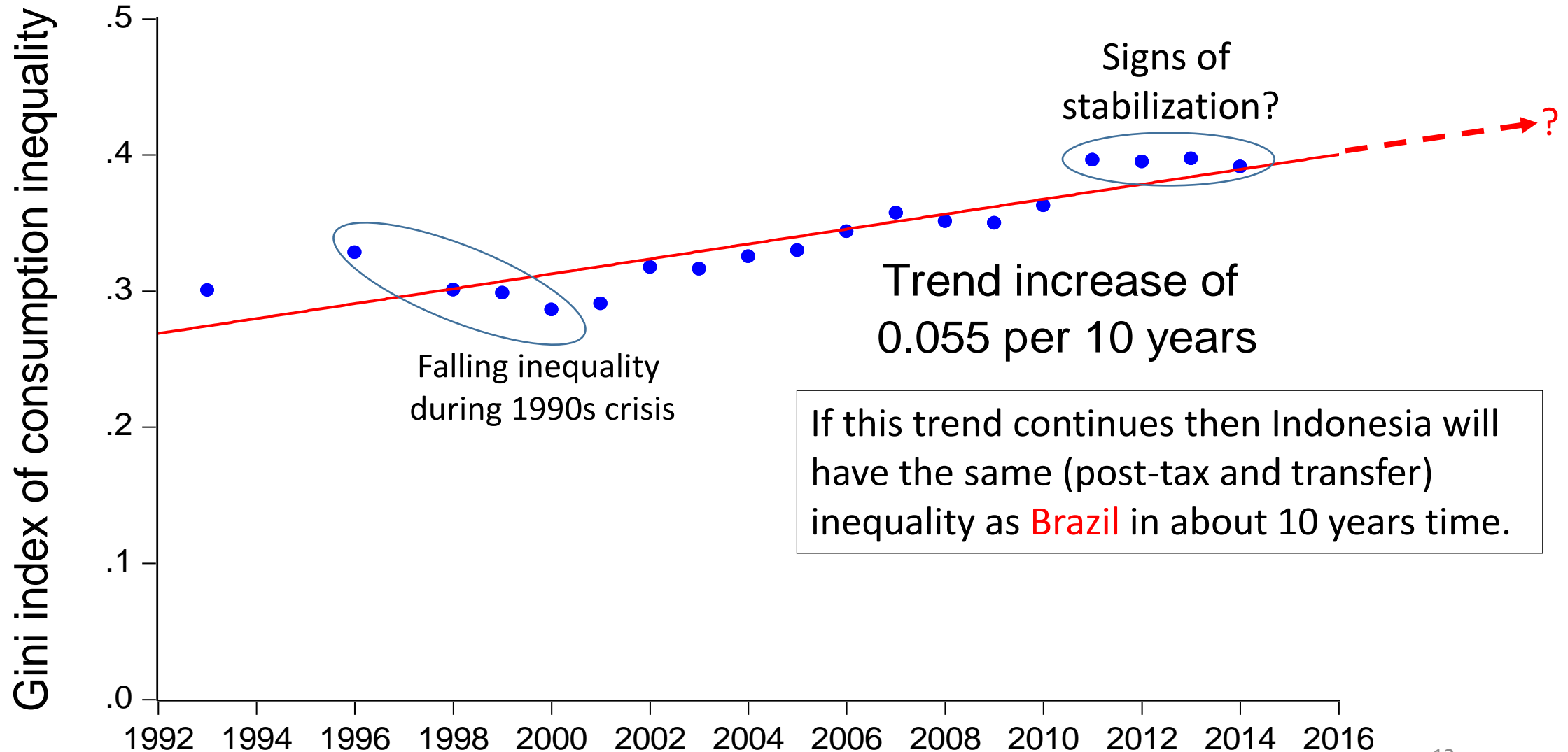
- **Rising global inequality** from 1820 to about 1990.
 - Driven mainly by divergent growth processes: today's rich world takes off from the early C19th (though some late starters).
- The pattern changed dramatically toward the end of the C20th. We have been seeing **falling global relative inequality**.
 - Driven by convergent growth processes, esp., high growth in Asia.
- Average inequality within countries has edged upwards since 2000.
- Signs of **inequality convergence**: tends to rise when low, fall when high.

Global relative inequality and its components



Rising inequality in Indonesia since 1990s

After long period of stable/declining inequality since 1970

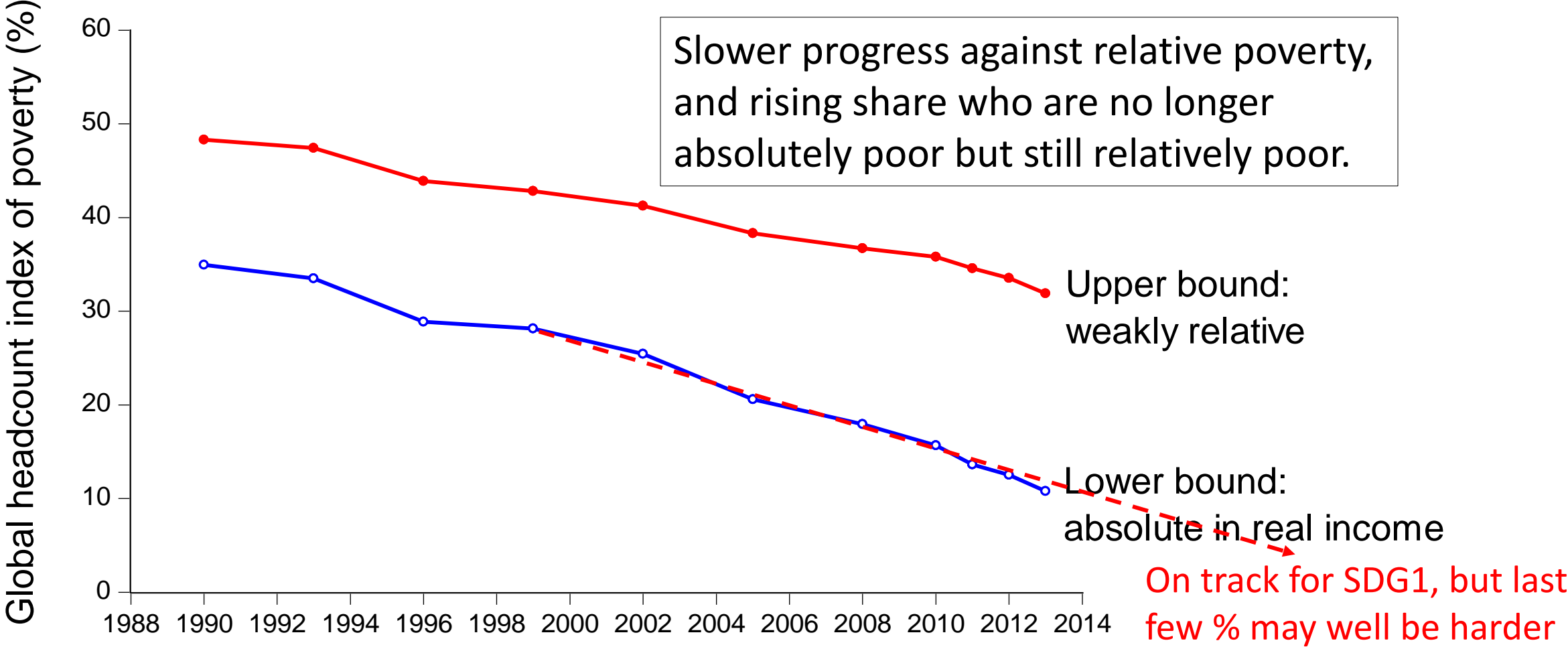


Falling global poverty over the long run

Bounds on global poverty measures:

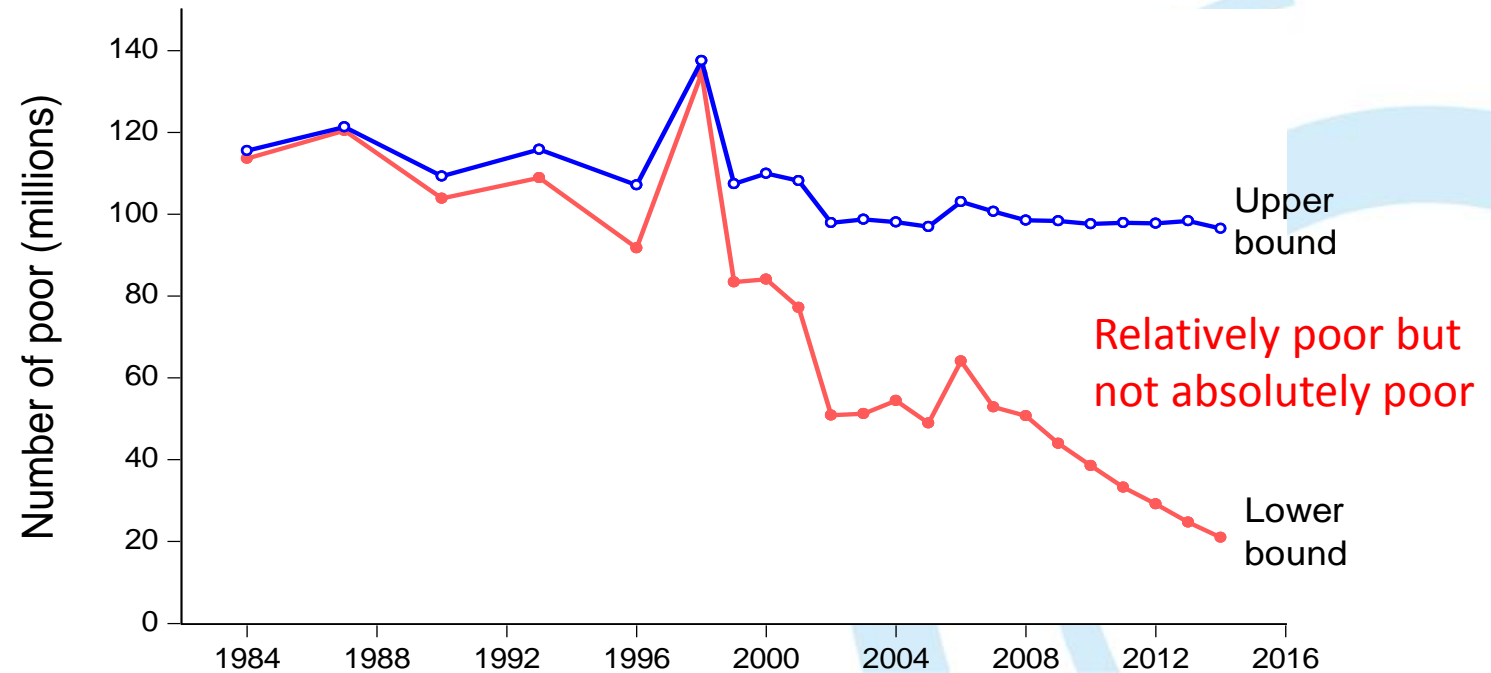
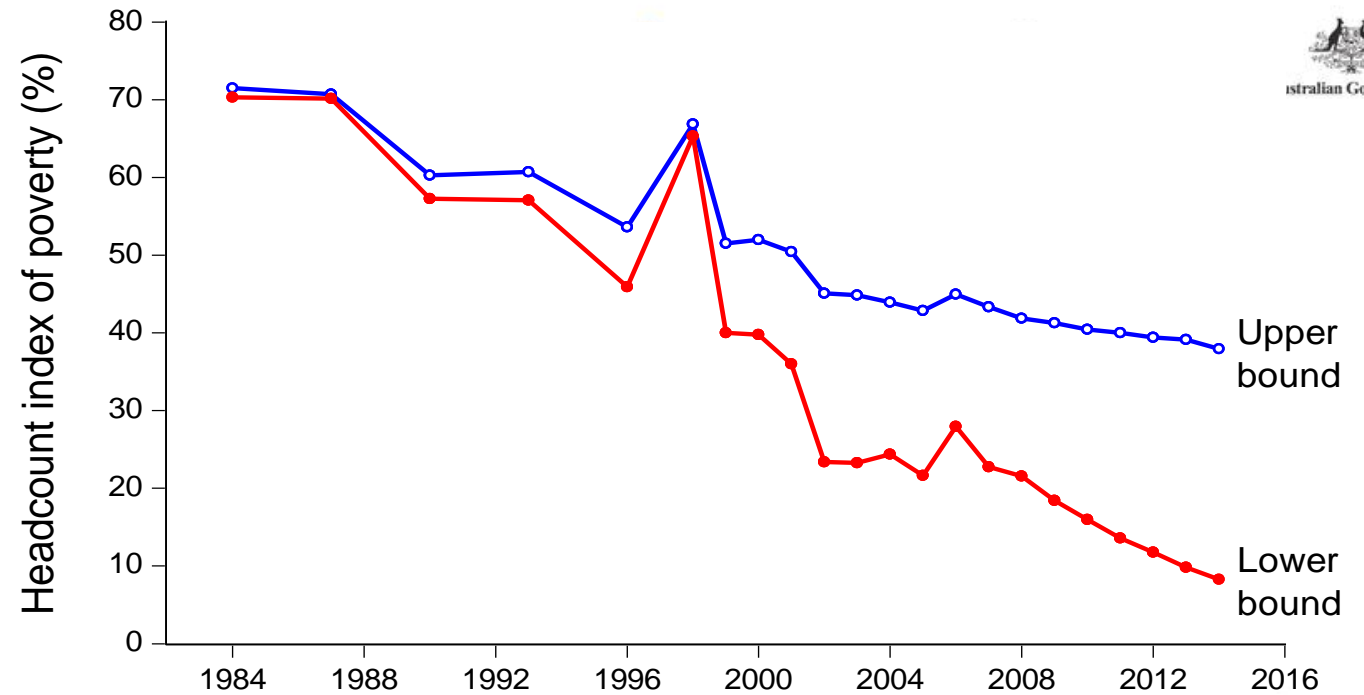
- Lower bound: an absolute line using the World Bank \$1.90 a day line for 2011
 - Assumes that relative income does not matter and that the real cost of social inclusion is constant.
- Upper bound: a weakly relative line based on the Gini-adjusted mean income in that country and date.
 - Allows for relative deprivation and rising costs of social inclusion, which call for **weakly relative measures**. Higher weight on lower incomes.
 - Poverty line rises with mean but not proportionally; (+)'ve minimum cost of inclusion.
 - Strongly relative lines—e.g. 50% of mean—are implausible in developing countries.

Global poverty rates for lower (absolute) and upper (relative) bounds



Bounds on poverty in Indonesia

- Declining incidence of poverty despite rising inequality.
- However, little decline in number for upper bound.
- Rising numbers of relatively poor.



Are the poorest being left behind?

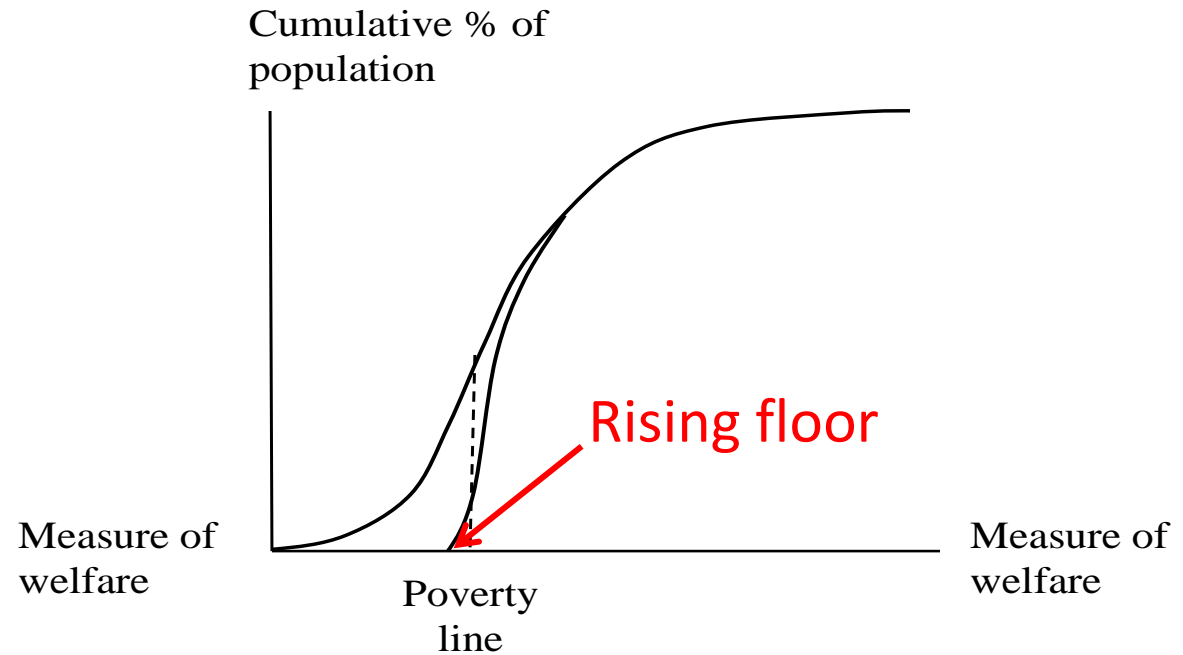
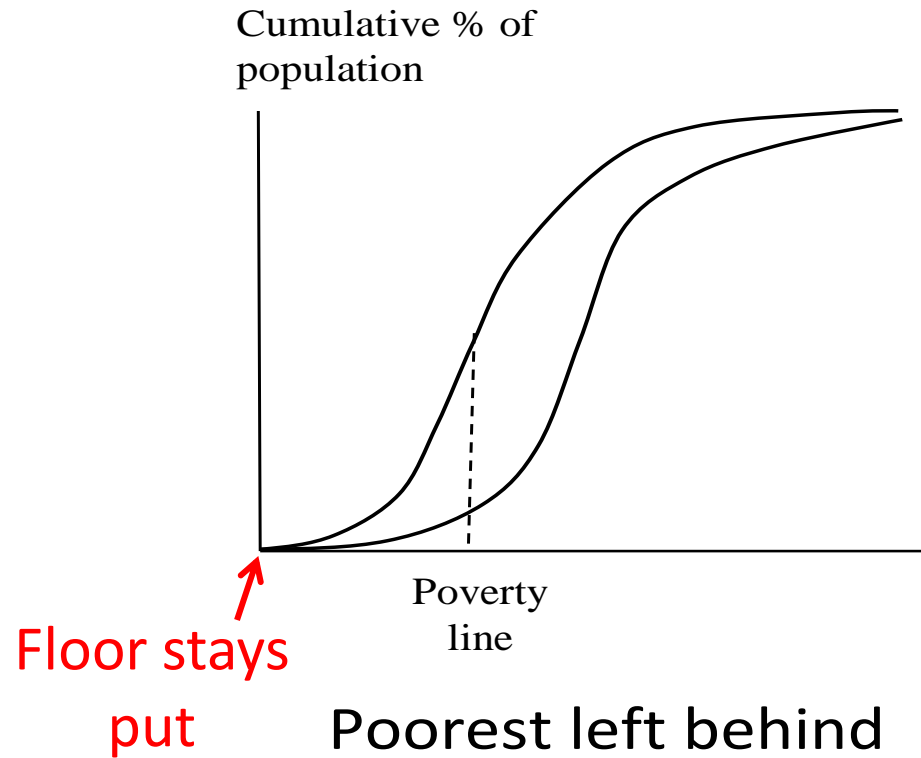


Conflicting views

- *“The poorest of the world are being **left behind**. We need to reach out and lift them into our lifeboat.”* U.N. Secretary-General Ban Ki-moon, 2011
- *“**Poverty is not yet defeated. Far too many are being left behind.**”* Guy Ryder, ILO
- Yet economists appear to tell a very different story. Adages such as *“**a rising tide lifts all boats**”* or claims that *“**growth is good for the poor**”* or that there has been a *“**breakthrough from the bottom**”*

How can we understand such different claims?

The counting approach may miss what is happening at the floor



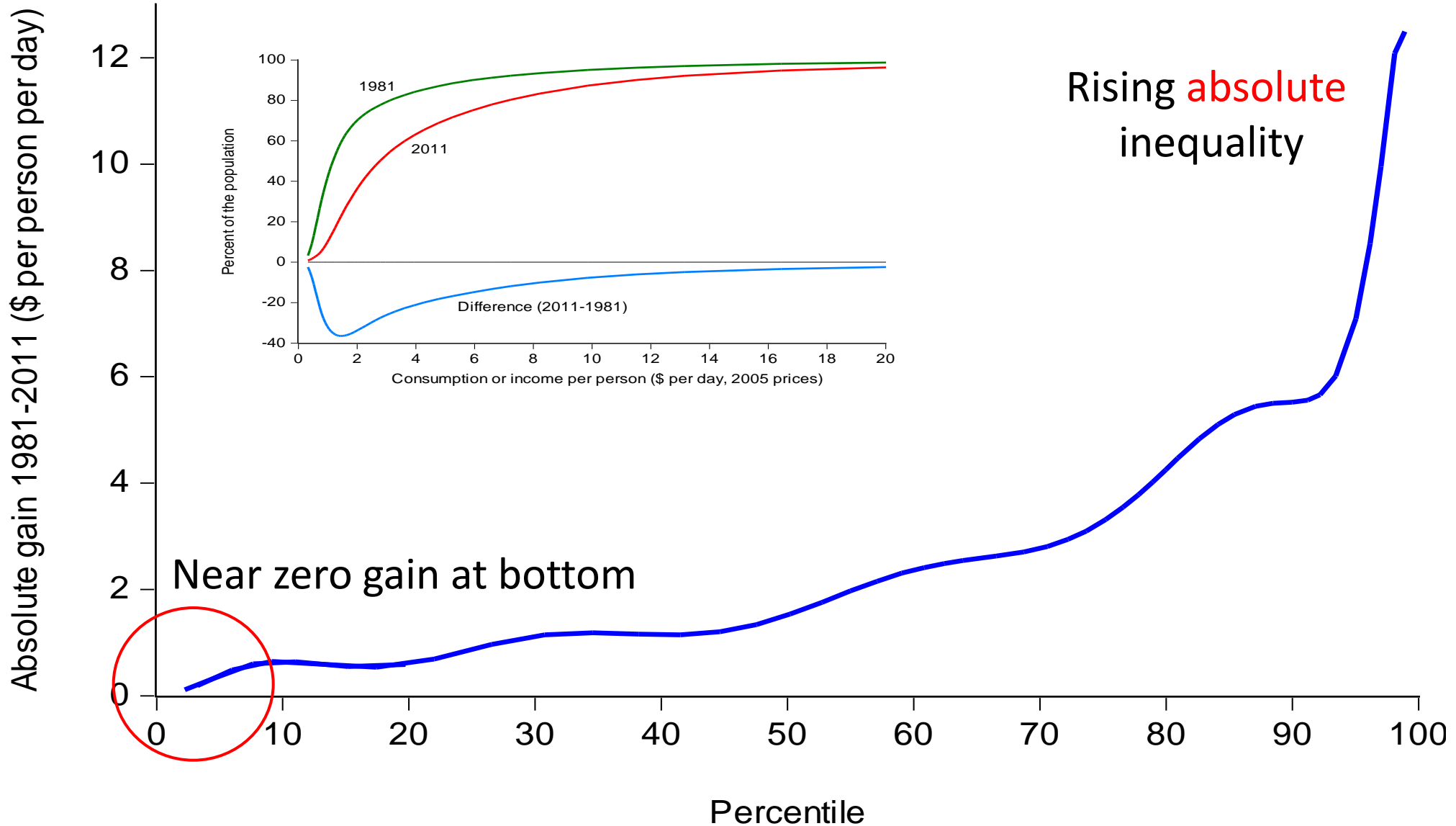
Same reduction in the incidence of poverty but without leaving the poorest behind

Arguments for monitoring the floor

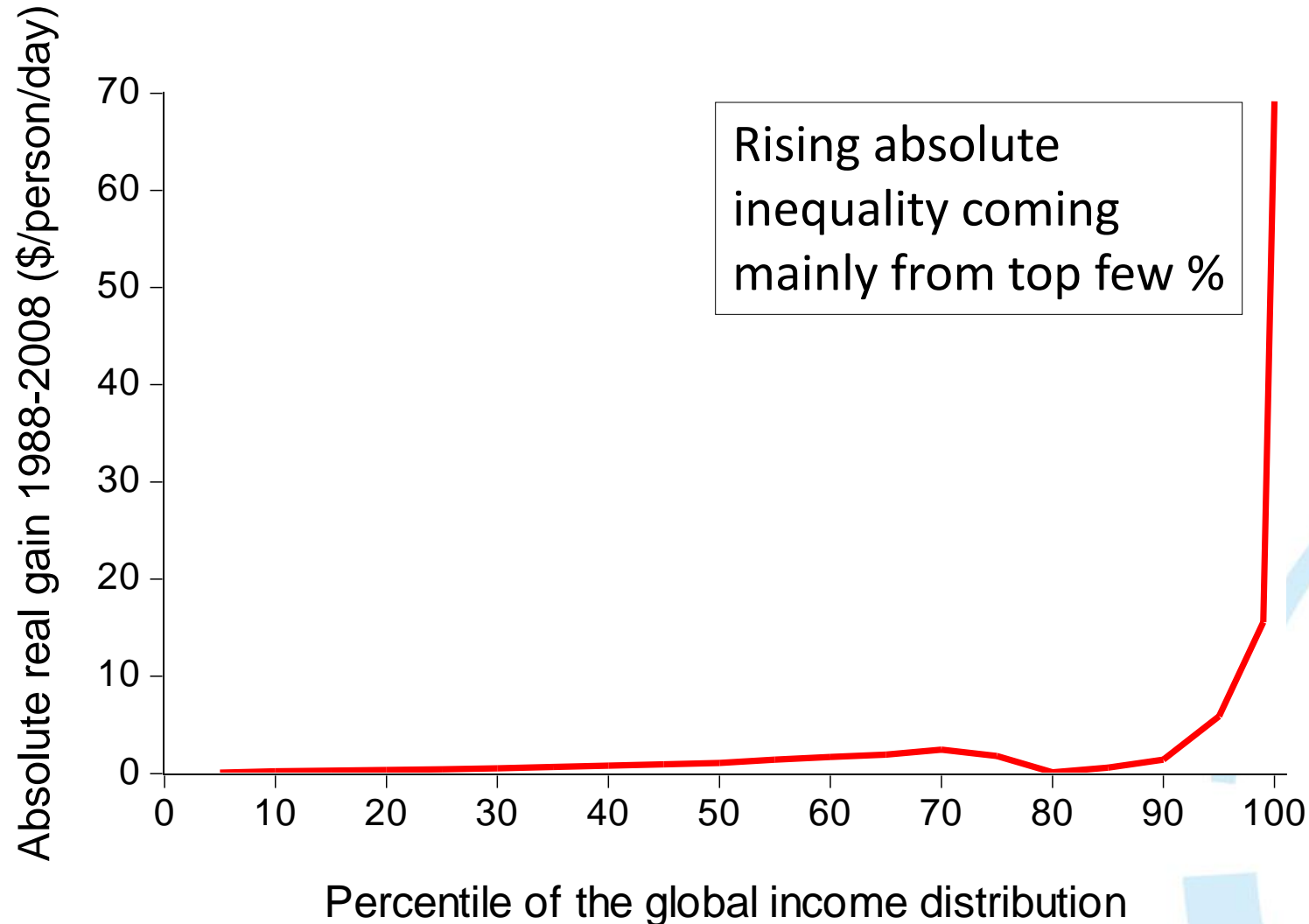
- Mahatma Gandhi's talisman:
 - *“Recall the face of the poorest and weakest person you have seen and ask if the step you contemplate is going to be any use.”*
- SDGs: *“ensure no one is left behind.”*
- Social policies aim to raise the floor
 - **Statutory minimum wage rates:** first appeared in late 19th century in an effort to help raise the consumption floor.
 - **Basic-income** guarantee (BIG): a fixed cash transfer to every adult. A firm floor.
 - Social policy as a *“right of citizenship”* rather than something to be targeted based on “need.”

Yes, the poorest have been left behind!

Fewer people living near the floor, but little change in the floor

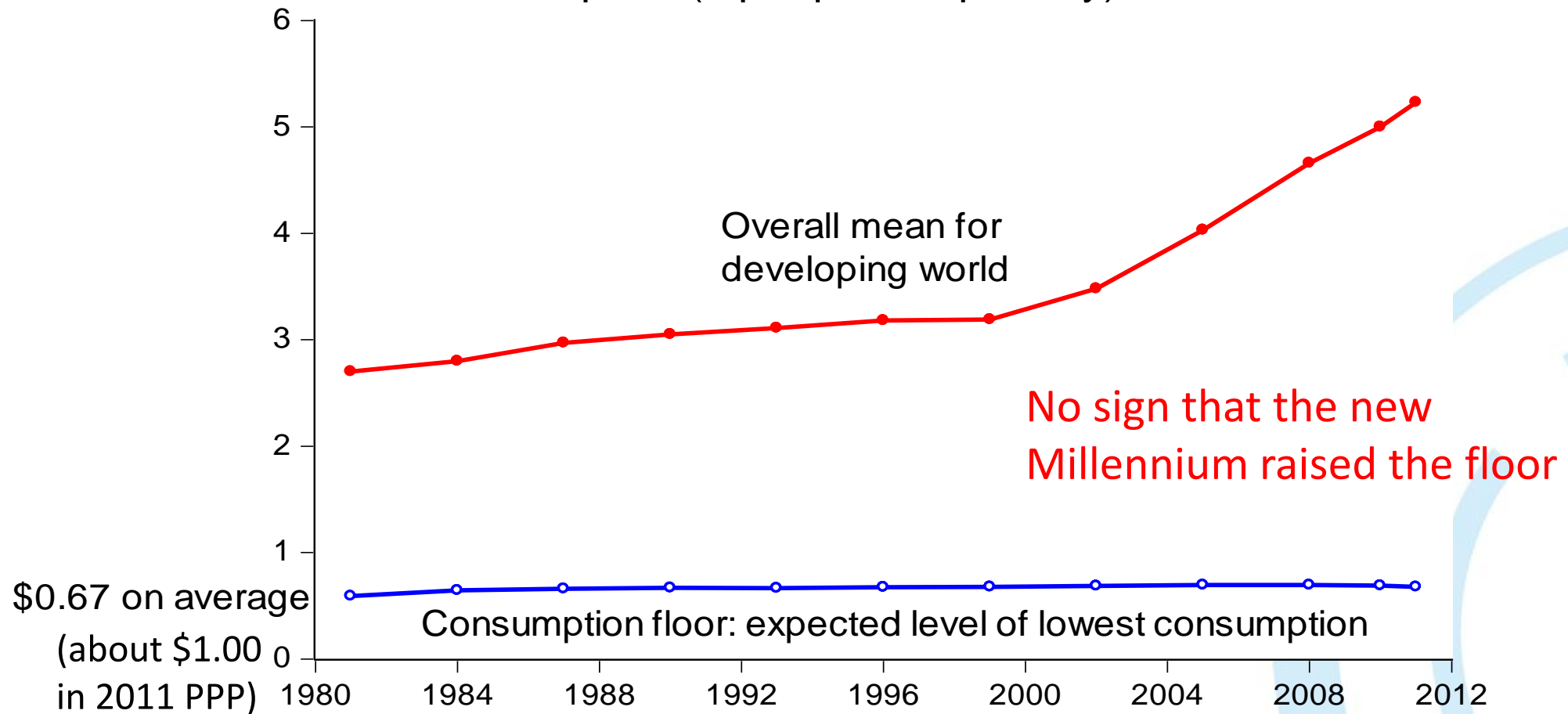


And globally it looks like this!



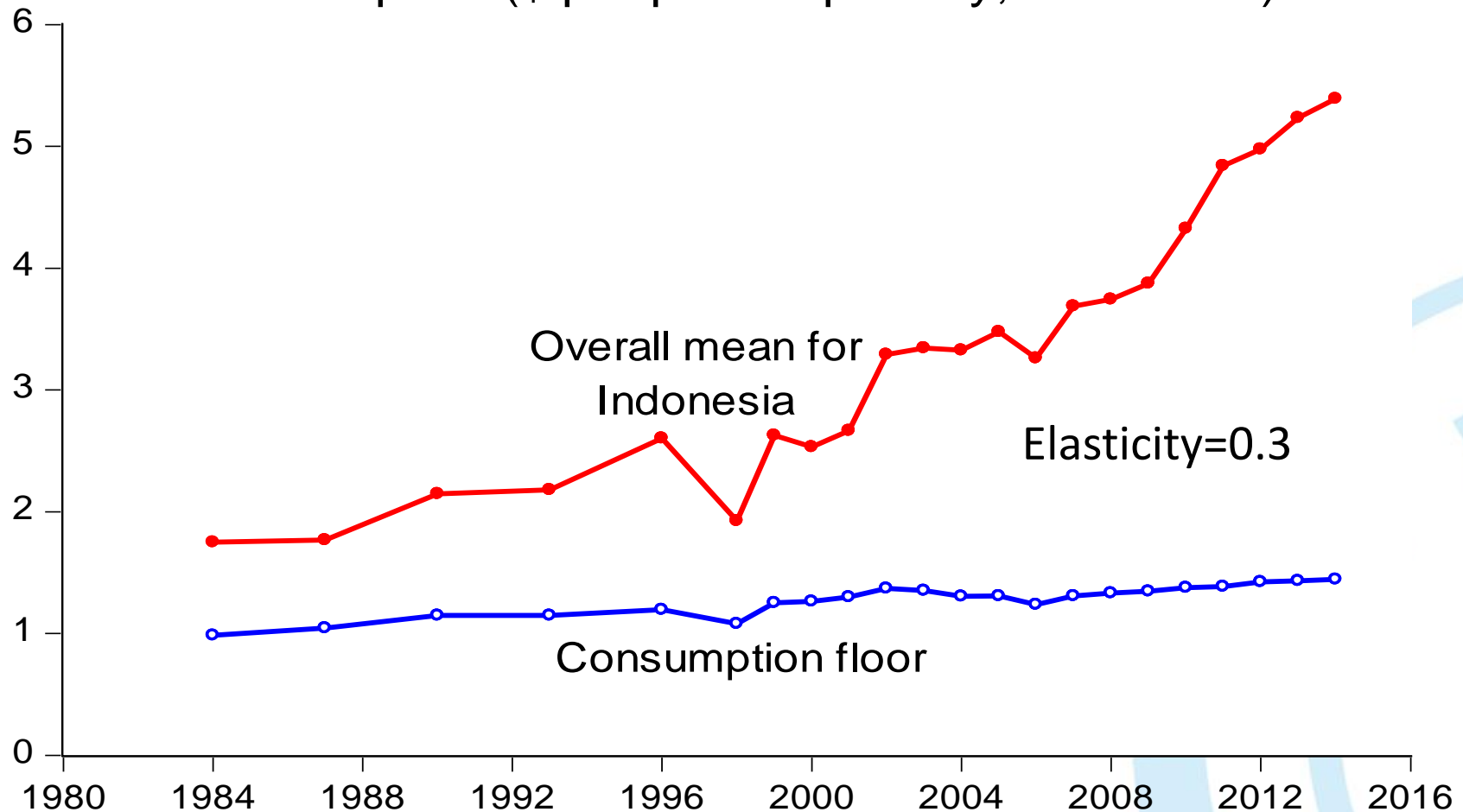
Much less progress in raising the consumption floor globally

Mean consumption (\$ per person per day)



Indonesia has made somewhat more progress in raising the floor

Mean consumption (\$ per person per day; 2011 PPP)



Policies to help assure pro-poor growth

Economic growth remains crucial, especially in poor places

- Growth has been distribution neutral on average
 - Falling inequality in some growing economies and in some periods (Indonesia 1970-90)
 - But rising in other countries/periods (Indonesia since '90s).
- Growth has been the main proximate source of progress against absolute poverty, incl. in Indonesia.
- **Trade off?** Little evidence of an aggregate trade off between growth in market economies and equity, but tradeoffs in policy design.
- **Virtuous cycle?** A degree of redistribution in high-inequality settings is likely to be good for growth, which (in turn) finances more pro-poor policies.

How to achieve more pro-poor growth?

Literature and policy discussions point to the need to:

- Develop human and physical **assets** of poor people => quality services
- Make **markets** work better for poor people (credit, labor, land)
- Remove negative **discrimination** (race, gender)
- Remove **biases against the poor** in public spending, taxation, trade and regulation
- Invest in **local public goods/infrastructure** not neglecting poor areas, incl. agriculture and rural development
- Remove restrictions on **migration** (between and within countries)
- Foster **labor absorption** from urban economies (small and medium sized towns)

Human development is crucial for fighting poverty and inequality

- Socio-economic differences in schooling and health care everywhere help perpetuate poverty and inequality across generations.
- Generalized gains in schooling can be inequality increasing initially; need for focusing on poor families.
- For a country such as Indonesia, **education expansion (quality and quantity) tends to be pro-poor.**
- New evidence on importance of **early childhood development** to break out of inter-generational poverty traps

Redistributive policies to complement pro-poor growth

Lessons from the advanced economies

- Fiscal incidence studies suggest that redistributive policies—mainly taxes and transfers—have reduced inequality substantially (OECD, IMF).
 - Average Gini for market incomes = **0.49**
 - Average Gini for disposable income = **0.31**
- (Though redistributive effort has not typically increased with the higher inequality of market incomes since mid-1990s.)
- The types of policies have varied over the history of the (current) advanced economies, in line with **administrative capabilities** and **aggregate resources**.

Fiscal incidence in Indonesia

- Indonesia does less redistribution than found in Latin America (less in turn than advanced countries). But Indonesia also has less inequality.

Gini	Market income	Final
Indonesia	0.39	0.37
Brazil	0.58	0.44

- Indonesia devotes 5% of GDP to social spending (transfers, pensions, health and education) vs. 24% in Brazil.
- In the past, Indonesia favored energy and other subsidies on normal goods over transfers, though this is changing (fuel subsidies eliminated in 2014).

Greater use of direct interventions in the developing world

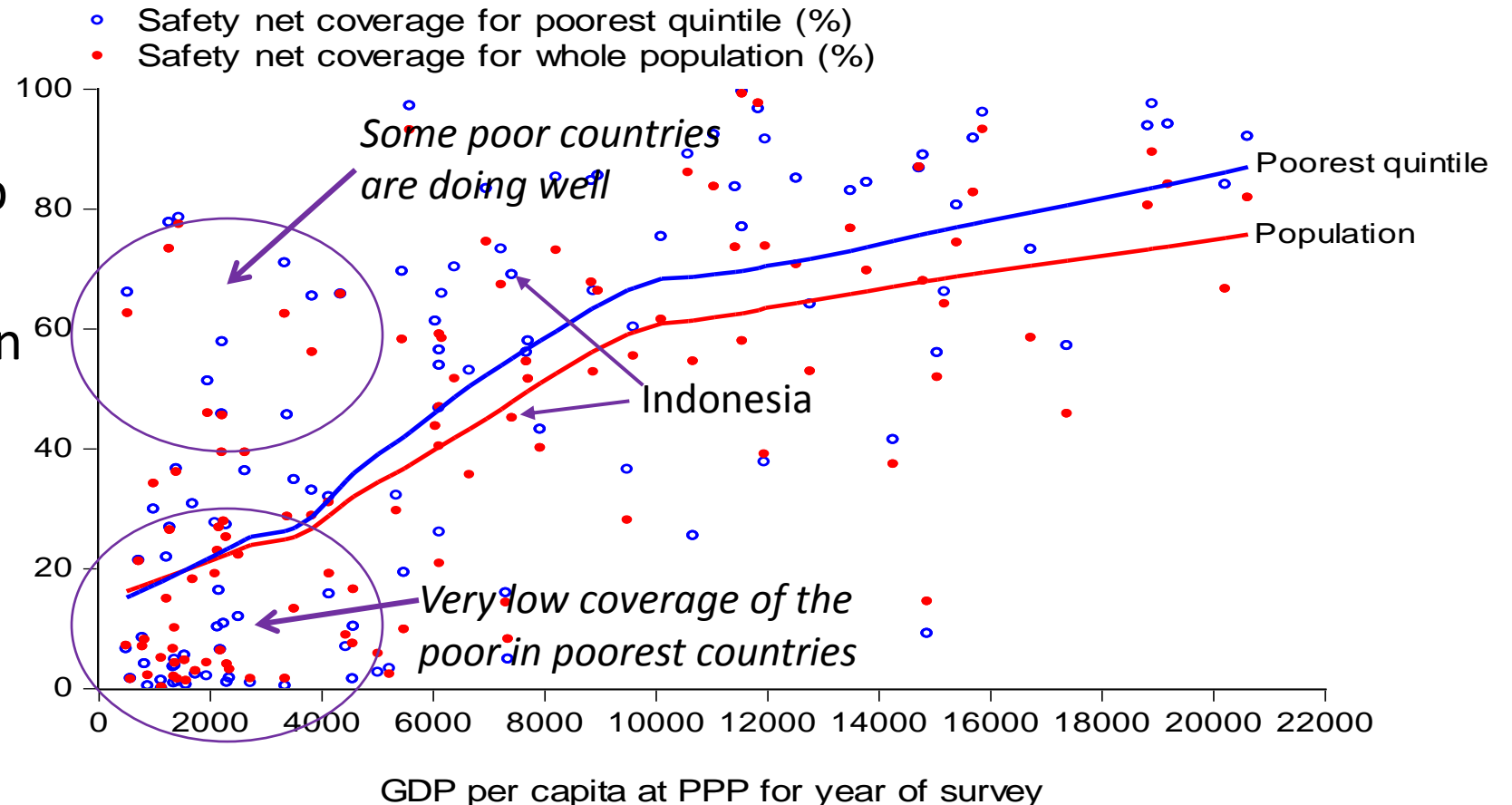
- Two main forms:
 1. Direct non-contributory income transfers to poor or vulnerable families; with or without **conditions**.
 2. Workfare schemes use work requirements for targeting.
- Today almost every developing country has at least one such program, though often with limited coverage.
- Roughly **one billion** people currently receive assistance.

But are these interventions reaching the poor?

Uneven coverage of poor people

The share of the poorest 20% receiving help from the social safety net (SSN) programs in developing countries

- Only about one third of those in the poorest quintile are receiving help from SSNs.
- And worse performance in poorer countries.
- Indonesia is doing relatively well.



Source: WB's ASPIRE data set

SSN=Non-contributory transfers targeted to poor and vulnerable people.

A new role for redistributive interventions, but many challenges ahead

- Success against relative poverty and in raising the floor will almost certainly require **more effective redistributive policies**.
- Constraints include information, incentives, financing and political economy. **Administrative capacity** is key.
- High marginal tax rates on the poor must be avoided; **poverty traps** due to fine targeting.
- **Information constraints** can be severe. Reliable fine targeting is rarely feasible in practice in developing economies.
- Method of **financing** is key to overall impact.

A menu of current policies

- Public services (health, education, security)
 - Targeted or universal
- Cash transfers
 - Targeted, state-contingent) or universal
 - Conditional (e.g., PKH) or unconditional
- Microfinance
- Workfare schemes
 - Low wage rate
 - Assets of value to poor people
- Minimum wage rate (if enforceable)
- Progressive income tax
- Stronger tax enforcement on companies and the rich



A policy proposal to consider seriously, for both pro-poor growth and redistribution

- **Basic full income**
 - Universal; all citizens (“poor” or not)
 - Cash plus imputed values of key in-kind services (health, education)
 - Cash accumulates in an account for children until age 18 (say)
- Financed by cutting other subsidies and programs that bring little benefit to the poor
- + progressive income tax when administratively feasible
- Supportive ID system (e.g., *Aadhaar* in India, but privacy concerns).

Six recommendations

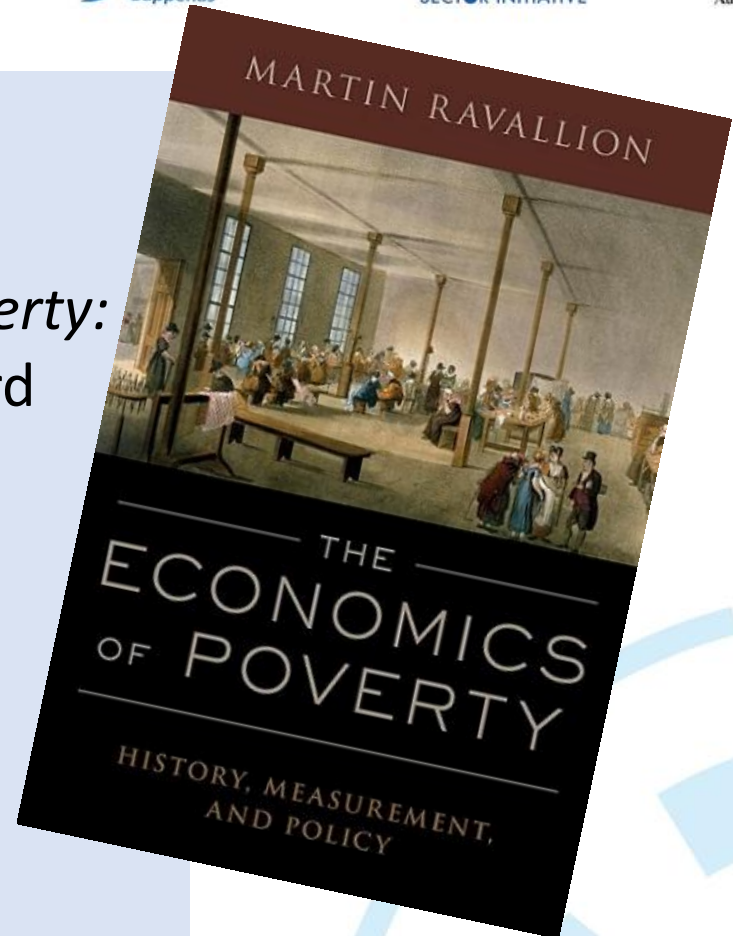
1. Tailor policies to the realities of the setting
2. Tap local information but with effective state support
3. Focus on poverty reduction not finer “targeting” *per se*
4. Protect and promote
5. Monitor and evaluate
6. Learn from mistakes

Further reading

Martin Ravallion, *The Economics of Poverty: History, Measurement and Policy*, Oxford University Press, 2016

economicsandpoverty.com

Martin Ravallion, *Interventions Against Poverty in Poor Places*, WIDER Annual Lecture, 2017



Terima kasih atas perhatian anda!