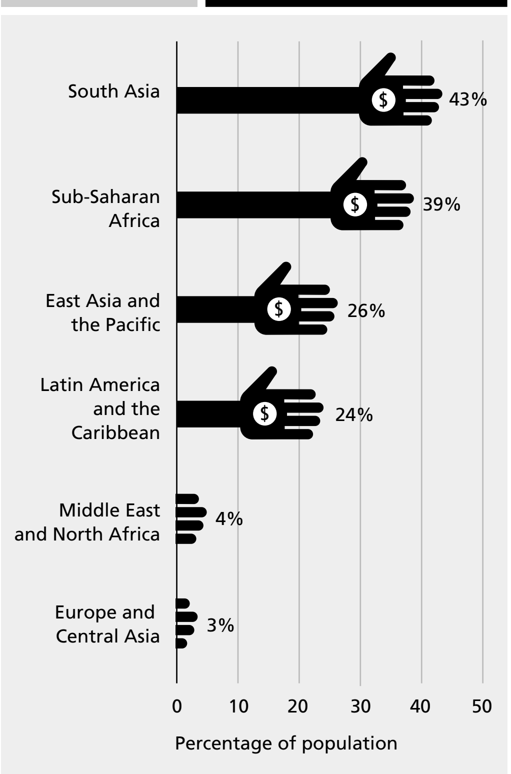
6

Poverty

How can poverty in different countries be compared?

The notion of poverty varies by country. Generally speaking, the richer a country is, the higher is its national poverty line. To allow for international comparisons, the World Bank has established an international poverty line of $1 a day per person in 1985 purchasing power parity (PPP) prices. According to this measure the portion of poor people in the world's population—those living on less than $1 a day—fell slightly between 1987 and 1993, from 30 percent to 29 percent. But the absolute number of poor people increased, from 1.2 billion to 1.3 billion. Another 2 billion are only a little better off.

Figure 6.1 **Population living on less than $1 a day, 1993**

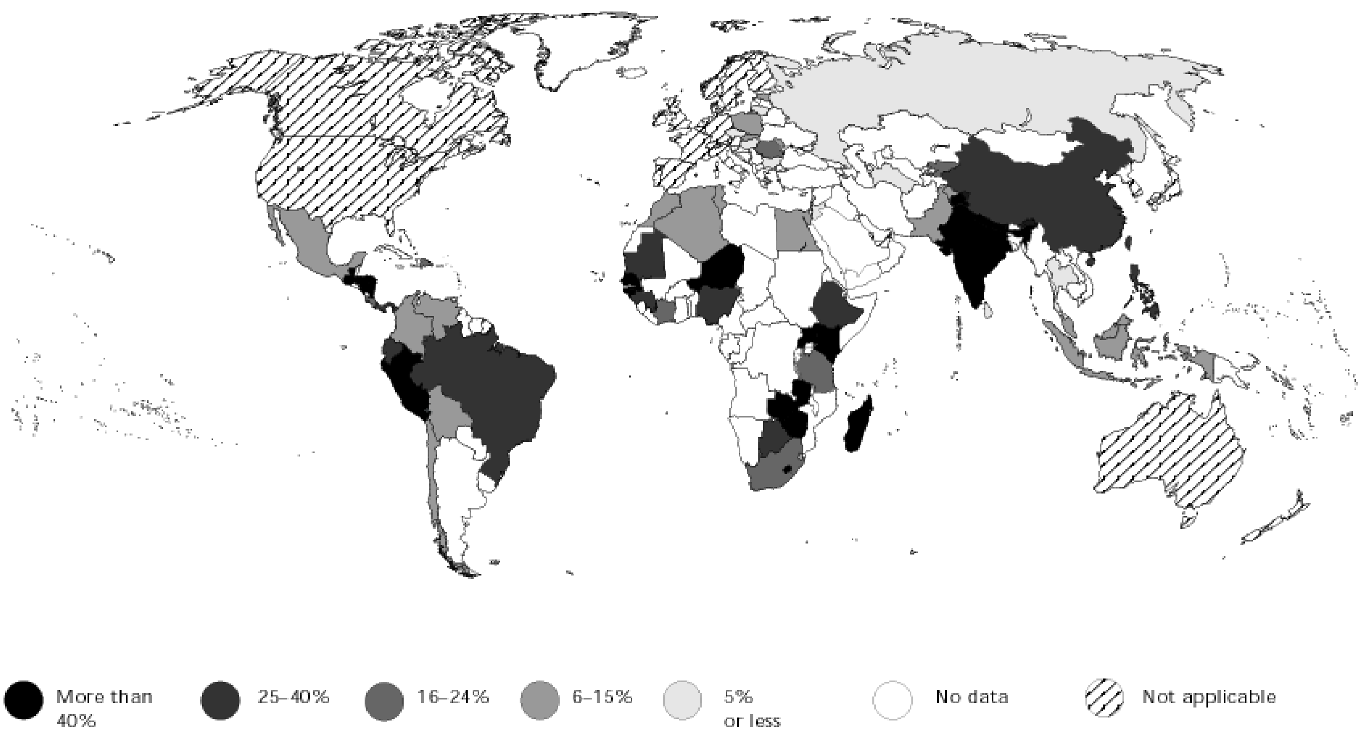


The Geography of Poverty

Most of the world's poor live in South Asia (39 percent), East Asia (33 percent, mostly in China and Indochina), and Sub-Saharan Africa (17 percent). South Asia also has the highest incidence of poverty (43 percent of its population), followed by Sub-Saharan Africa (39 percent; Figure 6.1). Countries in which more than half the population lives below the international poverty line include Guatemala, Guinea-Bissau, India, Kenya, Lesotho, Madagascar, Nepal, Niger, Senegal, and Zambia (Map 6.1 and Data Table 1).

Analysts have found a strong positive relationship between **economic growth** and poverty reduction. For example, East Asia (excluding China),which contains the world's fastest-growing economies, reduced the share of its population living in poverty from 23 percent in 1987 to less than 14 percent in 1993. But in Sub-Saharan Africa, where

Map 6.1 Percentage of population living on less than US$1 a day, 1981–95



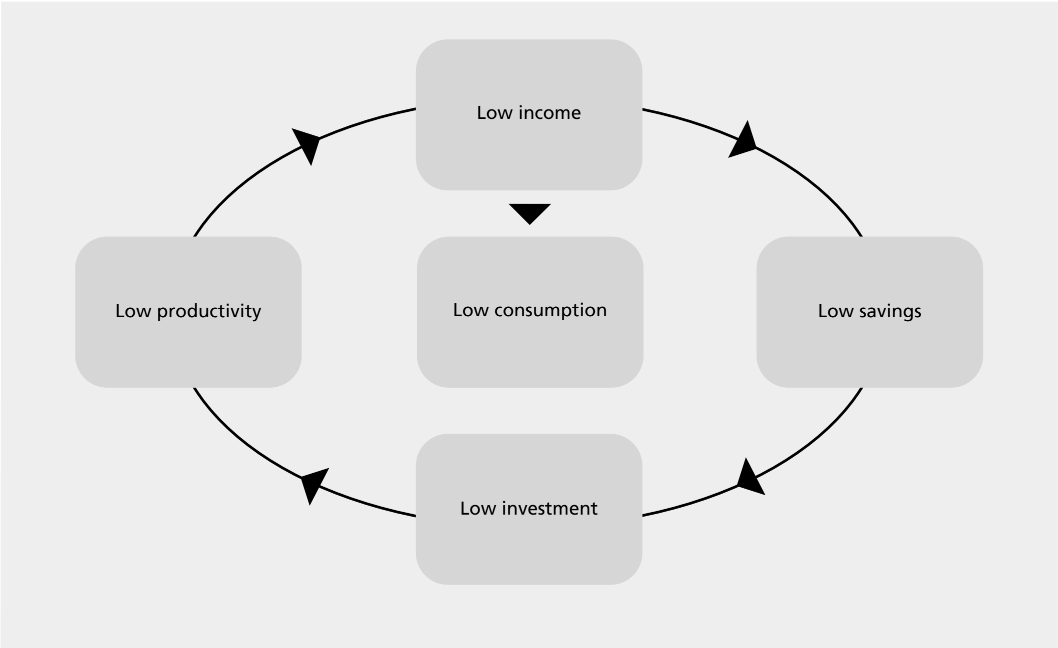
negative growth of GNP per capita predominated during that period, the incidence of poverty hardly changed.

The Vicious Circle of Poverty

Economists generally assume that people's willingness to save for future consumption grows with their incomes. The poorer people are, the less they can afford to plan for the future and save. The same logic applies to businesses and governments. Thus in poor countries, where most incomes have to be spent to meet current—often urgent—needs, national **saving** tends to be low. Low saving hinders desperately needed domestic **investment** in both **physical capital** and **human capital.** Without new investment, an economy's **productivity** cannot be increased and incomes cannot be raised. That closes the vicious circle of poverty (Figure 6.2). So are poor countries doomed to remain poor?

Recent data on gross domestic investment in East Asia suggest that the answer is no. Despite low initial GNP per capita, **gross domestic saving** and **gross domestic investment** in the region were high and growing until the 1998 financial crisis

Figure 6.2 **The vicious circle of poverty**



Can poor countries break the vicious circle of poverty?

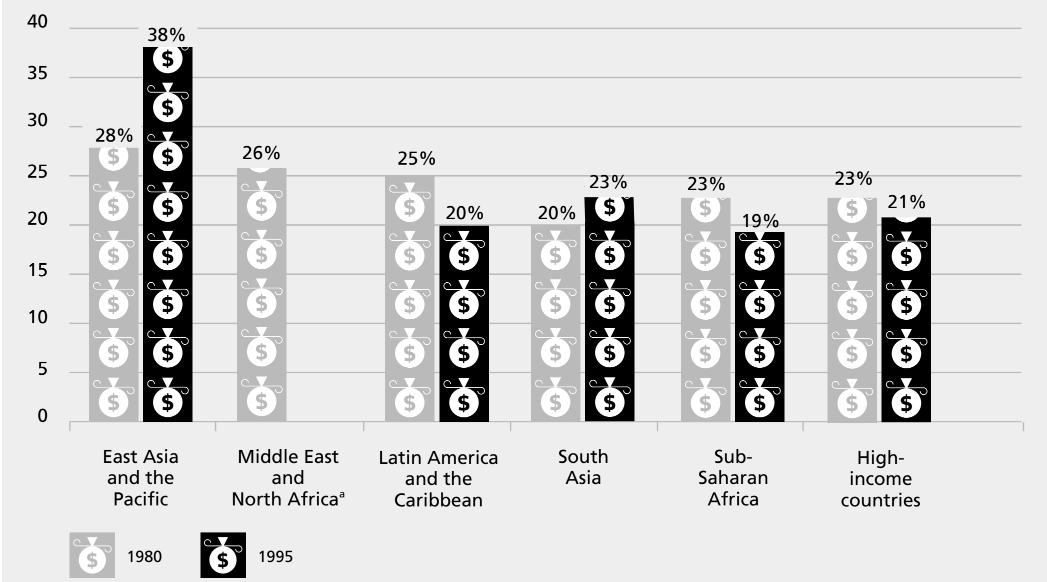
(Figure 6.3). Experts are still trying to explain this phenomenon. Generally speaking, however, many of the factors that encourage people to save and invest are well known, including political and economic stability, a reliable banking system, and favorable government policy.

In addition to domestic investment, foreign investment can help developing countries break out of the vicious circle of poverty, particularly if such investment is accompanied by transfers of advanced technology from developed countries. The opportunity to benefit from foreign investment and technology is sometimes referred to as the "advantage of backwardness," which should (at least theoretically) enable poor countries to develop faster than did today's industrial countries. However, many of the conditions needed to attract foreign investment to a country are the same as those needed to stimulate domestic investment.

A favorable investment climate includes many factors that make investing in one country more profitable and less risky than in another country. Political stability is one of the most important of these factors. Both domestic and foreign investors are discouraged by the threat of political upheaval and by the prospect of a new regime that might impose punitive taxes or expropriate capital assets. As a result a country can fall into another vicious circle, one seen historically in some Latin American countries (Figure 6.4). Political instability scares away new investments, which prevents faster economic growth and improvements in people's economic welfare, causing even

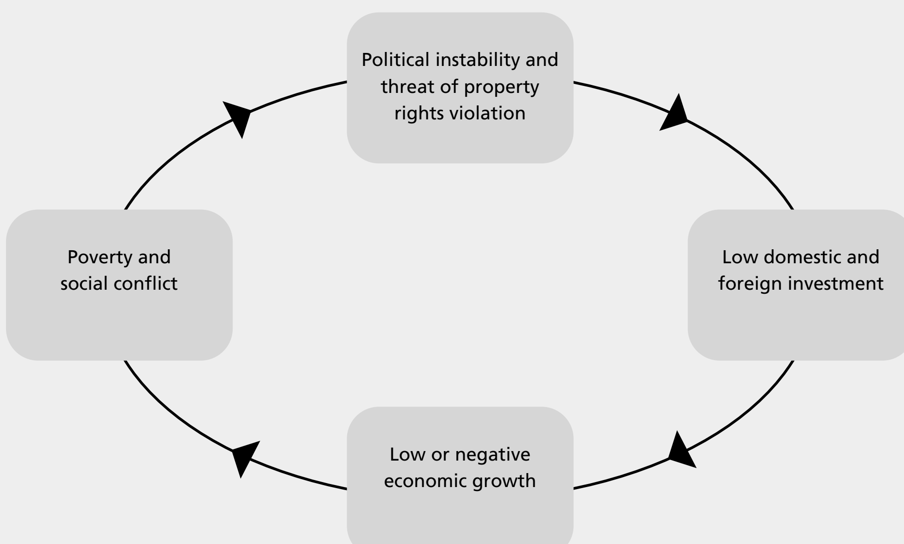
What is the relationship between poverty and political instability?

Figure 6.3 Gross domestic investment as a percentage of GDP, 1980 and 1995



a. 1995 data are not available.

Figure 6.4 The vicious circle of political instability



more dissatisfaction with the political regime and increasing political instability. Falling into this vicious circle of political instability can seriously impede efforts to boost economic development and reduce poverty.