



## Poverty

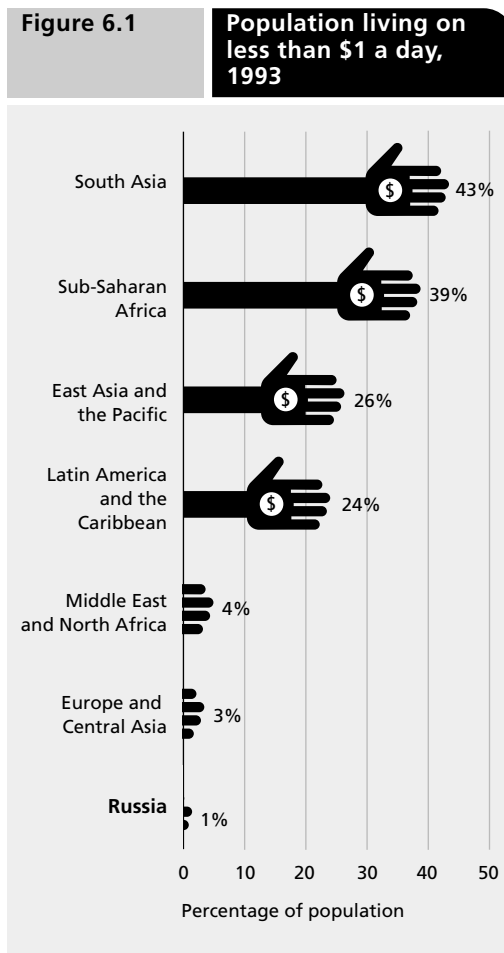
The notion of poverty varies by country. Generally speaking, the richer a country is, the higher is its national poverty line. To allow for international comparisons, the World Bank has established an international poverty line of \$1 a day per person in 1985 purchasing power parity (PPP) prices. According 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 slightly better off.

### The Geography of Poverty

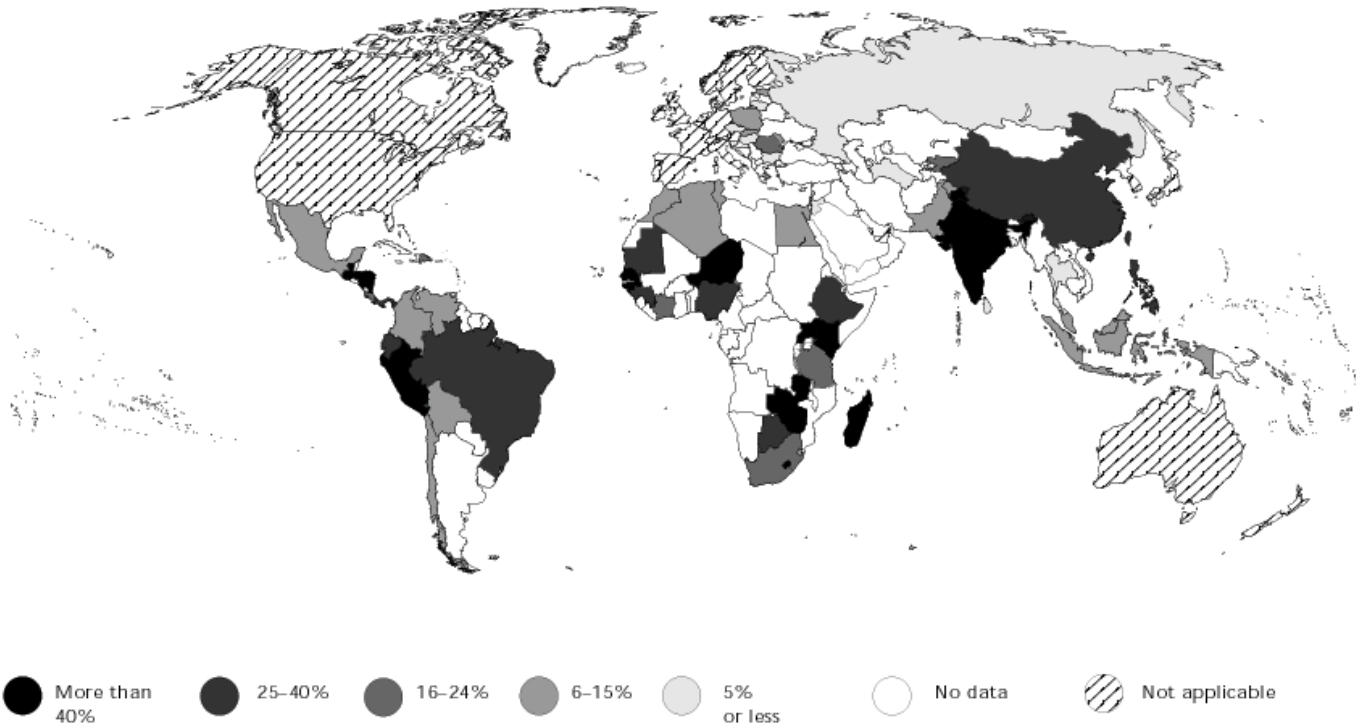
Most of the world's poor live in South Asia (39 percent), East Asia (33 percent, mostly in China and Indochina), and Sub-Saharan Africa (17 percent). South Asia also has the highest incidence of poverty (43 percent of its population), followed by Sub-Saharan Africa (39 percent; Figure 6.1). Countries 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).

*In Russia in 1993, about 1 percent of the population was living below the international poverty line with income less than \$1 a day per person, about 10 percent were below the international poverty line of \$2 a day per person, and about 30 percent were below the national poverty line*



Map 6.1

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



*officially established by the Russian government. By 1997, the share of population below the national poverty line had decreased somewhat, but then in 1998 the situation worsened dramatically, so that almost 40 percent of the population found themselves below the official poverty line established at about \$80 a month per person in PPP terms.*

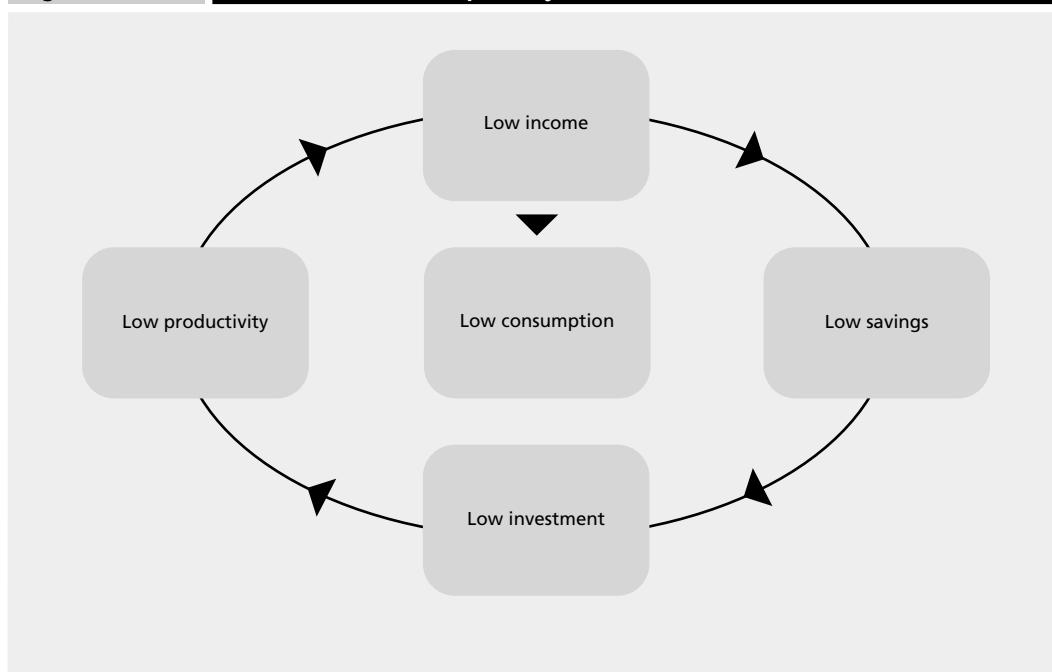
Analysts have found a strong positive relationship between **economic growth** and poverty reduction. For example, East Asia (excluding China), which contains the world's fastest-growing economies, reduced the share of its population living in poverty from 23 per-

cent in 1987 to less than 14 percent in 1993. But in Sub-Saharan Africa, where 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

**Figure 6.2** The vicious circle of poverty

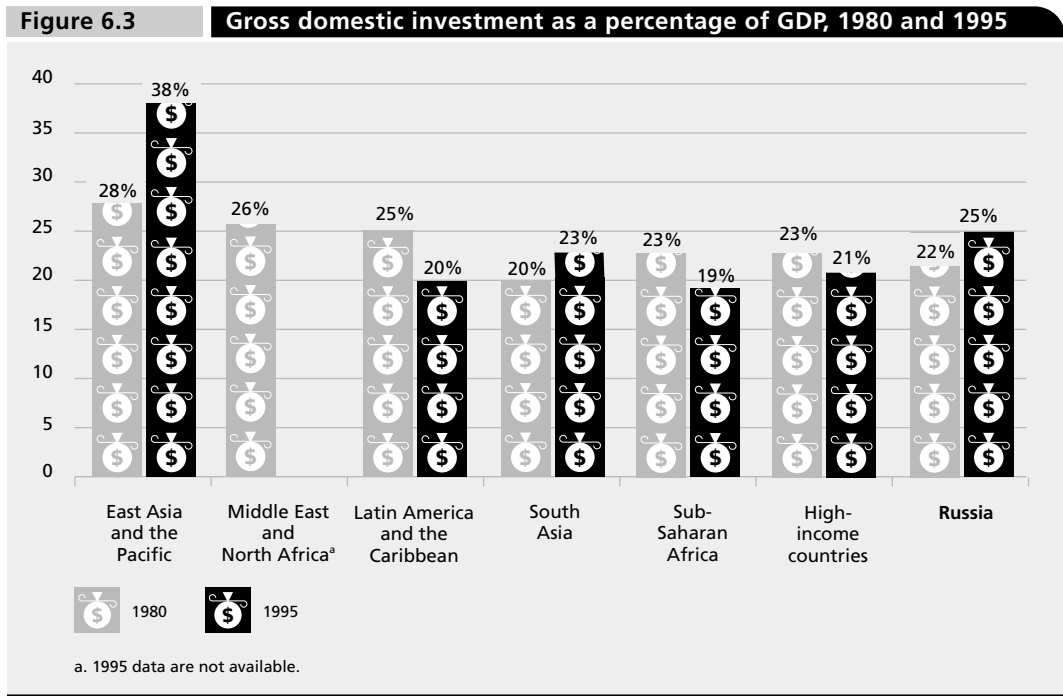


meet current—often urgent—needs, national **saving** tends to be low. Low saving hinders desperately needed domestic **investment** in both **physical capital** and **human capital**. Without new investment, an economy’s **productivity** cannot be increased and incomes cannot be raised. That closes the 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 6.3). Experts are still trying to explain this phenomenon. Generally speaking, how-

ever, 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.

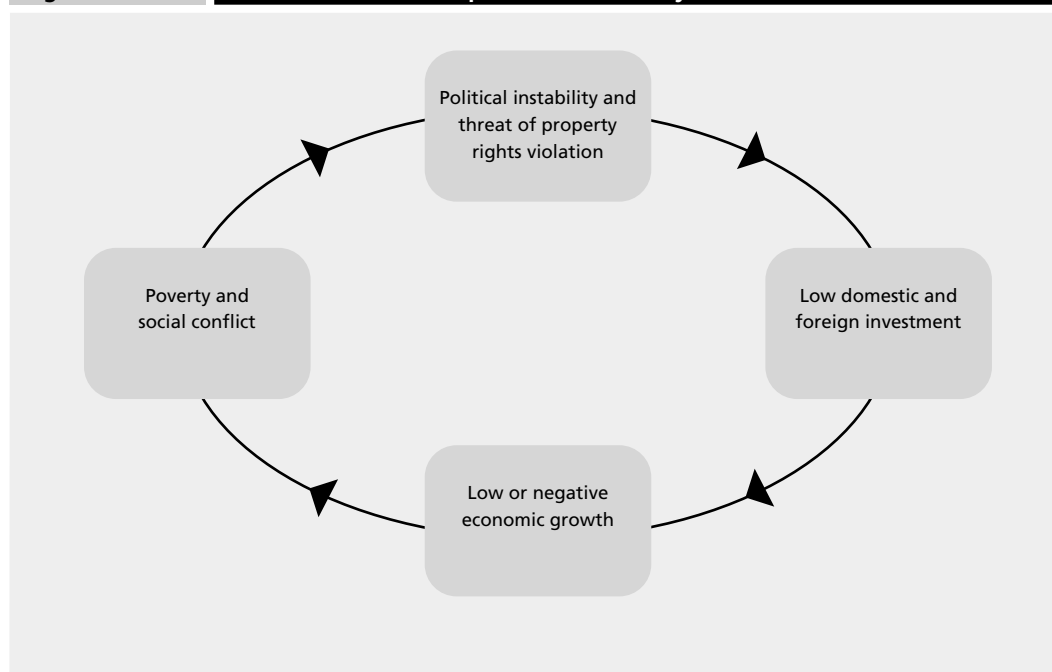
*Data on investment in Russia does not lend itself to simple interpretation. Investment appears to be rising (relative to GDP), and gross domestic investment does not seem too low by international standards (also relative to GDP). Yet there is a severe shortage of investment in the Russian economy. How can this be? These are some of the possible explanations:*

- *Investment has increased as a percentage of GDP because GDP has dropped by almost 50 percent since 1991.*
- *The low productivity of capital investment in Russia creates demand for more investment.*

- *Russia is undergoing radical economic restructuring, which requires even more investment than usual.*
- *The calculation of gross domestic investment includes increases in stocks of goods, which during a crisis often signals enterprises' inability to sell.*

*Russia's situation is also somewhat unusual because gross domestic saving is higher than gross domestic investment—in 1995 even official statistical data showed saving at 26 percent of GDP, compared with 25 percent for investment. This may well be an indicator that domestic savings are leaving Russia for more stable and productive economies. We know that this “capital flight” is enormous. However, because it is largely illegal, it goes unregistered, and is therefore not reflected in any statistics. One*

**Figure 6.4** The vicious circle of political instability



*of Russia's main development challenges is to create a favorable investment climate that transforms domestic savings into domestic investments, rather than just to increase people's willingness to save.*

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 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.