Poverty Is Good for Development

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» *The idea that poverty promotes economic development should be rejected. The arguments made for this idea are unconvincing. Theory and evidence suggest that poverty is more likely to limit development.*

There are two prominent versions of the idea that poverty promotes economic development. One version argues that poverty incentivizes workers, thus creating a strong, globally competitive economy. Another version postulates that higher marginal products of capital in poorer (capital-scarce) countries entail that they enjoy higher growth rates, such that they automatically catch up to rich countries in due course. Both versions should be rejected.

The first version can be traced back to the mercantilist thinking of the sixteenth through eighteenth centuries, which viewed the balance of trade (BoT) as indicative of the prosperity and power of the realm. A higher BoT was seen to require cheap raw materials (for which colonies proved useful) and cheap, and therefore poor, labor at home. Hunger was assumed to encourage work. Proponents of this idea were also opposed to direct income support for poor families, arguing that it discouraged work and would increase the wages demanded.

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Mercantilism regularly resurfaces in political debates across the globe (including in the 2016 Presidential race in the USA). But it has been rejected by most economists. Famously, in his *Inquiry into the Nature and Causes of the Wealth of Nations*, Adam Smith argued for a broader conception of development, based on command over commodities. Over the subsequent 100 years or so, Smith's insights opened the way to eventually ushering in progress against poverty as a goal for development, rather than a threat to it. Similarly, Smith saw higher real wages as desirable and favored antipoverty policies, such as subsidies to support the schooling of children from poor families.

The second version has more recent origins, namely in the higher growth rates seen in the developing world in the new millennium. It is what Wolf, Mahbubani, and others dub "The Great Convergence," whereby poor countries eventually catch up to rich ones in the future global economy.

Yet, while the recent economic success of China and India is undeniable, the idea that poorer countries tend *as a rule* to grow faster finds little or no support in the data. Rather, the modern literature on growth empirics suggests that there is convergence conditional on the various determinants of long-run income, such as education, health, and efficiency-promoting policy reforms (see *Economic Growth* by Barro and Sala-i-Martin). Growth economists appreciate that this is best understood as a dynamic adjustment process, as economies with diminishing marginal products of capital, but different starting points move toward their respective steady-state ("long-run") equilibria. That is clearly quite different to saying that poor countries will catch up to rich ones.

Indeed, I have argued elsewhere that theory and evidence suggest instead that developing countries starting out with a higher poverty rate tend to have *lower* long-run incomes, controlling for their initial means and other observed determinants of long-run mean income (see my 2012 *American Economic Review* paper). This holds even though conditional convergence is also evident in the transitional dynamics. I have also found that countries with a higher initial poverty rate need a higher rate of growth to have the same proportionate impact on the incidence of poverty.

Again the bad idea is revealed to be just that. Poverty is best seen as an impediment to development rather than its precondition for it.