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### The Meaning of Poverty: Questions of Distribution and Power

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# The Meaning of Poverty

## Questions of Distribution and Power<sup>1</sup>

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‘When *I* use a word,’ Humpty Dumpty said, in rather a scornful tone, ‘it means just what I choose it to mean – neither more nor less.’

‘The question is,’ said Alice, ‘whether you *can* make words mean so many different things.’

From *Through the Looking Glass* by Lewis Carroll

### I. Introduction

*Poverty* is a word that is used to mean many different things. The problem is that poverty is a concept that is used to define a great deal of economic policy, and, insofar as economic policy has – or fails to have – real impacts on people’s lives, the meaning of poverty is important.

Nowadays, poverty, especially poverty as it is experienced in the low-income parts of the world, has become central to a great deal of discussion among economists and policy makers, and we have various campaigns underway to eliminate poverty, or, as the slogan would have it, “to make poverty history.” The United Nations Millennium Development Goals (MDGs) project is at the pinnacle of these efforts. In these campaigns, the issue is absolute deprivation, and the current widely accepted standard defines poverty as living on less than \$2 per day and extreme poverty as living on less than \$1 per day. The \$2 per day and \$1 per day figures are in terms of 1990 purchasing power. In terms of today (2007) the equivalent would be to define poverty as living on less than \$3.20 per day, and extreme poverty as less than \$1.60 per day. The World Bank uses these standards to report each year on the number of people living in poverty and in extreme poverty, and

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<sup>1</sup> Paper to be presented at the Golden Jubilee Conference of the Bangladesh Institute of Development Studies, “Development Prospects for Bangladesh: Emerging Challenges,” Dhaka, December 2 and 3, 2007.

the Bank's figures are widely quoted. A central goal of the MDGs is to halve the number of people living below the \$1 per day threshold by 2015.<sup>2</sup>

This definition of poverty in terms of absolute deprivation seems to make good sense. When people do not have the basic necessities – the food, the shelter, the clothing – that they need to lead a reasonable life, they are living in poverty. Although we might disagree over the precise threshold (can one really live at all reasonably in 2007 on \$3.20 per day, \$1168 per year? can one even survive on half of that?), there would seem to be nothing wrong with the concept.

Yet there are problems with this absolute deprivation concept of poverty. First of all, there is the issue of whether or not an income measure can really capture what we mean by people living in an “unreasonable” situation of deprivation; not all the things that make for a reasonable existence can be readily translated into purchasable commodities. Then there is the issue of what we mean by “deprivation” – where does our sense of what people need come from?

My purpose here is, first, to review the different ways we can define poverty. I will argue (Section II) that what people generally mean by poverty – or, more generally, by economic well-being – cannot be adequately captured by a single, absolute measure. In particular, the meaning cannot be adequately captured by a person's or a people's absolute level of income. This point has been widely recognized and is embodied in the UN's Human Development Index (HDI), Sen's capabilities concept, and to a degree in the Millennium Development Goals (MDGs) themselves. The fact that there are several goals in the MDGs underscores the recognition that attaining an income goal alone does not eliminate poverty. A closely related issue that I will note in this section is that poverty (or well-being) cannot be captured adequately by any single measure or single combination of measures, such as the HDI.

I have, however, a further concern (Section III) that challenges all of these concepts of poverty and economic well-being. None takes into account issues of inequality in the distribution of income or the distribution of other measures of well-being. This failure to incorporate a consideration of distribution in defining poverty (or, more generally, economic well-being) is, I will argue, conceptually problematic, if not simply wrong. Although this conceptual issue has been widely recognized, its implications have not been adequately considered.

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<sup>2</sup> See Sutcliffe (2005, p. 14). Also see, World Bank, “Measuring Poverty at the Global Level,” at <http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/0,,contentMDK:20153855~menuPK:373757~pagePK:148956~piPK:216618~theSitePK:336992,00.html>, and The UN Millennium Development Goals at <http://www.un.org/millenniumgoals>. It is important to keep in mind that these amounts per day are defined in terms of real purchasing power, not in terms of actual exchange rates. Thus \$1.60 per day represents what a person could buy with that amount in the United States, not what could be bought in a low-income country if the \$1.60 were exchanged for the local currency and then used to buy goods there. Generally the latter would be substantially more than the former.

Perhaps more important, the failure to consider distribution creates serious practical problems for campaigns against poverty, at best limiting their impact and at worst dooming them to failure (Section IV). If poverty is understood in absolute terms without consideration of distributional issues, the social structures that generate poverty tend to be ignored. Policy is then viewed as a technical matter and often focuses on particular programs that are directed toward helping the poor improve their absolute situation: new seed varieties to raise income, mosquito nets treated with insecticide to improve health, more schools to raise the level of education. These sorts of policies, when they are actually implemented successfully, can have positive impacts (though sometimes these sorts of policies – the introduction of new seed varieties, for example – can have contradictory impacts). Yet they leave unexamined and unaddressed the social structures, the power relations, that have generated and continue to generate poverty.

To a large extent, the poor are poor because they lack power, and they lack power because they are poor. When power is brought into consideration, the focus of policy shifts towards such issues as land reform and the effective control of state actions – i.e., of the underlying factors that determine spending on health care, education and other social services. The problem of poverty, then, would be approached as a socio-political problem, not simply as a technical problem. (Technical changes can bring about changes in socio-political relations, and that is one of the reasons, in addition to their direct impacts, that they are often good. But technical solutions are less likely to be effective when they are implemented without consideration of power relations – about which, more in Section IV).

The discussion of the meaning of poverty is not new. The problem of figuring out what makes people “well off” or “poorly off” has long been examined by economists and philosophers, from Adam Smith through Karl Marx and up through John Rawls, Amartya Sen, and many others. Much of this discussion is very useful, and I will have occasion to draw upon some of it here. My principal purpose is to connect these issues to the current phase of the campaigns to eliminate, or at least reduce, poverty, and to the particular policies that arise in these efforts. Much of what I will say is a critique of the UN’s MDGs program. At the same time, however, I would hope to make some contribution to this long-continuing discussion.

## **II. Poverty as a Multidimensional Concept**

Most commonly, we measure people’s economic well-being by their income or material wealth. A person is rich or poor in common parlance because she/he has a high or low income or a large or small amount of material wealth. It all boils down to an amount of money. Nonetheless, while we sometimes become fixated on money, we usually recognize that it is not money *per se* that determines one’s well-being. Money is the measure of the things we can buy, the commodities that we see as determining our well-being. Insofar as it is true that people’s well-being is determined – or mostly determined – by commodities, goods and services available on the market, this is not unreasonable.

Actually, however, important components of what determines people's well-being are not goods and services available on the market. Furthermore, goods and services, whether or not they are available on the market, are themselves – like money – more accurately seen as a means to something else, something else that determines people's well-being. In a widely-quoted passage in *The Wealth of Nations*, for example, Adam Smith writes of poverty in terms of a person's ability to appear in public without shame, and, at his time, doing so would have been dependent on owning a linen shirt: "...in the present times, through the greater part of Europe, a creditable day-labourer would be ashamed to appear in public without a linen shirt, the want of which would be supposed to denote that disgraceful degree of poverty which, it is presumed, nobody can well fall into without extreme bad conduct."<sup>3</sup> It is not the linen shirt *per se* that establishes poverty, but the lack of the capability to appear in public without shame.

The capabilities concept of economic well-being has been established by Amartya Sen. He argues that "...the right focus for assessing standard of living is ... something that may be called a person's capability...[It is the] capability to function ...that comes closest to the notion of standard of living." (Sen, 1983, p 160)<sup>4</sup> The general capability to function in society involves, in addition to Smith's capability to appear in public without shame, "the most basic capabilities, e.g., to meet nutritional requirements, to escape avoidable disease, to be sheltered, to be clothed, to be able to travel, and to be educated." (Sen, 1983, pp. 162-63)

For the individual, many of these capabilities can be met with money. Nutritional requirements, for example, can almost always be met if the individual has sufficient money. In his well-known examination of famines, Sen points out that famines generally arise not because of an absolute society-wide lack of food but because people, or some people, do not have the "entitlements" that allow them to obtain food. (Sen, 1981) A principal entitlement is money with which one can buy food.

The fulfillment of some other capabilities, however, cannot be fully accomplished through the market. To a substantial degree, the individual's capability to avoid disease depends upon a broad set of social conditions and public goods (e.g., vaccination programs and clean air).<sup>5</sup> One's capability to become educated is also heavily dependent on non-market elements, though certainly aspects of an education can be purchased as

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<sup>3</sup> Smith (1937 [1776], Book Five, Chapter II, Article IV, pp. 820-821). I will have reason below to return to this passage. While I have seen this passage quoted many times, I have never seen comment on Smith's implicit assumption that one falls into poverty due to, presumably, one's own, "extreme bad conduct." In Smith's view, apparently, as in the view of many of his modern-day free market followers, poverty is not a structural or systemic problem, but a problem of the individual.

<sup>4</sup> Sen has developed this concept extensively in several sources. See, for example, Sen (1983, 1987 and 1992)

<sup>5</sup> Moreover, it is well established that inequality – represented by the distribution of income, but more generally the whole complex of social inequalities – can have profound impacts on health. The evidence and arguments on this issue are presented by Wilkinson (2005) and Kawachi and Kennedy (2006).

commodities.<sup>6</sup> And the capability to travel is usually dependent to a large degree on the existence of public goods – roads and ports.

Furthermore, even insofar as purchasable commodities do establish a person's capabilities, for different people different amounts (and types) of commodities are needed to establish the same capabilities. The most obvious example, given emphasis by Sen, is the difference between a person who has a significant physical handicap and a person who does not have such a handicap. The former – a person who is unable to walk, for example – will require more and different commodities to obtain the travel capability. Similarly, the capability to meet one's nutritional needs requires more commodities for a very large person than for a very small person. So the same amount of money will not provide the same degree of well-being for these two people.

Sen's capabilities approach to well-being and poverty has had a very large and positive impact, placing the measurement, analysis, and policy relating to material well-being on a more complete and realistic foundation. It has affected, in particular, the formation of the UN's Human Development Index and the Millennium Development Goals – both of which I will discuss shortly. There is, however, a basis for confusion in Sen's approach. On the one hand, he has developed the concept with reference to the capabilities of individuals – as the point about people with physical handicaps illustrates. On the other hand, the concept has been widely employed with regard to whole societies. Unless we believe that two societies intrinsically have, for example, very different sized people or very different proportions of physically handicapped people, similar national incomes (or wealth) in these two societies should lead to similar capabilities – at least with regard to these capabilities that can be met through the market. Even with capabilities that require large non-market components – health and education – the *overall capabilities* of the two societies to assure the *individual capabilities* of their people should have close relationships to the amounts of income (or wealth) in the two societies. If two societies with the same level of income (and wealth) are very different in terms of the individual capabilities, it is not because the two societies have different overall capabilities.<sup>7</sup>

It is now widely recognized that material well-being cannot be identified simply by income – whether we are looking at the income of an individual or a society. Nonetheless, a great deal of analysis and policy continues to be based on a one-

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<sup>6</sup> The extent to which one can purchase the education capability also depends in part on what one wants or what one means by education. For example, trying to provide what I considered a “good education” for my children, I realized that it was virtually impossible to buy a high quality (in the traditional sense) education where my children would partake in their schooling along with others from a great diversity of social, economic, racial and cultural backgrounds – even if I had had the money!

<sup>7</sup> This statement ignores the very different natural conditions – climate, for example – in which different societies exist. It might seem that in a country with a mild climate less income would be needed to provide the same level of nutrition and health (and general comfort) than in a society with a severe climate. For the points I want to develop, however, it will become evident that abstracting from this issue creates no problems. Furthermore, one could argue that natural conditions should properly be counted as part of the wealth of a society – however hard it would be to place a measurable value on this form of wealth.

dimensional focus on income, and economic development is largely seen in terms of economic growth (i.e., an increase in the level of income). When poverty is the focus of analysis, the measure is usually simply the level of income of the poor. The International Financial Institutions, most notably, continue largely along this one-dimensional route. Work that has emerged through the United Nations, however, has tended to be based on a more multi-dimensional understanding of material well-being.

With the *Human Development Report 1990*, the UN Development Program (UNDP) introduced the Human Development Index (HDI) along with the rationale behind the index. Part of the rationale was that:

“... people often value achievements that do not show up at all, or not immediately, in higher measured income or growth figures: better nutrition and health services, greater access to knowledge, more secure livelihoods, better working conditions, security against crime and physical violence, satisfying leisure hours, and a sense of participating in the economic, cultural and political life of their communities. Of course people also want higher incomes as one of their options. But income is not the sum of human life.” (UNDP, 1990, p. 9)<sup>8</sup>

The authors of the *Report* went on to explain the HDI, a partial measure of this broader standard of material well-being – broader as compared to the traditional income measure. The HDI is partial in that it is an index based on only three considerations: income, health, and schooling/literacy.<sup>9</sup> The index is based on only three components in part because of the data limitations; the security of livelihoods, working conditions, and other important factors mentioned in the quotation above are hard to measure, and finding comparable international data would be a veritable impossibility. Also, while the meaning of an index of three items is hard enough to justify (if it can be justified at all), an index of many more variables would completely lose meaning. (A brief description of the details of the construction of the HDI is provided in Appendix A.)

The emergence of the HDI as a measure of countries’ well-being or lack of well-being was a major and favorable development. It was a generally respected and generally accepted step towards providing a more realistic measure of people’s material situation,

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<sup>8</sup> Interestingly, in this chapter of the *Report*, where the rationale for approaching economic change in terms of “human development” is set out, the argument is justified by reference to a series of European philosophers, from Aristotle through, among others, Kant, Lavoisier, Smith, Marx, Matus, and Mill. Reference to non-European authority is nowhere to be found.

<sup>9</sup> I use the term schooling/literacy rather than education or knowledge – the terms more commonly used to describe these issues – because I think this is a more accurate description of what is included in constructing the HDI. This component of the HDI is a measure of enrollment rates and literacy rates, not education or knowledge, which are much broader concepts. Indeed, there is a widespread confusion over this issue in development economics, as what people usually mean by “education” is in fact “schooling” – that is, a particular kind of education that imparts a particular kind of knowledge. To confuse the two is to imply that people who do not have formal schooling are without education and knowledge, a grossly misleading idea.

and it both represented and advanced a wide dissatisfaction with the traditional one-dimensional focus on income.<sup>10</sup>

As a single-variable, summary measure of economic well-being the HDI has considerable political and popular appeal.<sup>11</sup> However, complex socio-economic phenomena are seldom if ever accurately describe by such a measure. There is, in particular, no rationale for the equal weights assigned to the three components of the HDI – or, for that matter for the 2-to-1 weights assigned to the two components of the knowledge/education index. Why, for example, would we think that a one percent increase in the log of income should be equal in value to a one percent increase in the average life span – and why should this trade-off be the same at all levels?<sup>12</sup> These formal problems in creating an index of economic well-being are not simply technical

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<sup>10</sup> It is somewhat ironic, however, that a departure from the one-dimensional focus on income has been used as a basis for arguing the distribution of economic well-being in the world has been becoming more equal; see Becker et al (2005), who argue: “The effects of health are sufficient to revert the results regarding the evolution of cross-country inequality up to the 1990s. Once health is accounted for, there is a significant reduction in inequality throughout the world up to 1990 and, even with the AIDS epidemic, a much more significant reduction in inequality between 1960 and 2000 than can be perceived from income alone.” Given the nature of income, health and education/knowledge, it is of course the case that the inequality represented in the HDI will be less than the inequality in the distribution of income. Also, it is by no means surprising that the movement in the distribution of the latter two variables over time has been rather different than the movement of income distribution. But the meaning of these phenomena for appraising the distribution of economic well-being in the world is by no means an obvious or non-controversial issue.

<sup>11</sup> In a 1999 address, the Deputy Chairman of the Indian Planning Commission, Shri K.C. Pant, defended the HDI in the following terms: “Over the years there has been some criticism of the human development index (HDI) on the ground that it is too simplistic and limited a measure of the extremely wide range of factors that determine a person’s quality of life. While such a criticism may be valid in terms of the academic appropriateness of the index, it completely misses the true utility of the concept. The average human mind, despite its potential to handle a wide range of concepts, feels most comfortable with a simple and intuitive idea even while recognising its limitations in representing complexity. It is perhaps for this reason that a summary measure like the per capita income has captured the thought processes not only of the average person but even of the academic world. Any effort to supplant this measure in a manner which would bring in the social aspects of human development would necessarily have to devise a measure which is equally simple and easy to understand. The HDI in my opinion has served this purpose admirably and has been instrumental in bringing about a significant shift in development perspectives.” Pant (1999).

<sup>12</sup> This criticism of the HDI – that the weights have no rationale – is somewhat vitiated by another criticism of the index, namely that that the three basic components are so highly correlated with one another as to make the index redundant. This problem of redundancy was raised early on in the HDI’s evolution by McGillivray (1991). More recently, Cahill (2005) has demonstrated again the high degree of correlation among the three components, and he has pointed out that because of this correlation the index itself is not very sensitive to the weights that are used. A further problem, but one that may also make little practical difference in light of the redundancy, is that the upper and lower limits used to establish the separate indexes that make up the HDI are in some cases arbitrary. Why, in particular, is 0 taken as the lower limit on literacy and enrollment, respectively, when no country is near this level, while the lower limits on income and life expectancy are set at \$100 and 25 years, respectively? See the appendix. Nonetheless, whatever quantitative problems exist with the HDI, its conceptual value – its focus on the multidimensional nature of human well-being – is undiminished.



issues; they reflect real problems – perhaps the impossibility – of describing and appraising a complex situation with a single variable.<sup>13</sup>

The formulation of the Millennium Development Goals appears to have embodied a recognition of the fact that material well-being cannot be described by a single variable. However, implicitly the MDGs accept the concept that *poverty* is defined in terms of income. The first goal of the MDGs is to “eradicate extreme poverty and hunger,” while the poverty part of the goal is to “reduce by half the proportion of people living on less than a dollar a day.” The multiplicity of goals in the MDGs – concerning education, gender equality, child mortality and other measures of health, environmental sustainability, and “a global partnership for development” – are apparently components of *development*, but they are not measures of *poverty*. (See Appendix B for a full listing of the MDGs.) This distinction may seem to be semantic nit-picking, but it underscores the continuing lack of clarity over conceptual issues that lies at the basis of economic strategies in and for low-income parts of the world. Nonetheless, the fact that the MDGs include a set of goals that are not simply income is an important and positive step away from a single-minded focus on income.

### III. Poverty as a Relative Concept

The problem with the MDGs, as with the HDI and many other conceptualizations of poverty, is that they ignore – or virtually ignore – issues of income distribution.<sup>14</sup> The dollar-a-day definition of extreme poverty is, as just pointed out, a primary basis for the MDGs, and the income component of the HDI includes only the per capita level of income in a country. The MDGs do include the promotion of gender equality and empowerment of women, and the UNDP has begun calculating and publishing, along with the HDI, a gender development index. But, as important and valuable as the focus on gender equality is, it is not the same as a general consideration of inequality issues and does not alter our understanding of poverty.<sup>15</sup>

Absolute poverty, whatever precise definition one uses, is wide-spread in the world, and creating conditions that move people – or, better yet, conditions that allow them to move themselves – from less than one dollar a day or less than two dollars a day to some

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<sup>13</sup> These sorts of problems are by no means unique to economics. Consider, for example, the effort to sum up human intelligence with the IQ measure. As with economic well-being, it is now recognized that human intelligence has several dimensions the totality of which cannot be captured by a single index. See, in particular, Gardner (1983).

<sup>14</sup> Elizabeth Stanton (2006) has presented a recalculation of the HDI based on taking into account the distribution of income, health, and schooling/literacy. It is a most useful exercise and demonstrates how rankings change when distribution is examined.

<sup>15</sup> Indeed, it is not only mathematically possible for gender equality to improve (as measured, for example, by the wage gap between men and women) while at the same time the overall distribution of income becomes more unequal, but this is precisely what has happened in the United States, and perhaps other countries, in recent decades.

higher material level is extremely desirable. In examining the dispute over how to define poverty, whether an absolute or relative concept is more meaningful, Amartya Sen (1983, p. 159) remarks: “There is, I would argue, an irreducible absolutist core in the idea of poverty. One element of that absolutist core is obvious enough, though the modern literature on the subject often does its best to ignore it. If there is starvation and hunger, then – no matter what the *relative* picture looks like – there clearly is poverty. In this sense the relative picture – if relevant – has to take a back seat behind the possibly dominating absolutist consideration.” Yet an exclusive focus on absolute poverty, which omits direct and explicit consideration of the distribution of income, has problems. Indeed, it is very misleading to define poverty simply by the absolute standard.

Poverty is a highly contingent socially constructed phenomenon, and the meaning of the term varies across societies and over time. This contingency is implicit in standard formal definitions of the term. Consider, for example, the definition offered in the *Merriam-Webster Online Dictionary*: “Poverty: 1 a : the state of one who lacks a usual or socially acceptable amount of money or material possessions.”<sup>16</sup> The crucial term here is “socially acceptable.” What is it that determines the “socially acceptable”? That is, what is it that determines our *standard* for defining poverty? A standard is needed in order to define poverty, and the standard, once we move beyond starvation and hunger, is necessarily relative.

Adam Smith’s statement, quoted above, regarding the “shame” of a person appearing in public without a linen shirt, recognizes the relative aspect of the poverty concept. At other times and in other societies, poverty would be signified by more or by less or by something entirely different than whether or not one possessed a linen shirt. The linen shirt standard reflected conditions of material well-being in Europe during Adam Smith’s time, but at other times and other places the standard would be different.

Karl Marx, on the other end of the ideological spectrum, expressed the same basic idea. In his 1847 essay, *Wage Labor and Capital*, discussing how we determine people’s economic well-being, he writes: “A house may be large or small; as long as the surrounding houses are equally small it satisfies all social demands for a dwelling. But if a palace arises beside the little house, the little house shrinks into a hut....Our needs and enjoyments spring from society; we measure them, therefore, by society and not by the objects of their satisfaction. Because they are of a social nature, they are of a relative nature.” (undated, [1847], pp. 268-69)

A more contemporary similar statement of the issue is provided by the anthropologist Marshall Sahlins (1974, p. 37): “The world’s most primitive people have few possessions, but they are not poor. Poverty is not a certain amount of goods, nor is it just a relation between means and ends; above all it is a relation among people. Poverty is a social status.” Sahlins’ statement carries with it the radical implication that “absolute poverty,” absolute in terms of a lack of goods and services, really has no meaning. “The world’s most primitive people” – Sahlins appears to have in mind the Bushmen of the

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<sup>16</sup> <http://www.m-w.com>.

Kalahari or the Alaskan Eskimos (presumably of an earlier era) – certainly have no more goods and services than the lowest income decile groups in virtually all current-day countries. Likewise, in terms of schooling and health care, these peoples are no better off than the bottom groups in current-day countries. Yet, according to Sahlins’ argument, within the context of their own societies they are not poor. Among relatively egalitarian, “primitive” societies, poverty is non-existent. It is only when we incorporate these peoples (conceptually if not practically) into a larger society, national or global, that they fall into poverty.<sup>17</sup>

Consideration of the historical experience of virtually any high-income country further underscores the contingent – or relative – meaning of poverty. In the United States, for example, at the end of the 18<sup>th</sup> century when the country became independent, by current day estimates GNP per capita was \$750 in 1990 prices, very close to \$2 per day. (Atack and Passell, 1994, Table 1.2) Yet no one views U.S. society at that time as having been one of massive poverty, as the \$2 per day measure would imply. Certainly there were people living in poverty at that time in the United States, but their poverty was determined by the standards of that period; it was their position relative to others – the middle income groups or perhaps the rich – that defined their poverty. The example suggests that there are no poor unless there are also rich, or that some people are poor only insofar as some others are rich.

These issues have been recognized by Sen (1983), but in a way that distinguishes between poverty in terms of capabilities and poverty in terms of resources. For Sen argues that poverty is an absolute concept in terms of people’s capabilities, but at the same time in different social circumstances – different societies – different resources or commodities are needed for people to achieve their capabilities. Referring to Smith’s linen shirt example, Sen points out that the capability to appear in public without shame is an absolute capability, but the resources needed to fulfill this capability are relative, determined by the standards of the particular society. “At the risk of oversimplification, I would like to say that poverty is an absolute notion in the space of capabilities but very often it will take a relative form in the space of commodities...” (p 161)<sup>18</sup>

The phenomenon by which people’s commodity-needs are determined in a relative sense, contingent on the society in which they live, is in part psychological. As Marx says, we measure our needs “by society,” which is to say we perceive our needs by what we see around us, what others in our society have, and what has been socially determined to be the norm. To say that our needs are psychological is not to say they are less real. Once beyond hunger and starvation, how people perceive their needs (and how others

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<sup>17</sup> I was led to the Sahlins quotation from its use by Wilkinson (2005, p. 67). Sahlins’ conception of poverty as a social status calls into question, to a degree, Sen’s argument that there is an “absolutist core” in the idea of poverty. If a whole society is going hungry, Sahlins would presumably argue that this situation is not accurately described as poverty. With all members of the society in the same position, there could be no separate social status of “poverty.”

<sup>18</sup> But note what Sen says, quoted above, in the same article about hunger and starvation, an absolutist core of poverty, overriding the relative concept in the commodity space.

perceive their needs) is what defines their position, their poverty, and certainly their “shame.”<sup>19</sup> The psychological – or the psychosocial – is no less real simply because it is not obviously connected to a biological need, as is a minimal caloric intake.<sup>20</sup>

Furthermore, as societies change, as economic growth takes place, all sorts of needs change. For example, as income rises in society, jobs tend to move out of and away from the home, generating a need for transport facilities. As another and related example, economic growth is generally accompanied by rising participation of women in the paid labor force, generating needs for services (or home capital equipment) to replace the work traditionally done in the home by women in most societies. Also, as the nature of work changes, education and training can no longer take place in and around the home (as it does in traditional agricultural societies), and thus there arises a need for schooling. New types of work associated with economic expansion also generate a need for dietary changes and stimulants. Pomeranz (2000, chapter 3) points out that during the 18<sup>th</sup> and 19<sup>th</sup> century the intensity of work in England greatly increased, providing a foundation for economic expansion, and this greater work intensity created a need for increased calories, supplied to a significant extent by sugar, and for a whole class of stimulants – tea, coffee, tobacco, and cocoa.<sup>21</sup>

Once it is recognized that needs are socially determined, contingent on social conditions and relative to norms of the society in general, then the role of income distribution as a factor defining poverty comes into focus. Poverty exists, as all seem to accept, when people’s needs are not met. In two societies where the absolute income of the bottom segment (say the bottom quintile) is the same, poverty will be greater in the society where income distribution is more unequal because in that society the bottom segment will be further from the norm and thus more lacking in that society’s socially determined needs. Economic growth in itself will tend to have a limited impact on poverty when inequality remains unchanged, for, insofar as society’s standards of needs rise along with the average level of income, those at the bottom will remain much in need.

Of course social norms or the standards by which we determine people’s needs are seldom clear, and the manner in which they are established is complex. For example, are standards set by what the median person or family has? Or are standards set by what the

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<sup>19</sup> I do not wish to belittle the importance of hunger and starvation in today’s world. There were in 2001, according to the World Bank’s estimates, 1.1 billion people living on less than \$1 per day (UN Millennium Project, 2005, Table 2.3) – a lot of people, most, if not all, of whom could be classed as hungry if not starving. My point, however, is not that absolute poverty (hunger and starvation) is unimportant or irrelevant, but that relative poverty is also a large part of the story in understanding poverty

<sup>20</sup> While psychological or psychosocial needs are not *obviously* connected to biological conditions, there do appear to be connections. In particular, the stress and other negative psychosocial impacts of social inequality are significantly and positively associated with ill-health and mortality in an apparent causal relationship. (Wilkinson, 2005)

<sup>21</sup> Pomeranz adopts from Mintz (1985) the term “drug foods” to describe the increased role of these commodities in Europe.

richest group is able to obtain? Is there one standard for a society or different standards at different levels? Are the needs of those in the middle determined by what those above them have while the needs of those at the bottom are determined by what those in the middle have? For the purposes of defining poverty, needs are probably best understood in relation to what those in the middle of the society have, and people are further in poverty the further they are from the median. However, the standards, even the standards of poverty, are probably influenced as well by those at the top of the society.<sup>22</sup>

The emphasis here on the inextricable connection between income distribution and poverty is not new. On the one hand, in high income countries, the standard for defining poverty has often been a relative one, connected to income distribution – for example, defining poverty as existing when a person’s income is less than one-half the mean. Indeed, countries in the European Union use 60 percent of the median income to define the poverty line.<sup>23</sup> The argument here, however, is that the same reasoning that leads to a relative definition of poverty in high income countries, a definition involving the distribution of income, applies in low-income countries as well – allowing for qualifications taking account of the extreme conditions of starvation and hunger.

On the other hand, there has been an increasing recognition of the importance of income distribution’s impact on poverty in low-income countries, even within the context of an absolute poverty definition. If economic growth is accompanied by equalization of the distribution of income, absolute poverty (the two-dollars-per-day definition) is reduced more than were the growth to take place without equalization. Because economic growth does not automatically mean greater income equality, there is concern for structuring growth in ways that would accomplish this more favorable reduction of absolute poverty. For example, Azizur Rahman Khan (2005), examining experience in a broad set of low-income countries and using an absolute measure of poverty, argues that increasing employment is a foundation for poverty reduction because of its impact on income distribution. While employment expansion reduces poverty through economic growth, its impact through shifting income distribution tends to be greater. As Khan (p. 8) notes: “A crude estimation of the elasticities of headcount rate poverty ... shows that the partial elasticity with respect to the Gini ratio of expenditure is higher than the absolute value of the partial elasticity with respect to PPP\$ income.” Similarly, in a broad analysis of poverty in Bangladesh, Binayak Sen, David Hulme and their associates (2004), using the absolute concept of poverty, give similar attention to the “growth elasticity” and “inequality elasticity” of poverty to evaluate change in recent decades. They point out, in particular, how, with rising inequality in Bangladesh, economic growth has reduced poverty significantly less than otherwise would have been the case.

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<sup>22</sup> It is, however, admittedly complex and exceedingly difficult, if not impossible, to clearly specify what “the society” is for purposes of understanding the standards by which poverty is determined. People are members of several societies, defined over ever larger geographic and conceptual spaces. Are standards set by the neighborhood? by the city or town? by the nation? by the so-called “global village”?

<sup>23</sup> See, for example, Eurostat (2000).

The argument here, however, is based on a different definition of poverty and implies not only that growth without greater equality will be less effective in reducing poverty but that growth without greater equality will tend not to reduce poverty or only have a partial impact on poverty reduction. (Moreover, beyond the conceptual issues discussed in this section, the relative definition of poverty that is tied up with income distribution has some practical policy implications that will be addressed in the next section.)

Absolute poverty still matters. What I am really advocating for here is not a definition of poverty simply in relative terms, but for a dual definition of poverty – one that takes account of both the relative and absolute situations. As I argued in the previous section, a single variable can seldom accurately describe a complex socio-economic situation, and poverty certainly falls into this category. While it may be tempting to simplify our understanding of poverty by wholly adopting the absolute or the relative approach, it would be misleading to do so. However, because the discussion of poverty in low-income countries is currently dominated by the absolute approach, I find it necessary to give emphasis to the relative concept.

#### **IV. Poverty as Distribution: The Practical Issue**

By giving emphasis to the relative concept of poverty, I am also necessarily giving emphasis to consideration of income (and wealth) distribution in any discussion of poverty. While it is possible to give attention to income distribution within the framework of the absolute concept of poverty – as many analysts do – a focus on the relative concept forces that attention to the fore in any practical discussion of policies that may reduce poverty. A critique of aspects of the Millennium Development Goals project will clarify some of the issues.

##### **IV.A. The MDGs, Economic Growth and Poverty Traps**

The policy approach of the Millennium Development Goals project has been elaborated in the Sachs Report, *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*. (UN Millennium Project, 2005) The MDGs project is based, as noted earlier, on an absolute poverty concept, with the first of the goals being to reduce the number of people living on less than \$1 per day by half by 2015.<sup>24</sup>

The Sachs Report, defining poverty as absolute poverty, focuses on economic growth. While economic growth *per se* is not among the MDGs, the Report takes economic growth as the key to attaining the MDGs – the poverty reduction goals and the various other goals. The Sachs Report does not assume simply that growth will automatically solve all problems – i.e., lead to the attainment of the various goals; it does give attention to the particulars of growth, specifying policies directed toward the various goals. Nonetheless, economic growth is the key, and attention to other aspects of progress falls within the growth framework. Questions regarding the distribution of income – to say

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<sup>24</sup> Jeffrey Sachs has also developed the approach of the Sachs Report in Sachs (2005).

nothing of questions regarding social and political power – are ignored.<sup>25</sup> In the entire text of the Sachs Report, neither the term “income distribution” nor the term “distribution of income” appears, and nowhere in the Report’s “Ten Key Recommendations” is there any reference to inequality or equality, except for the inclusion of “gender equality” along with many other issues on which poverty reduction strategies should focus (e.g., rural productivity, health, education, etc.)<sup>26</sup>

The Sachs Report’s basic approach to economic growth is to argue that the poor are poor because they are caught in a “poverty trap.” Because poor people and poor countries have such low incomes, they cannot save and invest sufficiently to raise themselves out of their poverty: “We can now see the essence of the poverty trap. The poorest countries save too little to achieve economic growth, and aid is too low to compensate for the low domestic savings rate.” (p. 34).<sup>27</sup> Following from this diagnosis of the problem and from the focus on economic growth, much of the Report is taken up with questions of how to mobilize sufficient capital so that investment rates can rise in low-income countries. The answer is a combination of larger amounts of foreign aid,

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<sup>25</sup> It should be noted that the Report does speak of “empowerment,” titling chapter 5 “Public Investments to Empower Poor People.” It seems, however, that empowerment here is identical to raising people’s absolute economic well-being: increasing food output, creating jobs, providing health care, expanding schooling, and so on. These are all good things. Power, however, is a relative concept and deals with a relationship among people. We cannot assess how improvements in the economic well-being of one group affect its members’ power unless we consider what is happening to the economic position of other groups; and this would require an examination of distributional issues, something that the Report does not address. Moreover, while economic well-being is an important part of power, it is not the whole story. See below, Section IV.E. for more on this issue.

<sup>26</sup> There is in one place a use of the term “distribution of wealth,” but only in a box on “the poverty-conflict nexus,” discussing the factors that tend to create a connection between political/social violence and poverty. Neither the word “redistribution” nor the term “land reform” appears in the Report. As best I can tell, the closest that the Report comes to addressing the distributional issues is in Chapter 6, “Key elements for rapid scale-up,” in a section on “Infrastructure,” where the following appears: “To prepare draft investment plans, many countries use population-to-facility ratios as guidelines for determining how many of a given facility they need to build for their population. This is a good start. But in the final strategy, countries will obviously need to conduct a more detailed analysis of where their facilities are located, and where and how many they need to build or rehabilitate. When building more facilities, countries also need to pay attention to equity of access. For example, many developing countries have first-rate hospitals and modern schools in their capital cities, but dilapidated facilities in their rural districts. *A much more equitable distribution of resources is vital to achieving the [Millennium] Goals.* Countries thus need to create investment plans that explicitly aim to increase the percentage of the population that has access to high quality facilities, such as the percentage of the rural population with access to a functioning clinic within 10 kilometers.” [emphasis added] (pp. 105-106). This is a very limited substitute, to say the least, for addressing issues of income or wealth distribution.

<sup>27</sup> Actually, the Sachs Report (chapter 3) lists four reasons for shortfalls in countries’ achievement of the Millennium Development Goals. In addition to the poverty trap, the Report lists “governance failures,” “pockets of poverty,” and “areas of specific policy neglect,” the last of these developing because “policymakers are unaware of the challenges, unaware of what to do, or neglectful of core public issues.” (p. 45) Yet the poverty trap issue is at the core of the argument, and it is the foundation on which many of the policy prescriptions are based.

larger amounts of domestic saving, and macroeconomic policies that will induce “huge new investments” (p. 63).<sup>28</sup>

The Report does contain numerous particular policy recommendations that are directly relevant to the conditions of the poor. These include (chapter 5), for example:

- Ensuring universal enrollment and completion of primary education through “[a]bolition of school fees and special incentives to get the most marginalized groups into school” (p 85), as well as construction of new schools and the hiring of more teachers.
- Raising food productivity of smallholder farmers through a new green revolution in Africa and in bypassed parts of Asia and Latin America, involving private investment to improve water availability and to expand infrastructure and extending knowledge and availability of the most productive technology.
- Job creation in manufacturing through expanding urban infrastructure, support for training programs, and favorable tax treatment for investors – especially, it seems, foreign investors.<sup>29</sup>

#### **IV.B. Barriers to Change**

By and large, these are worthy programs – though I would balk at the argument for favorable tax treatment to attract foreign investment (see below). The problem lies, first, in the explanations as to why such programs have yet to be implemented in much of the low-income world. Basically, the Report says that such programs have been lacking because of the poverty trap and because of ignorance. People in poor countries have not had the funds to pursue the necessary programs, and they have been ignorant – government officials, firms, and poor people – regarding the proper policies and the technologies that are needed. As to the alleged ignorance of government officials, for example: “[A]...reason why some [Millennium Development] Goals are not being met is simply that policymakers are unaware of the challenges, unaware of what to do, or neglectful of core public issues.”(p. 45) As to the ignorance of firm managers and of the

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<sup>28</sup> Sachs’ approach in his book (Sachs, 2005), which is very apparent in the Report as well, has been criticized for being unrealistic, made up of “utopian dreams”; see, in particular, the review by Easterly (2005). Not only is foreign aid unlikely to be effective in the way Sachs envisions, but Sachs’ and the Report’s projections of the growth of aid are excessively optimistic – and experience since 2005 has done nothing to suggest the contrary. But the ‘unrealistic’ accusation, as a critique of the analysis, misses the point. These are political documents as much as they are analytic documents. As in many political appeals, the authors seek support by asserting that the task *can be done*. This may or may not be effective politics, but it should not be allowed to detract attention from the underlying analysis.

<sup>29</sup> The argument for favorable tax treatment to attract foreign investment is introduced in Chapter 3, page 47. These three areas – schooling, agricultural technology, and job creation in manufacturing – are only some of the particular policies listed. Other issues of focus include health care, gender bias, capabilities in science and technology, and the environment.



poor themselves, the Report is replete with invocations to spread knowledge almost as though this were the ‘cure-all’ for poverty.

Spreading knowledge is a good thing. But lack of knowledge itself is seldom the central barrier to progress, and, when knowledge is lacking, the problem has roots that are not addressed by the Report. The Report appears to explain a lack of knowledge by a combination of a lack of understanding of the importance of knowledge and a lack of funds to support the spread of knowledge. It would seem more useful to recognize that knowledge is tied up with power and wealth.

Consider, for example, the issue of expanding schooling in low-income countries. India, in spite of its impressive economic growth in recent years and the much touted highly educated work force that has played a major role in that growth, continues to have a relatively poor record with basic education. In 2004, literacy among females over 15 was 47.8 percent and was 73.5 percent for males. (UNDP, 2006, p. 373).<sup>30</sup> While there are many aspects to an explanation of these low rates (and for the gender disparity), the following comment by Jean Dreze and Amartya Sen (1995, p. 107) is instructive:

“... local democracy has often been undermined by acute social inequality. The low involvement of women in local representative institutions such as village panchayats is a clear illustration of this problem. In large parts of [India], local government is in the hands of upper-caste men from privileged classes, who are only weakly accountable to the community and often end up using local public services as instruments of patronage. In some cases, the rural elite has been known not only to be indifferent to the general promotion of local public services but even to *obstruct* their expansion, to prevent the empowerment of disadvantaged groups. In Uttar Pradesh, for instance, it is still possible to find villages where a powerful landlord has actively opposed the creation of a village school.”

The Indian situation is not unique in demonstrating the connection between social power and the progress – or lack of progress – of schooling. Examining the situation of Northeast Brazil in an insightful paper titled “The Fear of Education,” Judith Tendler (2002) summarizes her findings as follows:

“In the research conducted for this paper...owners and managers of large modern manufacturing firms in the textile, garment, and footwear sectors of Northeast Brazil reported, to their pleasant surprise, that they have been able to live with illiteracy without compromising their ability to compete. They did not prize an educated workforce and, indeed, sometimes worried out loud that ‘too much education was a bad thing.’ This ‘fear’ of education also pervades the thinking of politicians and governments,

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<sup>30</sup> The rate for youth literacy, for people in the 15 to 24 age groups, was significantly higher: 67.7 percent for females and 84.6 percent for males.

particularly the departments that support economic development – and particularly at the subnational level, where decisions to fund and improve education are often made. These actors often construe their region’s ‘only’ comparative advantage in economic development as one of cheap labor; they worry that a more educated labor force may diminish that advantage by leading to a general increase in the region’s relative wage, and by reducing the prized ‘docility’ and ‘gratefulness’ of the region’s labor force; they also expect to lose the returns to their investment in better education, because of the fabled outmigration of the best workers. The above-noted experiences of firm owners and managers, in turn, seems to translate into a *lack* of pressure on governments by important local elites for improved education—a kind of fatal absence of demand-driven pressures. These various perceptions, it is important to note, are eminently rational in both private and economic terms.”<sup>31</sup>

Beyond such particular cases, various studies have indicated a general connection between inequality, especially in land holdings, and weak expansion of schooling. (Bowles, 1978; Galor et al, 2004; Alesina and Rodrik, 1994). The common point of these examples and more general studies is that they tend to demonstrate that the lack of progress with schooling in low-income parts of the world is not explained by a lack of will, ignorance about the gains from schooling, or even a lack of funds per se. Instead, a lack of progress in schooling is often, if not always, explained by the fact that powerful groups do not have an interest in advancing the schooling of the population. Their interest may be direct (a schooled labor force may be less docile) or indirect (a schooled labor force is not worth paying for) or it may operate on a broad social level (a schooled population may be less likely to accept the status quo). In whatever way this interest is seen, it is real, and the ability of those who have this interest to impose it on society in general is a result of their socio-political power and their economic position – which is to say it is a result of the unequal distribution of income and wealth. In many societies, then, it is hard to envision real progress in schooling without some changes in the structure of power and income and wealth distribution.

#### **IV.C. Distributional Impacts of Growth**

In its call for increasing “food productivity of smallholder farmers,” the Sachs Report again sees the problem in terms of ignorance. Advocating a new green revolution in

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<sup>31</sup> Tendler also draws a parallel between current era Northeast Brazil and the late 19<sup>th</sup> century South in the United States, and notes (pp. 51-52): “The U.S. Southern story helps us to understand three important aspects of the Northeast Brazilian case. *First*, it shows how the fear of education is not limited to individual firm owners or to business elites as a group. *Second*, the U.S. Southern story brings to the fore the central importance of the perspective of the backward *region*—as distinct from that of states and municipalities—in driving attitudes and actions toward education. Though strong regional entities existed in both cases, they nevertheless had almost no fiscal or implementation responsibilities in the education sector, which fall in the domain of local, state, and federal governments. *Third*, and seemingly unrelated to education, a particular form of industrial policy adopted by governments in lagging regions—recruiting outsider firms with tax exemptions and other subsidies—has had a strong negative impact, if only indirectly, on education.”

Africa and the left-behind regions of Asia and Latin America, the Report presents poverty alleviation and economic development as generally attainable through the ‘technical fix.’ While, as noted above, the Report’s recommendations fail to consider the distributional issues that create barriers to change, its focus on the ‘technical fix’ also obscures the distributional impacts of its preferred programs – of its prescription, in particular, for a new green revolution.

The distributional impacts of previous green revolutions are an issue of controversy. On the one hand, the increased production of food grains brought about by high yield seeds and associated inputs can contribute to general economic growth and increased availability and lower prices of basic foodstuffs, improving the lot of the poor. In addition, smallholders can benefit as producers as well as consumers. On the other hand, green revolution technology tends to be biased toward increasing the returns to land, and thus there can be a strong correlation between the size of land holdings and the extent of the gains that accrue to farmers. Also, the effectiveness of high yield seeds generally depends on access to water and to purchased inputs – not only the seeds themselves, but fertilizer and pesticides as well. Access to the purchased inputs and access to water generally requires access to credit (to finance irrigation systems in the case of water), and small farmers are at a distinct disadvantage in obtaining credit. In many circumstances, access to water depends directly on political power. Because the technology both enhances the returns to land and raises smallholders’ need for credit, it can exacerbate landlessness.<sup>32</sup>

Some experience suggests that the green revolution not only exacerbates inequality in general, but has a particularly negative impact on gender inequality. An FAO adaptation of work by Jiggins (1986) argues:

“...despite its success at increasing aggregate food supply, the Green Revolution as a development approach has not necessarily translated into benefits for the lower strata of the rural poor in terms of greater food security or greater economic opportunity and well-being....[The] introduction of high-yielding varieties of rice in Asia has had a major impact on rural women’s work and employment, most of it unfavorable by: increasing the need for cash incomes in rural households to cover the costs of technological inputs which has forced women to work as

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<sup>32</sup> The best description I know of these processes, as well as useful discussion of the history of the green revolution, is in Edelman (1980). As the green revolution was showing production gains in the early 1970s, its negative distributional impacts were recognized by the Director of the World Bank (and Vietnam era U.S. Secretary of Defense) Robert McNamara, who summarized situations in many countries with the following observation in 1973: "The data suggest that the decade of rapid growth has been accompanied by greater maldistribution of income in many developing countries and that the problem is most severe in the countryside", and ... "an increasingly inequitable situation will pose a growing threat to political stability" (McNamara, 1973, as quoted by Huizer, 1997). A friend who has worked with the people at the Bank over many years tells me McNamara’s recognition of the distributional impact of the green revolution, as illustrated by this quote from his Nairobi speech, was an important factor leading him to give so much attention to poverty.

agricultural labourers; increasing the need for unpaid female labour for farming tasks thereby augmenting women's already high labour burden; [and] displacing women's wage-earning opportunities through mechanization.”

Regarding the application of Green Revolution methods in Africa, the FAO report continues:

“[Attempts] to replicate the Green Revolution in Africa rarely recognized the importance of women's independent farming and income-generating activities to meet family food requirements and cash for the purchase of goods vital to family well-being....The failure to perceive and/or respond to differential allocation of resources and responsibilities between men and women in farming households meant that women's labour requirements for cash crop production were increased although control of the income remained in the hands of men. Moreover, women were allocated small plots of marginal land for food production which resulted in insufficient food for the family and increased pressure on fragile environments.”<sup>33</sup>

A review of analyses of the distributional impacts of the green revolution (Freebairn, 1995) found that most such studies, 80% of them, concluded that the introduction of the technology based on high-yield varieties of grain resulted in greater inequality at the producer and interregional levels. That a majority of such studies have this result does not make the general conclusion correct, and the distributional impact of the technology remains controversial. But the issue cannot be viewed as irrelevant, a conclusion that could be readily inferred from the Sachs Report. Moreover, as Freebairn's review suggests, the distributional impact of green revolution technology depends in large part on the overall framework in which it is adopted – the nature of the institutional and social framework. That is, the extent to which a ‘technical fix’ is likely to improve the conditions of the poor is largely dependent on the context in which it is introduced – on the way markets work and the way government policies are implemented, which are largely dependent on the prior structure of distribution and power.<sup>34</sup>

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<sup>33</sup> The FAO report appears on-line at <http://www.fao.org/FOCUS/E/Women/green-e.htm> (accessed September 28, 2007). Also, on the failure of development programs to recognize the different roles of men and women in agriculture, see Elson (1991)

<sup>34</sup> Freebairn (p. 277) also points out one of the strong motivations for attempts to deal with poverty by a ‘technical fix’: “A technological strategy for agricultural and rural development is politically attractive. If seeds, fertilizer, water control, and pesticides can assure a productive agriculture and a prosperous countryside, the struggles and dislocations of altering social relationships, landholding patterns, political power sharing, and other deeply entrenched arrangements can be avoided.” But, Freebairn continues, “If they cannot, however, other approaches are necessary to help alleviate the destabilizing and demoralizing effects of worldwide rural poverty.” For a recent and forceful critique of the green revolution strategy in Africa and more generally, see Holt-Gimenez et al (2006).

The context in which the green revolution has had its impact, in many parts of the world, has been one of great inequalities in the distribution of income and wealth; most immediately relevant is the unequal distribution of land holdings, which, as pointed out above, serves to create poverty and limit change. The long history of landlordism, latifundia-minifundia structures, and rural landlessness, which have characterized rural life in much of the world, have generated pervasive inequality and poverty (whether defined in absolute or relative terms). At the same time, the political power of large land holders has limited change: preventing social programs, blocking land reform, controlling water, and limiting the advances in productivity.<sup>35</sup>

#### **IV.D. Attracting Investment in the Context of ‘Globalization’**

A focus on growth without consideration of income distribution and power relations is also evident in the Sachs Report’s advocacy of tax concessions as a means to attract investment generally and foreign investment in particular. As the Report points out, existing evidence does suggest that tax concessions, when coupled with appropriate complementary policies in, for example, infrastructure expansion and training, do attract foreign investment. The connection between foreign investment and economic growth, however, is more complex than the Report suggests, and foreign investment’s impact on income distribution, and hence poverty reduction, is, at the least, a controversial issue.<sup>36</sup>

The poverty trap argument of the Report is essentially a supply-side argument, explaining the lack of investment in low-income countries as a result of an insufficient supply of capital. This reasoning – a reasoning shared by many policy makers and economists – leads to the proposition that the growth will be enhanced by foreign investment. To the extent, however, that growth is limited on the demand side – that is, by investment opportunities – foreign investment may have the effect of displacing domestic-source funds. An illustration of this phenomenon is provided by Mexico, where in 1980 the stock of foreign direct investment (FDI) was only 3.6 percent of GDP; it rose to 8.5 percent in 1990, 16.7 percent in 2000, and 26.5 percent in 2003. (UNCTAD, 2004, p. 405) However, throughout these years of rising FDI gross investment in relation to GDP was smaller than it had been in the 1970s and in the early 1980s (Mattar et al, 2002), and economic growth was relatively slow (even after the financial crisis of 1994). While the Mexican situation may not be typical, at the very least the impact of FDI on

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<sup>35</sup> On this last point – that large land holders tend to limit advances in productivity – see, for example, de Janvry (1981) and Griffin et al (2002) discussed below. Also, Khan (1972), in examining the possibilities for Bangladesh, explains how, even in a situation where land holdings are extremely small and large land owners are those with perhaps 30 acres of land, land reform can contribute to greater productivity as well as greater equality and poverty reduction.

<sup>36</sup> The Sachs Report cites Mutti (2003) to support its argument in favor of tax concessions. The Report counterpoises its advocacy of tax concessions with the general advice of the IMF and World Bank that governments should avoid tax concessions as a means to attract investment. It seems that the main concern of the IMF and the Bank is not the distributional impacts of tax concessions, but their implications for reducing the tax base in low-income countries and their ‘market distorting’ impact.

economic growth is a good deal more varied and complex than the Report suggests. (See, for example, de Mello, 1997.)

Even when foreign investment does induce more rapid economic growth, its impact on the distribution of income can be negative.<sup>37</sup> Studies that examine the relation between FDI and inequality often focus on the wage inequality that is generated by the entrance of foreign firms in low-income countries. For example, Dirk Willem te Velde (2003, p.4-5), focusing on Latin America, concludes:

“...not all types of workers necessarily gain from FDI to the same extent. The reasons for this include: FDI induces skill-specific technological change...and it provides more training to skilled than unskilled workers. A review of the micro and macro evidence shows that, at a minimum, FDI is likely to perpetuate inequalities ... New empirical evidence shows that FDI did not have an inequality-reducing effect in Latin America... In countries such as Bolivia and Chile, FDI may have increased wage inequality. While this does not imply that FDI was or was not good for development and poverty reduction in these countries, it does imply that most of the gains of FDI have benefited skilled and educated workers.”

As important as the wage inequality associated with foreign investment may be, there is an additional issue involved when the investment is attracted by tax concessions. The tax concessions approach to attracting investment places firms in a powerful bargaining position where they can play governments of different countries off against one another. Furthermore, the type of investment that is sensitive to tax rates is often highly mobile – garment assembly is a good example – and this mobility enhances the firms’ bargaining power once the practice of competing on tax concessions has been initiated. Examining the issue of structural reforms in Latin America and their impact on income distribution, Samuel A. Morley (2000, p. 29) writes:

“...in a world of perfect capital mobility, countries will be forced to compete in offering generous tax holidays, subsidized credits and other costly assistance as a way of attracting foreign capital. But it is not only foreign capital that is affected. The same argument is valid for domestic capital. Both government and labour will be forced to accept arrangements that are sufficiently generous to ensure that domestic entrepreneurs and

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<sup>37</sup> For a review of the issue and evidence, see Tsai (1995, p. 480) who concludes: “...two salient features emerge from our analyses. First, the partial correlation between stocks of FDI and inequality estimated by using the basic model is extremely sensitive to the inclusion of geographical dummies. This implies that the statistically significant correlation between FDI and income inequality widely obtained in earlier studies might capture more of the geographical difference in inequality than the deleterious influence of FDI. Second, to the extent that FDI does give rise to more unequal income distribution in the host LDCs, only the East/Southeast Asian LDCs appear to be the ones really harmed by the inflow of FDI during the period under consideration. We have to reiterate, however, that the above statement refers to the marginal impact only. ...But, even in the marginal sense our results tend to be supportive of the arguments of dependency theorists...”

holders of wealth are content to leave their money invested in their home country. In this way, opening up the capital account shifts the balance of power in favor of the holders of capital.”

While Morley’s primary concern is with the consequences of liberalization of capital markets, his observations underscore the problems of distribution and power that can be associated with efforts to attract – and retain – capital on the basis of tax concession competition.<sup>38</sup>

The tax concessions approach to inducing investment views economic growth as necessarily profit-led. To raise incomes in general, according to this concept, it is necessary to raise the income of capital first. Even if successful in generally raising incomes, the distribution of income is likely to become more unequal. It is an approach that is based on accepting and enhancing the power of capital, especially foreign capital. Profit-led growth may or may not yield more rapid growth, but it almost necessarily insures more unequal growth.

Experience of recent decades does not suggest that economic growth is most effectively enhanced by attracting foreign capital. For example, up through the 1970s, several countries in Latin America pursued their development with a heavy reliance on foreign investment, using tax policy and other means to attract that investment; Brazil and Mexico are prime examples. In East Asia at the same time, Taiwan and South Korea, while accepting foreign investment, limited and controlled that investment. The relative growth experiences of the two regions are well known. Moreover, while the differences in income distribution between the two regions are attributable to several factors, the much greater degree of equality in those East Asian countries is also worth noting.<sup>39</sup>

As the reference to the East Asian experience should indicate, foreign investment is not ‘bad.’ Whether foreign investment has ‘bad’ or ‘good’ impacts depends to a large extent on how it is attracted and controlled. Its impacts on economic growth and income distribution in recipient countries depend on several factors. Some of these factors – for example, the importance of support for training programs – are recognized in the Sachs Report. Yet any approach to foreign investment that does not consider the way it affects the distribution of income and power relations (let alone the complications of the way it affects economic growth) leads to an inadequate approach to poverty alleviation.<sup>40</sup>

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<sup>38</sup> Similar conclusions are expressed by Linda Beer and Terry Boswell (2002), who also focus on the way power relations are affected by “globalization.” They conclude (p. 51): “The research presented here indicates a shift in capital/labor relations brought about by globalization that have significantly contributed to the rise in income inequality seen throughout the world.”

<sup>39</sup> The handling of foreign investment in this period by Taiwan and South Korea is described, respectively, by Wade (1990) and Amsden (1989).

<sup>40</sup> I want to emphasize that the argument that foreign investment in low-income countries exacerbates income inequality, as put forth in various sources cited in this section, may be incorrect – or at least it may be correct only under circumstances that can be avoided with appropriate policy. The problem is that without consideration of the distributional issues, it is highly unlikely that a poverty alleviation program

#### IV.E. Alternatives<sup>41</sup>

The Sachs Report and the Millennium Development Goals project are a major advance over the approach of the Washington Consensus that for several years dominated much analysis and policy on economic development and policy questions. The Report and the MDGs project are valuable in going beyond a simplistic reliance on the market and a single-minded focus on economic growth to solve problems of poverty. Nonetheless, their failure to address issues of income (and wealth) distribution and power is a serious shortcoming that limits the extent to which poverty alleviation can be effectively addressed. Part of the problem lies in addressing poverty as simply an absolute issue; if the distributional aspect of poverty were recognized, these issues could not be elided from the discussion.

There are alternatives, various ways in which issues of distribution and power can be brought to the fore in poverty alleviation policy. At the foundation of alternative policies is a fundamentally different approach – different from that of the Sachs Report – to the role of the poor themselves. As Tariq Banuri (2005, p. 43) points out, “...the focus of [the Sachs Report] is not the empowerment of the poor nor the creation of knowledge to be placed in the hands of the poor; rather its focus is on doing something *for* the poor.” The Report essentially ignores an approach that “emphasizes investing in the social capital of the poor, social mobilization, building collective organization, enabling collective decision-making to emerge, and strengthening communities and community action. This [would enable] the poor to take charge of the process. Advocates of this approach never cease to remind us to treat the poor not as a problem but as people.”

Much is made of the concept of “empowerment” – in the Sachs Report, in various World Bank documents, and in many other discussions of poverty and economic development. Yet empowerment is usually presented in the narrowest economic terms, as a process or product of raising the incomes of the poor and educating (i.e., providing schooling for) the poor. Power, however, is a relative concept. To the extent that income is a foundation for power, it is relative income that matters. If, for example, the income of society’s bottom quintile rises by ten percent while that of the rest of society also rises by ten percent, it is difficult to argue that the former has more power. People in the bottom quintile may have a bit more flexibility in their lives, and this would seem to give them a bit more power in their relations with the rest of society. Still, the other members of society would have also gained flexibility. Without any change in the distribution of income, it is hard to see how the income increase would confer more power on the poor.

Power, furthermore, is not simply a product of income (or wealth). It depends on a complex of social and political arrangements – the social capital, social mobilization,

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can be effective. Moreover, to the extent that FDI does exacerbate inequality, it is likely to do so all the more when it is attracted by a tax concession program.

<sup>41</sup> Some of the issues discussed in this section are taken up at length in MacEwan (1999).



collective organization and decision making, and the strengthening of communities referred to by Banuri. There are programs that could further such arrangements, programs that would tend to improve the distribution of income and power in low-income countries and thereby contribute significantly to poverty reduction.

A prime example is redistributive land reform, which could provide a foundation for both improving income distribution and raising agricultural productivity in many low-income parts of the world. Not only could land reform directly alleviate poverty in the countryside, but, as pointed out above in the discussion of schooling, the political power of large landholders is often a barrier to change in other sectors of society. Land reform could not only shift the distribution of wealth and income, but could alter the distribution of political power as well.

The equality enhancing impact of redistributive land reform may be relatively obvious, but its productivity enhancing role is not so widely recognized. Keith Griffin, Azizur Rahman Khan, and Amy Ickowitz (2002, p 286), however, make the argument quite effectively. They point out that the

“relatively low ratio of interest rates to wages faced by large landowners [as compared to small holders] encourages them to adopt higher capital-labour ratios in cultivation, i.e., to use more mechanized techniques...Similarly, the relatively low ratio of land rental rates to wage rates faced by large landowners encourages them to cultivate their land extensively, i.e., to adopt lower labour-land ratios...In other words, small farmers cultivate the land more intensively and generate more employment per unit of land. Given that capital is scarce and labour abundant in rural areas of developing countries, the methods of cultivation used by small farmers more closely approximate the socially optimal methods than the capital and land intensive methods typically adopted by large landowners...[Consequently] output per unit of land, or yield, often is higher on small farms than on large. Indeed, there is a great deal of empirical evidence showing that yields vary inversely with the size of farms.”<sup>42</sup>

Griffin et al also make two additional points especially important here. First, large land holders have and seek to maintain a monopsonistic position with regard to the labor market, and thus they tend to abstain from selling land to small peasants, even when it would seem that doing so would enhance their profits. They are, however, concerned with social control, preventing small peasants (and presumably landless peasants) from having alternatives that would undermine the large land holders' power in the labor market.

Second, Griffin et al point out that a redistributive land reform would not only bring about poverty reduction in the rural areas, but would also contribute to poverty reduction

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<sup>42</sup> They cite Berry and Cline (1979) and Cornai (1985) regarding the empirical evidence.

in urban areas: “The reason for this is the incomes of the rural poor set a floor for urban wages, since no one will migrate from the countryside to the city unless they expect to be at least as well off as before migration. Higher rural incomes will therefore raise the ‘reservation wage’ of the urban poor and this will help to reduce urban poverty.” (p. 292).<sup>43</sup>

Land reform and the direct reduction of poverty and direct increase in output that it can generate are not simply ends in themselves. As pointed out, land reform also involves a shift in socio-political power. Moreover, this shift can be all the more effective and lasting when it is combined with the development of social institutions that continue to build the power of small holders. Various forms of rural cooperatives hold out the possibility of generating the social capital and collective organization on which such power can develop. Rural cooperatives, however, do not just happen. Their development requires various forms of policy support – for example, an appropriate legal framework and credit institutions that are directed towards supporting cooperatives. As Griffin et al comment (in a slightly different context): “One cannot... simply give land to the peasants and then abandon them, and expect that all will be well.” (p. 285).

The Sachs Report does not discuss or even mention land reform. Cooperatives are mentioned, but not discussed as a significant element in poverty reduction programs. Land reform and cooperatives are not panaceas for poverty reduction. Yet it is hard to see how poverty can be reduced in many low-income countries while land ownership remains highly unequal. And some forms of social institutions that enhance the power of the poor are a necessary component of poverty alleviation – and cooperatives seem a good candidate for this role.

There are other examples of ways in which poverty reduction programs can be shaped to bring about redistribution of income and power. The way social programs are organized is especially relevant.<sup>44</sup> As the Sachs Report and others have emphasized, schooling is an important part of any anti-poverty program. Yet little – virtually no – attention is given in the Report to either the structure or content of schooling and other social programs. It is relatively important whether schools and health clinics are provided to the poor or whether the poor are engaged in the creation and organization of these social institutions.

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<sup>43</sup> Griffin et al recognize the political problems associated with a redistributive land reform. They conclude their article by pointing out that because of the high ratio of the price of land to the annual value of the net output of the land, purchasing the land of large holders to redistribute it would be prohibitively costly. They end with the comment (p. 321): “The inescapable conclusion is that a major redistributive land reform is impossible if land transfers are based on free market prices; either government must act to depress land prices or there must be outright confiscation of some land. This is a painful nettle to grasp, but it is unavoidable if there is to be any hope of success.”

<sup>44</sup> These brief comments on social programs are elaborated in chapter 7 and the subsequent comments on training-for-jobs are elaborated in chapter 8 of MacEwan (1999).

Schools, after all, can serve the function of social control as well as the function of raising literacy and numeracy levels. Also, it is clear that more schooling does not necessarily lead to a reduction of income inequality; over the last several decades more schooling and more literacy has been virtually the world-wide norm, yet there has not been a corresponding reduction of income inequality. At the very least, in order for schooling to be equalizing, schools must be equal. Yet everywhere, the quality and content of schooling differs according to the social class of the students. Without any attention to this inequality, schools cannot play the central role in poverty reduction that is so often assigned to them.

Health clinics too can have very different impacts depending on how they are organized. The success that has been recorded in India's state of Kerala with regard to women's health in particular, but also with regard to life-expectancy and population growth, has been in large part attributed to the role of the poor themselves in the development of health clinics and in the formulation of their programs. Likewise, it would seem that schools would be more effective instruments to improve the position of the poor when the poor are involved in their formation and operation. As with cooperatives, these sorts of social programs are potentially valuable not only for meeting immediate needs with the services they provide, but also as institutions for expanding the power of the poor.<sup>45</sup>

As the discussion earlier regarding tax incentives for foreign investment indicates, any program to raise income, create jobs, and bring about greater equality is faced with problems because of "globalization." Whatever other positive or negative effects result from the greater economic integration of the economies of various nations, one consequence is a diminution of the 'policy space' of governments.<sup>46</sup> The high mobility of capital in the current era reduces the extent to which governments can direct economic activity, in particular encouraging investments that are most likely to have the largest social returns – that is, that are most likely to promote long run development and poverty reduction. Tax concessions have been adopted by many governments – and are advocated in the Sachs Report – as a means to encourage investment, but, as argued above, they are a poor tool.

Still, in the face of competition, governments are forced to be concerned with the problem of attracting and keeping investment. Capital is needed to generate jobs. There are, however, different ways to compete, and the different ways have different implications for both economic development in general and income distribution in particular. Perhaps the most important way to encourage investment is to create a general

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<sup>45</sup> The experience in Kerala state of India has complex roots and is not simply the product of 'enlightened' policy. Also, as has become increasingly evident, the favorable social experience in Kerala is in significant part dependent on remittances from citizens who are working abroad, especially in the oil-rich states of the Middle East. Nonetheless, there are positive lessons to be extracted from the Kerala experience. Yet Kerala gets no mention in Sachs Report.

<sup>46</sup> The concept of 'policy space' in the context of globalization has been developed, for example, in Gallagher (2007) and Wise (2007).

economic environment where investment opportunities, without special concessions, attract firms. In this regard, the attention given to infrastructure development and training by the Sachs Report is positive. If, however, particular steps are needed to encourage investment, there are actions that are preferable to tax concessions.

One potentially favorable policy is a training-for-jobs program. In various ways, governments can agree to provide training for workers that are needed by investors in return for the creation of jobs by those investors. While such a program can reduce investors' costs and thereby serve the same sort of incentive function as tax concessions, the implications are rather different. A training-for-jobs program, first of all, carries with it an upgrading of the work force. It pushes the economy in the direction of creating more skilled jobs. Instead of attracting investors with low-wage labor, it is a program that places a greater reliance on attracting investors with relatively skilled labor. Furthermore, in an era when firms 'cash in' their incentives and then move on to other locations, a training-for-jobs program assures that some gains remain even if firms leave. While workers may have been trained for jobs specific to a particular firm, the fact that they have gone through a training program means that they have expanded their ability to adapt. When firms leave, workers still have both the specific and the general skills.<sup>47</sup>

Other examples could be provided of the ways in which policy would be affected by giving income distribution a central role in efforts to reduce poverty. Employment programs, in particular, would be given a greater emphasis, for, as Khan (2005) and others have pointed out, employment expansion appears to have a greater impact on absolute poverty reduction through its impact on income distribution than through its impact on growth. The recognition of the importance of income distribution in poverty reduction may come from seeing this responsiveness of absolute poverty to a more equal distribution of income. Or it may come from accepting the argument that poverty itself is at least partly defined in terms of income distribution. Or the recognition may emerge from both of these sources. In any case, once the importance of income distribution is recognized, a different sort of approach to policy becomes necessary.

## **V. Conclusion**

An objection to an emphasis on income distribution in poverty alleviation programs is commonly raised by posing the question as to which of the following two options is preferable: Option I – a 10 percent increase in the income of the poor combined with a 20 percent increase in the income of the rich; or Option II – a 10 percent reduction in the income of the poor combined with a 20 percent reduction in the income of the rich? In Option II, the distribution is more equal, but it is unlikely that anyone – rich, poor, or external policy maker – would designate Option II as preferable.

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<sup>47</sup> The Sachs Report, as noted above, does advocate training programs as part of a package that would attract and keep investors. However, the Report seems to see the value of training as a means of helping tax concessions work, and not as a leading program in itself.

But the argument implicit in this question is a canard, an attempt to establish a thoroughly misleading story by suggesting that a more equal distribution of income is somehow necessarily in conflict with more rapid economic growth. The idea that a trade-off must exist between equality and growth (the so-called equity-efficiency trade-off) has a long history, and, ironically, has had support across the ideological spectrum. Apologists for the status quo have argued that inequality must be accepted in order to attain growth. Opponents of the status quo have argued that the organization of society must be fundamentally altered to make equality possible with growth. Both, it turns out, have been wrong.

In recent decades empirical work has established that there is no general connection between inequality and economic growth. Countries that grow faster are not more unequal than countries that grow slowly. It is also apparent that there is no firm connection in the other direction – that is, equality does not necessarily lead to more rapid growth. What is clear is that equality and growth can be compatible with one another. It depends on how growth is accomplished, what kinds of institutions are established and what kinds of policies are adopted.<sup>48</sup> Once it is clear that growth and equality are both possible and that poverty reduction depends on both raising incomes and reducing inequality, the problem becomes one of which economic strategy to pursue. The Millennium Development Goals project, it seems to me, is remiss: by failing to give attention to income distribution, it cannot generate a strategy that moves most effectively towards a growth-equity combination.

Regardless of how one defines poverty – whether in terms of people’s absolute or relative condition or, as I have advocated, a combination of relative and absolute consideration – income distribution (and wealth distribution) cannot be excluded from consideration. Just as absolute poverty is abhorrent in terms of basic human values and as an issue of social justice, so too is great inequality in the distribution of income – inequality as it exists in much of the world today.

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<sup>48</sup> I have reviewed this issue in chapter 3 of MacEwan (1999).

## APPENDIX A – THE HUMAN DEVELOPMENT INDEX

While the Human Development Index has changed in some ways over the years since its original introduction, the *Human Development Report 2006* (UNDP, 2006, p. 394) provides the following technical description:

The HDI is a summary measure of human development. It measures the average achievements in a country in three basic dimensions of human development:

- A long and healthy life, as measured by life expectancy at birth.
- Knowledge, as measured by the adult literacy rate (with two-thirds weight) and the combined primary, secondary and tertiary gross enrollment ratio (with one-third weight). [The “gross enrollment ratio” is the number of persons enrolled in school, regardless of age, divided by the total number of people in the relevant age group.]
- A decent standard of living, as measured by GDP per capita in purchasing power parity (PPP) terms in US dollars.

Before the HDI itself is calculated, an index needs to be created for each of these dimensions. To calculate these indices – the life expectancy, knowledge, and GDP indices – minimum and maximum values (goalposts) are chose for each underlying indicator.

Performance in each dimension is expressed as a value between 0 and 1 by applying the following general formula:

$$\text{Dimensions index} = (\text{actual value} - \text{minimum value}) / (\text{maximum value} - \text{minimum value})$$

The HDI is then calculated as a simple average of the dimension indices.

Goalposts for calculating the HDI:

<u>Indicator</u>	<u>Maximum value</u>	<u>Minimum value</u>
Live expectancy at birth (years)	85	25
Adult literacy (%)	100	0
Combined gross enrollment ratio (%)	100	0
GDP per capita (PPP US\$)	40,000	100

N.B.: The GDP index is calculated using adjusted GDP per capita (PPP US\$). In the HDI income serves as a surrogate for all the dimensions of human development not reflected in a long and healthy life and in knowledge. Income is adjusted because achieving a respectable level of human development does not require unlimited income. Accordingly, the logarithm of income is used.

## **APPENDIX B – THE UN MILLENNIUM DEVELOPMENT GOALS\***

### **Goal 1: Eradicate extreme poverty and hunger**

- Reduce by half the proportion of people living on less than a dollar a day
- Reduce by half the proportion of people who suffer from hunger

### **Goal 2: Achieve universal primary education**

- Ensure that all boys and girls complete a full course of primary education

### **Goal 3: Promote gender equality and empower women**

- Eliminate gender disparity in primary and secondary education preferably by 2005, and at all levels by 2015

### **Goal 4: Reduce Child mortality**

- Reduce by two thirds the mortality rate among children under five

### **Goal 5: Improve maternal health**

- Reduce by three quarters the maternal mortality ratio

### **Goal 6: Combat HIV/AIDS, malaria and other diseases**

- Halt and begin to reverse the spread of HIV/AIDS
- Halt and begin to reverse the incidence of malaria and other major diseases

### **Goal 7: Ensure environmental sustainability**

- Integrate the principles of sustainable development into country policies and programmes; reverse loss of environmental resources
- Reduce by half the proportion of people without sustainable access to safe drinking water
- Achieve significant improvement in lives of at least 100 million slum dwellers, by 2020

### **Goal 8: Develop a global partnership for development**

- Develop further an open trading and financial system that is rule-based, predictable and non-discriminatory, includes a commitment to good governance, development and poverty reduction—nationally and internationally
- Address the least developed countries' special needs. This includes tariff- and quota-free access for their exports; enhanced debt relief for heavily indebted poor countries; cancellation of official bilateral debt; and more generous official development assistance for countries committed to poverty reduction
- Address the special needs of landlocked and small island developing States
- Deal comprehensively with developing countries' debt problems through national and international measures to make debt sustainable in the long term
- In cooperation with the developing countries, develop decent and productive work for youth
- In cooperation with pharmaceutical companies, provide access to affordable essential drugs in developing countries
- In cooperation with the private sector, make available the benefits of new technologies—especially information and communications technologies

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\* From: <http://www.un.org/millenniumgoals/goals.html>

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