Poverty, Inequality and Growth

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Introduction

Pauvreté, inégalité et croissance, quels enjeux pour l'aide au développement ?

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Cet ouvrage rassemble les textes de la conférence co-organisée par l'AFD et le réseau de chercheurs européens EUDN (European Development Research Network) sur le thème « Pauvreté, inégalités, croissance : quels enjeux pour l'aide publique au développement ? ». La conférence avait pour objet de faire avancer les réflexions dans le domaine de la lutte contre la pauvreté, sujet rebattu et pourtant mal connu, difficile à appréhender et à traduire en politiques efficaces.

L'élimination rapide de la pauvreté sous toutes ses formes est incontestablement, comme l'a rappelé F.Bourguignon, un objectif de développement.

Il n'en a pas toujours été ainsi : la pauvreté a longtemps été considérée comme un non-problème ou un problème temporaire qui disparaîtrait avec la croissance. La croissance, résultat de l'accumulation des facteurs productifs et d'un progrès technique exogène, devait progressivement extraire les pays en développement (PED) du sous-développement et leurs habitants de la pauvreté.

Nul besoin de politiques sociales pour cela, seule comptait l'accumulation du capital.

Mais le sous-emploi et la pauvreté, loin de disparaître dans les PED, devinrent un réel sujet de préoccupation au tournant des années 1970. Amplifiés dans les années 1980, ils occupent, depuis une dizaine d'années, une place croissante dans les réflexions de la communauté internationale. La déclaration du Millénaire, tout autant qu'une liste d'objectifs à moyen terme, dresse un constat d'échec sur les stratégies passées : non, la croissance n'a pas permis de réduire significativement la pauvreté ; oui, des actions volontaristes, pouvant prendre la forme de politiques de redistribution, sont nécessaires pour réduire la pauvreté.

Pour autant, la lutte contre la pauvreté continue de susciter un certain scepticisme. Si les engagements pris par la communauté internationale d'œuvrer dans le sens d'une forte diminution de la pauvreté sous toutes ses formes d'ici 2015 renforcent le caractère prioritaire de cette thématique, le flou demeure sur les politiques à promouvoir dans ce domaine.

Pour faire de ce « slogan » un objectif consensuel, encore faudrait-il lui donner un contenu théorique et opérationnel crédible, identifier les vrais enjeux et les approches les plus fécondes, comprendre les processus à l'œuvre et reconstituer les chaînes de causalité… en bref, interroger les évidences qui pourraient conduire à sous-estimer la complexité des processus de développement, à simplifier la réalité et à apporter des réponses inefficaces.

Dans cette veine, le parti pris de la conférence a été de définir un angle d'attaque qui, à la fois, interroge le monde de la recherche et soulève de vrais enjeux opérationnels. La thématique a ainsi été abordée sous l'angle des rôles respectifs de la croissance et de la redistribution dans la réduction de la pauvreté. Est-il possible d'identifier les conditions nécessaires pour que la croissance profite aux plus pauvres ?

L'angle d'attaque, en posant la question de la conciliation de l'efficacité et de l'équité au service de la lutte contre la pauvreté, réunit des approches traditionnellement considérées comme indépendantes : pour les tenants du « premier théorème du bien-être »[1], l'efficacité économique est une chose, l'équité en est une autre, et l'alternative est entre l'une ou l'autre. Le « second théorème du bien-être », en mettant en évidence l'impact de la répartition initiale des ressources sur l'équilibre final, amène à des réflexions plus nuancées [2]. Un équilibre efficace pourrait être également équitable… La conclusion n'est pourtant pas simple ! Elle continue de faire l'objet de nombreux débats qui sont en partie repris dans les actes de la conférence.

Plusieurs questions sont abordées dans l'ensemble des documents qui suivent, comme autant d'étapes d'un raisonnement qui conduit à mettre en évidence le rôle de la lutte contre les inégalités dans la lutte contre la pauvreté : en premier lieu, des questionnements théoriques sur les interactions entre trois termes (pauvreté, inégalités et croissance), abordés aux différents niveaux d'analyse micro (dynamiques individuelles), méso (facteurs institutionnels) et macro (triangle pauvreté, inégalités, croissance) économiques, puis des enseignements de politique économique générale, et enfin

1. Selon lequel l'économie, livrée aux seules forces du marché, atteint l'équilibre et par là même une allocation efficace et optimale des ressources.

2. « First redistribute the initial resources and then let the markets do their job », in Dercon (dans cet ouvrage).

des conclusions sur les difficultés de mettre en œuvre et d'évaluer les politiques de lutte contre la pauvreté.

Bien sûr, le raisonnement n'est pas sans faille : la difficulté d'identifier des facteurs spécifiques dans un environnement complexe, les controverses méthodologiques et les lacunes de l'outil statistique ou encore le caractère désordonné et mal connu des politiques tentées dans ce domaine sont largement évoqués dans les articles et repris dans les commentaires.

Nous synthétisons dans cette introduction les principales idées développées lors de cette conférence, en privilégiant une présentation thématique.

1. La question des inégalités reconnue comme centrale dans la relation entre croissance et réduction de la pauvreté

Les stratégies de développement doivent-elles privilégier la croissance ou la lutte contre la pauvreté ? Cette question, récurrente en économie du développement, a été récemment abordée à la lumière de la « nouvelle économie de la croissance », et plus particulièrement sous le prisme de la relation entre équité et croissance. Il découle de ces analyses, à l'inverse de la thèse longtemps défendue, qu'équité et croissance sont conciliables.

1.1. Que sait-on sur la relation entre pauvreté, inégalités et croissance ?

Cette question fait l'objet de la contribution de F.Bourguignon. Elle est également abordée par O.Attanasio et C.Binelli dans la première partie de la leur. S.Dercon en explore la dimension microéconomique.

a. Identité arithmétique

Comme le montre la contribution de F.Bourguignon, l'évolution du taux de pauvreté [3] est la résultante mécanique de l'évolution du revenu moyen et des changements dans la distribution des revenus. Une modification de la distribution de revenus peut être décomposée en deux effets : une augmentation proportionnelle de tous les revenus à distribution inchangée (effet croissance) et une modification de la distribution des revenus relatifs (effet distribution). La réduction de la pauvreté dans un pays donné et à un moment donné dépend donc du taux de croissance des revenus, de la distribution des revenus et de son évolution.

Mais, sous ces relations mécaniques, se cachent des interactions complexes, la croissance modifiant la distribution des revenus, qui elle-même rétroagit sur la croissance et sur la pauvreté. Ces interactions en chaîne sont spécifiques à chaque contexte, rendant vaine toute tentative de généralisation.

Autant les relations entre croissance et pauvreté (à distribution de revenu constante, la croissance induit une baisse de la pauvreté) et entre pauvreté et inégalités (une détérioration de la distribution induit un accroissement de la pauvreté) sont aisées à appréhender car elles sont essentiellement arithmétiques, autant la relation entre croissance et distribution est complexe. Le véritable enjeu, pour concevoir une politique de développement qui réduise la pauvreté, consiste donc à comprendre les interactions entre croissance et distribution des revenus, à identifier les canaux de transmission des différents effets d'interaction et à traduire ces enseignements en opérations.

3. Part de la population vivant en dessous du seuil de pauvreté.

b. La croissance modifie la distribution des revenus

Le processus de développement d'une économie modifie la distribution des ressources entre secteurs, prix relatifs, rémunérations relatives des facteurs et dotations des agents. Ces changements ont un impact direct sur la répartition de revenus, quel que soit le degré de perfection sur les marchés des biens et des facteurs :

- la courbe de Kuznets en U inversé, qui relie inégalités et niveaux de développement, est l'exemple de formalisation le plus connu dans ce domaine. Elle repose sur les différentiels de productivité entre les secteurs et la modification de leur importance relative au cours du processus de développement, dans un contexte de marché du travail imparfait. D'autres théories et analyses empiriques ont suivi, qui ont contredit la célèbre courbe. Il apparaît aujourd'hui que les liens entre développement et évolution des inégalités sont très dépendants des pays... ce qui incite à replacer la relation dans son cadre socio-politique ;
- dans le domaine socio-politique, des analyses mettent en éviden ce la modification des rapports de force au cours du processus de développement, celle des relations sociales (notamment lors d'un processus d'urbanisation) et l'évolution progressive des institutions avec, nécessairement, un impact sur la distribution de revenus, qu'il soit indirect ou qu'il résulte plus directement d'une demande croissante de redistribution.

L'impact de la croissance sur la distribution de revenus est indiscutable mais très spécifique à chaque pays. Les conditions initiales déterminent donc les canaux de transmission théoriques les plus pertinents. Cette spécificité, comme le souligne F.Bourguignon, invite donc à adapter les politiques économiques aux conditions initiales : si la croissance a des effets automatiques sur la distribution de revenus par le biais de différents canaux identifiés, l'importance de ces canaux peut être modifiée par des choix politiques de manière à faire évoluer la distribution de revenus dans le sens souhaité.

c. Les inégalités ont un impact sur la croissance, sans que des conclusions claires puissent en être tirées.

Depuis le milieu des années 1950, de nombreux modèles théoriques ont été développés pour étudier l'impact d'une inégale distribution des richesses sur le processus de développement.

Approche théorique

Un premier courant de pensée suggère l'existence d'une relation positive entre inégalités et croissance. Trois arguments fondent ce courant. Le premier s'appuie sur l'hypothèse de Kaldor selon laquelle la propension marginale à épargner est plus forte chez les riches que chez les pauvres. En raison de la corrélation théorique entre le taux d'épargne et le taux de croissance, les économies « inégalitaires » connaîtraient donc une croissance plus forte. Le second s'appuie sur le caractère indivisible de l'investissement. Dans un contexte de marchés financiers imparfaits, une concentration de la richesse serait nécessaire pour financer les coûts fixes liés à la promotion de nouvelles activités industrielles et d'innovations technologiques. Enfin, le dernier argument est celui de l'incitation des salariés, une rémunération fixe indépendante des résultats décourageant tout effort tandis que son indexation sur des critères de performance inciterait les travailleurs à maximiser la production globale.

Ces théories fondent le dilemme entre croissance d'un côté et équité de l'autre. De nombreuses critiques ont été formulées par la suite à leur encontre. La vision dominante serait aujourd'hui plutôt celle d'un impact négatif des inégalités sur le taux de croissance :

- une première justification est d'ordre socio-politique. Une forte inégalité dans la distribution des revenus induirait deux types de réaction : (i) dans un contexte démocratique, la demande d'une redistribution des revenus par un système de taxation progressive sera forte et sa mise en œuvre détournera la classe riche de l'investissement ; (ii) dans une société oligarchique, l'absence d'expression politique d'une volonté de redistribution génèrerait une instabilité sociale et à terme des désordres politiques, détériorant le climat des affaires et dissuadant les investisseurs potentiels. De plus, et en supposant que l'exercice des droits civiques soit lié au niveau d'éducation, l'élite pourrait décider de ne pas engager de programmes d'éducation de masse afin de prévenir le risque d'une perte de pouvoir. Aussi, les sociétés inégalitaires tendraient-elles à réduire le taux d'accumulation de capital humain afin de ralentir la transition vers la démocratie et contribueraient ainsi à l'émergence de « trappes de pauvreté » [4] ;
- une deuxième justification fait appel aux défaillances de marché : l'élasticité de la pauvreté à la croissance est très variable et d'autant plus faible que la distribution des revenus est inégalitaire et que le fonctionnement des marchés handicape les plus pauvres. Ce thème est largement développé dans l'article de S. Dercon.

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4. Rappelons qu'une trappe à pauvreté est une situation d'équilibre dans la pauvreté, dont il n'est pas possible de sortir (i) sans un apport externe provenant d'une politique de redistribution nationale et/ou internationale (aide) ; (ii) sans un changement fondamental dans le fonctionnement des marchés.

Contrairement aux hypothèses qui fondent les « théorèmes du bien-être », l'environnement économique se caractérise par des défaillances de marché. Et contrairement aux conclusions du premier théorème, il y a complémentarité entre lutte contre les inégalités et croissance économique, dans la mesure où les inégalités ont beaucoup à voir avec les imperfections de marché. Associées à une répartition inégale des actifs, les défaillances de marché peuvent enfermer les pauvres dans des « trappes à pauvreté ».

Dans un premier temps, S. Dercon se penche sur la question de l'accès sous-optimal au crédit pour les pauvres. Les marchés du crédit étant imparfaits, la capacité d'emprunt d'un individu est liée au niveau de ses revenus et des garanties apportées. Aussi une répartition inégale des richesses affecte-t-elle à la fois les trajectoires de sortie de la pauvreté (trappes à pauvreté pour ceux qui ne peuvent emprunter pour améliorer leur revenu) et le taux de croissance (non financement de projets économiquement viables). La dynamique économique tend à maintenir cette situation : la capacité d'emprunt étant contrainte par la capacité de garantir les flux de remboursement futurs et donc par la dotation initiale en patrimoine, les ambitions d'investissement et de production des plus pauvres sont au mieux bridées, plus probablement non réalisées, compromettant tout début d'accumulation de richesses chez les plus pauvres. Une reproduction à l'infini des situations de pauvreté s'instaure. Ce développement renvoie à la question de la persistance des inégalités dans une société donnée, au traitement de l'inégalité des chances et à l'importance de la mobilité sociale.

Dans un deuxième temps, S. Dercon souligne que l'impact d'externalités sur les inégalités initiales perpétue et exacerbe la pauvreté. La criminalité, par exemple, résulte de la pauvreté et des inégalités et contribue à leur reproduction. Autre exemple, les disparités géographiques se renforcent et s'aggravent, des régions voire des pays étant de plus en plus marginalisés par rapport à d'autres. Un tel phénomène peut s'expliquer par l'effet de concentration des entreprises dans une même région attractive, au détriment de celles qui n'ont pas pu ou su attirer les investissements initiaux. Il peut s'expliquer par le niveau initial de biens publics ou d'actifs qui fondent l'attractivité de certaines régions au détriment d'autres moins bien dotées. Ces régions, qui ont manqué le train du développement et ne peuvent plus le rattraper, sont typiquement en situation de trappe à pauvreté, dans le sens où seul un choc exogène important ou un apport financier massif pourraient les extraire de leur situation de pauvreté.

Les pauvres des pays du Sud sont enfin fortement exposés aux désastres naturels, aux pandémies, aux conflits et aux chocs économiques tels que les variations de prix des matières premières ou de change. L'absence de mécanismes d'assurance rend plus aiguë encore cette fragilité. De nombreuses études montrent que cette exposition aux chocs peut ralentir la croissance et enfermer les pauvres dans des trappes à pauvreté. Les ménages pauvres ont certes développé des stratégies de gestion des risques (utilisation de plants plus résistants à la sécheresse, migrations saisonnières, etc.), ainsi que des stratégies de réponse aux risques (notamment l'auto-assurance par l'épargne ou par l'élevage d'animaux domestiques que l'on pourra revendre en cas de besoin ; mécanismes de soutien mutuel informel). Ces stratégies souffrent cependant de coûts de mise en œuvre importants qui entament leur efficacité et contribuent à la persistance de la pauvreté, aussi bien au niveau des revenus directs que dans l'accès à l'éducation ou la santé.

Analyses empiriques

O.Attanasio complète son propos par une analyse des études empiriques sur la relation entre inégalités et croissance. Si les premières d'entre elles ont mis en évidence une corrélation négative entre inégalités et croissance et un impact positif symétrique de revenus égalitaires, les conclusions de ces observations ont ensuite été amendées et parfois remises en cause par une série d'études, dont certaines concluent à l'absence de corrélation significative entre croissance et inégalités. Ces résultats ont été récemment revisités par Banerjee et Duflo, qui ont montré que la seule régularité statistique « robuste » est un fléchissement du taux de croissance lors des modifications dans la répartition des richesses, quels que soient la nature et le sens de ces modifications.

Plusieurs difficultés méthodologiques expliquent l'apparente contradiction des résultats empiriques. En premier lieu, ces travaux se sont fondés sur des expressions simplifiées de modèles théoriques qui identifient l'inégalité comme un déterminant pertinent de la croissance. Or il n'est proposé aucun fondement de l'hypothèse sous-jacente d'une corrélation forte entre l'inégale distribution des revenus et des actifs. En second lieu, les observations portent sur des modifications à court terme dans la distribution qui reflètent plus sûrement une redistribution des revenus que des actifs. Ensuite, l'absence de données statistiques fiables ou homogènes invite à la prudence dans l'interprétation des résultats. Enfin, une critique méthodologique souligne le caractère endogène de l'inégalité qui est étroitement déterminée par la croissance économique. Si des techniques permettent d'isoler le sens de la causalité, ce domaine reste peu exploré.

D'un point de vue méthodologique, cette revue de littérature invite à enrichir l'analyse macroéconomique d'approches microéconomiques qui, telle celle de Dercon, permettent de tester la pertinence de l'impact des imperfections de marché dans la relation inégalités-croissance.

1.2. Enseignements et interrogations

S'il n'existe pas de consensus sur la manière dont la croissance et la distribution des revenus interagissent et si les conclusions des études empiriques ne se rejoignent pas toujours, il est en revanche possible d'affirmer aujourd'hui (i) que la croissance seule ne suffit pas à réduire la pauvreté ; (ii) que redistribuer les revenus et les actifs pour augmenter le bien-être social dans un pays donné n'est pas forcément nuisible à la croissance.

Cela étant, P.N. Giraud souligne que si, sur le plan théorique, le dilemme équité-efficacité ne se pose pas systématiquement (puisqu'il existe des politiques de réduction de la pauvreté et/ou des inégalités qui accélèrent aussi la croissance), en revanche, le dilemme existe presque toujours en pratique « ne serait-ce que parce qu'on ne sait pas faire les redistributions de “capacités” requises par les modèles sans leur donner la forme pratique de transferts de revenus, et que ces derniers peuvent réduire les incitations à accumuler des riches, donc la croissance. Ou encore parce que les politiques de réduction des imperfections de marché sont elles-mêmes soumises aux imperfections des institutions ».

Au-delà des difficultés « pratiques », il reste, sur le plan éthique, légitime de chercher à concilier efficacité et équité, en posant la réduction de la pauvreté absolue comme principal objectif de développement, et en lui adjoignant l'objectif de réduction des inégalités, puisque les inégalités semblent être un maillon déterminant de la lutte contre la pauvreté.

Enfin, sur le plan politique, l'importance des gains à retirer d'actions de réduction de la pauvreté et/ou des inégalités et les moyens les plus efficaces pour les mettre en œuvre semblent spécifiques à chaque pays, voire à chaque situation locale. Ce constat rend vaine toute tentative de généralisation des réponses politiques face à l'objectif de réduction de pauvreté, invitant à analyser et à comprendre les processus d'interaction entre pauvreté, inégalités et croissance dans chaque contexte spécifique. P.N. Giraud suggère cependant qu'il pourrait y avoir, avec la globalisation, un processus en cours d'homogénéisation des institutions et des comportements, pouvant réduire les différences nationales et conduire à des conditions plus homogènes qui permettraient une certaine généralisation des « bonnes politiques ».

Pour l'heure, le passage de la théorie à la pratique se fait difficilement, en raison de la mauvaise connaissance des dynamiques de pauvreté à l'œuvre dans chaque contexte. S.Lambert, par exemple, met l'accent sur trois faiblesses majeures : on ne sait pas qui cibler en priorité parmi les plus pauvres ; on n'a pas suffisamment étudié les bénéfices des interactions sociales ; on n'a pas suffisamment mis en évidence les interventions efficaces quelles que soient les imperfections de marché. Autre lacune, le rôle des différentes institutions reste peu étudié et mal appréhendé.

2. Quelles politiques économiques ?

Ces différentes analyses ont montré la nécessité d'inventer des combinaisons de politiques de croissance et de redistribution adaptées à chaque contexte. Mais quel poids accorder à la croissance d'un côté, à la redistribution de l'autre ? Par ailleurs, quel contenu donner à une politique de redistribution ? Comme le dit S.Dercon, « le défi pour l'économiste comme pour le décideur consiste à identifier les mesures qui vont profiter au maximum aux plus pauvres ».

2.1. Des politiques pour remédier aux défaillances de marché ?

La théorie économique a montré comment des défaillances de marché pouvaient, dans un contexte d'inégale répartition des richesses, induire des phénomènes de trappe à pauvreté. Comme le souligne D.Cohen, en réduisant les imperfections de marché, on fait « d'une pierre deux coups » : l'économie fonctionne de manière plus efficace, induisant une production accrue de richesse, et les plus démunis retrouvent des opportunités de sortir de la pauvreté. Le coût de telles politiques (mesuré en termes de coûts administratifs ou bureaucratiques) doit cependant être comparé à ses avantages (si tant est que l'on ait une idée du degré d'entraves qu'induisent les imperfections de marché au niveau microéconomique).

Mais quelle politique pour réduire les imperfections de marchés ? S. Dercon a montré la difficulté de définir des politiques « pro-pauvres 'qui soient' efficientes » :

- des programmes de crédit à destination des pauvres se sont multipliés pour remédier aux imperfections du marché de crédit. Cependant, ils se sont souvent soldés par des résultats décevants en raison de capacités de mise en œuvre insuffisantes, notamment administratives, et de phénomènes d'appropriation par des groupes moins pauvres. Si quelques programmes ont été des réussites, la capacité des institutions de microcrédit à atteindre les pauvres est limitée et les coûts de gestion importants exigent un soutien financier externe récurrent. Par ailleurs, la tendance récente à augmenter la taille des programmes de microcrédit porte en elle le risque d'engendrer des dispositifs dont la complexité et la lourdeur de gestion menacent leur viabilité et leur efficacité. Une solution alternative consisterait d'un côté à fournir des transferts directs aux pauvres, de l'autre à initier des réformes législatives (droits de propriété, etc.) et à s'attaquer aux autres causes de l'inégalité des actifs ;

- les actions mises en œuvre pour répondre aux situations de marginalisation de certaines régions visent à y accroître le capital local et communautaire. Ces actions manquent cependant de lignes directrices et de priorités clairement définies. De nombreux doutes les accompagnent. Alors que les bailleurs de fonds défendent l'idée selon laquelle la construction de routes est un vecteur efficace pour leur développement, S. Dercon souligne que la réalisation d'infrastructures ne contribue pas systématiquement à renforcer le potentiel de croissance des régions pauvres. Des actions alternatives, telles l'irrigation, l'éducation ou la santé, pourraient être plus efficaces dans la mise en valeur de leur potentiel. Sur ce même thème, une question de fond a été posée par D. Cohen : faut-il vraiment soutenir le développement de régions « sous-développées » sans avenir économique ? Ne faut-il pas laisser opérer les flux de populations des zones peu développées vers les zones les plus dynamiques ? N'est-il pas plus facile de sortir d'une trappe à pauvreté en ville, ce qui justifierait un soutien à l'exode rural ?

- enfin, pour remédier aux imperfections sur le marché de l'assurance, les interventions de type « filets de sécurité » sont mises en place, fondées sur des transferts vers les pauvres et visant par exemple à stimuler l'accumulation d'un certain type de capital humain et/ou physique (éducation, certains biens publics, etc.) ou à offrir des emplois aux plus pauvres. En parallèle aux mécanismes *ex post,* des mécanismes *ex ante* pourraient être envisagés en vue d'aider les pauvres à se couvrir contre les risques : mise en place de systèmes d'assurances à destination des pauvres, soutien aux mécanismes d'assurance mutuelle informelle dans les communautés, etc.

Il reste beaucoup à apprendre sur les programmes lancés dans ces différents domaines. En particulier, comme le souligne S. Lambert, il faudrait apporter des réponses à des questions essentielles comme l'impact du microcrédit ou de l'éducation sur le revenu et la mobilité sociale.

2.2. La production de biens publics

De manière générale, D. Cohen a montré que le lien entre pauvreté, inégalités et croissance passait en grande partie par la production de biens publics, nécessaires au bon fonctionnement des marchés (construction d'institutions, infrastructures économiques, etc.) et également susceptibles de réduire directement des inégalités par l'accès gratuit qu'ils permettent à des biens essentiels ou à du capital (capital humain notamment). Dans le cas de l'Afrique, D Cohen suggère comme solution pertinente la mise en place d'une politique qui consisterait à fournir des biens publics dans certaines régions dynamiques (zones de prospérité) qui tireraient les autres, sur le modèle du pari chinois.

2.3 Le rôle déterminant des politiques de redistribution

O. Attanasio montre que lorsqu'une corrélation négative entre inégalités et croissance s'explique par des imperfections de marché, les modèles concluent à un impact positif sur la croissance des politiques de redistribution. L'impact des politiques de redistribution sur la réduction de la pauvreté passe alors par deux canaux : d'un côté, un taux de croissance plus élevé du PIB, en raison de moindres inégalités, contribue à la réduction plus rapide de l'extrême pauvreté, de l'autre, la redistribution accroît la part relative dans la distribution du revenu national des plus pauvres.

D'autre part, à croissance égale, des études montrent que le taux de réduction de la pauvreté est plus faible dans les pays fortement inégalitaires. L'inégalité peut conduire, y compris dans un contexte favorable de croissance, à un accroissement de la pauvreté.

Les politiques de redistribution sont donc fortement préconisées pour lutter contre la pauvreté, pour de multiples raisons évoquées par divers intervenants. On retiendra, dans le désordre, que :

- une politique de redistribution engendre un double dividende : elle réduit la pauvreté aujourd'hui tout en accélérant sa réduction demain ;
- les politiques de redistribution sont souhaitables dans tous les contextes. F. Bourguignon supposait que l'effet de la croissance était vraisemblablement plus grand dans les pays à bas revenu et

aux inégalités les plus faibles, alors que la redistribution semblait constituer un levier d'action plus important dans les pays inégalitaires et à revenu intermédiaire. D. Cogneau a contesté cette assertion : il n'est pas évident qu'une politique de croissance soit forcément préférable à une politique de redistribution dans les pays à bas revenu. Sur la base d'une analyse des élasticités (croissance, Gini), D. Cogneau montre qu'on ne peut affirmer que la redistribution doit être privilégiée dans des pays à revenu intermédiaire et inégalitaires (comme le Brésil), du moins par rapport à des pays à bas revenu et moins inégalitaires (exemple du Niger). Dans cette dernière catégorie de pays, il faudrait des taux de croissance très élevés pour réduire la pauvreté ; une politique de redistribution est donc une option à considérer ;

- comme l'a souligné D. Cogneau, il est aujourd'hui plus facile de définir des politiques de redistribution que des politiques de croissance : « Il n'y a pas de consensus sur la définition de ce qu'est une bonne politique de croissance ». On a certes tiré des leçons des mauvaises politiques du passé mais on est moins sûr des facteurs qui accélèrent la croissance. En revanche, le contenu des politiques de redistribution est plus précis (dépenses publiques, fiscalité, sécurité sociale, programmes conditionnels ciblés…), même si leur impact sur la croissance est encore mal cerné ;
- enfin, une politique de redistribution, a souligné D. Cogneau, est un argument de légitimité pour des Etats qui en manquent fortement.

2.4. Quelle redistribution ?

O.Attanasio souligne que toute politique de redistribution requiert une identification précise de l'objet et des caractéristiques temporelles de l'intervention :

- concernant le « calendrier », l'alternative se situe entre une intervention redistributive ponctuelle (aux effets de long terme) et un processus d'interventions continues ;
- pour l'objet d'intervention, l'alternative se situe entre redistribution des actifs et redistribution des revenus. Qu'est-ce qui est possible techniquement et politiquement ? Comment de telles politiques de redistribution interagissent-elles avec les marchés existants ? Restent-elles distinctes dans la pratique (ou bien une politique de redistribution des actifs ne passe-t-elle pas nécessairement par une taxation des revenus, s'apparentant ainsi à une redistribution des richesses ?).

C. Morrisson montre que la description de l'objet de la redistribution peut être judicieusement éclairée par la distinction :

- d'une part, entre redistribution des richesses (accroissant la capacité de gain d'un individu ou d'un ménage, comme l'éducation ou la santé, la redistribution de terres, etc.) et redistribution du revenu (allocation chômage, etc.) ;
- d'autre part, entre impôt sur le patrimoine et impôt sur le revenu.

Il confirme ensuite que de nombreux arguments plaident en faveur d'une redistribution des richesses. L'objectif serait de contribuer à une plus grande distribution du capital car elle seule permet un renforcement des capacités de gain des plus pauvres, susceptible de faire disparaître la pauvreté d'une manière définitive. La distribution des revenus, pouvant engendrer des distorsions et réduire les incitations à l'accumulation, ne serait justifiée que pour répondre à une obligation morale de secourir, dans leurs besoins primaires, les plus démunis.

Une redistribution des richesses qui consisterait à fournir des actifs aux plus pauvres grâce à des ressources issues d'une taxation indolore (et non distorsive) sur l'épargne et sur l'investissement serait la manière la plus efficace de promouvoir l'équité sans nuire à la croissance. En effet, une telle redistribution peut ne pas porter atteinte à la croissance et peut même réellement l'intensifier dans certaines circonstances. On finance une accumulation de capital humain et matériel au profit de familles pauvres (qui n'auraient eu aucun moyen de le faire seules) en réduisant la consommation (en grande partie) des ménages taxés. En revanche, dans le cas d'une redistribution de revenu, le transfert est consommé, ce qui peut avoir un effet négatif sur la croissance. En conclusion, C. Morrisson insiste sur la nécessité de privilégier certains types de redistribution de richesse, comme par exemple le financement de l'accès à l'éducation pour tous par un impôt sur les biens de luxe. Cette redistribution indirecte des revenus n'affecterait pas l'épargne mais la consommation et s'inscrirait dans une logique de renforcement des capacités de gain des populations fragiles.

Ainsi, selon le mode de redistribution choisi, les effets des politiques de redistribution sur la croissance et sur la réduction de la pauvreté différeront. Mais il paraît difficile en pratique de dissocier une redistribution des richesses de celle des revenus. La distinction entre richesse et revenu est ambiguë dans son application pratique. Le financement d'une politique de redistribution des richesses ou du capital suppose la mise en place d'un système d'imposition progressive qui redistribue de fait les revenus des classes aisées vers les classes les plus pauvres.

Dans la pratique, compte tenu de l'impossibilité d'une redistribution directe du capital, des politiques indirectes de redistribution par la correction des imperfections de marché ont été mises en œuvre, en conditionnant notamment l'attribution d'aide aux familles à une modification des comportements d'accumulation (obligation d'envoyer les enfants à l'école – formation professionnelle – etc. cf. les programmes PROBECAT et PROGRESA au Mexique). Ces programmes de transferts conditionnels de revenus semblent donner de bons résultats en termes d'accès à la santé et à l'éducation (le rôle central confié aux femmes est, comme le souligne C. Morrisson, fondamental) et peuvent constituer des exemples à suivre.

Un effort de synthèse conduirait à préconiser une articulation entre des mécanismes de redistribution des revenus ciblés dans le temps, dont l'objet serait de corriger certaines imperfections de marché et d'offrir aux individus piégés dans des trappes à pauvreté une opportunité d'y échapper, et des politiques à long terme de redistribution du capital, avec la mise en œuvre de politiques éducatives, sociales et éventuellement de redistribution d'actifs productifs (remembrement par exemple).

3. Quels enseignements pour un bailleur qui souhaite intervenir sur la question de la pauvreté et des inégalités au niveau local?

L'article de J.P. Platteau ne s'inscrit pas directement dans le prolongement du débat précédent. Il en constitue cependant un éclairage original, centré sur l'analyse de l'aide décentralisée. Ce type d'aide, censé allier la lutte contre la pauvreté et la lutte contre les inégalités politiques, n'a pas toujours les effets escomptés dans des contextes où la marginalisation politique reste la règle.

Depuis le *Rapport sur le développement dans le monde 2000* de la Banque Mondiale et la mise en œuvre des *Documents stratégiques de réduction de la pauvreté* (DSRP), les politiques de lutte contre la pauvreté font une place croissante à la « dé-marginalisation » des populations. La « voix des pauvres » doit être entendue dans les débats qui engagent leur avenir. A ce titre, le processus de décentralisation, en vigueur depuis le début des années 1990, est renforcé, comme le sont les mécanismes d'aide décentralisée. En pratique, ces mécanismes, qui devraient favoriser la prise de décision au niveau des communautés de base, sont censés améliorer le contenu et l'efficacité des politiques de lutte contre la pauvreté. Mais dans les faits, que constate-t-on ? Cet article met en avant quelques réussites et de nombreuses limites.

3.1. Le besoin d'évaluation des programmes décentralisés pour limiter les captures d'aide par les élites locales

J.P. Platteau a analysé les problèmes liés à l'usage de mécanismes décentralisés d'aide dans la lutte contre la pauvreté et les inégalités. Bien que l'auteur réaffirme l'intérêt des projets de développement basés sur la participation des communautés locales, il met en garde contre les risques de capture des flux d'aide par les élites censées représenter les acteurs locaux. Plusieurs enseignements sont à tirer de cette analyse. Le premier est qu'un arbitrage existe entre l'avantage informationnel des communautés de base et le risque de capture par les élites. Ce risque peut produire des résultats décevants dans le sens où la nouvelle approche dite participative ne conduit pas nécessairement à une meilleure absorption de l'aide et ne permet pas systématiquement d'atteindre les populations nécessiteuses de manière plus efficace que les anciennes approches du développement.

T. Addison nuance ce point en précisant que la capacité des élites locales à capter l'aide dépend largement du mode de fonctionnement des démocraties locales. Il note que cette capacité est notamment renforcée par l'absence de réelle compétition politique au niveau local ainsi que par les difficultés d'accès des communautés pauvres aux sources d'information concernant les projets qui leur sont destinés. Par conséquent, l'amélioration du fonctionnement des démocraties locales peut être considérée comme une des conditions pour limiter la capture des flux d'aide par les élites.

Le deuxième enseignement est que le mécanisme de décaissement des flux d'aide par tranches et assorti de conditions est approprié en matière de développement participatif, dans la mesure où il permet de discipliner les chefs locaux et les acteurs intermédiaires. Néanmoins, selon T. Addison, ce système peut poser des problèmes dans le contexte de pays en situation de *post* conflit, où il est nécessaire, d'un point de vue humanitaire, de délivrer une aide massive immédiate.

Le troisième enseignement découle directement des deux premiers. Il s'agit de l'importance qui doit être accordée à la détection des fraudes dans le cas des projets de développement reposant sur les communautés locales. Cela suppose que les évaluations *ex post* des projets aillent au-delà des analyses purement bureaucratiques, comprenant un rapport financier et un descriptif des réalisations physiques. J.P. Platteau souligne le délicat problème de la tendance des évaluations ex-post à mettre l'accent sur les réussites du projet et à en occulter les échecs et prône une meilleure utilisation des évaluations dans l'amélioration des projets en cours ou à venir.

Une certaine forme de coordination entre les bailleurs permettrait d'accroître l'efficacité des évaluations. Néanmoins, comme il est en pratique impossible d'éliminer toute concurrence entre agences d'aide, il est important que les bailleurs en dernier ressort ne sanctionnent pas systématiquement la détection d'un détournement d'aide par un tarissement des sources de financement à l'opérateur. En effet, cette capacité à détecter les irrégularités devrait être plutôt considérée comme un signe de compétence et de rigueur.

Enfin, la problématique du détournement de l'aide par les élites locales peut être lue, d'après F. Tarp, dans la perspective plus large du débat sur la décentralisation. Le risque d'un mauvais usage de l'aide dépend selon F.Tarp de la nature des services offerts, certains étant délivrés de manière plus efficiente que d'autres à un niveau décentralisé, parce qu'ils ne font pas l'objet d'économies d'échelle.

3.2. Le besoin d'évaluation des politiques de redistribution

Dans la lignée des recommandations de JP. Platteau, O.Attanasio défend l'idée qu'il est crucial d'évaluer l'impact des politiques de redistribution sur les imperfections de marché et le comportement des agents économiques, pour améliorer la connaissance des mécanismes en jeu et enrichir les politiques à venir.

L'évaluation des politiques de redistribution reste par nature délicate car elle se situe au croisement de préoccupations d'actions (quelle appréciation porter sur l'efficacité d'un programme pour une éventuelle généralisation dans le cadre d'une politique nationale – peut-on anticiper les effets d'une modification des composantes d'un projet – est-il possible de dupliquer un programme dans un contexte ou une géographie différents et quels en seront les impacts ?) et politiques (faisabilité politique de tests sur des populations cibles et comparaison avec des populations exclues – appréciation objective des jugements portés par les bénéficiaires – souci des autorités de communiquer sur des actions « valorisantes »). L'objet d'une évaluation, qui est de contribuer à l'enrichissement et à l'amélioration des politiques ou projets, rend encore plus aiguë la difficulté de l'exercice, car son ambition est à la fois d'apprécier des effets d'une modification des paramètres d'un programme donné dans un contexte stable et d'anticiper des effets d'un programme spécifique appliqué dans un contexte différent.

Cette ambivalence soulève plusieurs difficultés méthodologiques. L'évaluation empirique, sur la base des informations recueillies, apporte un éclairage sur les effets d'un programme spécifique dans un contexte spécifique. Il serait hasardeux d'en extrapoler des conclusions générales, d'y chercher la définition de principes « réplicables » ou les fondements de la mesure par anticipation des effets d'un projet. Seul le recours à des modèles économiques théoriques, dont la validité repose sur la pertinence des hypothèses qui le sous-tendent, pourrait aider à prévoir l'impact d'un programme dans un contexte donné.

L'exploitation par l'environnement politique et la presse des effets d'un projet et/ou de son évaluation contribue également à la difficulté de l'exercice d'évaluation. En effet, l'horizon politique ne recouvre pas celui de l'évaluation.

Aussi les auteurs suggèrent-ils, compte tenu de la nature propre du processus politique qui sous-tend la décision et l'architecture des interventions ou des projets, qu'il serait préférable de pouvoir procéder à des évaluations sur des opérations pilotes avant que ces interventions ou projets ne soient mis en œuvre définitivement.

4. Enseignements, interrogations et prolongements

Nombre d'enseignements ressortent des différentes interventions faites lors de la conférence. Parallèlement, de nombreuses interrogations subsistent, qui illustrent la complexité du sujet et la « jeunesse » des travaux dans ce domaine, tout en ouvrant la voie à autant de sujets de recherche.

◆ L'élimination de la pauvreté absolue, sous toutes ses formes, est un objectif prioritaire incontestable. Pour y parvenir, la croissance ne suffit pas. Une politique de redistribution est indispensable, associée à d'autres types de politiques selon un dosage très dépendant du contexte.

->La question se pose de savoir si l'objectif de réduction de la pauvreté absolue peut effectivement être un objectif en tant que tel ou si, comme le suggère D. Cogneau, il ne devrait pas faire partie d'un contrat social global.

◆ Les inégalités sont apparues comme un maillon déterminant dans la relation entre croissance et réduction de la pauvreté, même si les conclusions des études empiriques ne sont pas toujours convergentes.

-> La question se pose donc de savoir si la lutte contre les inégalités ne devrait pas devenir également un objectif de développement. Cette question, abordée par P.N. Giraud, recouvre bien évidemment des dimensions politiques qui pourraient en freiner l'exploration.

◆ En théorie, point de dilemme : politiques de croissance et redistribution sont conciliables. Et cette conciliation efficacité/équité peut être « pareto-optimale » [5], d'autant plus que les politiques de redistribution renforcent les capacités des plus pauvres à être « économiquement efficaces ».

-> Dans les faits, la conciliation n'est pas toujours optimale : fortement dépendante du contexte de sa mise en œuvre, elle fait la part belle au pragmatisme. Comme le souligne P.N. Giraud, « le potentiel et l'étendue possible des politiques de réduction de la pauvreté et/ou des inégalités, l'importance des gains à en attendre, les moyens les plus efficaces pour les mettre en œuvre, tout cela est hautement spécifique à chaque pays, voire à chaque situation locale [...]. Il n'existe pas de recettes universelles ». De nombreuses études théoriques et pratiques (évaluations) sont nécessaires pour essayer de mettre à jour des régularités (que la globalisation pourrait favoriser).

-> Les politiques de réduction de la pauvreté, pour être mieux définies, doivent s'appuyer sur des études plus nombreuses, qui prennent en compte les comportements des ménages (meilleure connaissance des fonctions d'utilité), les dynamiques (trajectoires des ménages pauvres) ou le rôle des

5. Une situation est dite optimale au sens de Pareto s'il n'existe pas de situation autre qui permette d'accroître le niveau de satisfaction d'un ou plusieurs agents économiques sans faire diminuer celle d'au moins un autre agent.

interactions sociales dans un contexte donné. Ces études devraient prendre en compte la culture et les institutions du pays. D.Cogneau souligne ainsi l'impact des institutions sur les résultats des politiques de redistribution et développe les incidences de cette conclusion : les institutions de chaque pays sont très spécifiques, reflétant à la fois la géographie, l'histoire, la culture. Leur impact sur la croissance d'un côté, la redistribution et la lutte contre la pauvreté de l'autre est tout autant spécifique, induisant un dosage original de politiques de croissance et de redistribution dans chaque contexte. Pourtant cruciales, les interactions entre institutions, croissance et distribution de ressources sont encore mal connues.

-> L'évaluation des politiques et programmes, bien que complexe, est cruciale pour améliorer la compréhension des phénomènes en jeu (besoin d'analyses sociologiques, politiques, anthropologiques, etc.) et enrichir les politiques et programmes à venir.

Quels prolongements donner à ce travail ?

Les dynamiques de pauvreté sont multiformes, complexes, enchâssées dans une imbrication d'interdépendances. La lutte contre la pauvreté appelle des interventions propres à chaque contexte, et avant toute chose, d'importants efforts d'analyse et de compréhension des dynamiques à l'œuvre. Elle appelle aussi une remise en question de nombreux intérêts acquis. Les objectifs sont-ils ambitieux ou utopiques ?

- Une politique ou un projet de lutte contre la pauvreté ne peuvent faire l'économie d'une approche contextuelle et causale qui analyse, dans un contexte donné, les formes de pauvreté d'un groupe d'individus ; qui décortique les mécanismes d'appauvrissement, de marginalisation, de maintien dans des trappes à pauvreté ; qui identifie les formes d'inégalités à l'origine des situations de pauvreté ; qui imagine les canaux pertinents pour lutter contre ces formes d'inégalités et parvenir ainsi à réduire durablement la pauvreté ; qui évalue les actions menées pour améliorer la compréhension des phénomènes en jeu. Les acteurs de la lutte contre la pauvreté veulent-ils/peuvent-ils financer des politiques à ce point exigeantes ? La recherche est-elle capable de relever le défi ?

- Une politique de lutte contre la pauvreté devrait reposer sur des politiques sectorielles de redistribution qui en renforcent l'efficacité et la cohérence. Les rapports de force peuvent-ils évoluer dans le sens d'une plus grande redistribution des richesses et des droits ?
- Une politique ou un projet de lutte contre la pauvreté devraient faire l'objet d'évaluations systématiques de manière à améliorer les interventions futures, au risque de modifier fondamentalement les pratiques des gouvernements, des donneurs et la hiérarchie des bénéficiaires des projets. Les parties prenantes sont-elles prêtes à accepter ces évolutions ?

La mise en œuvre de véritables politiques de réduction de la pauvreté appelle des évolutions de fond dans les pratiques des acteurs nationaux et internationaux. Ces évolutions seront rendues possibles par (i) une compréhension accrue des processus à l'œuvre dans le domaine de la lutte contre la pauvreté ; (ii) une diffusion accrue des savoirs sur ce thème ; (iii) un engagement des acteurs aux différents niveaux de responsabilité.

Introduction

Poverty, Inequality and Growth, What's at Stake for Development Aid?

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This publication brings together texts from a conference jointly organised by the AFD and the European Development Research Network (EUDN) entitled « Poverty, Inequality, Growth: What's at Stake for Development Aid ? ». In seeking to further thinking about the fight against poverty, the conference's topic was well chosen. Though combating poverty is a widely debated subject, it has remained poorly understood, difficult to grasp and difficult to translate into effective policy.

As François Bourguignon reminded us, the rapid elimination of poverty in all its forms is one of the incontestable objectives of development.

This has not always been the case: poverty was long seen as a non-issue, or as a transitory problem that would disappear with growth. A product of the accumulation of productive factors and exogenous technical progress, growth alone was to lift developing countries out of poverty. Social policies were superfluous.

Yet under-employment and poverty, far from disappearing in developing countries, became real concerns at the beginning of the

1970s. Amplified during the 1980s, they have, for about ten years now, occupied a growing place on the international community's agenda. The medium-term goals listed in the Millennium Declaration are also an admission that strategies used in the past have failed: no, growth has not significantly reduced poverty; yes, more aggressive actions, perhaps in the form of redistribution, are necessary to reduce poverty.

For all this, the fight against poverty continues to encounter scepticism. While the international community's commitment to work towards significantly reducing poverty in all its forms by 2015 underline that it is a priority, policies to promote poverty reduction remain vague.

In order to build a consensus around the fight against poverty, it must be given credible theoretical and operational substance; real priorities and the most promising approaches must be identified; the processes at work must be understood; and, the chains of causality must be recreated... Put otherwise, everything that might lead to oversimplification, ineffective solutions and an underestimation of the complexity of the development process must be examined with a critical eye.

Using this as a starting point, the conference attempted to outline an approach that would both encourage the participation of the research community and identify the real operational stakes. The subject was thus broached from the angle of the respective roles of growth and redistribution in poverty reduction: *i.e.*, is it possible to identify the necessary conditions under which growth will benefit the poorest ?

By raising the possibility that efficiency and equity would combine in the fight against poverty, this approach reunites traditionally separate ideas: for the supporters of the First Welfare Theorem[1], economic efficiency is one thing, equity is another and they posed a mutually exclusive choice. Highlighting the impact of the initial distribution of resources on the final balance, the Second Welfare Theorem leads to more tempered positions: an efficient balance can also be equitable. [2] This conclusion is not simple however, and it continues to be the subject of numerous discussions that will be in part reprinted in articles in this publication.

Several issues are raised in the papers that follow, each taking a step towards demonstrating the role of the struggle against inequality in the struggle against poverty. Theoretical reflections on the theory of the interaction between poverty, inequality and growth are discussed first. These are dealt with on different levels: microeconomic analysis (individual dynamics), mesoeconomic analysis (institutional factors) and macroeconomic analysis (the triangle of poverty, inequality and growth). Lessons learned in terms of general political economics follow, and finally, some conclusions regarding the difficulty of implementing and evaluating policies in the fight against poverty are offered.

Of course, this approach is not perfect: the difficulty in identifying specific factors in a complex environment, the controversies concerning the methodology employed and the shortcomings of the statistical tools, as well as the disorderly and poorly known nature of policies attempted in this area are widely cited in the articles and contributions of the participants.

Addressing each theme consecutively, we will summarise the main ideas developed during the conference.

1. According to which the economy, left to market forces, reaches a balance and from there an efficient and optimal allocation of resources.
2. “First redistribute the initial resources and then let the markets do their job.” Dercon (in this volume).

1. Inequality is Central in the Relationship Between Growth and Poverty Reduction

Should development strategies prioritise growth or the fight against poverty ? This recurring question was recently raised in light of New Growth Economics, and more particularly through the prism of the interaction between equity and growth. These analyses show that, contrary to what was long held true, equity and growth are not mutually exclusive.

1.1. What is known about the interaction of poverty, inequality and growth?

This question forms the subject of F. Bourguignon's contribution, also being addressed by O. Attanasio and C. Binelli in the first part of their presentation. S. Dercon examines the microeconomic perspective of the question.

a. Arithmetic Identity

As F. Bourguignon demonstrates, changes in the poverty rate [3] are the result of changes in average income and shifts in income distribution. A change in income distribution can be broken down into two effects: a proportional increase of all income with distribution unchanged (the growth effect) and a change in the distribution of relative income (the distribution effect). The reduction of poverty in a given country at a given time thus depends on the income growth rate, and changes in income distribution.

These mechanistic relationships however, hide complex interactions, with growth modifying income distribution, and distribution

3. I.e. the proportion of the population living below the poverty level.

itself having a retroactive effect on growth and poverty. These chain interactions are specific to each context, making it impossible to generalise.

The relationships between growth and poverty and between poverty and inequality are easy to understand because they are essentially arithmetic: if income distribution remains constant, growth leads to a reduction of poverty, while worsening distribution leads to an increase in poverty. However, the interaction between growth and distribution is complex. In terms of formulating a development policy to reduce poverty, the crux of the matter is understanding the interaction between growth and distribution, identifying the channels through which these effects are transmitted and translating these lessons into concrete actions.

b. Growth Affects Income Distribution

Economic development alters the distribution of resources between sectors, as well as relative prices, relative pay and agents' allocations. These changes have a direct impact on distribution, regardless of the degree of perfection in the markets for goods and factors :

- Kuznets' bell-shaped curve, linking inequality and development, is the best known formalised expression of this relationship. It points to productivity differentials between sectors and changes in their relative importance during development, in the context of an imperfect labour market. Other empirical theories and analyses followed Kuznets, contradicting his bell-shaped curve, and today it appears that the link between development and the evolution of inequality is heavily country-dependent... As a result, the relationship has been reinserted into the socio-political framework.

- Socio-political analyses have pointed to the balance of power during development: social relations (notably during urbanisation), and institutional development with, necessarily, an impact on income distribution, whether it is indirect, or the direct result of an increasing demand for redistribution.

The impact of growth on income distribution is indisputable, but it is specific to each country. Initial conditions thus determine the most relevant channels. This specificity, as F. Bourguignon points out, suggests that economic policies be adapted to initial conditions: if growth has automatic effects on income distribution via certain channels, particular policies can be adopted to influence these channels and change income distribution.

c. Inequality Has an Indeterminate Impact on Growth

Since the mid-1950s, several models have been developed to study the impact of unequal wealth distribution on development.

The Theoretical Approach

A first line of thought suggests the existence of a positive relationship between inequality and growth. This is based on three arguments. The first draws on Kaldor's hypothesis, according to which the marginal propensity to save is stronger among the rich than among the poor. Because of the correlation between savings and the growth rate, « unequal » economies have higher growth. The second is founded on the indivisible character of investment. In a context of imperfect financial markets, a concentration of wealth is necessary to finance new industrial activities and technological innovation. Finally, the last looks at worker incentives, with fixed pay discouraging effort, and performance-based remuneration encouraging maximised production.

These theories form the base of the growth-equity dilemma. They have been widely criticised and the current outlook tends toward believing that inequality has a negative impact on growth:

- The first argument is socio-political. Marked inequality in terms of income distribution leads to two kinds of reaction: (i) in a democratic setting, the demand for income redistribution through a progressive tax system would be strong and its implementation would discourage the upper class from investing; (ii) in an oligarchic environment, the impossibility of asking for redistribution politically would lead to social instability and eventually political disorder, causing a deterioration of the business climate and dissuading potential investors. Moreover, if the exercise of civil rights is linked education levels, the elite could decide against broad-based educational programmes in order to reduce the risk of losing power. Thus, inegalitarian societies would tend to reduce the level of human capital accumulation in order to slow democratisation and thereby they contribute to the emergence of « poverty traps ».[4]
- A second argument is based on market deficiencies: the elasticity of poverty to growth is quite variable and weaker when income distribution is unequal and when the functioning of the markets handicaps the poorest. This idea is developed in detail in S. Dercon's article.

4. A poverty trap is a situation of balance in poverty from which it is impossible to escape: (i) without an external contribution stemming from a national and/or international redistribution policy (aid); and, (ii) without a fundamental change in the functioning of the market.

Unlike the hypotheses that underpin the welfare theorems, the economic environment is characterised by market imperfections. Also, unlike the conclusions of the First Welfare Theorem, there is a complementarity between the fight against inequality and economic growth, insofar as inequality is closely informed by market imperfections. Linked to an unequal distribution of wealth, market imperfections can imprison the poor in « poverty traps ».

S. Dercon first delves into the issue of the poor's sub-optimal access to credit. As credit markets are imperfect, an individual's borrowing capacity is linked to both income and collateral. Thus the unequal distribution of wealth has an impact on both removing an individual from poverty (poverty traps for those who cannot borrow in order to improve their income) and the growth rate (non-financing of economically viable projects). The economic dynamic tends to maintain this situation: as borrowing capacity is limited by the ability to guarantee future repayment and thus by initial wealth, the investment and production ambitions of the poor are at best impeded and at worst completely circumvented. This compromises any possibility the poor might have of accumulating wealth and a vicious cycle sets in. This leads back to the issue of the persistence of inequality in a given society, the inequality of opportunity and the importance of social mobility.

Secondly, S. Dercon underscores the fact that the impact of externalities on initial inequality perpetuates and exacerbates poverty. Crime, for example, both stems from poverty and inequality and contributes to their reproduction. Similarly, geographical disparities become stronger and worse, with regions and even countries becoming increasingly marginalised. This can be explained by the concentration of companies in one region to the detriment of regions that were unable to attract initial investment. It also can be explained by the initial level of public goods or assets that make some regions more attractive than other less-endowed ones. These places, having missed the development train and not being able to catch up, are typically in a poverty trap, insofar as only some kind of major, exogenous shock or massive financial input will raise them out of poverty.

Finally, developing countries are also exposed to natural disasters, pandemics, conflicts and economic shocks such as fluctuations in the price of raw materials or exchange rates. The lack of insurance mechanisms makes their already tenuous situation even more fragile. Numerous studies show that this exposure to shocks can slow growth and imprison the poor in poverty traps. Poor households have, of course, developed certain risk-management strategies (using drought-resistant crops, seasonal migrations, etc.), as well as risk-coping strategies (notably self-insurance through savings or livestock that can be sold should the need arise, as well as informal mutual support mechanisms). However, these mechanisms are costly, thus reducing their efficiency and contributing to poverty persistence, both in terms of direct income and access to health services or education.

Empirical Analyses

O. Attanasio rounds off his discussion with an analysis of empirical studies of the relationship between inequality and growth. The first of these suggests a negative correlation between inequality and growth, and a symmetrical positive effect of income equality. These findings however, were subsequently modified and called into question by a series of studies, some of which concluded that there was no significant correlation between growth and inequality. Banerjee and Duflo recently reviewed these studies and demonstrated that the only "robust" statistical regularity is a drop in the level of growth during changes in wealth distribution, regardless of the nature and direction these changes take.

Several methodological problems explain the apparent contradiction between these empirical results. First, the work is based on simplified expressions of theoretical models that identify inequality as being a relevant determinant of growth. However, no foundation for the assumption of a strong correlation between income and assets distribution is provided. Secondly, the observations deal with short-term changes in distribution that more certainly reflect a redistribution of income rather than of wealth. Moreover, the lack of trustworthy or homogenous statistical data calls for prudence in interpreting the results. Finally, methodological criticism underscores the endogenous character of inequality which is closely determined by economic growth. While techniques to isolate this causality exist, the subject remains relatively unexplored.

From a methodological point of view, this review of the literature suggests the need to enrich the macroeconomic examination of microeconomic approaches which, like that of Dercon, make it possible to test the impact of market imperfections on inequality and growth.

1.2. Lessons and Questions

While there is no consensus on how growth and income distribution interact, and while the conclusions of empirical studies often diverge, it is nevertheless possible to state that: (i) growth alone is not sufficient to reduce poverty; and, (ii) the redistribution of income and wealth to increase social welfare in a given country is not necessarily harmful to growth.

This being the case, P.N. Giraud stresses that, at the theoretical level, the equity-efficiency dilemma does not always arise (as there are poverty and/or inequality reduction policies that also accelerate growth). At the practical level however, the dilemma almost always exists « even if only because we do not know how to redistribute the "capabilites" required by the models without giving them the form of income transfers, and that the latter can reduce the incentives to accumulate wealth, and thus growth. Or because market imperfection reduction policies are themselves subject to the imperfections of institutions. »

Beyond the « practical » difficulties, it remains ethically legitimate to attempt to reconcile efficiency and equity by setting the absolute reduction of poverty as the principle objective of development, and by adding the objective of reducing inequality to it, since inequality is a major component in the fight against poverty.

Finally, at the political level, the benefits to be drawn from poverty- or inequality-reduction measures and the most effective ways of implementing them appear to be specific to each country, and even to each local situation. This observation makes any attempt to generalise political responses in the face of poverty reduction vain, thus calling for analysis and understanding of the process of interaction between poverty, inequality and growth in each specific context. P.N. Giraud suggests, however, that with globalisation, an ongoing process of homogenisation of institutions and behaviour that could reduce national differences and lead to more standardised conditions, might permit a certain generalisation of « good policies. »

For the time being, translating theory into practice is proving difficult, due to a poor knowledge of the dynamics of poverty at work in each context. S. Lambert, for example, identifies three major weaknesses: we do not know whom to prioritise among the poor; we have not sufficiently studied the advantages of social interactions; and, we have not sufficiently demonstrated measures that are effective regardless of market imperfections. Another shortcoming is that the role of various institutions has not been sufficiently studied and is poorly understood.

2. Economic Policy Options

These different analyses have shown the need to develop mixed growth and redistribution policies that are adapted to each context. It remains to be determined however, how much importance should be given to growth, and how much to redistribution. Moreover, the substance of a redistribution policy has yet to be defined. As S. Dercon states, « the challenge for the economist and the policy maker is to identify those policies that maximally benefit the poor. »

2.1 Policies to Compensate for Market Imperfections

Economic theory has shown how market imperfections could, in a context of unequal wealth distribution, lead to poverty traps. As D. Cohen says, by reducing market imperfections, one can « kill two birds with one stone. » The economy operates in a more efficient manner, leading to a heightened production of wealth, and the most destitute rediscover paths that will lead them out of poverty. The cost of such policies (measured in terms of administrative or bureaucratic costs) nevertheless must be compared with the advantages (insofar as it is possible to identify the negative effect of market imperfections at the microeconomic level).

Yet it remains to be determined which policy should be adopted to reduce market imperfections. S. Dercon demonstrated the difficulty of defining « pro-poor » policies that are « efficient ».

- Credit programmes targeting the poor, in response to credit market imperfections, have increased. However, their results are often disappointing, either because implementation capabilities (particularly administrative) are insufficient or because of appropriation by groups that are less poor. While some programmes have succeeded, the ability of microcredit institutions to reach the most destitute remains limited and management costs remain high, necessitating continual external financial support. In addition, the recent trend towards expanding microcredit programmes risks that complex and unwieldy mechanisms will be created that hamper the programmes' viability and effectiveness. An alternate solution would be to provide direct transfers to the poor, and to combine these with legislative and other reforms (property laws, etc.) that attack the causes of inequality.
- Projects to reduce the marginalisation of certain regions by increasing local and community capital. These programmes however, lack clearly defined guidelines and priorities. There are several doubts. While donors defend the notion that building roads is an efficient way of encouraging a region's development, S. Dercon

argues that infrastructure does not systematically contribute to strengthening the growth potential of poor regions. Alternative projects, such as irrigation, education or health programmes could be more effective. Along these same lines, D. Cohen poses a fundamental question: should the development of "underdeveloped" regions be pursued even if they have no economic future? Would it not be a better idea to allow populations to migrate from underdeveloped areas to those where activity is more dynamic? Is it not easier to escape a poverty trap in a city, and does this not justify supporting rural exodus ?

- Finally, to fix imperfections in the insurance market, « safety net » interventions have been set up, based on the idea of transfers to the poor that seek, for example, to stimulate the accumulation of a certain kind of human capital and/or physical capital (education, certain public goods, etc.) or to provide work for the poorest. Along with *ex post* mechanisms, *ex ante* ones could be envisaged with a view to helping the poor protect themselves from risk: setting up insurance systems for the poor, supporting informal mutual insurance mechanisms within communities, etc.

There remains much to be learned from programmes initiated in different areas. In particular, as S. Lambert states, answers must be provided to essential questions such as the impact of microcredit or education programmes on income or social mobility.

2.2. The Production of Public Goods

D. Cohen illustrates that the link between poverty, inequality and growth functions to a large degree via public assets such as institutions, economic infrastructures, etc. (which are necessary for the proper functioning of markets). These are also capable of directly reducing inequality by providing free access to essential goods or to capital (notably human capital). In the case of Africa, D. Cohen suggests providing certain dynamic regions (zones of prosperity) with public assets that would attract others, as per the Chinese model.

2.3. The Decisive Role of Redistribution Policies

O. Attanasio shows that when a negative correlation between growth and inequality can be explained by market imperfections, the models conclude that redistribution policies have a positive impact on growth. Poverty reduction thus takes place through two channels: a higher level of GDP growth (due to a reduction in inequality) that contributes to a more rapid reduction of extreme poverty; and, an increased relative share in the national income of the poorest.

If growth is equal, studies show that the level of poverty reduction is weaker in strongly inegalitarian countries. Inequality can lead, even in a context conducive to growth, to an increase in poverty.

Redistribution policies are thus strongly recommended to fight against poverty, for many reasons cited by various contributors. The following were chosen, in no specific order :

- A redistribution policy pays a double dividend: it reduces poverty today and accelerates its reduction tomorrow.
- Redistribution policies are desirable in all contexts. F. Bourguignon suggests that the effect of growth is probably larger in countries with low income and weaker inequality, while redistribution would be a more important tool in inegalitarian

countries with medium income. D. Cogneau contested this statement: it is not clear that a growth policy is necessarily preferable to a redistribution policy in low-income countries. Based on an analysis of elasticities (growth and Gini factors), D. Cogneau argues that it is impossible to state that redistribution should be preferable in medium-income inegalitarian countries (such as Brazil), at least not over low-income less inegalitarian countries (Niger, for example). In this last category of countries, high growth levels would be also necessary to reduce poverty. Thus, redistribution is an option worth considering.

- As D. Cogneau stressed, it is currently easier to define redistribution policies than growth policies. "There is no consensus concerning the definition of a good growth policy." Of course, lessons have been learned from bad policies in the past, but factors that accelerate growth are less well known. On the other hand, the contents of a good redistribution policy are more precise (public spending, taxes, social security, targeted conditional programmes etc.), even if their impact on growth is still not well known.
- Finally, a redistribution policy, as D. Cogneau highlighted, is an argument that lends legitimacy to states that are sorely lacking it.

2.4. Forms of Redistribution

O. Attanasio emphasised that any redistribution policy requires an exact identification of the measure's goal and time frame:

- With regards to the schedule, the alternative is between a one-off redistributive measure (with long-term effects) and a continuous process

- In terms of its goal, the alternative is between a redistribution of assets and a redistribution of income. What is technically and politically possible remains to be determined. How would redistribution policies interact with existing markets and, could these policies remain separate in practice (must an asset redistribution policy take place through income taxation, and thus affect wealth redistribution) ?

C. Morrisson argues that redistribution goals can be clarified by the following distinction:

- Wealth redistribution (increasing an individual or household's earning capacity, through education, health, land redistribution, etc.) and income redistribution (unemployment benefits, etc.).
- Taxes on assets and taxes on income.

He then points out that numerous arguments are made in favour of wealth redistribution. Its goal is to contribute to a wider distribution of assets because this alone enables the poorest to strengthen their earning ability, making it possible to do away with poverty permanently. Income distribution, which could lead to distortions and reduce incentives to accumulate wealth, is only justified on the level of basic needs to meet a moral obligation to rescue the most impoverished.

A redistribution of wealth that consisted of providing assets to the poorest through resources gained from painless (and thus non-distortional) taxation on savings and investment would be the most effective way of promoting equity without hampering growth. In fact, this type of redistribution could conceivably intensify growth under certain circumstances. An accumulation of human and material capital is financed for the poorest of families (who would have no way of doing it themselves) by reducing the consumption (to a large degree) of taxed households. In contrast, with income redistribution, the transfer is consumed, and this can have a negative impact on growth. In his conclusion, C. Morrisson stresses the need to favour certain types of wealth redistribution, such as financing access to education for all for example, through a tax levied on luxury goods. This indirect redistribution of income would affect consumption rather than savings and would work to strengthen the earning ability of the most fragile parts of the population.

Thus, depending on the redistribution method selected, the effects of redistribution policies on growth and poverty reduction will vary. However, it is difficult in practice to disassociate wealth redistribution from income redistribution. The distinction between wealth and income is ambiguous at the practical level. Financing a wealth redistribution policy or capital redistribution policy presupposes a progressive tax system that redistributes the income of the wealthy to the benefit of the poor.

At the practical level, given the impossibility of direct capital redistribution, indirect redistribution policies correcting market imperfections have been implemented, most notably by making aid to families conditional on a modification of accumulation behaviour (mandatory enrolment of children in school, vocational training, etc. such as the PROBECAT and PROGRESA programmes in Mexico). These conditional transfers of income seem to have had good results in terms of access to health and education (the central role women is, as C. Morrisson states, key) and could be an example for others to follow.

An effort at drafting a summary leads to a clearer definition of the link between income redistribution mechanisms with clear timetables (the goal of which is to correct certain market imperfections and to give individuals an opportunity to escape poverty traps), and long-term capital redistribution policies (with the implementation of educational and social policies, and possible redistribution of production assets via reallocation, for example).

3. Lessons for Donors Dealing with Poverty and Inequality at the Local Level

J.P. Platteau's article does not tie in directly with the preceding discussion. It nevertheless provides original insight into the study of decentralised aid. This kind of aid, which is supposed to assist in the struggle against poverty and political inequality, has not always had the expected results in contexts of political marginalisation.

Since the *World Development Report* 2000 was published by the World Bank and Poverty Reduction Strategy Papers (PRSPs) were implemented, poverty reduction policies have accorded ever-increasing attention to population « demarginalisation. » The « voice of the poor » must be heard in discussions about their future. Thus since the 1990s, the decentralisation process itself and decentralised aid mechanisms have both been strengthened. At the practical level, these mechanisms, which should enhance the decision-making powers of grassroots communities, are also supposed to improve the content and effectiveness of poverty reduction strategies. This article takes stock of the situation, highlighting some successes and the multitude of stumbling blocks encountered.

3.1. The Need to Assess Decentralised Programmes to Limit Aid Being Commandeered by the Local Elite

J.P. Platteau examines the problems in using decentralised aid mechanisms in the fight against poverty and inequality. Although the author reaffirms the usefulness of development projects based on local-community participation, he warns of the risk of aid being appropriated by the very elite that is supposed to represent local actors. Several lessons can be drawn from this analysis. The first is that there is an trade-off between the advantage of a better information of grassroots communities and the risk of aid appropriation by the elite. This can lead to disappointing results insofar as the new, so-called « participatory » approach does not necessarily lead to better aid absorption and does not systematically make it possible to gain access to needy populations any more efficiently than earlier development approaches.

T. Addison tempers this point by showing that the local elite's capacity to appropriate aid depends largely on the way local democracies work. He notes that this ability is substantially strengthened in the absence of any real political competition at the local level, and also by problems encountered by poor populations in gaining access to information about the projects designed for them. As a result, improving how local democracies work can be one way to prevent aid from being misappropriated.

The second lesson is that disbursing aid in instalments and with matching conditions is appropriate for participatory development, insofar such mechanisms make it possible to strengthen discipline among local leaders and intermediary actors. Nevertheless, according to T. Addison, this system can present problems in post-conflict contexts, where it is necessary from a humanitarian point of view, to provide massive aid immediately.

The third lesson stems directly from the first two. It has to do with the importance accorded to detecting fraud in local-community based development projects. This presupposes that *ex post* project evaluations go beyond simple bureaucratic analyses, including a financial report and a description of physical achievements. J.P. Platteau highlights the delicate problem of the tendency of *ex post* evaluations to overshadow failures with project successes and recommends a better use of evaluations to improve current and future projects.

Specific co-ordination between donors would make it possible to increase evaluation effectiveness. As it is impossible to eliminate all forms of competition between aid agencies however, it is important that the donors not systematically sanction aid misappropriation by curtailing funding. Rather, the ability to detect anomalies should be seen as a sign of competence and rigour.

Finally, the problem of aid misappropriation by local elite can be put, according to F. Tarp, into the larger perspective of the discussion on decentralisation. The risk of aid being misused depends on the nature of services provided, some being furnished more efficiently than others at the decentralised level, as economies of scale are not involved.

3.2. The Need to Evaluate Redistribution Policies

Along the lines of recommendations presented by J.P. Platteau, O. Attanasio supports the idea that it is crucial to evaluate the impact of redistribution policies on market imperfections and the behaviour of economic actors in order to understand the mechanisms and improve future policies.

The evaluation of redistribution policies is by nature delicate, since it lies at the meeting point of action (how to evaluate a programme's effectiveness for generalisation to a national level, whether it is possible to anticipate the effects of modifying one component, if a programme can be duplicated in a different context or geographical area, and what its impact might be etc.) and policy (political feasibility of tests on target populations and comparing these with excluded populations, objective evaluation of the judgment made by the beneficiaries, concern on the part of the authorities to communicate « image-enhancing » actions). The goal of evaluations (to contribute to enriching and improving policies or projects), makes the exercise even more difficult, because it seeks to both evaluate the effects of modifying one parameter of the programme in a stable context and to anticipate the programme's impact in a different context.

This ambivalence leads to several methodological difficulties. Empirical evaluation, based on gathered information, provides insight into the effects of a specific programme in a specific context. It would be dangerous however, to extrapolate general conclusions from it, or to look for "replicable" principles or the foundations of anticipatory evaluation of the effects of a proposed project. Only theoretical economic models, whose validity rests on the relevance of the hypotheses that underpin them, could help forecast the impact of a future programme in a given context.

The political (or media) exploitation of project outcomes and/or evaluations also makes the evaluation exercise more difficult. In fact, the political horizon is not as broad as that of the evaluation.

Thus, the authors, bearing in mind the nature of the political process that underpins the decision and architecture of measures or projects, suggest that it would be preferable to be able to carry out evaluations on pilot operations before these projects or measures are permanently implemented.

4. Lessons, Questions and Future Directions

Many lessons emerge from the conference, with still more questions remaining. These both illustrate the complexity of the subject, and the relative newness of research in the area, while providing direction for future research.

- The elimination of abject poverty, in all its forms, is an incontestable priority. In order to achieve this, growth alone is not sufficient. A context-informed redistribution policy, linked to other policies is indispensable.

-> The question arises whether the goal of abject poverty reduction can actually be a goal as such or if, as D. Cogneau suggests, it should form part of a global social contract.

- Inequality has emerged as an important component in the relationship between growth and poverty reduction, despite the fact that empirical studies do not always converge on the same conclusions.

-> Thus, should the fight against inequality be a development objective ? This question, dealt with by P.N. Giraud, obviously involves a political dimension which could slow the speed of its exploration.

- A theoretical dilemma: growth and redistribution policies are compatible. The conciliation between efficiency and equity can be "Pareto-optimal" [5] especially since redistribution policies strengthen the ability of the poorest to be « economically efficient ».

-> In fact, conciliation is not always optimal: strongly dependent on the context in which it is implemented, conciliation takes a good deal of pragmatism. As P.N. Giraud highlights, « the potential and the possible scope of poverty and/or inequality reduction policies, the importance of gains to be made, the most efficient means to implement them, are all highly specific to each country, even to each local situation[...]. There are no universal answers. » Numerous studies, both theoretical and practical (evaluations), are needed to bring the consistencies (that globalisation could enhance) up to date.

-> In order to be better defined, poverty reduction policies must draw on more studies taking on board household behaviour (better knowledge of utility functions), dynamics (the trajectories of poor households), or the role of social interactions in a given context. These studies should take the country's culture and institutions into account. D. Cogneau stresses the impact of institutions on redistribution policy outcomes and develops the consequences of this conclusion: the institutions of each country are highly specific, reflecting its geography, history and culture. Their impact on growth, on one hand, and redistribution and the struggle against

5. A situation is said to be Pareto-optimal if it is not possible to increase the level of satisfaction of one or several economic agents without diminishing that of at least one other agent.

poverty, on the other, are just as specific, leading to specially tailored growth and redistribution policies in each context. The interaction between institutions, growth and resource distribution, which are crucial, is still poorly understood.

-> The evaluation of policies and programmes, though complex, is crucial for improving our understanding of the phenomena involved (need for sociological, political and anthropological analyses, etc.) and enriching future policies and programmes.

The Next Step

The dynamics of poverty are multiform, complex and embedded in a matrix of interdependencies. The fight against poverty requires measures specific to each context, and above all, major efforts of analysis and understanding of the dynamics at work. Established interests must be called into question and it must be determined whether goals are either ambitious or just utopian.

- A policy or project in the fight against poverty must spare no effort in carrying out contextual and causal analyses of the form of poverty affecting its target group of individuals. They must clearly expose the mechanisms leading to impoverishment, marginalisation and imprisonment in poverty traps, and identify the forms of inequality at the root of poverty. They must conceive of channels for fighting against these forms of inequality and thus sustainably reduce poverty. They must evaluate their actions to improve the understanding of the phenomena at work. Whether those involved in the fight against poverty are able and/or willing to finance projects to this demanding level remains to be seen.

Can research take up the challenge?

- Anti-poverty policies should be based on sectoral redistribution policies that strengthen its efficiency and coherence. Is the balance of power moving towards a greater redistribution of wealth and rights?
- Policies should be evaluated systematically in order to improve future interventions, at the risk of fundamentally changing donor and government practices and the hierarchy of the project beneficiaries. Are stakeholders ready to accept these changes?

The implementation of veritable poverty reduction policies necessitates major changes in the practices of national and international actors. These evolutions will be made possible by: (i) a heightened understanding of the processes at work in the fight against poverty; (ii) wider dissemination of knowledge on the issue; and, (iii) a commitment by actors at different levels of responsibility.

The Poverty-Growth-Inequality Triangle

by François Bourguignon
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An issue which is often recurring in discussions on development is whether the main focus of development strategies should be on growth or on poverty and/or inequality. This paper argues that this way of formulating the question of the goal of development strategies is a false dilemma. Its resolution can be simply put in two statements. First, the rapid elimination of absolute poverty, of all forms, is a meaningful goal for development. Second, the reduction of absolute poverty necessarily calls for highly country-specific combinations of growth and distribution policies.

These statements, however simple they may appear, raise a number of conceptual, measurement, theoretical and empirical issues, which are discussed in the present paper. Before proceeding, it is important to make a caveat regarding the distinction between absolute and relative poverty.

Absolute poverty is defined in reference to a poverty line that has a fixed purchasing power, determined so as to cover needs that are physically and socially essential. Setting the reduction of absolute poverty as the prime development goal is thus simply saying that a fundamental objective of development is to ensure that everybody satisfies his/her basic needs. The poverty line may be multi-dimensional however, comprised of two measures: an income-related poverty line (for needs fulfilled by income) and non-monetary measures (for other needs). Because basic needs are likely to evolve over time, absolute poverty lines need not be the same across countries, even after income poverty has been corrected for purchasing power parity. Poverty lines do not need even to be the same in a given country across long time intervals.

This absolute definition of poverty, which is in use in a large number of countries, must be contrasted with a relative definition of poverty, whereby the poverty line is defined not in terms of some well defined basic needs, but as a fixed proportion of the mean income of the population. For instance, the EU officially considers those whose economic resources are below 50 per cent of the mean income in Member Countries as poor. Of course, one might consider that this relative definition of income poverty, by which the poverty line is continuously updated and explicitly based on mean income changes, rather than being formed at rather long time intervals and on a more discretionary basis, is the limit of the absolute definition of poverty. But, what matters for the purpose of this paper is that such a relative definition of poverty – sometimes referred to as « relative deprivation » – becomes in some sense independent of growth. The absolute level of income and therefore, a large part of the development process, becomes irrelevant with such a definition. Only relative incomes, or pure distributional features matter. Fixing the poverty line relative to average income can show rising poverty, even when the standard of living of the poor has in fact risen. While there is an increasing consensus among economists that relative deprivation is important, there is no such agreement that individual welfare depends only on one's relative position, and not at all on one's absolute standard of living as determined by income [1].

Once it has been accepted that reducing absolute income poverty is a meaningful development goal, then a direct link may be established between development, growth and distribution. Analytically, it is easily shown that a kind of arithmetic *identity* links the growth of the mean income in a given population, the change in the distribution – or in « relative » incomes – and the reduction of absolute poverty. In other words, poverty reduction in a given country and at a given point of time is fully determined by the rate of growth of the mean income of the population and the change in the distribution of income. As illustrated in Figure 1 by the Poverty-Growth-Inequality (PGI) triangle, a development strategy is thus fully determined by the rate of growth and distributional changes in the population.

Formally, the relationships implicit behind the PGI triangle are not simple. For instance, the elasticity of poverty with respect to growth for a constant distribution is neither constant across countries with different development levels and distribution, nor across the various ways of measuring poverty. The same observation applies to the elasticity of poverty with respect to inequality indicators.

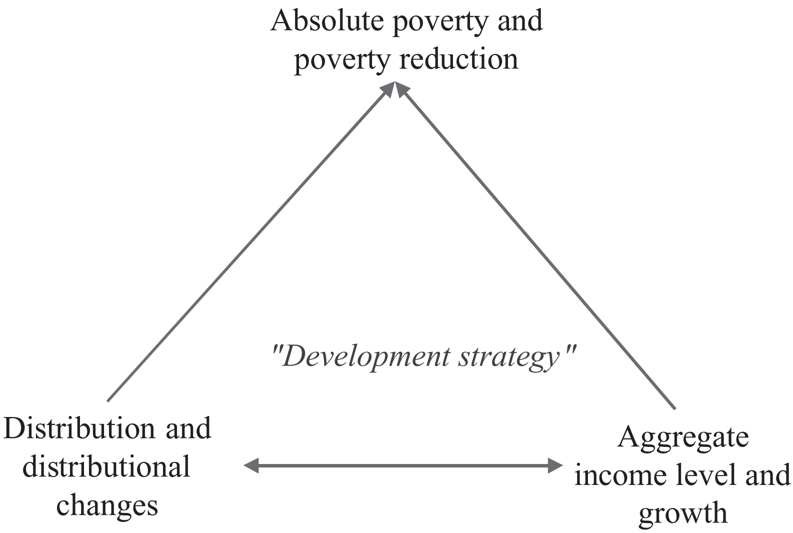
The real challenge in establishing a development strategy aimed at reducing poverty is not so much in the essentially arithmetic relationships between poverty and growth on the one hand, and poverty and inequality on the other. It lies instead, in the interactions between distribution and growth. There is indeed little controversy among economists that growth is essential for (income) poverty reduction, with the

1. Note that it is also possible to define poverty as a combination of the absolute and relative definitions. On this see Foster (1998), Atkinson and Bourguignon (2000) or Ravallion (2003).

assumption that the distribution of income remains more or less constant. In effect, much evidence points in this direction (for example Deininger-Squire 1996; Dollar and Kraay, 2001; Ravallion, 2001, 2003; Bourguignon, 2003). Likewise, there is much evidence that a worsening of distribution tends to increase poverty. Yet, the real issue in establishing a development strategy is whether growth and distribution are independent of each other or, on the contrary, are strongly interrelated. Is it the case for instance, that faster growth tends to reduce inequality or, on the contrary, to increase it? Or, are there reasons to believe that too much inequality in a given country either slows or accelerates growth ? On the distributional consequences of growth, the findings of a number of recently published microeconomic-based case studies indicate clearly that the relationship is both strong and complex. This is in contrast to the large number of cross-country regressions which find no significant relationship between growth and inequality, and on the basis of which it would be tempting to conclude that « growth (of any nature) is good for the poor ». Regarding the effects of inequality on growth, cross-country studies are mostly inconclusive, too. The difficulty is that it is not easy to come up with the direct microeconomic evidence that would identify that precise relationship.

This paper attempts to clarify the debate regarding growth vs. distribution development strategies by providing a rigorous analysis of the relationships that exist among the three vertices of the PGI triangle. Section 1 discusses the simple arithmetics of poverty, inequality and growth. Section 2 briefly examines the two-way relationship between growth and distribution. Finally, Section 3 concludes by discussing the scope for, and role of redistributive policies.

Figure 1 : the Poverty-Growth-Inequality Triangle



1. The Simple Arithmetics of Poverty, Inequality and Growth

A change in the distribution of income can be decomposed into two effects: a proportional change in all incomes that leaves the distribution of relative income unchanged (a growth effect); and, a change in the distribution of relative incomes, which, by definition, is independent of the mean (a distributional effect).[2]

To show this, it is useful to begin with the following definitions :

- « Poverty » is measured by the absolute poverty headcount index, *i.e.*, the proportion of the population below a particular *poverty line* (e.g. $1 a day) as derived from household survey data. Other indices such as the headcount (with the same poverty line) could also be used.
- « Inequality » (or « distribution ») refers to disparities in *relative income* across the whole population, *i.e.*, disparities in income after normalising all observations to the population mean so as to make them independent of the scale of incomes.
- « Growth » is the percentage change in mean welfare level (*e.g.* income) in the household survey.

From this it may be shown that a change in poverty is a function of growth, distribution and the change in distribution. This is illustrated in Figure 2, where the poverty headcount is simply the area under the density curve to the left of the poverty line (here set at US$1 a day). This figure shows the density of the distribution of income, that is, the number of individuals at each level of income

2. This decomposition has been discussed in detail in Datt and Ravallion (1992) and Kakwani (1993). See also Fields (2002) and Bourguignon (2003).

(represented on a logarithmic scale on the horizontal axis). The move from the initial to the new distribution goes through an intermediate step, which is the horizontal translation of the initial density curve to curve (I). Because of the logarithmic scale on the horizontal axis, this change corresponds to the same proportional increase of all incomes in the population and thus stands for the pure « growth effect » with no change taking place in the distribution of relative incomes. Then, moving from curve (I) to the new distribution curve occurs at constant mean income. This movement thus corresponds to the change in the distribution of « relative » income, or the « distribution » effect.

Of course, there is some path dependence in this decomposition. Instead of moving first rightwards and then up and down as in the figure, it would have been possible to move first up and down and then to move rightwards. Presumably, these two paths are not necessarily equivalent except for infinitesimal changes. This is an issue that shall be ignored here, assuming in effect that all changes are sufficiently small for path dependence not to pose a problem.

For sufficiently small changes in mean income and in distribution, the preceding decomposition corresponds to an identity which expresses the change in poverty as a function of the growth in mean income and changes in the distribution of relative income.

Change in Poverty ≡ F(growth, distribution, change in distribution)

A formal statement of the above identity – *i.e.* the expression of function F( ) – is offered in Bourguignon (2003), with the assumption that the distribution function is log-normal (a standard approximation of empirical distributions in the applied literature). It is shown there that both the growth and the inequality elasticity of poverty are increasing functions of the level of development, and are decreasing functions of the degree of relative income inequality. The same reference also shows how the decomposition identity may be applied to observed growth spells for which distribution data are available at the two ends of the spell.

This discussion leads to some simple facts. It shows clearly that both growth and inequality changes play a major role in generating changes in poverty. However, the impact of these phenomena will depend on the initial level of income and inequality. Moreover, the relative effects of both phenomena may differ quite dramatically across countries.

Figure 2. Decomposition of change in distribution and poverty into growth and distributional effects

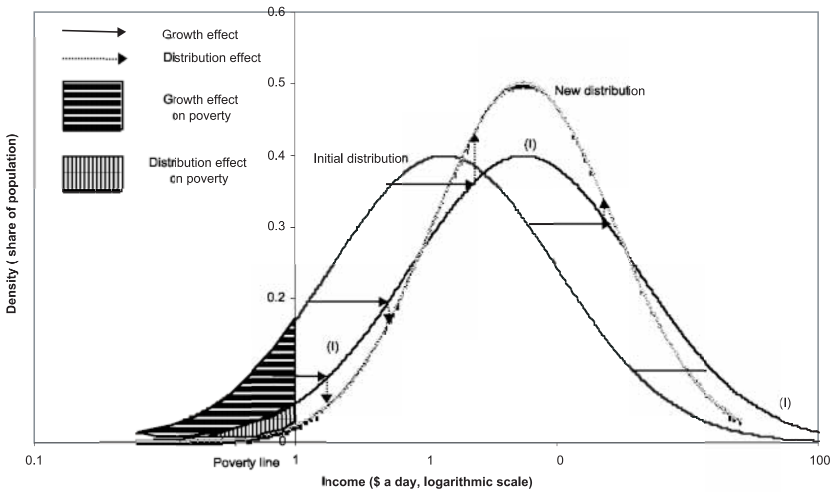
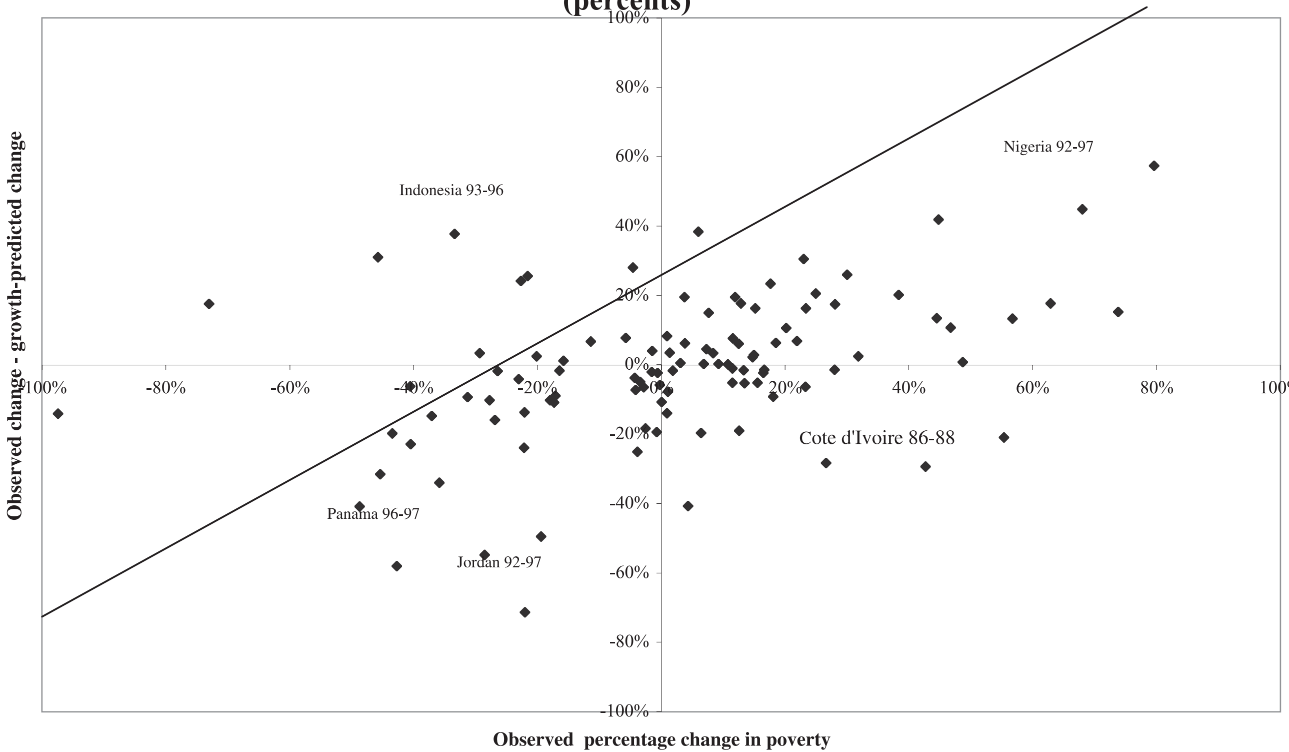


Figure 3 provides a first illustration of the preceding conclusion. It is based on an actual sample of growth spells during which both changes in mean income per capita – or consumption, depending on the data source – and in the distribution of relative income were observed. Applying the identity discussed above, it is a rather simple matter to identify what of the observed change in poverty is due to growth – under the assumption of a constant distribution of relative income – and what is due to changes in the distribution of relative income. Figure 3 shows the contribution of distributional changes to the observed percentage change in poverty for the various growth spells in the database. As actual poverty changes are on the horizontal axis, the distance between a point in that graph and the first bisector measures the distribution of the effect of growth on poverty changes. Thus, points above the bisector correspond to spells in which growth was positive and contributed to a decline in poverty, whereas points below the bisector correspond to spells with negative growth.

The striking fact about Figure 3 is the importance of the distribution-related change in poverty. Of course, it is not the mean that matters here – in effect it is arbitrarily set to zero in the identification of the distribution effect – but the dispersion of that effect. Mere observation of Figure 3 suggests that variations in the poverty headcount larger than 20 per cent (in absolute value) over a few years are far from unlikely. Indeed, approximately 30 per cent of the observations shown in Figure 3 are in that range, and practically twice that proportion show distribution-related changes in poverty larger than 10 per cent.

It follows from this very simple exercise that *distribution matters*

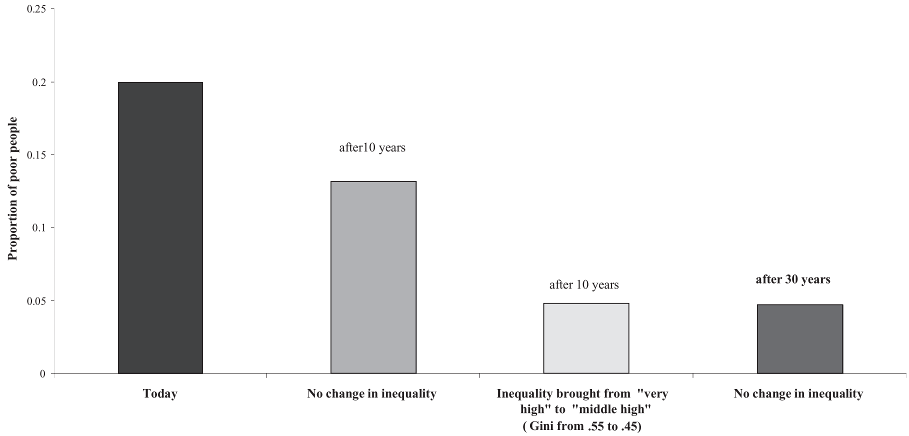
Figure 3. Distribution-related poverty change in a sample of growth spells (percents)



for poverty reduction. Over the medium term, distributional changes may be responsible for sizeable changes in poverty. In some instances, such as in Ethiopia, these changes may even offset the favourable effects of growth. Between 1981 and 1995, growth could have reduced the poverty headcount by some 31 per cent. Yet, because of changes in the distribution that contributed to a 37 per cent increase in poverty, the final effect was a net increase in poverty of 6 per cent. The case of Indonesia between 1996 and 1999 is the opposite. There, distributional changes compensated for the adverse effect of growth on poverty.

As a second illustration, consider Figure 4 in which a hypothetical experiment is made on the basis of a log-normal distribution of relative income calibrated on Mexican data. Extreme poverty in Mexico today affects 20 per cent of the population. Suppose that from now on, real income per capita grows at an annual rate of 3 per cent (a rather large figure given historical long-run trends) and distribution remains unchanged. A simple application of the identity linking poverty reduction and growth shows that, given the degree of inequality prevailing in Mexico, poverty would be reduced by a little less than 7 percentage points over a period of ten years, that is, 0.7 percentage point a year. Imagine now, that during these ten years, the Mexican government is able to bring down the level of inequality observed today to the lower levels observed in the mid 1980s. This would be equivalent to bringing Mexico from a « high » level of inequality – a Gini equal to 0.55 – to a “middle high” level – a Gini of 0.45. From Figure 4, it can be seen that the poverty rate would drop by more than 15 percentage points in ten years, subsequently affecting less than 5 per cent of the population! A simple

Figure 4. Change in poverty in a middle-income country with high inequality : 3 percent annual growth in income per capita



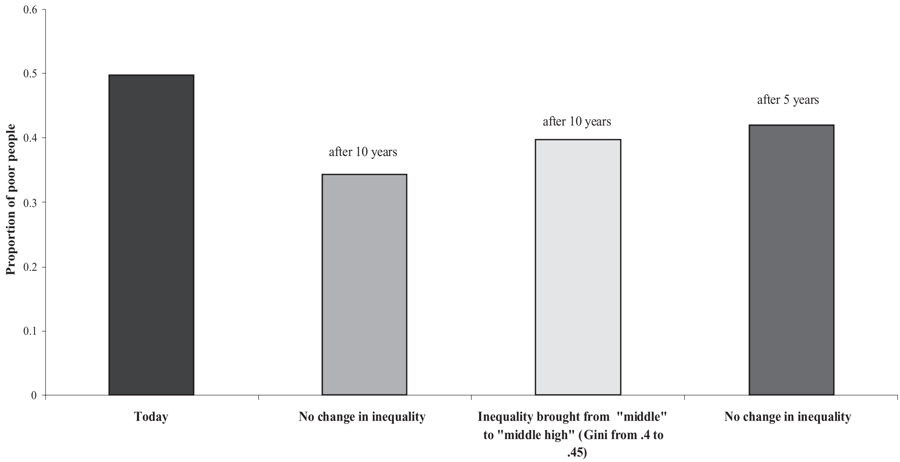
calculation shows that it would take approximately 30 years to reach the same result without any change in distribution. The power of distributional changes for poverty reduction is indeed extremely high in such a context.

The preceding argument should not be interpreted as indicating that distributional changes are always important for poverty reduction in countries where inequality is initially high. Figure 5 shows an experiment that is more or less the opposite of the last one for a low-income country with a middle initial level of inequality (a Gini coefficient equal to 0.4). Without a change in the distribution, a 3 per cent annual income growth rate would reduce poverty from its initial level of 50 per cent to 35 per cent in ten years. But, suppose now that, during these ten years, inequality increases from a "middle" to a "middle high" level – i.e. the Gini coefficient increases from 0.4 to 0.45. Then, Figure 5 shows that the reduction in poverty would be halved. In terms of poverty, five years of growth would be simply lost.

What can we conclude from these simple exercises? First, that it is important to consider growth and income distribution *simultaneously*, and that income distribution matters as much as growth for poverty reduction. Of course, one can object to the preceding examples that they necessarily refer to a limited time period. It is difficult to imagine that inequality will be increasing – or decreasing – continuously forever, or at least for very long periods of time. As there are probably limits to the level of inequality that a country may reach, if only for political economy reasons, then one may hold that growth is the main factor for poverty reduction in the long run. Over a sufficiently long time horizon, growth per se is indeed « good for the poor ». However, development and poverty reduction goals include specific time horizons. We are not interested in eliminating poverty at some undetermined point in the future but in a specific time interval. The examples above show that inequality does change over time and that a poverty reduction strategy with a specific time-frame may be jeopardised by an adverse evolution in distribution.

A second lesson to be drawn from the previous examples is that country specificity matters a great deal. Comparing the first columns in Figures 4 and 5, it can be seen that the same growth rate causes different percentage changes in poverty in the two hypothetical countries being considered. The growth elasticity of poverty is higher in the case of the middle-income country. As mentioned earlier, theory and evidence show that both growth and distribution elasticity of poverty depend positively on the level of development, and negatively, on the degree of inequality. This means that optimal growth-distribution strategies aiming at poverty reduction in a given time-frame should logically differ depending on initial conditions. For instance, it is likely that changing distribution is probably more important for middle-income inegalitarian

Figure 5. Change in poverty in a low-income middle inequality country with 3% annual growth in income per capita



countries, while growth is probably more important, in relative terms, for low-income egalitarian countries. Also, this last point suggests that effective redistributive policies may in fact yield a double dividend : they reduce poverty today, and accelerate poverty reduction in the future.

Is the knowledge of the identity that links poverty reduction, growth and distribution sufficient to determine the optimal mix of growth and distribution-oriented policies in a development strategy? Certainly not. For one, it is also necessary to know the relative cost of achieving some progress on each front. And further, it is also fundamental to understand any possible interaction between the two types of policies. In the preceding examples of various combinations of growth and inequality reduction, a central issue is whether a 3 per cent annual growth rate may be obtained independently of the distribution of income, or whether such a pace of growth is likely to cause changes in distribution. Likewise, one may question whether the distributional changes considered in Figures 4 and 5 can take place without some negative or positive impact on the rate of growth. This relationship between growth and distribution is discussed next.

2.
Two-way Relationship Between Growth and Distribution

This section focuses on the two-way relationship between growth and distribution. We know that economic growth modifies the structure of the economy and therefore may potentially affect the distribution of income and welfare. But is there any systematic pattern in this evolution? As for the effects of inequality on the rate of growth, the relevant questions are: does the initial level of inequality affect the rate of growth of an economy in a systematic way? If so, can progressive redistribution policies accelerate or slow growth? There is a huge literature on these questions. Rather than surveying it in detail, the intention here is to summarise the lessons that can be drawn from it and to comment on how they can feed our reflection on development strategies and redistribution policies.

2.1 Effects of Growth on Distribution

There are many channels through which economic growth may modify the distribution of income and welfare, and much effort has been spent in formalising the corresponding economic mechanisms. In the process of development economic growth modifies the distribution of resources across sectors, relative prices, factor rewards (labour, physical capital, human capital, land, etc…), and the factor endowments of agents. All these changes are likely to have some direct impact on the distribution of income, whether factor and goods markets are assumed to be perfect or not. In effect, since Kuznets and Lewis, theoretical constructs regarding the effect of growth on the distribution of income have all focused on one or several of these basic mechanisms. Kuznets' celebrated "inverted-U curve" relating inequality and development (of almost 50 years ago) highlighted the role of labour-market imperfections and productivitiy differentials across sectors with fluctuating importance in the main economy. Individual accumulation behaviour and subsequent aggregate changes in factor rewards due to the falling marginal product of capital explained the same evolution in Stiglitz's (1969) neoclassical model of growth and distribution. Since then, many other channels based directly or indirectly on these basic mechanisms – the « segmentation » of the economy and changes in prices and factor rewards – have been uncovered, though they do not always lead to the inverted-U effect of growth on inequality.

Institutional change is also closely linked with the process of economic growth in the sense that growth tends to modify institutions, social relations, culture, etc. Various hypotheses have been formulated as to how this process takes place. The simplest mechanism is through nonhomothetic preferences. As income grows the demand for social services changes. For instance, people become politically more active (as in Gradstein and Justman, forthcoming), changing the distribution of political power and the evolution of institutions. Within the influential framework proposed by North (1990), it may also be that the transaction costs which prevent institutional changes become increasingly affordable with economic growth. More directly, it may also be observed that the process of urbanisation that accompanies development is naturally tied to an evolution of social relations in the population (*e.g.*, a greater need for co-ordination).

All these institutional changes may be to the disadvantage of some groups and to the benefit of others. They are thus bound to affect the distribution of rights and of welfare in the society. They are also likely to prompt disadvantaged groups to react – via feedback, and with an effectiveness that is a function of their power in society – and clamour for modifications to their rights. Growth is thus likely to cause substantial changes in policies, and in particular, in redistribution. This might be one explanation for the so-called Wagner law, according to which the share of public expenditures in GDP tends to increase with the level of development.

Taken together, do these various effects of growth on the structure of society identified by economic theory sum to a clear evolution of the distribution of resources? Is Kuznets' inverted-U curve of the historical evolution of inequality in various countries, explained by the sectoral reallocation of the population in the development process, a universal relationship? Or, is the evolution of distribution along development essentially country-specific ? This question dominated the debate on development throughout the 1970s and the beginning of the 1980s. During this period it seemed that the inverted-U hypothesis was verified across countries at different levels of development (see in particular Paukert, 1973; Chenery and his collaborators, including Ahluwalia, e.g. Ahluwalia, 1976; and Ahluwalia, Carter and Chenery, 1976). After some time, however, and as more and better data became available, it appeared that while this empirical relationship was valid across countries in the 1970s, it did not at all fit the evolution of inequality subsequently observed in a sample of countries.[3]

The best illustration of this last point is provided by a thorough exploitation of the database on distribution compiled by Deininger and Squire (1996). Being a secondary database of estimates published in studies on distribution around the world, it is far from perfect.[4] Yet, because measurement errors affect the variable being explained – i.e., inequality – it should not interfere with checking the validity of the inverted-U hypothesis. Figure 6 summarises the results they obtained. Data come from an unbalanced panel, with several observations for each country at approximately ten-year intervals. When the observations are pooled together and a simple regression is performed of the Gini coefficient over income per capita, and the inverse of income per capita, then a clear inverted-U curve is obtained. However, the curvature loses significance when the estimation is made on decadal differences for each country in the sample, that is to say, when only time changes are taken into account. In effect, one can see in Figure 6 that the maximum difference in the Gini coefficient across development levels is now, at most 2 percentage points, when it was approximately 5 percentage points before. Finally, when fixed country effects are introduced in the original estimation so that all countries are assumed to follow parallel, rather than identical paths, then the inverted-U shape disappears. In effect, the curve becomes practically flat, and even the inequality drop for low incomes fails to be statistically significant.

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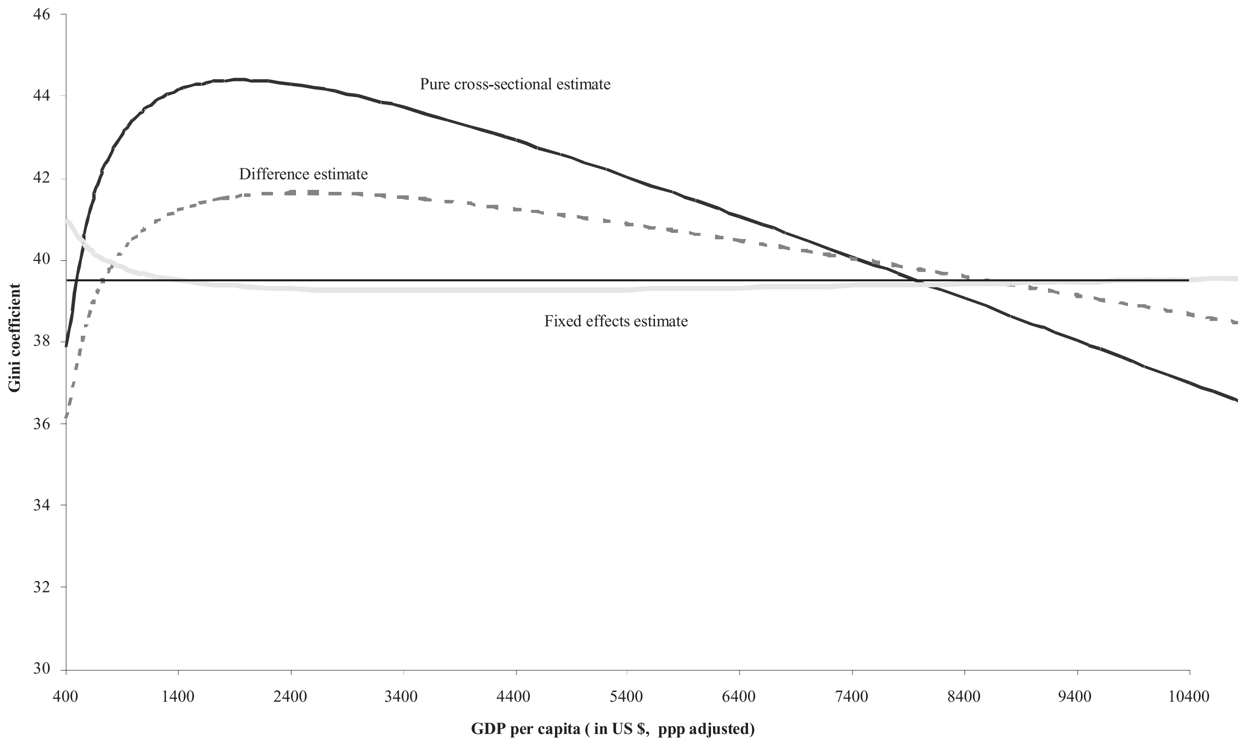
3. Using an unbalanced panel of data in developing countries, Bourguignon and Morrisson (1998) show that the inverted-U hypothesis was probably verified in the 1970s but not in later periods as additional countries were added to the original sample.

4. See in particular the critical analysis made by Atkinson and Brandolini (2001).

Figure 6. Cross-country estimates of the Kuznets curve (Deininger and Squire, 1998)



Do these results imply that growth has no significant impact on distribution? Certainly not. They simply mean that there is too much country specificity in the way growth that may affect distribution for any generalisation to be possible. Indeed, case studies (as opposed to cross-sectional studies) show that distributional changes in a given country have much to do with the pace and structural features of economic growth in the period under analysis. Even when no apparent change took place in distribution over the period, growth-related phenomena generally tended to counteract long-run socio-demographic trends towards more or less inequality. The case of Brazil provides a good illustration. According to a recent study by Ferreira and Paes de Barros (1998), inequality was unchanged between 1976 and 1996, whereas mean income per capita increased overall by a few percentage points. *Prima facie*, this would seem to suggest that sluggish growth in Brazil had no impact on distribution. Deeper analysis shows however, that some socio-demographic forces existed during the period that should have contributed to a drop in inequality (a drop in fertility and average family size among poor people, as well as progresses made in education). From this evidence, it might be inferred that slow growth was indeed responsible for an increase in inequality that offset the effect of those equalising socio-demographic forces. In fact, a more detailed analysis shows that a major contributor to greater inequality was the difficulty of the poorest households in incorporating themselves into the labour market, a obvious consequence of slow growth. [5]

5. For more case studies of this type see Bourguignon, Ferreira and Lustig (2003) as well as the general discussion in Bourguignon (2004).

More case studies of this type are certainly needed for a better understanding of the distributional consequences of growth or stagnation. The country specificity of that relationship is encouraging in two respects. First, from an analytical point of view, it may mean that the various channels through which growth affects distribution identified by economic theory are indeed valid, but are more or less relevant depending on the initial conditions prevailing in a country. If so, it may be hoped that further detailed case study work would help to check the effectiveness of these channels. Second, from a policy point of view, country specificity may also mean that there is ample room for policy intervention in determining the distributional consequences of growth. A number of development strategies involving different « mixes » of growth and distribution have been proposed in the last three decades, *e.g.*, redistribution with growth, pro-poor growth etc. (on this, see Bourguignon, 1998; Rodrik, 2003). It may be the case that some countries have deliberately chosen one particular strategy, or that one strategy was easier to implement than others, given initial conditions. In any case, what matters is that even if growth has some automatic effects on distribution through different channels, the importance of these various channels may probably be modified by policy choices. More directly, redistribution undertaken alongside the development process may also contribute to modifying possibly adverse primary distributional effects of growth.

2.2 Effects of Inequality on the Rate of Growth

The preceding discussion is only one side of the relationship between growth and distribution. The other (related) side is the dominant view today namely, that inequality is not a final outcome but that it plays a central role in determining the rate and pattern of growth. This line of enquiry was pioneered by Galor and Zeira (1993), followed soon after by the empirical papers by Persson and Tabellini (1994) and Alesina and Rodrik (1994), who were the first to point out that initial inequality seemed to be empirically associated with lower growth rates.

This literature has proposed several hypotheses for why progressive redistribution may be growth enhancing. First, credit market imperfections are used to point out that redistributing capital from capital-rich enterprises or individuals to capital-poor and credit-constrained people increases efficiency, investment and growth. Second, political economy arguments have been proposed. Too much inequality in a redistributive democracy leads to more redistribution and less capital accumulation. Alternatively, too much inequality leads to collectively organised or individually led violent redistribution. Others hypotheses (economies of scale in goods markets, etc.) have also been put forward in the literature. These various hypotheses are briefly discussed below.

a) Credit Market Imperfections

This strand of literature predicts a negative correlation between wealth inequality and economic growth based on a very simple mechanism. For simplicity, assume that rich individuals in a society have access to a credit market with an annual rate of interest of 10 per cent, whereas the poorest ones, lacking collateral, face a rate of 50 per cent. In the absence of quantity constraint on the credit market, this segmentation means that all projects with a rate of return of 10 per cent or higher proposed by the first group of individuals are actually undertaken, while only those with a rate of return of 50 per cent or higher proposed by the second group will be funded. It is clearly inefficient that projects with rate of return just below 50 per cent – and above 10 per cent – are left unexploited in the poorer group. But suppose now that some wealth is redistributed from the first to the second group. With this additional wealth, individuals in that group can now undertake those projects with a rate of return slightly less than 50 per cent, since they do not need to borrow to do so. In this framework, wealth redistribution from rich to poor thus generates more investment and/or a higher rate of return on capital.

This argument, adapted from Piketty (1997), may be extended to several other situations. The basic point is that the impossibility of poor people to borrow (lacking sufficient collateral or from more fundamental imperfections of the credit market), together with their low initial wealth, prevent them from seizing investment opportunities that would be more profitable for both society and themselves than some investments undertaken elsewhere in the economy. Thus, poor people do not have the same chances in life as richer people because they cannot educate their children, however talented they may be, or because they can't get loans to start up a business, or because they can't afford insurance. Countries with a high poverty headcount or with unequal distribution of wealth thus underutilise their productive and growth potential to a greater degree than countries with fewer poor people or with more equitable distribution.

Formalised versions of the preceding argument may be found in the models of Galor and Zeira (1993), Banerjee and Newman (1993), Aghion and Bolton (1997) and others. In these models, credit is rationed because of asymmetric information. This affects the ability of poor people, or possibly of the middle class, to freely choose occupations or investments, and this influences the evolution of inequality and output. Note that some models (*e.g.*, Banerjee and Newman, 1993; Galor and Zeira, 1993) assume that indefinite accumulation of wealth is not possible so that the "poverty trap" persists over the long term. In contrast, if there is no exclusion, inefficiencies are temporary. People will save and their wealth will increase over time. Sooner or later they will be free of the credit constraint, because they will all have sufficient collateral to be entrepreneurs or to send their children to secondary school and college if they so wish (Ray, 1998).

These models have nothing to say about how high inequality comes about in the first place, but they do suggest that a history of high inequality may persist indefinitely, carrying with it inefficiencies in production and slow growth. The same economy would exhibit different rates of growth if it were possible to redistribute wealth at no cost.

b) Redistribution in a Democratic Context

A second strand of literature predicts a positive correlation between inequality and average tax rates. It is through this channel that early empirical studies (*e.g.*, Persson and Tabellini 1994; Alesina and Rodrik 1994) attempted to explain why greater inequality leads to lower growth. When political rights to vote are extended to the majority of the population, the amount of redistribution is decided by the median voter, and this determines, directly or indirectly, the rate of growth of the economy. The hypothesis of these models is that: first, more unequal societies generate more redistribution than more egalitarian ones; and, second, that redistribution diminishes incentives to invest and slows economic growth because of the distortional effects of taxation (disincentives to exert effort or to save).

It turns out that the existing evidence on taxation is not supportive of the hypothesis that tax rates are higher in high-inequality countries. Perotti (1996) even shows that the effect of the fiscal system in many high-inequality countries is actually regressive. A possible explanation for this apparent contradiction between theory and evidence is that, because of heterogeneous political weights, the « decisive » or « pivotal » voter may not be the « median voter », even in countries which are officially democracies. If the « decisive » voter has an income larger than the mean income, he/she will be in favour of a regressive distribution.[6] Under these conditions, an important issue seems to be the extent to which the inequality of the distribution of resources in a society determines both the nature of the public decision process and the identity of the « decisive » voter. [7]

c) Redistribution Through Social Conflict

Social conflict and political instability are other channels that may link inequality to efficiency or growth. Alesina and Perotti

6. This argument is developed in Benabou (1996).

7. A new class of model is obtained by endogenising the "decisive" voter. See for instance, Acemoglu and Robinson (1996), Ades and Verdier (1996), Robinson (1997), and Bourguignon and Verdier (2000a, 2000b).

(1996) argue that inequality can lead to less political stability, and this in turn can lead to sub-optimal investment levels. Rodrik (1997) finds that countries that experienced the sharpest drops in growth after 1975 were those with divided societies and with weak institutions, and that this crippled the ability of their political systems to respond effectively to external shocks. Violence levels, as measured by recorded homicide rates, have recently increased sharply in both of the most unequal regions in the world (Latin America and Sub-Saharan Africa), and in the regions where inequality has grown fastest (Eastern Europe, Russia and Central Asia). Bourguignon (1999) and others have documented the increasing social and economic burden imposed on society by this rising violence, both in terms of the direct costs in lives and medical resources, and in terms of the opportunity costs of (both public and private) resources diverted from other activities towards preventing and fighting crime.

Other theoretical arguments may be called upon to justify a negative relationship between the distribution of resources, economic efficiency and growth. One of them, which actually extends an argument developed in the 1970s, is based on the presence of economies of scale in some consumer goods which could not be exploited if inequality reduced the demand for these goods (see Shleifer and Vishny, 1998). But not all theoretical arguments go in the same direction. Indeed, the old Kaldorian theory that redistributing from rich to poor runs the risk of reducing the aggregate savings rate in the economy may certainly not be rejected on *a priori* grounds. Tentative empirical verifications through "growth regressions" with inequality variables on the right-hand side have yielded ambiguous (or even contradictory) outcomes. Initial results based on pure cross-sections seem to suggest that over the last 20 to 30 years, more inegalitarian countries tended to grow more slowly. But the same problems that beset the Kuznets curve soon appeared. First, this result depended very much on the sample and inequality data being used. Second, it turned out to be strongly influenced by country-fixed effects. For instance, controlling for regions was sufficient to make inequality insignificant (see Deininger and Squire, 1996). Of course, fixed effects models were also estimated on the basis of decadal country data on growth and initial inequality (Forbes, 2000, Zhou, 2000). However, the corresponding estimates then showed a positive association between inequality and growth, as with the Kaldorian argument. Overall, it is thus fair to say that the available aggregate evidence is essentially inconclusive.

It is also fair to say that panel data regressions, which should supposedly correct for fixed effect biases, ask too much from the data. To see this, it must be noted that it is not because inequality in year t is taken to explain growth between years t and t+10 that inequality may be considered as « exogenous ». Some common unobserved determinants may actually underlie the two observations, and no convincing instrument may be available to correct for the resulting endogeneity bias.[8] Being able to identify the effect of inequality on growth would thus require relying on truly exogenous innovations in inequality variables. But when and where did such an « exogenous » change in inequality ever occur ?

8. In this respect, it is not clear that lagged values of both inequality and growth used in GMM system estimates are valid instruments. They may also be influenced by the same unobserved variables as contemporaneous inequality and growth.

There are two ways out of this inconclusiveness of aggregate cross-country analysis. The first consists in trying to estimate structural models of the inequality-growth relationship, including in the analysis some formalisation of the various hypotheses revised in this and the preceding sections on the distributional consequences of growth. This is likely to be a formidable task, and it is not clear that all the data necessary for such an ambitious analysis are actually available.

The second strategy is to check whether the microeconomic mechanisms behind the preceding hypotheses have been verified, and then derive some rough estimate of the likely aggregate effect on growth of various types of redistribution from this. Concerning the credit market imperfection hypothesis, for instance, it would be sufficient to identify the difference between the marginal product of capital (possibly human capital) in the poorest segments of society (in the informal sector, for example) and in the rest of the economy. Some simple calculations should then allow us to obtain an order of magnitude of the inefficiency of the economy due to the credit market imperfection, and how much potential gain there may be in getting rid of that imperfection through wealth redistribution. Not enough seems to have been done in that direction for the time being. Yet, this is probably the only way to confirm the intuition provided by economic theory that too much inequality is harmful to growth and that inequality tends to perpetuate itself.

3.
Scope for - and role of - redistribution in development

What does all this imply for policy and, more precisely, for redistribution policy? Taken at face value, the preceding arguments would seem to lead to the following virtuous circle scenario. Progressive redistribution of income over a period of time accelerates poverty reduction for given patterns and rates of growth. If one interprets the potentially negative relationship between inequality and growth literally, then this redistribution policy would enhance growth. It would then be sufficient to have some policy instruments at one's disposal that guarantee that growth is pro-poor (*i.e.*, it reduces inequality) for the virtuous circle to start and lead progressively to faster growth, decreasing inequality and accelerated poverty reduction.

Until recently, this was the interpretation given to the idea that equality could be favourable to growth. « Reduce inequality through redistribution or through promoting 'pro-poor' growth and you will obtain sustainable growth. » Unfortunately, this is in no sense the conclusion that can be drawn from the arguments invoked to justify that inequality is harmful to growth. The argument and its implications are slightly subtler and it is worth having them clearly in mind.

The arguments in the previous section tend simply to suggest that the redistribution of wealth from rich to less rich people may have some positive impact on growth. This may occur by bypassing credit market imperfections that prevent productive investment from taking place, lowering the tax rate, or freeing other distortional income redistribution mechanisms. The important point here is that it is redistribution of *wealth*, not of income, that may produce this favourable effect on economic efficiency and growth. In effect, income transfers (if they are not lump-sum) would have exactly the opposite effect on growth. By lowering the expected return from acquiring physical and human capital, they might distort the economy and reduce savings and investment, and therefore the rate of growth. In order to enhance efficiency and growth, redistribution should thus ideally be concerned with wealth rather than with current income or possibly consumption expenditures.

Is it feasible that such direct wealth redistribution take place at no cost? This is doubtful. Redistributing property can only be done under exceptional circumstances, which often involve political violence. Such circumstances can hardly be considered economic policy options. Land reform is a case in point. Today, few programmes would actually involve authoritarian land redistribution. Instead they are generally based on subsidised transactions in the land market. Typically, land is being bought from large landowners at what is thought to be the market price. It is then sold to landless peasants or smallholders with some kind of subsidised credit scheme. Overall, the whole operation is somewhere between a wealth and an income transfer. Taxes levied (generally on the whole population) to finance the credit subsidy typically represent an income transfer with obvious distortional effects. The credit subsidy part clearly contributes to wealth accumulation among poor peasants. [9]

9. For a comprehensive analysis of land reform, see World Bank (2003b).

More generally, it must be realised that the theoretical arguments showing that wealth redistribution, but not income redistribution, enhances economic efficiency and growth leads to a paradox. This is because redistributing wealth generally involves some non-lump sum income transfers, and the latter have a negative effect on efficiency and growth. In the long run, it may well be the case that the positive wealth effect is stronger than the negative income effect. This is likely to depend mostly on the relative importance of the wealth accumulation part of the redistribution policy being considered.

Two final remarks are in order. The first has to do with the fact that even pure income transfers generally spill over into some kind of wealth accumulation. The second is about the recent appearance of the so-called « smart transfers » in the redistribution toolbox of policy makers. Are pure income transfers so bad? Until recently, it is true that conventional wisdom insisted on their negative effects, resulting from the adverse incentives on labour supply and on savings by the beneficiaries of transfers and tax payers… effects which were reinforced by the natural leakage of benefits to non-target groups. As discussed by Ravallion (2003b), this is now being questioned, partly as a result of the studies reviewed above and partly because new empirical findings have emerged.

To the extent that beneficiaries may improve their standard of living, income transfers may contribute to the accumulation of human capital, for instance through better nutrition. Under these conditions, apparently « pure » income transfers do lead to some wealth accumulation among poor people. Another channel via which income transfers may affect the assets owned by poor people is insurance. Indeed, many economists now consider that in the presence of high macroeconomic volatility, targeted transfers can be useful instruments for social protection. They also may contribute to pro-poor growth (*i.e.*, growth that reduces poverty) by avoiding dissavings – for instance by taking children out of school – or helping credit-constrained poor people be productive workers or take up productive opportunities for self-employment.

Strong arguments can also be made in favour of the « smart transfers » of the Progresa/Oportunidades (Mexico) and Bolsa Escola/Bolsa Familia (Brazil) type. These are essentially means-tested income transfer programmes with a built-in conditionality. Benefits are conditional on children under a certain age attending school and visiting a medical centre twice a year. In effect, for those households which would have sent their children to school and to the doctor anyway, these programmes are pure income transfers. Yet, they effectively contribute to human capital accumulation for the others… provided of course that the supply of education and health services match the induced increase in demand. A very serious evaluation showed that these programmes were indeed effective in raising school enrolment rates and health outcomes in the targeted populations (see for instance Skoufias and Parker, 2001 on Progresa; Bourguignon, Ferreira and Leite, 2003 on Bolsa Escola; and the general discussion in World Bank, 2003).

That redistribution tools can be effectively used to modify the distribution of physical and human capital in the economy is an important piece of knowledge that should inspire policy makers. Given the analytical framework developed in the preceding section, this indeed means that possible adverse consequences of growth on the distribution of income may be corrected by redistribution at a low or even, negative cost. On the other hand, this redistribution is also likely to make future growth more favourable to the poorest segments of society. Very interesting full-scale experiments are presently taking place in various countries and are being closely followed by researchers. Evaluating all the implications of these programmes will take some time and much effort by the development economics research community. Yet, existing results raise hopes that the complementarity between growth and equity might be better exploited in development strategies.

Thus we see, in light of new theories on the social costs of uninsured risks and unmitigated inequalities, that developing the research agenda on the role of targeted transfers in developing countries is important for answering a key policy question: given the constraints faced by low-income countries, can efficient redistribution work in practice? There is good empirical evidence to support the theoretical arguments that have been put forward, but more work is needed.

What about asset redistribution programmes ? Their feasibility will be largely a function of the political context. Asset redistributive schemes have to fulfil political incentive compatibility constraints. While there are social benefits to be expected from any exogenous redistribution of wealth in slow-growth and authoritarian societies, this would be clearly opposed by the ruling class. Such redistribution is thus more wishful thinking than a real policy option.

We have learned much about the political economy of asset redistribution in recent years. Redistribution may be necessary for growth. Fixed costs of education and liquidity constraints prevent the poor from becoming educated without transfers from the upper-income and politically active class. But poor people are unlikely to mobilise themselves to ask for more transfers. Political participation depends on the educational level or income of economic agents.

Mechanisms of asset redistribution are more general than they appear. The mechanisms analysed in the context of education and political rights in the previous section are relevant in other political economy contexts, such as trade reform or land reform. The arguments are in fact, valid for any economic reform or policy that increases the economic pay-off of the incumbent elite but also reduces its political power by enabling new segments of society to be politically effective and to ask for downward redistribution.

Initial conditions also matter. Initial income per capita levels (initial income inequality) positively or negatively affect the likelihood that a country will achieve democratisation, and its average rate of growth, on any given time horizon. Initial per capita income levels positively or negatively affect the speed of (full) democratisation in countries that are experiencing a democratic transition.

Social stratification cannot be separated from changes in political institutions. The elite in power may favour the emergence of a middle class purely for reasons of political economy. Under some circumstances the elite group may have incentives for strategically « promoting » the creation of a restricted middle class by providing education. This allows them to reap the benefits of higher economic growth triggered by the accumulation of human capital, while at the same time mitigating the likelihood of expropriation after partial or full democratisation. The process of social stratification thus cannot be separated in a historical perspective from the process of political transition.

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Comment

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François Bourguignon's main points may be summarised as follows:

1) Absolute poverty elimination may be reasonably taken as THE target of development strategies;
2) Redistribution of income is a complement to growth for achieving poverty reduction, and might deliver a triple dividend. Redistribution contributes to poverty reduction: (i) directly if targeted at the poor; (ii) indirectly by increasing the elasticity of poverty to growth; and, (iii) again indirectly in the case when redistribution of income increases growth (capital market imperfections or other mechanisms);
3) Many good normative and positive arguments favour redistribution of assets (land, education, physical capital) over redistribution of income. Nevertheless, redistribution of assets usually calls for some redistribution of income, like targeted and conditional transfers programmes; and
4) The proportions of the cocktail of growth and redistribution strategies should be considered as country specific. More emphasis could be given to redistribution in middle-income and unequal countries, while growth should be privileged in the case of low-income and egalitarian countries.

I largely agree with the global philosophy outlined by François Bourguignon, especially with respect to points 2 and 3. I strongly support his advocacy of the distributive component of development strategies. In the first part of my comments, I will thus mainly criticise point 4, by arguing that it is not so obvious that a « growth stance » is preferable to a « redistribution stance » in low-income countries. In contrast with the Kuznetsian prior, many low-income countries are highly unequal, especially in Sub-Saharan Africa. Some initial and gradual redistribution efforts might be needed in order to set them on a growth path that would be more pro-poor. I will also ask whether we really know what could be called a « growth policy », whose content is less clear than a redistribution policy. In the second part of my comments, I will more supplement, than criticise François Bourguignon's arguments, recalling that a growth-redistribution package should be seen as a part of a broader institutional agenda.[1]

1) Is Redistribution for Middle-Income Countries Only?

According to François Bourguignon's figures, both growth and redistribution tend to have more impact on monetary poverty reduction in richer and less unequal countries. It follows that it is difficult to rank all countries on the basis of the elasticities of

1. I could have added another section discussing the absolute poverty reduction target from the standpoint of equalisation of opportunities. I doubt in fact, that absolute poverty elimination can and should constitute the alpha and the omega of development strategies. However important it is, it can only be one part of a social contract. In my opinion, absolute poverty reduction should be viewed as part of an equalisation of opportunities programme, within a more dynamic and multidimensional framework which calls for even more redistribution efforts. Most Poverty Reduction Strategy Papers suffer from a static bias and dramatically miss dynamic issues (demographic, intergenerational). These points are commented at large in Cogneau (2003b). See also Bourguignon (2003) on the extension of the income poverty paradigm.

poverty to growth and to redistribution. For example, in order to achieve any poverty reduction target, both the growth effort and the redistribution effort needed in Indonesia is lower than in Côte d'Ivoire or Senegal. If we assume that for all countries « growth effort » is well measured by the growth rate and « redistribution effort » is well measured by the Gini reduction, then poverty elasticities give a policy-mix ordering that is only partial.[2] Among the countries considered by François Bourguignon, three clubs may be identified within which « policy mixes » may be compared and ordered. Indonesia stands alone with growth and Gini elasticies being the highest of all. Brazil, Côte d'Ivoire, and India then make a second club, relative returns to redistribution being the highest in Brazil, and being higher in Côte d'Ivoire than in India. The third club includes Niger, Senegal, and Zambia, also ranked in this order in terms of the relative returns of redistribution. Among the second club, Brazil is indeed the caricatural middle-income and inegalitarian country (a fortiori when compared to India and Côte d'Ivoire). However, in the third club, Niger is a low-income and (according to Bourguignon's numbers) [3] egalitarian country. In very poor countries, the growth elasticity is so low that redistribution emerges as an option. Then, on the sole basis of short-term elasticities,[4] I feel that it cannot be said that redistribution should be favoured in middle-income unequal countries (like Brazil), more than in low-income and equal countries (like Niger).

2. Given that a growth rate and a Gini variation (or even a tax-transfer scheme) cannot be directly compared.

3. Which, in the cases of Niger and Senegal, stand in contrast with the figures of the recent World Development Indicators, see Table 2.

4. These comparisons do not take into account the effect of redistribution on elasticities (the double dividend effect). See Bourguignon (2002), and Cling et al. (2003).

Table1

A Partial Ordering of Policy Stances on the Basis of Elasticities

	Elasticity to growth	Growth to halve poverty	Elasticity to Gini	Gini variation to halve poverty	Return to redistribution is higher and return to growth is lower than in…
Indonesia	5.5	9%	13	-4%	No country
Brazil	2	25%	10	-5%	India & Côte d'Ivoire
Côte d'Ivoire	3	17%	5	-10%	India
India	3.5	14%	5	-10%	No country
Niger	0.7	71%	2	-25%	Senegal & Zambia
Senegal	1.5	33%	2	-25%	Zambia
Zambia	1.5	33%	1.5	-33%	No country

Source: For elasticities, Bourguignon's computations

At least three other arguments can be considered which in the end make the growth-redistribution trade-off even more difficult to circumscribe.

First, the magnitude of the redistribution effort that is needed to achieve the same poverty reduction (*i.e.*, the inverse of the level of the elasticity to the Gini) is far more important in Côte d'Ivoire or in Niger than in Brazil. Large redistribution efforts may appear to be politically unfeasible and/or growth impeding. Concerning the latter argument (redistribution impeding growth), let us only stress that there is not much agreement about the sign and the magnitude of the impact of redistribution on growth, whether in the short or in the long term. As Bourguignon reminds us, modern theories imply a non-linear, often non-monotonic and even idiosyncratic relationship between growth and inequality. On empirical grounds, the conclusion of a decade of econometric tests on aggregate data is that there is an absence of evidence. For instance, Banerjee and Duflo's (2003) paper finds only tenuous evidence of a short-run relation running from changes in inequality (whether positive or negative), whatever their direction, to growth. Interpreting this result is difficult [5]. If one nevertheless gives a causal interpretation to their estimates, it follows that a variation of the Gini index of 3 percentage points [6] translates in a growth loss of between –2 per cent and –3 per cent over five years. In countries with high growth elasticities and low Gini elasticities, this kind of loss may mitigate the direct redistribution benefits in terms of poverty reduction, even if it does not cancel it and does not preclude some double dividend in the longer run. Moreover, as Banerjee and Duflo themselves argue, this short-term negative result does not prevent redistribution from having a positive effect on growth in the longer run (« triple dividend »). In any case, this discussion about the uncertain growth costs of redistribution leaves open another about the potential distributive costs of growth that should be given some consideration. This reminds us that when we are talking about growth in daily life we are not talking about homothetic growth, leaving inequalities constant, but about a growth pattern

5. In the simple "hold-up" model that Banerjee and Duflo propose, countries are confronted with growth opportunities which may only be seized when some influential groups are compensated enough. Large compensations lead to large changes in inequality, and in the end to growth losses.

6. That is, a 5 per cent variation for a country with a Gini index of 0.6.

that could be either pro-poor or not (in the meaning given by Ravallion and Chen, 2003).

Second, growth and redistribution efforts are not necessarily measured on the same scale for each country. Countries do not have the same growth opportunities. Should we consider that it is as easy to grow at a rate of 3 per cent per capita in Brazil as it is in Niger? I would argue that given some long-term historical and geographical characteristics, and even more prosaically, given past performance, Niger is more « handicapped » in terms of growth than Brazil.[7] In the terminology of growth econometrics, they are not in the same convergence club. This may also be the case of Senegal in comparison with landlocked and desertic Niger, or of Côte d'Ivoire in comparison with India, so that even our former « policy-mix clubs » might not make sense at all. The same arguments prevail in the case of redistribution efforts. It may be easier to change the Gini coefficient in some countries than in others, because of institutional specificities and political economy issues. I return to this last point in the second part of my comments.

Third, growth strategies are no more (and might be less) obvious than redistribution strategies. Assume you are relatively sure that for a given country, growth would have greater returns (and fewer costs) in terms of poverty reduction than redistribution. What then is a « growth strategy » ? It seems that we have learned more about what impedes growth in certain cases (« very bad policies » such as large macroeconomic imbalances and highly distortional environments), but little about what accelerates growth

7. Cling et al. (2003) show that for most African countries, even some of the richest, the growth rates required to achieve the Millenium Development Goal of halving the $1 per day headcount by 2015 are well above historical records.

(« good policies »). As already mentioned, we know even less about the distributive prerequisites of growth. In contrast, redistribution policies have more clear contents, whether they function through public expenditures, the tax system, the social security system, targeted and conditional transfer programmes, etc., and even if, again, their growth consequences are not well known.

Table 2 shows that, contradicting the Kuznetsian prior, the poorest countries in the world – those in which the incidence of $1 per day absolute poverty is the highest – are also highly unequal countries. [8] Some initial redistribution efforts might be needed in order to set them on a growth path that would be more pro-poor. At least redistribution issues should be given more consideration in the Poverty Reduction Strategy Papers written in these countries. While these nations probably lack the administrative capacity to manage very ambitious tax-transfers schemes, there are nevertheless many ways in which economic decisions could be made more favourable to the poor : through the reorientation of public expenditures; the public management of utilities (water, electricity); the reform of direct and indirect taxation and of highly dualistic social transfer schemes; and finally, the reform of inefficient and inegalitarian health systems.[9] International aid undeniably has a great role and responsibility in this domain. Moreover, while the democratic legitimacy of many African states is put into question, it should not be forgotten that the management of social justice is one the pillars of the legitimacy of state. I give a little more room to this last argument at the end of the next section.

8. There are also good reasons for thinking that inequalities are underestimated by surveys in these countries, either due to sample design and under-reporting of income or expenditures. I will not delve into this issue here.

9. Especially in countries which are ravaged by the AIDS epidemic.

Table 2

Low-Income African Countries are also Unequal

	P0 rate 1$/day	Gini index	Growth elasticity
Burkina-Faso 1994	61.2	48.2	-0.71
Mali 1994	72.8	50.5	-0.47
Niger 1995	61.4	50.5	-0.68
Nigeria 1996/97	70.2	50.6	-0.51
Madagascar 1997	63.4	46.0	-0.68
Senegal 1994/95	26.3	41.0	-1.45

Source: World Development Indicators 2001

Note: The Gini index is calculated on per capita consumption expenditures. For Brazil in 1997, the Gini index reaches 0.59 but is calculated on income data. Income Ginis are usually considered to be higher by 0.06 points on average

2) Growth and Redistribution are Part of a Broader Institutional Agenda

Economists usually decompose the growth process into the accumulation of productive resources (human and physical capital), and improved efficiency in using these resources. A new core consensus is emerging that the bulk of long-term growth differentials depend on the second factor rather than on the first: both rates of accumulation and factor productivity growth being largely conditioned by enduring « institutions » (Hall and Jones, 1999). Furthermore, international databases show that within-country inequality levels are rather stable over time, and are even more stable than differences in average income levels between countries. This stability of inequality may be explained by institutional persistence, so that in many cases, some institutional change might be needed to achieve a significant (within-country) inequality reduction, if not a significant growth acceleration.

Some even argue that these institutions also simultaneously constrain the feasibility, implementation and success of the so-called « growth policies »; that for instance, once some institutional settings are controlled for, macroeconomic policies no longer significantly influence growth (Acemoglu *et al.*, 2003). The same is certainly true of redistribution policies being institutionally constrained. As each country's institutional setting is largely idiosyncratic (coming from geography and history), the institutional argument adds to the above discussed country-specificity of the growth and redistribution policy mixes, as institutions define the set of feasible growth and redistribution policies. Moreover, if institutional change is a precondition for policy change, the same kind of institutional change is not necessarily suited for both redistribution of income and growth acceleration. Some inegalitarian institutions may act in favour of growth while some egalitarian ones may restrain growth. The reverse may also be true: some institutional settings make a low level of inequality and a high level of long-term growth compatible, such as in most developed countries and East-Asian countries. The diversity of the institutions of countries that succeeded in eliminating absolute poverty makes a good case for what has been called virtuous « institutional complementarities ». Not all institutional combinations are adequate to bring about a reduction in absolute poverty, but here again, there remains as previously argued for policies, a large degree of freedom (see the works of Dani Rodrik).

The reciprocal interaction between institutions, growth and distribution of resources has not been, up to now, very well understood. Because of this, it would be too quick to claim that institutions are deeper fundamentals that « cause » growth, distribution and policies; some growth and distributional patterns may also be preconditions for some institutional changes to occur. In particular, some « exogenous » redistribution of resources, driven by historical shocks (wars, colonisation, and globalisation), ideology or technology, may change the political equilibrium and lead to « institutional (r)evolutions ». Growth, distribution and institutions are again probably jointly determined. However, the size distribution of land in countries is probably one example in which institutional shocks mattered. It may be shown that regions whose population density was higher in 1500, ended today with a more equal distribution of land and of income. This may be explained by the interaction between the pre-colonial distributions of wealth within colonised regions and the features of European colonisation (institutional shock). Interestingly in terms of poverty reduction, it is the income share of the bottom quintile that is most influenced by land distribution (Cogneau and Guénard, 2003)[10]. The differential « democratisations » of educational systems during and after colonisation surely offers another example of an institutional determination of the distribution of resources (Cogneau, 2003a). In those two examples, there is probably a complex chain of causality running from initial agrarian or educational institutions, the distribution of resources they generate, the distribution of power that follows, institutional features in other fields in turn (political systems, judicial systems, state reform, social sectors…) and again in the overall distribution of resources[11]. I would then finally and tentatively contend that some redistribution of resources is a central element of most institutional improvements, whatever the level of income. The weakness of the « developing states », especially in Africa, may be partly explained by their inability and unwillingness to redistribute resources. This inability and unwillingness generate a loss of legitimacy which is detrimental to law enforcement and political stability, and therefore also, to growth.

10. In the case of Vietnam, Ravallion and Van de Walle's (2003) results show that an equal distribution of land assets approximates that which would maximise total consumption: the actual post-reform distribution lies in between.

11. Even in a densely populated country like India, Banerjee and Iyer (2002) give indications that Indian districts that were placed under a landlord's indirect rule, rather than direct British rule had: (i) a more unequal distribution of land during the colonial period; and, (ii) ended today with higher inequalities, lower agricultural productivity, and a lower supply of public goods. Furthermore, Iyer (2002) finds that Indian districts that were ruled by the British now exhibit a lower level of public goods delivery than districts never annexed to the British Empire, even once the highly selective colonial annexation policy has been controlled for. On the institutional determination of high inequality levels in Latin America, see also Sokoloff and Engerman (2000).

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Comment

by Pierre-Noël Giraud
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The paper given by F. Bourguignon is quite outstanding for its breadth of vision, clarity, precision and concern for pragmatism. I should like to comment on what appear to me to be the three main messages delivered by this paper, which are pitched on three distinct levels: development theory, economic strategy and ethics.

1. Theory

The message is that there are poverty reduction strategies and/or inequalities that also accelerate growth. Therefore, the equity-efficiency trade-off does not always arise.

This message is reassuring, particularly for economists. Let us stop letting questions of efficiency cause us discomfort when we are politically in favour of more equity: the two are not necessarily incompatible.

Theoretical models describe the possible existence of poverty traps. If credit market and insurance failures and geographical externalities, etc. were simply to make it harder for the poor to escape poverty, and the poor always ended up being « pulled along » by average growth, then the equity-efficiency trade-off would inevitably arise. In contrast, while there are real poverty traps due to threshold effects, making for a plurality of balances, then strategies targeted at breaking these traps are clearly Pareto efficient and none can justify opposing them.

My question is as follows: what do we know today, over and above the models that demonstrate the possibility that they exist, of such poverty traps? Are they particularly in the big cities ? Once the well-identified prerequisite of granting land rights to shantytown dwellers has been met, doesn't the big city consistently present too few opportunities for all to fulfil their productive capabilities ? And if there are poverty traps in rural areas where the opportunities for economic interaction are infinitely fewer, isn't rural exodus simply the solution ? In other words: are there poverty traps that human mobility in itself suffices to break ?

2. Economic Strategy

The message is : the potential and possible extent of poverty reduction strategies and/or inequalities, the importance of the gains to be derived from them, and the most efficient ways of implementing them are all highly specific to each country, or even local situation. Let us be unabashed about being pragmatic, there are no universal recipes.

My question is : why do such differences exist between countries: it is their potential, or efficiency or the poverty reduction strategy methods they adopt ? I understand that today the emphasis is on « pragmatism» as per the sometimes hasty and somewhat dogmatic generalisations of the Washington Consensus era. However to research workers looking for regular phenomena, this is very frustrating. So, is there really nothing more to be said about what generates such specific national features ?

Are they based on behavioural differences founded on cultural differences ? For example, wealthy Chinese would reinvest in China, whereas their Argentinean counterparts would reinvest in Switzerland ?

Are they founded in institutional differences ? Doubtlessly, but this response is too facile and too fashionable these days. Which institutions make poverty reduction strategies more efficient and why ?

Furthermore, with the advent of globalisation, isn't there a process under way to standardise institutions and behaviour patterns that could even out our national specificities ? Let us take two simplified examples of microeconomic mechanisms at work in the dynamics that interest us here, and see how globalisation is affecting them.

An example of a mechanism that undermines income transfers to reduce inequality : « These transfers reduce the incentive to accumulate wealth, and thus growth. » But if, thanks to financial globalisation, the rich now place their savings on global markets, what remains of the mechanism ?

An example of a mechanism that facilitates transfers : « These transfers encourage economies of scale on the internal consumers goods market. » But if, because of commercial globalisation, the markets become global, what is left of the mechanism ?

To summarise, doesn't globalisation continually reduce the specific role of national factors ? Aren't we moving towards more uniform conditions that would foster generalisation of « good policies » to a certain degree ?

3. Ethics

In practice, and notwithstanding the point of theory mentioned above in point 1, there is almost always an equity-efficiency trade-off. Might this be because we have not learnt how to make the « capacity » redistributions required by the theoretical models without giving them the shape of income transfers, and that the latter may reduce the incentives to accumulate wealth, and therefore growth ? Or alternatively, could it be because the market-failure reduction strategies are themselves subject to institutional failures ?

Nevertheless, and this is the third message: it is « ethically » legitimate that absolute poverty reduction should be the prime development goal.

But what lies behind this upstanding unanimity around the goal of absolute poverty reduction ?

I need to make four remarks before developing this question :

1) Absolute poverty thresholds may not be so absolute after all. Here are a few pointers :

- At the US$1/day threshold, 80 per cent of Europe's population in 1820 was absolutely poor. What can that possibly mean ? This figure is taken from the famous article by Bourguignon and Morisson: « Inequality Among World Citizens: 1820-1992 », published by the AER. During a presentation seminar of a draft of this paper, I put this to François Bourguignon. At the time he admitted that in fact, there might not be much sense in using this indicator over such long historical periods. In that case, what is the historical depth of its validity ?

- The US$1/day threshold is calculated in PPP (Purchasing Power Parity). Consequently it should theoretically be possible to survive in the United States on $1/day. This is patently not so.
- Populations living on US$1/day or less today, enjoy much longer life expectancy than those of the middle classes in rich countries 150 years ago.

Briefly, one could ask whether this threshold is nothing other than the subjective appraisal of what the wealthy considers to be intolerable in terms of inequalities… in other words, it is a relative threshold.

2) As Bourguignon acknowledges in his work, economists increasingly consider that inequalities count in individual perceptions of well-being. For my part, I contended in a book published in 1996, *The Inequality of the World*, that beyond the minimum for subsistence, wealth was an essentially relative concept and I explored the consequences of this thesis. In fact, I always find it interesting to explore the consequences of heterodox, if not frankly odd theses: there is always something to learn from them. I am not asking anyone to go so far as to agree with me up to this point, but, if « inequalities count » in well-being or utility, then why not take account of them in the choice of development goals ?

3) All the more so as until recently, this was the case : development goals were actually based on the reduction of inequalities :
- Internal inequality reductions in rich countries during the 19th century and until after the Second World War. The socialist parties militated for, and the enlightened bourgeoisies finally

came round to the idea of limiting inequalities, by accepting social minima indexed against the average income.

- International inequality reductions in the 1950s-70s. The Third World country leaders set themselves the goal of narrowing the gap between average rich country wealth as quickly as possible, generally with the proviso that internal inequalities be kept reasonable, and compatible with popular mobilisation to hasten catching up with rich countries.
- International inequality reductions yet again from the 1980s and with the Washington Consensus. This time however, internal inequalities no longer inhibited the goal of maximum growth, *i.e.*, catching up and in so doing, reducing international inequalities. It was accepted that these inequalities could be allowed to increase in the short term during structural adjustments, which were considered indispensable prerequisites to maximum growth.

4) Lastly, critics of « liberal globalisation » essentially accuse it of increasing international inequalities between the world's citizens, of increasing the numbers of absolute poor, or of not reducing their numbers fast enough. This proves that the issue of growing inequalities strikes a chord in at least a section of opinion.

To my mind these few remarks beg the following questions :

- Why and how have we come to a consensus around the thesis : « the prime development goal of strategies and primarily public development aid must be absolute povertyreduction » ?
- Which values underpin this choice ? We take particular note that they are not even Rawlsian. Rawls' criterion would have it that

the income growth of the least well-off is maximised, which goes much further than absolute poverty reduction.

- With the growing globalisation that increasingly submits the living conditions of all to universal scrutiny, with the declaration of « human rights» diplomacy by certain powers in the rich world (explicitly founded on the principle that everybody counts as one and that all men are equal) – even if the implementation of this diplomacy often belies its principles – won't inequality reduction goals have to be tackled ? This though, pertains to international inequalities, leaving it to each state to sort out its internal inequalities, or even global inequality directly.

The Microeconomics of Poverty and Inequality: The Equity-Efficiency Trade-Off Revisited

by Stefan Dercon
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In this paper I want to discuss a key question in development: why do so many people around the world stay poor ? I will argue that serious market failures and asset inequalities are important causes of this poverty persistence. In many cases this appears to result in poverty traps, into which people may fall relatively easily but from which they cannot as easily emerge. Reviewing core insights in current development economics, I will discuss three examples of market failures that are likely to contribute to such poverty traps: credit market failures, geographic and other externalities, and risk-induced traps. To back this up, I will use examples from empirical microeconomic analysis on developing countries. I will conclude with the policy implications of these findings, emphasising ways of increasing the impact of aggregate growth on poverty.

Traditional textbook economics teaching emphasised that equity considerations could and had to be considered separately from efficiency considerations. The simple argument was that the economy, when left to its own devices, could achieve the most efficient outcome. The theoretical foundation of this view can be found in the First Welfare Theorem, which states that any competitive equilibrium will lead to an efficient allocation, in which none can be made better off without making another worse off. All resources would then also be used in the best possible way. While textbook economics is quick to acknowledge that the conditions for a competitive equilibrium are stringent, this remains a powerful and widely used view as a benchmark for thinking about the economy.

Equity considerations have little role to play in this perspective. In fact, any measure favouring the poor is considered costly : redistribution reduces economic incentives and performance. Okun (1975) famously described redistribution as like carrying money from the rich to the poor in « a leaky bucket ». Voltaire's Dr. Pangloss would also have been proud of this theory: do not interfere with the distribution of resources, or the best possible outcome is not achieved. In short, there is a fundamental trade-off between efficiency and equity.

The Second Welfare Theorem brings only limited solace. This theorem appears to open the road to redistribution, by showing that any efficient allocation can be achieved as a competitive equilibrium for a particular distribution of initial resources. In simple terms, this means that one can separate efficiency considerations from equity ones: first redistribute the initial resources and then let the markets do their job. Markets are then allowed to do what they are best at: the efficient allocation of resources. The social planner – the philosopher-king of economic theory – would take care of equity. The redistribution of initial endowments can then achieve an equitable or fair allocation that is also efficient. The conditions for this to be possible are in fact even more stringent than for the First Welfare Theorem. But the crucial issue is to find a way of redistributing wealth without affecting the process leading to a competitive market outcome. In fact, however attractive the theorem, the principle that redistributions exist that do not affect incentives is bound to be wrong.

So where does this leave the poor? Traditional textbook economics has to place any concern for the poor resolutely into the « redistribution » camp : any support we may give to the poor removes resources from the economy, and reduces its overall efficiency and growth.

Of course, many economists have for years argued that the underlying assumptions of these welfare theorems are fundamentally flawed: market failures abound. Furthermore, with market failures, the principle of interventions that may be efficiency-enhancing is well established. During the last few decades, economists have shown that imperfections such as asymmetric information, uncertainty and externalities mean that there are always, at least theoretically, interventions that will be able to make many better off without making anyone worse off (Greenwald and Stiglitz, 1986).[1]

A subset of these interventions is of particular relevance for the poor. These are related to market failures that specifically hurt the

1. Joseph Stiglitz probably most clearly expressed this view in a number of publications, as well articulating the limitations of this view for practical politics. See for example Stiglitz (1998). In applied economic thinking, the implications of this view are still not sufficiently well established, and given the complexity of considering the impact of market failures, many applied economists continue to use the competitive market as the benchmark to think through and assess the impact of any policies and interventions.

poor, and interact with their living conditions in such a way as to exacerbate their poverty. They do this by reducing the efficiency by which the poor use their assets, while leaving the rich largely unaffected. In some cases, these market failures may even lead to poverty traps – equilibrium outcomes of poor living conditions from which the poor, using their own resources – cannot escape. Interventions focused on the poor (redistribution) would in that case lead to efficiency increases for the poor. They may in fact also increase overall efficiency. In other words, there is no efficiency-equity trade-off: rather, redistributive interventions, designed in particular ways, could increase overall efficiency. In this paper, I will focus on examples of this principle and the empirical evidence for this view.

I am aware of the potentially dangerous implications of an excessive emphasis on redistribution for the conduct of economic policy. The fact that there may be virtuous cycles of pro-poor interventions and growth does not mean that just any policy of redistribution is going to stimulate income growth. The naïve emphasis on redistributive policies would be misplaced not least in the poorest economies, in which overall incomes per capita are too low to give a decent living to the majority of the population. The challenge for the economist and the policy maker is to identify those policies that maximally benefit the poor.

Some have argued in recent years that the best possible policy for the poor is simply to stimulate growth. « Growth is good for the poor » became more than a title of an often quoted paper (Dollar and Kraay, 2001); for some it is a credo. The essential point of this research, based on econometric cross-country research, was that on average across the sample of the world, a 1 per cent increase in mean income in a country also resulted in a 1 per cent increase in the mean income of the 20 per cent poorest in society. Even if one may question elements of the method used, this fact is hard to dispute. The main qualification is related to the interpretation of this result. By virtue of its method, it picks up the average effect, meaning that in many countries the impact on the poor is even more positive, but in others the impact on the poor is much smaller. Ravallion (2001) correctly pointed out that « looking beyond the averages » is important in this respect. The main lesson is that in some countries growth is achieved that is largely in favour of the poor; in others growth is much less so in their favour.[2] The challenge is therefore to identify growth policies that benefit the poor most. Clearly, the most pro-poor of growth policies would be those that do not involve a trade-off with redistribution – as will be discussed further in this paper.

The next few sections will introduce some important cases in which policies focused on the poor have clear efficiency gains, starting in the next section with poverty persistence and traps related to capital market imperfections. In section 2, I discuss geographic and other externalities, and in section 3, risk. Section 4 concludes with a further discussion on the implications for development policy.

1. Credit Market Failure and the Poor

The most easily observable market failure is the failure of credit markets to conform to the assumptions of perfectly competitive

2. For those countries for which we have quantitative evidence on incomes across the distribution, in very few cases mean incomes grew substantially, but incomes of the poorest quintile decreased. The statement "growth is not bad for the poor" is therefore quite correct. Using non-monetary indicators, such as health or education, this is not necessarily the case.

markets. Under perfect and complete markets, anyone with a profitable project should be able to get a loan at the current interest rate. If markets were perfect and efficient, no bank would ask for collateral to secure the loan. In practice, without collateral, one typically would not get the loan. Collateral requirements can be understood as an important means by which credit markets handle the central problems that bedevil these markets: asymmetric information, such as moral hazard and adverse selection, and enforcement problems. Since imperfect information means that borrowers may not be able to know which projects are more risky among many risky projects, or whether lenders will implement other actions than initially committed to after the loans have been granted, collateral may be asked for to secure the loans. Collateral may also help to enforce the repayment of loans.

Starting from initial asset inequality, it is obvious that this may be a market failure that is particularly hurtful for the poor. But it is more than an equity issue : it may mean that the poor may not be able to use their other assets as efficiently as the rich. In a classic paper, Eswaran and Kotwal (1986) develop a simple model to illustrate its implications. A further simplified version goes as follows : consider a village with farm households, each with differing amounts of land and labour. The efficient productive technology involves using land, labour and fertiliser as essential inputs. Labour, land rental and fertiliser markets are assumed to work efficiently : at the governing price, they can all be obtained without restriction. However, the credit market is not perfect. The result is that credit can only be obtained using land as collateral, while all inputs have to be paid for in cash. The nature of agricultural production implies that output is only obtained at the end of the season, while inputs need to be applied early in the season. In short, there is a need for working capital to acquire inputs. The land-rich farmer can easily acquire fertiliser and, if necessary, extra land and labour to make sure inputs are used as efficiently as possible. However, the land-poor farm household must find other ways of raising the cash to farm. It would need to raise cash by working on other farmers' land or even rent out its land. Under general conditions, it can be shown that the poor farmer will be using its assets – land and labour – less efficiently than the rich farmer. The poor farmer will be using less fertiliser than optimal, and farm too intensively in terms of labour (with more labour per unit of land) than efficiency would require. His poverty in terms of assets leads to inefficiency. In this example, asset inequality combined with market failure, results in differential efficiency between the poor and the rich. The rich do not just earn more income because they have more assets, but they can also use them more efficiently. Market failures exacerbate the initial inequality. Better working credit markets and/or more equal asset distribution would be efficiency and equity-enhancing.

There is much suggestive evidence that similar processes are common in agricultural settings, often linked to credit market failures. A key prediction of this model is that the marginal return to bringing more land into production by the poor outweighs that of the rich, and that average output per hectare is larger for the poor than for the rich. This negative correlation between cultivated land area and output per hectare is commonly observed in developing countries. Binswanger *et al.* (1995) provide a comprehensive overview of the evidence and investigate different explanations.

Land quality heterogeneity is certainly part of the story, but factor market failures, including those related to credit, are likely to be relevant as well. The model also predicts less intensive use of purchased inputs by the poor. Although many other reasons for limited innovations and modern input use by the poor have been proposed, credit market imperfections are also typically part of the explanation (Feder *et al.*, 1985). In any case, it provides suggestive evidence for the scope for equity-efficiency enhancing interventions.

The relevance of this stylised model is not restricted to agricultural activities. In general, if access to profitable activities requires some initial cash outlay or start-up costs, then those with limited access to credit markets may well be excluded. Much suggestive evidence for this exists from Africa. While off-farm activities are generally hailed as an important route for enrichment, access to some of the simplest activities, such as livestock rearing for milk products, trading, small shops or some handicrafts, require relatively important investments. Empirical research in both Tanzania and Ethiopia, where off-farm income is essential in many marginal areas, found that those with the least assets restricted their off-farm activities to gathering activities (selling dungcakes or firewood) or handicrafts without substantial start-up costs such as weaving, while others managed to enter into much higher return off-farm activities (Dercon and Krishnan, 1996). In Western Tanzania, where cattle provide an important high-return activity, one mature cow cost about 50 per cent of median crop income. In Ethiopia, the median investment needed to enter into charcoal making, dungcake

3. Eswaran and Kotwal (1986) assume constant returns to scale but also monitor costs related to hired labour – limiting the overall farm size at which the rich farmers will operate.

collection, weaving, or food processing – activities with relatively low returns – was 0–20 birr (up to €3). More lucrative activities, such as starting a shop, trading livestock, or providing transport services, required 300–550 birr (€45-€80). A mature cow costs about 400 birr (€60). These are large sums in an economy in which mean per adult income is less than €200 a year (Dercon, 2002a).

The model described is effectively a static model, but its potential dynamic implications are intuitively appealing. Starting from some inequality in assets, those with more wealth earn higher returns and plausibly can accumulate at a high rate, while the poor enter into technology or activity portfolios with lower returns, and may not be able to start accumulating any wealth. This intuition is at the basis of a number of growth models leading to poverty traps for some and accumulation for others. Banerjee and Newman (1993) show the adverse impact of asset inequality on growth, linked to credit market failures. Entry into profitable activities is closed off for those with limited assets, and they are trapped in poverty, while others can climb the occupational ladder. A poverty trap is an equilibrium outcome and a situation from which one cannot emerge without outside help, for example, via a positive windfall to this group, such as by redistribution or aid, or via a fundamental change in the functioning of markets. Much other work suggests poverty traps and overall efficiency and growth losses due to poverty and inequality combined with credit market failure, whereby some people are unable to exploit growth-promoting opportunities for investment, not just in physical capital or profitable activities, but also in human capital (*e.g.* Galor and Zeira, 1993; Aghion and Bolton, 1997; Benabou, 1996).

These poverty perpetuating mechanisms[4] have not gone unnoticed to the development policy community. Interventions in credit markets have been widespread for a number of decades, aiming to provide credit for poorer groups at subsidised rates. The principle of intervening in favour of the poor is well founded, and in principle, it is a type of intervention that would be both equity and efficiency enhancing. In practice, these interventions are typically bedevilled by problems. Large-scale credit programmes meant for the poor were often characterised by huge inefficiencies and appropriation by less poor groups, indeed undermining the entire credit system (an example is the classic Integrated Rural Development Programme in India and similar programmes in Africa). It should not have come as a surprise : credit market failures exist for well-known and well-founded reasons – not just due to some obscure conspiracy by private banks. It is highly unlikely that government, *parastatal* or even NGO schemes could succeed in overcoming the serious informational and enforcement problems that undermine the emergence of private credit market transactions in many contexts (Besley, 1994). Monitoring and enforcement is bound to be costly, inviting large administrative and bureaucratic costs. In short, most evidence suggests that any efficiency gains from relieving credit constraints by some may well have been wiped out by the inefficiencies of

4. There is much suggestive and some quantitative evidence that credit constraints result in sub-optimal educational investment. Despite the fact that the returns to education are (still) relatively high on average in most developing countries, time and money spent on education by the poor is still relatively limited. Cash constraints mean that the high costs of schooling both directly and in terms of opportunity costs of time may well outweigh its return, not least during difficult times (Jacoby and Skoufias, 1997). Furthermore, current poverty often results in limited nutrition during childhood, reducing the return to time spent at school (*e.g.* Bhargava, 1999 for Kenya; Glewwe *et al.*, 2001 for the Philippines). A detailed discussion of the market failures relevant for underinvestment in schooling and other human capital investments is beyond the scope of this article.

administering the programmes. With less poor groups often taking large chunks of the earmarked credit, the equity gains may well have been limited and unlikely to have been achieved in the most cost-effective way.

Of course, in last decade or so, a number of success stories related to microcredit have emerged, such as the Grameen Bank in Bangladesh or Bancosul and other initiatives in Central America. This has led to many major donors and NGOs developing similar schemes everywhere in the world. The principles of some of the successful microfinance schemes are well-known : with clever mechanisms overcoming information and enforcement problems, using group-based lending, joint liability and further incentives to repay by offering larger loans once current loans have been repaid.

Still, it should be recognised that their ability to reach the poorest groups is not well established, while most of these microcredit institutions incur considerable administrative costs so that, without subsidies, they could not be sustained. The review by Morduch (1999) has shown that despite their relative success, microfinance operations are rather costly, reaching needy groups but typically not reaching the poorest. Also a strong positive impact on incomes is not easily established.

The picture becomes more problematic when put in the context of what apparently has been happening in a number of developing countries: a rapid scaling up of the size of microfinance schemes, often involving government and *parastatal* agencies. It is hard to see that there are substantial increasing returns to microfinance activities. More critically, this has been at the cost of careful attention to the design of context-adjusted products. What has worked for

Bangladeshi women interested in small-scale production activities may not easily work for rural women involved in agricultural processing activities in, say, Tanzania. In the contexts of Bangladesh's Grameen Bank, the activities these groups were involved in where sufficiently dissimilar to be of limited covariance (so that if one group could not repay due to bad luck in business, this did not mean that all had bad luck), while the eviction of non-repayers was socially acceptable and strongly enforced. However, this is not easily implemented elsewhere.

Credit market activities will always be fraught with problems ; reaching the poorest via microcredit products will continue to be difficult and costly. However, the fact that these programmes may need to be subsidised is not in itself a problem: if anything, by the very nature of the consequences of credit market failure and the disproportionate impact on the poor, challenging resources to overcome this market failure to the poorest serves both efficiency and equity purposes. The key issue, however, is whether they are the most cost-effective means of serving the poor. There is very relevant theoretical work by Hoff and Lyon (1995) that suggests that direct transfers to the poor may be superior to credit in terms of efficiency gains in a world with credit market failure due to asymmetric information.[5]

5. The argument is that the poor family, when receiving the gift, fully considers this gift part of its wealth, so the gift is internalised in its actions, including those actions not observable by the outside world. If it received subsidised credit, the household does not internalise the consequences of its actions fully, for example, the consequences of its default on others that would like to participate in the credit market. The market may consequently shut out low-wealth individuals in the case of subsidised credit, and the overall efficiency loss may be higher than if the poor family were to be reached by transfers.

The underlying market failure in credit markets may also not necessarily be best resolved by encouraging other institutions to enter into credit operations for the poor. The poor may well have capital goods that could be used for collateral provided there would be legal mechanisms to transfer the goods. For example, property rights and titles may not be officially established, so that enforcement problems cause exclusion of the poor from credit markets. Offering formal property rights, for example to the occupiers of slum dwellings, may be sufficiently to open credit market transactions (Bourguignon, 2000).[6]

An alternative policy could be to acknowledge that credit markets are not easily improved and instead to attack the other main reason why the poor may remain excluded: asset inequality. Indeed, all the models discussed would suggest that redistribution of assets would benefit the poor more than it hurts the rich, when viewed in terms of total output. Over time, it may even benefit all. Much excellent work exists on the issues related to land reform (*e.g.* De Janvry *et al.*, 2001; Bardhan, 1996 ; Binswanger *et al.*, 1995). Political economy problems, other remaining market failures and general equilibrium effects on agricultural labour markets are just examples of the issues raised. In any case, it should be acknowledged that in densely populated areas, such as in Ethiopia or Bangladesh, redistribution or related policies such as tenure security is unlikely to achieve much more than a small dent in poverty levels. Still, land redistribution, not least in contexts such as Latin America, should not be dismissed out of hand, at least not for economic reasons.

6. Arguably, this could already be seen as a form of redistribution, from common or even private land towards some of the poor, sufficient to unlock their exclusion from credit markets.

2. Externalities

Another common cause for market failure is the presence of externalities. Externalities are said to be present if economic or other interactions create social gains or costs beyond those taken into account by those involved in the interaction. The standard example is environmental damage from production involving pollution not accounted for by the buyers and sellers of the commodity produced. My focus here is on externalities that interact with initial inequalities to perpetuate and exacerbate poverty. Tackling such externalities would again not just enhance efficiency but also reduce poverty.

A classic example is crime caused by rampant poverty and inequality. Bourguignon (2001) discusses the theory and evidence suggesting that higher poverty and inequality may promote crime, affecting aggregate efficiency. There is evidence from survey data from South Africa that consumption inequality within and between neighbourhoods leads to higher crime rates (Demombynes and Ozler, 2002). Crime and lawlessness may well affect the poor disproportionately. One of the most striking findings of the participatory processes of « Consultations with the Poor », part of the work for the World Bank's *2000/01 World Development Report*, was the emphasis in most country studies on the way crime and lack of rule of law strongly negatively affected their ability to better themselves (World Bank, 2000).

A more general phenomenon in developing countries, that can be best understood in terms of externalities involves geographically defined areas that appear to stay behind *i.e.*, poor neighbourhoods, or even poor regions or countries. If one looks at the performance of the developing world, it has been striking over recent decades that some developing countries – largely in Africa – appear to have become increasingly marginalised, with low economic growth, persistent population growth and generally, persistent poverty, while other developing countries including large parts of Asia, including China and more recently parts of India, manage to achieve considerable growth and poverty reduction. Less studied but at least as important is that even in countries in which growth is high, there appear to be areas that systematically stay behind and do not benefit from the overall economic growth in terms of income growth and poverty reduction. Certain regions in China and India may well fit this bill. Much less documented but no less true, the geographical disparity in growth and poverty reduction performance within African countries is similarly present.[7]

Such disparity may well be explained in the context of Strand's modern growth theory emphasising agglomeration or location effects. It predicts that firms will exploit increasing returns resulting from the presence of externalities to locate in the same geographical areas, implying that firms would locate in clusters. The corollary is that some otherwise similar or less attractive locations may have missed the boat: not only would they not get the required investment, any capital present may well move out to capture the higher returns elsewhere. For those areas that missed the boat, there is a negative externality from the success of other areas. This argument may help to explain the marginalisation of many parts of Africa (Collier, Hoeffler and Pattillo, 2001), but also within

7. For example, the diversity of experience in terms of growth and poverty reduction across communities during the recovery of the 1990s in Ethiopia is documented in Dercon (2002a, 2003).

countries. Clearly, this is a form of a poverty trap : although initially these areas may not have been very different, once they missed the boat, they can only escape by a serious exogenous shock or massive effort. They face a substantial threshold that they need to overcome to attract or retain capital for accumulation.

Other explanations similarly emphasise externalities related to the specific local context, for example, low local endowments in terms of public goods, common property resources and private asset holdings. If growth processes require a certain threshold of local endowments to take off, then poorly endowed areas may well find it hard to escape poverty. There is evidence from a number of countries that this may indeed be the case. Jalan and Ravallion (2002) identify geographic poverty traps in rural China during the 1980s, finding that community characteristics affect the income growth performance of otherwise identical individuals, controlling for latent heterogeneity. Their results showed that in some areas living standards were falling, while elsewhere *otherwise identical households* were enjoying rising living standards, an effect entirely due to externalities from the initial community characteristics. De Vreyer *et al.* (2002) find similar effects using a panel dataset for Peru. Borjas (1995) finds evidence that neighbourhood characteristics in the US influence a child's schooling performance and adult wages.

Recall that these are again market failures that specifically affect those at the lower end of the asset distribution – this time with assets broadly defined to include public and environmental goods – so that interventions to rectify their predicament may well be both efficiency and equity enhancing. Given that poverty traps are identified, this empirical evidence would justify « poor areas » programmes: massive investment programmes in particularly deprived areas to build up locational and community capital. However, these empirical studies lack sufficient detail and a clear narrative about how these externalities come about. More evidence would be needed to guide and prioritise the type of interventions that would be most beneficial.

For example, most rural « poor areas » are typically characterised by remoteness – often linked to the lack of roads and communications infrastructure. One of the most common donor policy responses is to build roads into poor areas. While undoubtedly bringing some benefits to remote communities, it is not necessarily the case that this is what is needed to unlock the growth potential of an area. In some countries, there is evidence that this may well be an appropriate response.[8] Still, historically much road building in developing countries has been *in response* to local economic growth or at least in recognition of some growth potential (such as cash crops or mining), and it was not the main cause of growth. Alternatives, such as irrigation, health or educational schemes may be more important to unlock their potential. Encouraging migration may even be a superior policy.[9]

A number of alternative narratives are presented in Dasgupta (2003), emphasising the local interaction of environmental and reproductive externalities. Locally, communities or regions may be

8. Ravallion and Jalan (2002) present evidence for China that roads are relevant for growth; microdata from Ethiopia using a much smaller sample suggest similar effects (Dercon, 2003).

9. Some governments take this idea even a step further. Despite plenty of disastrous examples of resettlement schemes from across the world, including from its own history, the Ethiopian government is embarking on the voluntary resettlement of 2.4 million people from marginal areas in the next three years.

stuck in poverty traps linked to overexploitation of natural and other resources, and/or high population growth that harm each person individually in the short or long run, but that are based on behaviour that is rational from the singular point of view of each individual. An example is a community living in a marginal area in terms of agricultural and natural resources, but with each individual lacking the skills or opportunities to leave. Common property resources are used to obtain firewood, and households have incentives to have more hands to gather the increasingly scarce firewood. The result is both overexploitation of the common resources as well as excessive population growth, contributing to ever higher impoverishment. An alternative narrative is related to the externalities from norm-based behaviour that may induce an equilibrium poverty trap within a region or area with high fertility and low incomes. Individual households have no incentives to change their behaviour due to co-ordination failures, despite the resulting persistent poverty. There is evidence for both narratives in Dasgupta (2003), mainly from India.

3. Risk and Poverty Traps

Another serious market failure impacting disproportionately on the poor is the lack of insurance and protection in the face of risk. Complete insurance markets (or, to be technically more accurate, complete state-contingent markets) is another assumption for perfect markets that tends to be violated in practice. Problems with asymmetric information and enforcement issues, not dissimilar to those causing credit market failures, are again typically responsible for the limited spread of insurance mechanisms in developing countries.

Even if they wanted to, the poor could not get insurance for most of the risks they face.

Uninsured risk causes considerable hardship to the poor. Developing countries are still characterised by a high incidence of natural disasters, drought, conflict and insecurity, as well as economic shocks, such as commodity price shocks and currency shocks. Health problems are widespread, as are pests in agriculture. It is commonplace to view these as « transitory » problems, requiring temporary solutions, such as some form of safety net, after which one should get back to the bigger issues of development. For the policy maker it also often means that it is just a social issue that should not distract the key (macroeconomic) policy makers from the bigger issue of how to stimulate growth in the economy. However, this is misleading. There is increasing evidence that risk and shocks are a main cause of lower growth, in addition to resulting in lower growth of incomes of the poor and possibly poverty traps. Focusing attention on the poor could be then again contributing to both growth and equity.

Households in developing countries have developed sophisticated mechanisms to cope with risk. Typically, one could consider two types of responses: risk-management strategies and risk-coping strategies. Risk-management strategies involve trying to shape the risks they face by entering into activity portfolios that are more favourable in terms of risks. For example, entering into low risk activities or diversifying into portfolios of activities with differing risk profiles (growing more drought resistant crops, entering in petty trading or firewood collection, seasonal migration, etc.). Risk-coping strategies involve activities to cope with the consequences of risk in income. Two types are commonly observed : self-insurance using savings, often in the form of cattle or small ruminants, to be sold off when the need arises, and informal mutual support mechanisms, by which members of group or community provide transfers to each other in times of need, typically on a reciprocal basis.

These strategies are not without cost : income risk-management strategies result in a reduction in mean income to face risk and variability in income, while adjusting asset portfolios to cope with risk typically involves investing in liquid assets with lower returns rather than in productive illiquid investment. This affects their long-term income and their ability to move out of poverty. Indeed, there is growing evidence that these strategies imply a substantial efficiency loss for the poor, which the rich – typically better protected via insurance, asset and credit – do not have to endure (a review is in Dercon, 2002). Morduch (1995) documents how more profitable technologies are not adopted because they are too risky in a particular setting in India. The same farmers have been found to hold livestock as a precaution against risk even when more productive investment opportunities exist (Rosenzweig and Wolpin, 1993). Rosenzweig and Binswanger (1993) found that the loss in efficiency between the richest and poorest quintiles in their sample from India was more than 25 per cent, attributable to portfolio adjustments in assets and activities due to risk exposure. Over time, these are very substantial efficiency losses, affecting the poor disproportionately.

These strategies may trap the poor in poverty: to avoid further destitution, they are forced to forgo profitable but risky opportunities, and with it the opportunity to move out of poverty.[10] Even so, they cannot fully protect themselves: there is much evidence that although the strategies contribute to less variability in consumption and nutritional levels, they are still not able to cope with some serious, repeated shocks, not least those affecting whole communities, regions or countries (Morduch, 1999 ; Dercon, 2002). These uninsured shocks typically wipe out assets, pushing the households affected down the asset distribution. They could be pushed below some critical threshold, trapping them into poverty from then on, for example, due to the risk strategies they then need to follow to avoid further destitution, or due to other processes.[11]

There is growing evidence that these processes are an important cause of poverty persistence and possibly permanent traps in developing countries. Jalan and Ravallion (2003) investigated the presence of poverty traps using data from China, and although they did not find a pure poverty trap, they found that households took several years to recover from a single income shock, and that the recovery was much slower for the poor. Dercon (2003), using panel data from rural Ethiopia, found signs of poverty persistence linked to uninsured shocks, with the impact of rainfall up to four years ago affecting current *growth* rates, and the extent to which households had suffered in the famine of 1984-85 still contributing to explain

10. See Banerjee (2003) for a formal poverty trap model building on this idea.

11. One mechanism could be the classic nutrition-productivity poverty trap (Dasgupta and Ray, 1986). It is well established that below some critical level nutritional level, no productive activity of any sort is possible. So if during a crisis, all assets are wiped out except for a person's labour, then if the crisis also pushes the person's nutritional status below this threshold, there is no hope of ever recovering using own productive means. Only a serious windfall, such as in the form of aid, could induce the person to climb out of poverty, provided it is sufficient to pass the threshold value of nutritional status.

growth rates in the 1990s. Furthermore, it took on average ten years for livestock holdings, a key form of savings in rural Ethiopia, to recover to the levels seen before the 1984-85 famine. In a careful study, Elbers *et al.* (2003), use simulation based econometric methods to calibrate a growth model that explicitly accounts for risk and risk responses, applied to panel data from rural Zimbabwe. They found that risk substantially reduces growth, reducing the capital stock (in the steady state) by more than 40 per cent. Two-thirds of this loss is due to ex-ante strategies by which households try to minimise the impact of risk. Barrett (2003) has suggestive evidence of poverty traps from looking at livestock holdings of pastoralists in Kenya.

There is also increasing evidence on the long-term implications of uninsured shocks, focusing on health and education. For example, the permanent impact of drought on children is well documented : lower adult height, poor education outcomes and therefore lower lifetime earnings. For example, the impact of the drought in Zimbabwe in the early 1990s on a particularly vulnerable cohort of children was estimated at about 7 per cent of lifetime earnings (on this and other evidence, see Dercon and Hoddinott, 2003).

All this evidence points to the important consequences of a lack of insurance and protection in developing countries, particularly affecting the poor. Given that the root cause is again a market failure, exacerbated by inequality and poverty, there is a clear case for interventions that are potentially both equity enhancing and stimulating of efficiency and growth. In developed countries, not least in Europe, the failings of the insurance markets are largely resolved via some form of universal social insurance and substantial direct means-tested transfers. For developing countries, this is not likely to be cost-effective, involving high administrative costs and high informational requirements. To put it simply, the means for such systems are unlikely to be available.

The most commonly advocated response is to develop a safety net, based on targeted transfers to the poor. The evidence presented thus far on the impact of risk (and in the previous sections) would suggest that the case for such targeted transfers goes beyond pure equity considerations : they could have important efficiency and even growth benefits. Recently, much attention has been paid to evaluating different possible designs of such schemes in order to maximally reach the poor and vulnerable (for a review see Ravallion, 2002). Some programmes use « contingent transfers» , where transfers are specifically linked to some attempt to stimulate human or physical capital accumulation. Best known are programmes linking transfers to school attendance, such as the Food-for-Education Programme in Bangladesh, or Mexico's Progresa. Similar in nature are some Food-for-Work programmes in Ethiopia, where transfers are provided to finance labour given by communities willing to create certain public goods.

Alternative programmes involve transfers with targeting using community based rules or « self-targeted programmes ». The latter are typically workfare programmes in which anyone willing to work can get a job. To ensure that the poor and only the poor are reached, wages are set at low levels. The most successful and famous example was the Employment Guarantee Scheme in Marahastra, India – see Dreze and Sen (1989) – averting famine by large scale employment generation in 1973-4.

More recently, schemes in Argentina and Indonesia appear to have had some success after serious macroeconomic shocks. Much more needs to be learned about the actual cost-effectiveness of different schemes in providing ex-post protection. However, targeted transfers, at a much larger scale than currently available, could be an important tool to provide protection and insurance to poor households, to avoid poverty traps and allow them to partake in growth.

Targeted transfer schemes and other safety nets are not the only instrument available to the policy maker. They are *ex-post* mechanisms, but much could also be done *ex-ante*. Since the underlying market failure is the lack of insurance possibilities, more attention should be paid to measures providing incentives and means to the poor to protect themselves better against hardship. This includes the development of insurance products tailored to the poor, strengthening the existing risk-coping mechanisms, such as supporting community based systems or self-insurance via savings, and assisting risk management by providing access to credit.

On some of these issues, there have been significant initiatives in recent years. The microfinance industry appears to have discovered the benefits of insurance products, although often in the context of protecting their loan portfolios. Still, very little research on micro-insurance seems to have taken place. An active micro-insurance movement appears to have established itself (Brown and Churchill, 2000), but it is by no means comparable in size and influence in development policy as the microfinance industry.

Also, much work needs to be done in terms of the design of appropriate products.[12] Even more surprising is the lack of attention to strengthening savings possibilities for the poor. The benefits of savings as a buffer against shocks are substantial (Deaton, 1992; Dercon, 2003), but the poor need to have access to reliable and liquid savings instruments, with limited transactions costs and a safe return. With few exceptions, such as SafeSave in Bangladesh, initiatives remain relatively thin on the ground. If microcredit institutions offer savings instruments then it is largely as instruments for accessing credit – for example, as a means to develop reputation and commitment. Flexible savings instruments for risk-coping motives are usually not encouraged.

A key issue for any policy aimed at reducing risk faced by the poor is credibility. It needs to be recalled that an important reason why the poor may not take up profitable but risky activities is that despite their poverty, they cannot expose themselves to further destitution. A policy package of ex-ante and ex-post mechanisms – providing ex-ante insurance and ex-post protection against further destitution – may well be able to unlock the potential of many of the poor people and provide them with the necessary opportunities to take up more risky and higher return activities and investments. In short, it may be the stimulus to allow them to grow out of poverty. However, they will only respond to the policy package offered if

12. For example, in the design of microcredit products much was learned from traditional credit associations such as ROSCAs and the way they functioned. In terms of insurance products, very little research has been conducted on the type of products offered by indigenous insurance associations, such as funeral associations. Many of these groups have far more formalised ways of operating than the literature, emphasising self-enforcing reciprocal informal arrangements, would suggest. Details on one such local institution, funeral societies across Ethiopia, and lessons for insurance and other product design are in Bold and Dercon (2003).

it is credible that all commitments will be honoured. This means that if there is a crisis, they will pay out the insurance policy, or provide the promised targeted transfers.

4. Conclusions

This paper has highlighted a number of important market failures that disproportionately affect the poor and limit their ability to partake in growth, so that they may remain stuck in poverty. I have focused on three core market failures : credit market failures, locational externalities and lack of insurance. Each of these market failures largely affect the poor, and interact with poverty and inequality to contribute to poverty persistence and even poverty traps. Since it is poverty persistence linked to market failures, the usual trade-off between equity and efficiency does not apply : addressing these types of poverty also has substantial efficiency and potential growth gains. A key problem with poverty traps is that without large exogenous positive shocks or windfalls, standard mechanisms of aggregate growth may not have much impact on these groups. Simply letting « just any growth » solve this poverty is not an option. There is an efficiency and an equity case for channelling resources to the alleviation of these traps. There is clear case for development aid to support specifically these types of activities.

The core market failures identified and the impact on the poor have often been recognised in development policy. The paper briefly discussed the experience with standard programmes in dealing with these issues. A key conclusion is that while we may have an increasingly better idea of the extent of the problems faced by the poor and its efficiency implications for the wider economy, it still remains an issue how to most effectively deal with these problems. For example, microcredit schemes are now one of the key instruments to deal with persistent poverty, but their success is more mixed than policy makers like to present. Similarly, development action has long focused on attempting to address « poor areas » with integrated schemes, involving different angles, but their success in transforming these areas is also questionable.

In more general terms, even if one accepts the presence of poverty traps, resulting from the interaction of inequality and poverty on the one hand, and market failures on the other, it is not easily established whether it is better to address the inequality or poverty first (for example, by targeted transfers), or to tackle the market failure (for example, by establishing a voluntary insurance or a credit scheme). A combined approach may be most fruitful: use targeted transfers to address the market failure or its direct consequences. Some schemes arguably exploit this, such as transfer programmes conditional on educational participation (redistribute resources, but address the under-investment in education linked to credit market failure) or transfers linked to better common property resource management. However, their success largely depends on the correct identification of the underlying causes of the poverty traps.

All this means that more attention will need to be paid to the design of interventions *i.e.*, the products and opportunities offered. Not least in the context of « poor areas », much more work is required to understand the processes underlying continuing impoverishment. All this would also mean that much more attention should be paid to the careful evaluation of programmes. In many ways, we have learned too little from past mistakes, and the lack of systematic data collection on most interventions taking place in the developing countries is mortgaging our ability to improve in the future. Addressing poverty is only a waste of money if it is done badly using poorly designed schemes.

Overall, nevertheless and what may be different from the past, is that there is much more evidence to convince the economic policy maker that addressing poverty is not just an issue of equity. The trade-off with growth and efficiency is at worst far less than typically suggested ; in many instances there may not be a trade-off at all.

The most striking example is the impact of risk on growth and poverty. Even though the evidence is still only limited, it all points to large income growth losses due to risk. This provides a powerful argument for increased attention to transfer schemes to the poor in times of need, and, at least as important, for the design of better insurance and protection schemes for the poor. The potential benefits would be substantial.

However, such schemes can only be successful if they are credible. The poor have often felt cheated by empty promises, and one can forgive their scepticism. Policy documents and government statements have persistently been full of promises of safety nets and other programmes targeted to the needy, often with the best intentions. To deliver these promises, strong and sustainable institutions are necessary, and in most contexts they do not exist. Credibility is especially a key issue if one aims at encouraging the poor to engage in more profitable but risky activities. Credibility is not easily gained and policy makers in poor developing countries face an uphill struggle to acquire it. There is clearly an important role for aid and the donor community : by supporting and guaranteeing the enforcement of these measures it would allow these social protection mechanisms to provide genuine insurance against poverty.

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Comment

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This paper, using recent literature in development microeconomics, aims at showing that policy interventions focused on the poor can exist, which, quite apart from their intrinsic merit in redistributive terms, can also prove to be growth enhancing. In this sense, the arguments presented here belong to a line of rationale that tries to convince otherwise reticent policy makers that, even on efficiency grounds, redistribution can prove a reasonable policy choice.

The paper gives a very clear presentation of various possible mechanisms that lead to potential poverty traps, the existence of which offers a strong justification for policy interventions focused on the poor that could be both equity and efficiency enhancing. The possibility of efficiency enhancing policy interventions in case of market failures is theoretically well known. Focusing on some of the market failures that specifically hurt the poor in developing economies, this paper highlights some of the most important paths through which poverty can become sticky and it offers guidelines as to how one should go about breaking these vicious circles.

Three types of market failures are considered: credit market, externalities and insurance market. The first and the last ones – credit and insurance markets failures – can be grouped together since they both relate to failures of intertemporal markets. The source of those failures can usually be traced back to the same kind of asymmetric information and enforcement problems, and they generally co-exist. In these situations, the main point is that poverty and inequality cause market failures to perpetuate poverty and to exacerbate inequality. The other type of market failure examined in this paper is linked to the existence of externalities that markets cannot internalise, the best known example being that of the « tragedy of the commons ».

1. Escaping Traps

Basically, once market failures are identified, policies can often not directly remedy these failures, but they might allow the poorest households that are most vulnerable to these failures to bypass the market. Successful policies would be those which give non-market means to the poorest to raise themselves to being able to re-enter the market and to escape from the trap mechanisms.

Following the order of the paper, let's take the example of microcredit interventions. The paper rightly underlines that the question of whether these reach the very poor has indeed not been answered very convincingly. Further, nor do I think the question of a causal link between access to microcredit and more efficient use of assets has been empirically answered. Regarding the issues raised in this paper, the important question would be to know whether microcredit, when obtained, actually helped to break out of a poverty situation. This question, as far as I know, is not dealt with in the empirical literature on microcredit, for the simple reason that there is no data available. In fact, there are no data that follow those who once, but no longer, benefit from microcredit. Several things might have occurred: they might have dropped out because they were incapable of keeping up with the repayment scheme ; they might not have renewed their loan after reimbursing an earlier one because they felt it was not worth it ; or in the happy alternative, the microcredit indeed allowed them to scale up their activity to the point where they could access the formal credit market (they acquired collateral of some sort). Only if exits of this last type actually exist, can we say that microcredit is a promising tool for breaking the vicious circle described in the paper, leading to a more efficient use of household resources and, in the aggregate, enhanced growth. Hence, it would be indeed of major importance given the sheer amount of subsidies paid into these sort of programmes all around the world, to conduct surveys that would provide the necessary data (I strongly support the author's call for systematic data collection !).

In the meantime, we are limited to thinking of microcredit as a potentially powerful redistributive device, in particular due to the self-selection it induces, and it should be evaluated for its actual capacity to redistribute and alleviate the fate of the poorest, even if it is not sufficient to propel them durably out of poverty.

The other type of policy discussed in this paper is programmes of contingent transfers. In a bit of an ad-hoc way, this discussion takes place on the section dedicated to risk, although the « insurance » dimension of those schemes is not clear. In any case, these programmes are clearly a promising instrument for poverty alleviation, in particular because their effectiveness does not depend directly on which market is failing, so that a precise diagnostic in this respect is not really needed. For programmes making transfers conditional on school attendance for children, there are good reasons for thinking that they could have, at least within generations, the capacity to help households out of poverty, reducing the sources of inefficiency arising from the interaction of poverty and market failures. Obviously, evaluating this is difficult. Research on the Progresa programme pointed at a positive (if not very large) impact on education achievement. What is needed now to complement these results are studies assessing the impact of education on income and social mobility. Only then will it be possible to assess whether these sorts of programmes permit some households to escape the poverty trap.

It should be underlined here that, as is often the case, country (or region) specificity might call for special care when trying to generalise those programmes. Even if those programmes can hardly go wrong in terms of redistribution, one should stress that their performance in terms of human capital accumulation might be very different in different environments. In particular, in urban settings where children as young as 12 can generate income that is not necessarily entirely pooled with parental income (as in urban Brazil for example), a subsidy given to the parent might not provide as much incentive for school attendance as it could in a rural setting, such as the one covered by the Mexican programme. Here again, special attention should be paid to context specificity.

2. Social Interactions

Among the various types of externalities discussed in the paper, I would like to briefly underline the last one, quickly mentioned by the author, namely the existence of social interactions (other externalities listed are crime, geography, and common property resources). They are of special interest because contrary to the other externalities discussed in the papers, they could provide positive externalities, rather than negative ones. Take the example of investment in education, which is arguably an essential way out of poverty. On the one hand, if externalities are at play, remedying credit market failure will not be sufficient to address underinvestment in education. In fact, it will not directly affect the social environment. On the other hand, such social interactions might increase the leverage of some redistributive policies. For example, transfer programmes conditional on school attendance will be effective at decreasing cost as average schooling in the community will increase.

The difficulty in taking this into account when evaluating policies lies in the fact that these interactions are particularly tricky to identify empirically.

3. Redistributing Assets

The author concludes from his discussion that, if one accepts the presence of poverty traps, what the policy maker should do is not well established. Bringing people out of poverty traps could be done by directly addressing income distribution issues (through transfers) and/or by tackling market failure. Nevertheless, it is also clear that to be less vulnerable to market failures of whatever type, households need assets. Hence, if it is difficult to pinpoint exactly which market failure is actually at play in a particular context, so that designing adequate conditional transfer schemes might be difficult, it will generally be true that redistributing assets will effectively enhance the poor's ability to cope with market failures of all sorts and increase the efficiency with which they can use whatever assets they have.

Once the presence of poverty trap is accepted then, it might well be that the main policy implication is simply that redistribution of assets is needed and effort should be made to design feasible redistribution policies. Highly desirable policies such as land reform (as implied by the discussion on credit market failure) might be politically difficult to implement, but the various arguments presented in the paper are encouragements to move in this direction. Trying to redistribute human capital through conditional transfers is probably easier in this respect, but will not have a very immediate impact on poverty exits and on efficiency gains. Other mechanisms can be envisaged (minimum wage policy, employment programmes...) that would be also potentially useful in fighting poverty traps.

The main question we have to answer is that of evaluating which of these modes of redistribution has the strongest impact on both poverty and efficiency. Indeed, the policy question will be to choose how to spend limited resources most efficiently. This means to focus efforts on : 1) evaluating the best way of targeting transfers to the poor; and, 2) evaluating the best way to take advantage of potential social interactions.

Comment

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The main idea of S. Dercon's paper concerns the necessity of moving beyond the traditional equality-growth trade-off, and it argues the possibility that there is no trade-off at all, but that both are complementary. This issue of complementarity is the key focus of the conference « Poverty, Inequalities and Growth: What's at Stake for Development Aid ».

Dercon's argument is that the fight against poverty and economic growth complement each other, insofar as the persistence of poverty is largely related to market failures. Solving these failures may work both ways by enhancing economic growth and taking people out of the poverty trap.

The three core market failures discussed in the paper are:

1. Failures in the credit market: most of the evidence suggests that the poor have difficulty in accessing the credit market because of their lack of education and their low initial investment capacity. Poor households cannot access the credit market in order to finance their children's education or buy fertilisers and tractors to improve their farming productivity. They are then caught in a poverty trap. Moreover, the literature frequently insists on

the use of the credit market as a key means of helping the poor to increase their initial asset allocation through loan strategies. The Grameen Bank in Bangladesh is often pointed to as an excellent model of a bank providing access to credit and thus acting as a facilitator of redistribution and capital accumulation in developing countries.

2. Externalities : most of the studies on this belong to the new economic theory, particularly the issue of geographical disparities in prosperity between countries and between regions of the same country. The paper points out that some regions may be cumulatively and irreversibly left behind in terms of development; whole regions, already cut off from prosperity, are excluded from production and capital accumulation. Solving this type of failure, by giving some means of production to the poor, might a priori increase economic growth.
3. The failures related to insurance markets, particularly the exclusion of the poor from cover for their health risks. According to a paper on health, serious diseases often have irremediable consequences for the poor. The Grüber papers demonstrated that the poor are simply not protected against serious diseases and that these diseases could draw them into a vicious circle of poverty. Hence, solving the insurance market failures is a means of fighting against poverty and favouring economic growth.

This conclusion suggests that the most appropriate solution consists of correcting these market failures, since it would be likely to solve the problems of both poverty and growth. However, a twofold question remains : what is the macroeconomic impact of these three failures and what are the possibilities of enhancing growth and protection against inequality once they are corrected ? We will only talk here about externalities.

The existence of externalities would seem to be evident: on the one hand there are concentrations of activity, and on the other, concentrations of poverty. But this evidence does not emerge clearly from macroeconomic statistics. The promise of endogenous growth theory was based on the existence of significant externalities involving human or physical capital. But, after 20 years of relentless work trying to prove and measure them, our conclusion today is that, at the macroeconomic level, there are no significant externalities of either human or physical capital. From a macroeconomic perspective, we must thus reappraise the global legitimacy of these externalities as a useful tool in fighting poverty.

However, while we may suppose that a natural polarisation occurs between developed and non-developed regions inside a country, there is no evidence to show that fighting inequality can increase economic growth. Providing poor regions with the means to survive is admittedly an appropriate objective in fighting inequality, but it does not ensure global prosperity. Nevertheless, with regard to the possible trade-off between fighting inequality and global prosperity, it might be necessary to allow developed regions to achieve a sufficient level of prosperity to be able to carry the low prosperity regions, at least via migration.

The Sapir Report examines Europe and has come to the same conclusion: is the structural funds policy of the European Union (allocating more resources to the poor members than to the prosperous) an appropriate development strategy ? Would it not be preferable to apply the same strategy as in China, by encouraging the development of a prosperous coastal region, even if the poor farmers have to wait until prosperity reaches them ? This question is essential. Economic theory seems to favour a negative trade-off between inequality and growth.

As for the African context, if as we are told, the continent's main problem is the lack of access to the sea, harbours, and infrastructure, then is the adopted approach of reducing individual poverty – obviously essential for equality and for ODA objectives – an appropriate solution. If the objective is to increase growth, would the correct policy not be the one adopted by China: developing some prosperous regions and concentrating resources on the regions with efficient infrastructures (harbours, airports, etc.) and that will in the long run be able to develop the rest of the country?

These questions have not yet been answered, but they partly invalidate the naïve support of the market failures approach.

To return to our original question on the relationship between growth and inequality, we know that growth is not always the right tool for reducing poverty ; Hicks, Solow, Harrod, and Bourguignon have already demonstrated that growth has a neutral effect on inequality. However, the question of their converse causal relationship remains open.

Inequality, Growth and Redistributive Policies

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In this paper we discuss the interaction between inequality, growth and redistributive policies of various kinds. The paper starts with a brief review of two important brands of literature. The first concerns the theoretical channel through which inequality might have an impact (possibly a negative one) on growth. The second concerns the empirical evidence on the relationship between inequality and growth. Our final conclusion on the latter is rather negative: the relationship between inequality and growth is in theory very complex and many channels are likely to interact. Moreover, the importance of many of the effects discussed in the literature is likely to be enhanced or reduced by specific institutions. Therefore, it is not surprising that the empirical evidence is somewhat inconclusive.

In the central part of the paper (section 2) we discuss redistribution policies design and we distinguish between two kinds of redistribution policies. The first, which is more oriented towards the short run (high frequency), includes income maintenance programs and insurance programs, such as unemployment insurance. The second is oriented towards the long run and tries to redistribute assets or reduce inequality in the accumulation of assets. The main asset that we consider here is human capital. We discuss possible motivations and possible problems with both approaches.

In the final part of the paper (section 3) we discuss different approaches to policy evaluation and the important issue of 'scaling up'. In particular, we discuss both methodological problems with evaluations as well as political and ethical problems that are likely to be relevant in practice. We consider as an example the evaluation of a specific intervention, which is also discussed in Section 3: the *PROGRESA* program in Mexico, which explicitly targets the accumulation of human capital in deprived areas and among very poor households.

1. Inequality and growth: theory and evidence

Obviously a comprehensive review of the enormous literature on the relationship between income and growth is beyond the scope of this paper. There exist some excellent surveys, such as Benabou (1996) and Aghion *et al.* (1999). Here we simply summarize some of the most influential theories and critically assess the relevant empirical evidence.

1.1. From inequality to growth: the theory

Since the mid-1950s and Kuznets' hypothesis of an inverted U relationship between income inequality and economic growth, several theoretical models have been developed to study the impact of an unequal distribution of resources in the development process. We can identify two main classes of theories. The first suggests the existence of a positive relationship between inequality and growth through individuals' savings and incentives to invest; the second underlines the negative effects of an unequal resources distribution on a country's growth prospects through three main channels — political and social instability, fiscal policy and taxation, capital accumulation in the presence of credit markets' imperfections and inefficient financial markets. In what follows, we review the main contributions from both the two sets of theories while also stressing some implications for redistribution policies.

1.1.1. Does inequality enhance growth?

The view that inequality is growth enhancing is based on three main arguments. The first comes from a long tradition in economic thought starting with Kaldor's hypothesis that the marginal propensity to save of the rich is higher than that of the poor ; under the assumption that the growth rate of GDP is positively related to aggregate national savings, more unequal economies will grow faster.

Such an argument has been criticized for a variety of reasons, which are summarized, for instance, in Ray's (1998) textbook. It implies monotonicity in the relationship between saving propensities and income levels, while such a relationship might well be non-monotonic and follow an inverted U. The marginal propensity to save might be increasing from low to middle levels of income and decreasing for the highest income quintiles. If that is the case, the relationship between inequality and growth is positive only at very low levels of income when a certain degree of resource polarization is needed to allow a fraction of the population to accumulate wealth. During the process of economic development, actual savings influence back on income dynamics allowing the initial resources' distribution to consolidate over time ; high levels of income inequality tend to be transmitted from one generation to the next, locking a country in the vicious circle of decreasing aggregate savings as the proportion of the low-saving poor increases relative to the fraction of the highly-saving rich.

A second class of explanations of a positive effect of income inequality on growth emphasizes the existence of investment indivisibilities: investment projects, the setting up of a new firm or the implementation of innovations involve significant fixed sunk costs. As shown in the theoretical model developed by Galor and Tsiddon (1997), wealth polarization is needed in order to start new industrial activities and promote the diffusion of technological innovations that are at the heart of a successful development process. Moreover, modern economies with highly diversified product demands need a certain degree of occupational diversification; income inequality is needed in order to avoid an excess supply of highly-qualified labor force (Galor and Moav, 2000).

The third argument in favor of a growth-enhancing effect of inequality is based on incentive considerations and was first formalized by Mirrlees (1971). In the presence of moral hazard, when output depends on the unobservable effort of the employees, a constant wage independent from obtained results will discourage any effort — while sizing the reward on final output will enhance workers' incentives and maximize aggregate production [1].

Overall, this first set of theories underline the existence of a fundamental trade-off between equity and economic growth. Looking at

1. This line of reasoning has been questioned by Aghion et al. (1999), who note how in the presence of a high degree of risk and uncertainty and risk-averse employees, output-sized wages may result in efficiency losses.

the practical implementation of redistribution policies, the negative impact of income equalization increases when the policies are financed through a system of progressive taxation that further decreases the incentives to save.

1.1.2. Is there a negative relationship between inequality and growth?

The theories that support the view of a growth-reducing impact of income inequality can be divided into three broad categories. The first one underlines the diffusion of political and social instability in the presence of an unequal resources' distribution. Income polarization increases violence and social discontent; illegal activities are more likely to surge and protests can result in riots and coups d'état (see Hibbs, 1973, Venieris and Gupta, 1983, 1986, Gupta (1990), and Alesina and Perotti, 1996). Divided and fragmented societies find it difficult to implement reforms and economic stabilization programs that would benefit all income groups and enhance the growth potential (See Fernandez and Rodrik, 1991, and Alesina and Drazen, 1991); social instability and lack of law enforcement discourage private investments and penalize economic growth. Moreover, high income inequalities tend to be associated with phenomena of ghetto formation and poverty traps; the rich tend to live in « lucky islands » far from the rest of the population that has neither voice nor influence on the development process (see Durlauf, 1994, 1996). Highly unequal societies accumulate low levels of social capital that emphasize the division between poor, low educated, and rich, highly educated classes. Poverty transmits from one generation to the next in a vicious circle of persistent inequalities and social exclusion that tend to have a long-run negative impact on economic performance ; the equilibrium growth rate and aggregate human capital level tend to be lower for all income groups with respect to more integrated and homogeneous economies [2].

The second category of models that predict a growth-reducing impact of income inequality focuses on fiscal policy and taxation. Bertola (1993), Alesina and Rodrik (1994), and Persson and Tabellini (1994) have developed political economy models that establish a link between inequality and growth through the joint effect of a political and an economic mechanism. In the presence of a skewed-resources distribution, the demand for income redistribution is high and the preferred level of progressive taxation in a majority voting system tends to increase. High tax rates imposed on the rich disincentive investment and capital accumulation, thus lowering the rate of economic growth. Benabou (1996) has proposed a generalization of the political economy models considering the relationship between inequality and growth in non-democratic systems. In an oligarchic society where only the rich élite can vote, there is no demand for redistribution; the negative impact of income inequality goes through the diffusion of public discontent and social instability rather than through progressive taxation. Moreover, under the assumption that political rights are conditioned on education levels, the rich élite could decide not to finance mass education in order to prevent the risk of loosing political power through the demand for income redistribution expressed by the voting majority ; unequal societies would therefore tend to show lower rates of human capital accumulation and a slower transition from oligarchy to democracy with respect to more equal economies (see also Bourguignon and Verdier, 1998).

2. See Knack and Keefer (1997), and Benabou (1994).

The third class of models that predict a negative impact of inequality consider economies where capital markets are imperfect. Income inequality is shown to be growth reducing because it decreases investment opportunities and it worsens borrowers' incentives [3]. In the absence of capital markets' imperfections, all individuals would invest the same amount of resources no matter the initial distribution of human capital endowments, since the opportunity cost of investing is the same for lenders and borrowers. However, when credit markets imperfections are present, individuals' borrowing capacity is conditioned on high income and collaterals' availability. Then, the distribution of wealth negatively affects aggregate investment and the rate of economic growth because poor agents cannot obtain loans to finance potentially profitable investment projects. Society is divided in income-education classes and social divisions tend to become permanent through the endogenous evolution of income dynamics influenced by education investment decisions [4]. In two related papers, Banerjee and Newman (1993) and Aghion and Bolton (1997) identify ex-ante moral hazard as the primary source of credit market imperfections. In both papers, moral hazard is caused by borrowers' limited liability, the fact that loans repayment cannot exceed borrowers' wealth. As a consequence, a poor borrower that wants to finance a risky project will choose a sub-optimal level of effort with respect to the one that would guarantee the highest repayment rate. Moral hazard is due to the positive relationship between effort and wealth; the poorer an individual is, the more he/she needs to borrow, and the less his/her level of effort, since he/she will

3. For a detailed discussion, see Aghion, Caroli and García-Penalosa (1999).

4. Galor and Zeira (1993) were the first to develop a model of human capital investments in the presence of inefficient financial markets.

have to share a larger fraction of the returns from his/her investment with the lender.

The models based on market imperfections predict that resource redistribution would be growth-enhancing through a positive incentive effect on borrower effort that could more than outweigh the potentially negative effect on lender effort ; under the assumption of decreasing returns to human capital accumulation, a redistribution from the wealthy to the poorly endowed will have a significant positive effect on aggregate productivity, shifting resources towards the individuals with the highest marginal returns.

1.2. From inequality to economic growth: the evidence

Together with a rich theoretical literature, the interest in the dynamics of the development process and the endogenous evolution of income distribution has motivated several empirical tests of the relationship between inequality and growth. There are several difficulties that the empirical literature has to deal with. First and foremost, there is a basic identification problem. It is likely that the growth performance of different countries is affected by many factors that are not necessarily observed and consistently measured. It might therefore be the case that measures of inequality reflect these differences in unobserved factors, and not the causal link predicted by the theoretical models we discussed above. Second, and related to the first issue, it might be statistically difficult to distinguish the effect of inequality from the effect of other related phenomena, such as the prevalence of poverty. While it is true that inequality is determined by the entire distribution while the prevalence of poverty only by the bottom tail, in practice the cross country variation in the two variables can be quite similar. Third, there are important data problems. Most theoretical models identify wealth inequality as the determinant of the long-run growth rate since it is the distribution of productive assets that determines investment in physical and human capital, which in turn affects growth. However, data on wealth distribution are unavailable for a representative number of countries and researches have resorted to income disparities as a proxy for *wealth* inequality, under the assumption of a strong correlation between the two measures; alternatively, few empirical studies have used the distribution of land [5].

In this section we present a short literature review of the main empirical studies of the impact of inequality on growth. Next, we focus on possible explanations for the inconclusiveness of the results, concluding with some examples of possible improvements and suggestions for future research.

1.2.1 Empirical studies

The role of income inequality in the growth process has been studied in a cross-country regression framework where the average rate of growth of per capita GDP is regressed on an inequality measure at the start of the time interval and a set of explanatory variables. Therefore, reduced-form equations rather than structural relationships have been estimated, without testing the relevance of the specific mechanisms underlying the theoretical explanations presented in the previous sections. The first studies found a strong negative correlation between inequality and growth (See Alesina and Rodrik, 1994 and Clarke, 1995) and a symmetric positive

5 See Alesina and Rodrik (1994), Deininger and Squire (1998) and Deininger and Olinto (2000).

impact of income equality [6]. Birdsall, Ross, Sabot (1995) suggest that these facts offer a possible explanation of the difference in growth performance between egalitarian East Asia and unequal Africa and Latin America.

However, the statistical relationship uncovered in these studies turned out to be much weaker than it first appeared, and several subsequent studies challenged the obtained results. Fishlow (1996) showed the sensitivity of the correlation to the inclusion of regional dummies among the explanatory variables; using an improved data-set on inequality measurement, Deininger and Squire (1998) found no significant impact of income inequality on growth.

Further challenges to the robustness of the first studies came from panel data analysis that exploit the time series together with the cross-section variation of data in order to test whether a change in the distribution of resources in a country has an impact on its long-run growth prospects, regardless of the country considered. Time series of five-year average growth rates have been regressed on initial inequality and a standard set of explanatory variables included in growth regressions [7]; these studies have found a zero, nonlinear, or even positive relationship between income inequality and growth (see Barro, 2000, Forbes, 1998 and Banerjee and Duflo, 2000). However, panel methods have been highly criticized for the use of high frequency data that do not seem to offer appropriate tests of a relationship that operates through long run mechanisms fairly stable over time.

6. See Persson and Tabellini (1994) who measure equality with the income share of the third quintile of the income distribution as a proxy of the income share of the middle class.

7 Per capita GDP at the beginning of the time interval, average years of male and female secondary schooling, and the value of the investment deflator as a proxy for market distortions.

Recently, all previous results have been questioned by Banerjee and Duflo (2000) ; with the use of non-parametric techniques, they show that the only statistically robust regularity is a decrease in growth rates as a response to changes in income inequality, whatever the direction of these changes.

1.2.2 Methodological problems and data quality

The contradictory results on the impact of inequality on growth are not totally unexpected and can be related to three main methodological problems that affect the empirical studies reviewed above.

First of all, as already mentioned, empirical tests use reduced form versions of the theoretical models that identify inequality in the distribution of wealth and productive assets as the relevant determinant of economic growth and specify the explicit channel through which its impact is transmitted. No evidence is presented to support the underlying assumption that the correlation between income and asset inequality is strong; moreover, panel data analysis consider changes in the distribution over short time intervals that are more likely to reflect some redistribution of income rather than of assets. A positive example of an empirical study that has explicitly tested the transmission channel implied by the theory is Perotti (1994), who estimated the impact of inequality on growth in the presence of credit market imperfections. He finds a significant growth-reducing effect of income inequality that increases in the presence of inefficient financial markets. Binelli (2001) has tested the relationship between inequality and growth through credit market imperfections in the context of a gender-sensitive model of human capital investment—confirming the results obtained by Perotti of a significant growth-reducing impact of income inequality in the presence of credit constraints. Easterly (2002) takes a step forward and tests the relevance of different competing mechanisms that justify a positive relationship between equality in the distribution of income and growth. He finds that inequality has a significant negative impact on three important determinants of successful economic performance: quality of institutions, investment in education, and degree of openness; he concludes that an unequal income distribution represents a significant obstacle to economic prosperity.

The second problem that weakens the empirical results on the relationship between income distribution and growth is the poor quality of the data on inequality. Deininger and Squire (1996, 1998) first raised this issue, pointing at the inconsistency of the existing evidence, and constructing a new expanded and improved dataset on income inequality for the period 1950-1997. However, Deininger and Squire data themselves have been criticized because of the heterogeneous methodologies with which they have been constructed (see Atkinson and Brandolini, 1999). Moreover, the dataset is very unbalanced and some of the regions and country rankings in inequality levels seem implausible. At an aggregate level, average inequality means for Latin America and Africa seem too high, whereas the average level computed for East Asia too low ; looking at cross-country differences, surprisingly high heterogeneity appears among European countries.

These serious drawbacks have motivated J. K. Galbraith to construct a new dataset that measures inequality with differences in the levels of pay in the manufacturing sector. Data on manufacturing earnings have been collected as a matter of official routine in most countries around the world from the beginning of the 1960s; the United Nations International Development Organization (UNIDO) has placed the resulting annual data in a unifying and systematic accounting framework, which makes cross-country comparisons highly reliable. However, although coverage and accuracy are significantly improved, Galbraith's dataset has his own limitations; the most serious one relates to the data chosen to measure inequality. Changes in manufacturing payrolls cannot be used to test the impact of resource distribution on growth, since they are not a reliable proxy for either income or welfare inequality ; on the contrary, they are useful to evaluate the effects of growth on inequality that is measured with earnings variations [8].

The third methodological criticism to the cross-country empirical literature refers to the endogeneity of inequality that is jointly determined with economic growth so that no stable relationships can be established between the two. A causal link from inequality to growth could be identified only in the presence of exogenous changes in the inequality index; however, the distribution of income evolves endogenously with the development process and it seems to be difficult or hardly impossible to disentangle the impact of one on the other. In addition, Bourguignon (2000) has underlined the limitations of measuring inequality (equality) with aggregate indexes such as the Gini coefficient (the income share of the middle three quintiles). Observed changes in aggregate measurements could be caused by shifts in the right hand side of the income distribution

8. See Aghion, Caroli and García-Peñalosa (1999).

and may therefore not be relevant to test a model where inequality is predicted to have an impact through the lack of access to credit and/or insurance markets by the poor.

Overall, two important recommendations emerge from the previous literature: the impact of inequality on growth should be tested with the use of structural rather than reduced form empirical models, and long-run rather than short-run tendencies should be examined. Moreover, as emphasized by Bourguignon (2000), macro-economic evidence should be complemented with micro-economic studies that can offer an essential contribution to test the relevance of market imperfections in the inequality-growth relationship. Cross-country regressions could be used to identify average patterns in the data and case studies based on reliable micro data would be necessary complements to identify effective policy interventions; misleading conclusions could be reached on the basis of average estimates computed at the macro level without considering the specific needs and peculiar features of different countries.

2. Redistribution, poverty and economic growth

The theoretical models that identify a negative relationship between inequality and economic performance due to the existence of market imperfections predict, in principle, a growth-enhancing impact of redistribution policies since they promote a reallocation of resources that maximizes marginal returns.[9] In addition, redistribution has been identified as an effective tool for poverty eradication, the overarching objective of economic development.

9. Easterly and Rebelo (1993) perform a direct test of the relationship between income redistribution and economic growth; they find a positive impact of redistribution on growth.

On one hand, higher GDP growth rates due to lower inequality contribute to a faster reduction in absolute poverty; on the other, redistribution increases the poor's share of total income and its increments through growth (see Ravallion (1997) and Cornia (1999)). Even if initial distribution is irrelevant to growth, if all income levels evolve at approximately the same rate, the poor benefit less from the growth process when they control a lower share of aggregate income; therefore, in the presence of higher income inequality, the rate of poverty reduction decreases. Ravallion (1997) performs an empirical test with data for twenty-three developing countries and finds evidence of lower rates of poverty reduction for higher inequality levels at given growth rates of GPD ; he concludes that inequality can result in rising poverty despite good underlying growth prospects.

Adelman (2000) underlines how equitable development paths can be achieved if a prior equalization of access to the main production factor is promoted. The equality-enhancing growth performance of East Asian countries is an example; redistributive land reforms were implemented before promoting rural development so that the benefits from subsequent improved agricultural productivity were widely distributed.

The arguments above assume, however, that redistribution policies do not affect the growth mechanism and, more generally, the structural parameters of the model. Whether this is the case probably depends on the nature of re-distributive policies and on the channels through which these policies interact with existing market imperfections. What is crucial for the desirability and the design of redistribution policies is how they can correct existing market imperfections and how they interact with existing markets and change private incentives.

Given these considerations and the possible complementarity between equity and economic prosperity, it is important to identify the conditions under which the negative impact of inequality on growth can efficiently be reduced and the most effective redistribution policy be implemented. It turns out that a relevant distinction has to be made between short- and long-run interventions. In this section, we discuss these issues.

2.1 Redistribution policy design: object and timing

The effective design of any redistribution policy requires a clear identification of the object and timing of the intervention. According to the theoretical models reviewed above, it is assets or total wealth that should be reallocated; however, this can be practically and politically unfeasible. Moreover, as we mentioned above, one should ponder how the implementation of a given re-distributive policy interacts with existing markets and incentives. Finally, the distinction between wealth and income redistribution appears to be ambiguous when it comes to practical implementation. The financing of asset redistribution policies requires a system of progressive taxation that effectively redistributes current income from high- to low-income groups; therefore, wealth and income reallocation are not entirely alternative and mutually exclusive redistribution mechanisms. For a detailed discussion of these issues, see Bourguignon (2000).

In practice, given the unfeasibility of direct asset redistribution, policy makers have favored the use of indirect instruments that correct for insurance and credit market imperfections, which have been identified as two main sources of low investment by the least favored groups. The so-called « market land reform » programs started in Colombia, Brazil, and South Africa are some examples; instead of being expropriated, land is purchased at market prices from large land owners and resold on credit to landless peasants (see Deininger (1999)).

Credit market imperfections of the kind assumed in the theoretical models discussed above can affect negatively both the investment in physical capital and various productive activities and the investment in human capital. If the poor are denied access to credit, they cannot undertake productive investment projects that require long-term financing and/or high fixed costs, even though they might have high expected returns. Means-tested transfer programs that subsidize families for the opportunity cost of sending their children to school can be considered as substitutes to the lack or inefficiency of credit and insurance markets. Recent programs have also considered transfers conditional on particular types of behavior. In what follows we discuss the possible reasons for conditionality.

Together with the identification of the object of redistribution, the timing of the interventions is another important aspect. An important question concerns the self-sustainability of the programs — namely the need of continuous interventions versus the implementation of one-time redistribution in order to permanently affect aggregate output and economic growth. Theoretical models do not provide a unique answer; some contributions, such as Aghion and Bolton (1997), call for permanent redistribution policies, while others, such as Banerjee and Newman (1993) and Piketty (1997), reach the opposite conclusion and suggest the possibility of a one one-shot intervention with long-term effects on aggregate performance.

Different policy implications depend on different (and untested) assumptions used to model individuals' distribution of wealth and its evolution over time. Aghion and Bolton (1997), for instance, develop a model of growth and income inequality in the presence of credit market imperfections and analyze the trickle-down effect of capital accumulation due to the endogenous evolution of the cost of capital during the development process. As more capital is accumulated, more funds become available to finance a decreasing number of borrowers; the lending terms become more favorable to the borrowers, allowing an increasing fraction of the poor to obtain credit and finance investment projects; therefore, inequality tends to decrease. Wealth redistribution accelerates the trickle-down effect and improves productive efficiency thanks to an incentive effect on borrower effort that more than outweighs the possible disincentive effect on effort supply by the rich; however, since in the model wealth converges to a unique invariant distribution, permanent redistribution policies have to be set up in order to positively impact the long run equilibrium level of aggregate output.

On the contrary, Banerjee and Newman (1993) show how a one-time redistribution can have long-run effects on production efficiency. The model focuses on the evolution of occupational choices over the process of development; in the presence of borrowing restrictions, occupations that require high capital investments are chosen by the rich, and the poor work for the wealthy employers. Wage contracts are viewed as substitutes for financial contracts, and the occupational patterns in turn determine the future distribution of wealth. The authors stress the non-linear and endogenous evolution of the relationship between inequality and growth due to the interplay between individual choices and aggregate variables ; the non-linearities of their model allow us to conclude that one-shot redistribution can have permanent effects, avoiding the distortions induced by continual redistributive interventions.

Finally, it is possible to consider models where the absence of insurance mechanisms interacts with investment choices so that poorer individuals end up choosing less productive investment projects. In such a situation, it is also important to consider the reasons for the failure of private insurance markets.

Together with the absence of unique and agreed prescriptions from the theory, empirical evidence has shown high degrees of heterogeneity in growth responses to redistribution policies. Overall, theoretical models and empirical studies suggest the need to design policy interventions that account for the peculiar features of different countries and vary according to the reasons that motivate redistribution.

Poverty is a multidimensional phenomenon that includes inadequate income, low life expectancy, high mortality rates, prevailing morbidity and malnutrition, together with high illiteracy rates, low rates of school enrolment and completion, lack of productive assets, and lack of political representation.[10] Shocks that can throw individual households into poverty can be temporary (loss of a crop or of employment) or permanent (disability). At the

10. See World Bank World Voices of the Poor (2000). See Morduch (1994) for a definition of vulnerability and for the construction of a ‘vulnerability’ index that can be considered an alternative to a poverty index.

same time, the effects of these shocks are related in that temporary shocks (either their occurrence or even their possibility) might jeopardize accumulation and productive investment.

Likewise, government interventions can be distinguished between those aimed at short and long run phenomena. We now turn to the discussion of the distinction between short run and long run interventions.

2.2 Short run interventions

Employment insecurity and exposure to risk appear to characterize the dynamics of poverty and social exclusion. The most disadvantaged groups can rarely find permanent employment and tend to engage in informal, casual and daily wage labor with no security and low earnings ; high uncertainty and income fluctuations due to weather and price variability [11], and the absence or weakness of financial and social insurance institutions worsen poverty status. The lack of effective insurance mechanisms increases poverty rates, and, even more importantly, prevents poor individuals from engaging in long run productive projects, such as investment in more productive crops or in human capital.

For these reasons, government interventions that provide insurance against short term income fluctuations might be particularly important. However the design and implementation of such schemes has to deal with the very reasons that prevent private markets to provide these services. Information asymmetries, the prevalence of large informal sectors, and so on constitute big obstacles to the provision

11. Seasonal fluctuations in food and water availability are identified as two critical sources of uncertainty for poor families living in rural areas in developing countries (Voices of the Poor, 2000).

of efficient insurance. The problems that have to be faced in this respect fall into one of the following categories :

(i) unobservability of earning ability/effort: in the presence of an insurance scheme, such as unemployment insurance, individuals might not exert appropriate effort, either in work or in finding a job when unemployed;

(ii) prevalence of informal sectors (unobservability of income): individuals might claim unemployment benefits even when they have a job.

To deal with these problems, the literature has studied several schemes. Hopenhaym and Nicolini (1998) consider an optimal unemployment insurance scheme in the presence of moral hazard. Their optimal scheme trades off insurance and incentives and proposes a benefit schedule that declines with the duration of unemployment and becomes negative after a job has been found for an amount proportional to the duration of unemployment. Pavoni (2001), by changing some of the assumptions, obtains an optimal scheme much more similar to observed unemployment insurance schemes observed in reality.

Besley and Coate (1992, 1995) consider 'income maintenance' programs that tackle explicitly the 'screening' and 'incentives' problems mentioned above. These authors show how imposing work conditions (workfare rather than welfare) might solve some of these problems. The idea is reasonably simple: the imposition of work (and the low level of compensation) makes the scheme unattractive to individuals who already have a job while also putting in place the right incentives to get out of it. In what follows we give examples of recent programs that have used these ideas.

Another problem that needs to be taken into consideration is the interaction of a proposed intervention with existing insurance mechanisms. Attanasio and Rios-Rull (2000), for instance, consider a situation where individuals face aggregate (village level) shocks and idiosyncratic shocks. In the absence of government interventions they have to bear the aggregate shocks, which are fully observable. Idiosyncratic shocks are partly insured within a village but are unobserved by the government. A government intervention can be thought of as redistribution across villages so as to smooth out (temporary) village level shocks. Attanasio and Rios Rull show that if idiosyncratic shocks are not fully insured because of the less than perfect enforceability of contracts, the provision of aggregate insurance reduces idiosyncratic risk sharing and can even, in some extreme examples, reduce welfare. Attanasio and Rios Rull (2002) propose a sophisticated scheme that avoids the crowding out of private insurance.

Having discussed some of the conceptual issues at stake, it is worth mentioning some examples of short-run interventions. Among the broad range of possible interventions, employment programs directly address one of the main sources of income uncertainty. Three examples of labor market interventions that provide temporary safety nets are PROBECAT in Mexico and *Proempleo* and *Trabajar* in Argentina.

PROBECAT *(Programa de Becas de Capacitacion para Trabajadores)* is a short run training program targeted at increasing earnings and employment opportunities of Mexican unemployed and displaced workers. During a training period of one to six months, trainees receive minimum wages and the local employment office provides placement. The program is run throughout the country and covers more than 500,000 Mexican workers. An evaluation conducted by the World Bank with data from 1999 found no evidence of a significant positive impact of PROBECAT on the probability of employment after three, six, and twelve months, and on the level of wages after training [12]. Although disappointing, the finding that the program does not have an impact in the medium to long run does not run out the short run beneficial effects due to decreased income uncertainty thanks to the minimum wage salary.

Proempleo is an experiment run in a welfare-dependent region of Argentina between 1998 and 2000. As in many developing countries, welfare assistance goes through low wage temporary work offered by the State for infrastructure building or the provision of community services. The experiment was designed to test the efficacy of wage subsidies and training provision as means of assisting the transition from workfare to a regular job. Three randomly selected samples of potential participants were drawn ; the first one was offered a voucher that entitled a private-sector employer to receive a sizable wage subsidy to cover part of the total wages paid to the employees, the second one received in addition up to two weeks skill training and the third one was used as the control group. An evaluation of the program finds evidence that voucher recipients had a significantly higher probability of employment, although their income levels were not higher than for the control group and were below minimum wages ; the impact was significant only for women and young workers. This evidence suggests that voucher

12. A previous evaluation with data from 1995 reached the opposite conclusion of a positive and significant effect of the program on both after training wages and employability; however, the results are not reliable since the evaluation methodology suffers from serious econometric problems.

recipients were willing to take up private sector jobs in the expectation of more stable future income stream, even at the expense of present wage cuts (see Galasso, Ravallion and Salvia, 2001).

Trabajar is an employment program instituted by the Government of Argentina at the end of the 1990s as a response to the sharp increase in the unemployment rate, especially among the poorest income deciles. The program has two main objectives : increasing employment rate among poor families through the provision of short term work at relatively low wages, and supporting socially useful projects in poor areas to help repair and develop local infrastructure. Project proposals are submitted by local governmental and non-governmental organizations that are required to cover the non-wage costs; priority is given to projects that are targeted towards poor areas and benefit local communities. Participants are excluded from any other employment or training program and can not receive unemployment benefits; moreover, low wages assure good targeting towards low-income workers and give incentives to take up regular jobs as soon as they become available. The evaluation carried out by Jalan and Ravallion (1999) finds a satisfactory targeting performance since participants tend to have lower education levels and live in poorer neighborhoods with respect to non-participants; moreover, with the use of propensity-score matching methods, they estimate a pro-poor distribution of net income gains from the program, with higher average gains for younger workers.

2.3 Long run interventions

Exposure to risk and lack of effective insurance mechanisms do not only affect employability and short-term consumption choices;

they can also affect future outcomes through a negative impact on productive assets and long-term investment plans. The potential adverse effects on human capital accumulation raise particular concern ; inadequate investments in education tend to transmit poverty to future generations that cannot increase their earning potential and move up the social ladder.

Empirical studies have found evidence of an adverse impact of temporary income shocks on human capital investment decisions. Using a set of surveys specifically designed to study households' responses to income fluctuations during the Latin American economic crisis at the end of the 1990s, Gaviria (2001) finds that households respond to adverse shocks by increasing labor force participation, selling productive physical assets, and disinvesting in human capital ; low- and middle-income households appear to be more likely to react by decreasing the amount of resources invested in human capital.

Further evidence of a negative impact of income risk on assets' accumulation comes from some recent studies that have analyzed changes in consumption patterns in response to uninsured income variations. Skoufias and Quisumbing (2003) summarize the results of five IFPRI studies using household panel data from Bangladesh, Ethiopia, Mali, Mexico and Russia to examine how households are able to insure their consumption from income shocks ; they find evidence that food consumption is better insured from idiosyncratic shocks than non-food durable consumption.

The results obtained by Attanasio and Székely (2003) show that in the short run Mexican households tend to react to temporary wage shocks by decreasing health and education expenditures by more than they contract non-durable consumption ; on the contrary, in the long run no significant difference between expenditure categories is identified.

Given the long-term impact of downturns risk, and the general perception that liquidity constraints to the accumulation of human capital and other productive assets are binding for large sectors of the population of developing countries, effective redistribution policies should combine short run income maintenance interventions with education programs, progressive social spending, and, possibly, direct interventions of asset reallocation, such as land redistribution.

Economists and international organizations have always identified investment in education as a policy priority in order to promote economic growth and poverty alleviation (see, for instance, Becker (1995), UNDP (1990) and World Bank (2001)). Many different kinds of school policies have been implemented, ranging from infrastructure building, teacher training and books provision, to means-tested conditional cash transfers in order to foster investment in education by low-income families. While the motivation for intervention in the process of human capital accumulation is clear (the relevance of liquidity constraints, the potential positive externalities that education might have and its role in the process of economic growth), the question of what inventions are most effective is not. In recent years, an entire new literature is being developed on the evaluation of different education policies, ranging from supply to demand interventions. Much more work is still needed to put together all the pieces of what constitutes a successful intervention. We are still far from a full understanding of the mechanisms behind the success stories and the failure. We discuss the need of « scaling up » below.

A further challenge that future education interventions face in Latin America is partly a consequence of early successes in stimulating the accumulation of human capital. As it emerges in Sanchez and Shady (2002), in several Latin American countries there has been a substantial increase in secondary education. At the same time, the return to secondary education (relative to primary education) has decreased. Meanwhile, the number of individuals entering tertiary (college) education has stagnated or increased very slowly, while the return to this type of education has increased substantially. It is clear that liquidity constraints can become very relevant if, to reap the returns of tertiary education one has to go through many years of secondary education — whose return (which might constitute a fall back option in case the child is not successful) has decreased.

One of the most visible and most innovative programs has been the PROGRESA program started in Mexico in 1998. The program presents a number of interesting features. First, it combines interventions in education with interventions in nutrition and health. Given the mounting evidence on the importance of the first few years of life for the formation and subsequent development of children, the focus on early nutrition is certainly a positive feature, even though research that quantifies the long run effects of early nutrition is still needed. Second, the program focuses on mothers, in that all transfers are given to them and they are required to attend some courses on vaccination, hygiene, and contraception. The program quite visibly shifts the balance of power within the household and, for that very reason, might be more effective.[13] Third, the education grant increases with the grade and is marginally higher for girls than for boys. There is a large increase from primary to secondary education grants. Fourth and most importantly, the transfers are conditional on specific actions to be taken by the beneficiaries. The nutrition subsidy is conditioned on the participation into the health component and the courses. The education transfer is linked to school attendance and, to a certain extent, progress.

One possible criticism of the way the program operates concerns the rationale for the conditions imposed on the transfers. If the intervention is justified by the presence of liquidity constraints to the accumulation of human capital, one wonders whether it would not be more efficient to give households with children cash and let them make the best use of it. There are several justifications for the conditions imposed on the grant. One simple — if unattractive — possibility is myopia : households might simply fail to recognize the highest return. A second and more interesting justification relies on less than perfect altruism on the part of the parents, so that children's future welfare is discounted more than it should be. Finally, conditionality might serve as a self-targeting mechanism, so that only households with high enough expected return to education select into the program.

PROGRESA, now renamed *Oportunidades*, has quickly become the largest welfare program run by the Mexican government and it has become the only welfare program in Mexico to survive a change

13. Attanasio and Lechene (2002) show, using the Progresa data, that an increase in the share of women income increases the expenditure share on children clothing and reduces that on alcohol and tobacco.

of administration. *Oportunidades* is being expanded to urban areas and to cover a wider set of children. Following the (perceived) success of PROGRESA and now *Oportunidades*, similar programs are being sponsored across the developing world and in particular in Latin America by governments, international financial institutions, and other organizations. Countries where programs based on conditional cash transfers meant to foster the accumulation of human capital by improving health, nutrition and education, include Colombia, Argentina, Brazil, Nicaragua, Honduras, Turkey and so on.[14]

One of the reasons for the success and the exposure received by PROGRESA and *Oportunidades* is the fact that, when it was started, the Mexican government undertook a serious evaluation of its effect based on a quasi-experimental design. In particular, a number of targeted villages were selected to be part of wide data collection exercises. Some of these villages, randomly selected, were excluded from the program for two years. To be more precise, as the expansion of the program took, for budgetary and logistic reasons, over two years, the 'control' villages were put, for evaluation purposes, at the back of the queue. In other words, given the timetable for expansion, villages that were to start later were determined, to a certain extent, randomly.

The evaluation of PROGRESA was contracted to IFPRI and the results of that study are well summarized by Skoufias (2000) and by many of the reports cited in that study. The PROGRESA

14. Several of these evaluations include an evaluation, often based on quasi-experimental methods. The case of Honduras is particularly interesting as not only was the limited budget used to justify randomisation in and out of the program, but different areas were randomised into different versions of the program—some including demand interventions, some supply, and some both.

data set is now public and has become an invaluable source of information for researchers working in this area. This set of studies has shown considerable effects of PROGRESA both in nutrition and secondary education. Much work is now being done on the PROGRESA database to better understand the mechanisms through which the program operates.

However, even the PROGRESA evaluation, which has been one of the best, is not without problems, both from a methodological point of view and from the point of view of its reception. As far as the former point of view is concerned, one should consider that the 'control' sample was not excluded from the program forever. If there are anticipation effects, they could contaminate the result of the evaluation. Moreover, even if one thinks that the evaluation study estimates the effect of the program accurately, the extrapolation to different programs and contexts is problematic. As for the reception of the evaluation, the administration of the program had considerable problems in justifying to the press and the public opinion the ethics and morality of the evaluation. This indicates that, perhaps not surprisingly, evaluations of welfare programs are very difficult. At the same time, given the uncertainty surrounding the effects of specific interventions, they are very important. It is to the issues of the evaluation of welfare programs that we now turn.

3. Evaluation of policy interventions

Economic evaluation of past and new experiences can offer useful suggestions for the design and practical implementation of cost-effective policy interventions. However, the evaluation of welfare programs is inherently very difficult. To estimate the effect of a program one cannot compare the outcome of interest for a subject participating into a program to the outcome for a non-participant, unless assignment to the program is random or exogenous to the variables of interest. In most applications, it is not ; the individuals who can benefit most from the program choose to participate in it, or the government assigns programs to areas that need them most. Some of these problems can be overcome in the presence of data that are rich enough. And data are useful when one can introduce exogenous variation into them. However, exogenous variation often means excluding — in a more or less arbitrary way — individuals from social programs. This obviously creates problems of a different nature. In what follows we first discuss two different approaches to evaluation and then the political economy of evaluations.

3.1 Quasi experimental methods vs. structural models: evaluation and scaling up

In the literature on evaluation one finds very different approaches to these problems. While there are many technical issues, one does not add much violence to the nature of the debate by saying that on the one hand there is an approach that makes substantive use of behavioral models and of structural assumptions used to estimate these models — while on the other hand there is an approach that tries to minimize the role played by economic theory and more or less ad-hoc assumptions. This second approach evaluates only those programs for which experimental or quasi-experimental evidence exists—that is, random experiments or so-called natural experiments. Program effects are estimated by comparing treated individuals or communities to « control » individuals or communities.[15] The first approach, instead, imbeds individuals in models where they are assumed to rationally solve optimization problems. The selection issues referred to above are tackled head on, in that this approach has the ambition to model completely the behavior of the subjects of the intervention. Notice that, with this approach, one can evaluate policy interventions even before they are implemented. These models are estimated using the available data and specific assumptions on relevant functional forms (on specific functions to be optimized and on the distribution of errors). These assumptions, which are often impossible to test, are obviously crucial to the results one obtains.

Both approaches are far from perfect and suffer from important limitations. The approach based exclusively on quasi-experimental methods suffers from two related problems. First, randomized experiments or natural experiments are few and far between. There are moral and ethical concerns that we discuss more below. More importantly, even when quasi-experimental data exist, they typically provide a precise and robust answer to a very narrow question : what is the effect of a specific program in a specific context. If one needs answers to slightly more general questions, as it is often the case, it is typically impossible to extrapolate them without the use of some structure or some economic analysis. In other words, by

15. Kagitcibasi, Sunar and Sevda (2001) and Tan, Lane and Lassibille (1999) are examples of randomized studies for education policy; Case and Deaton (1999), Angrist and Lavy (1999) and Duflo (2001) are examples of natural experiments. Using data from South Africa, Case and Deaton find that lower student-teacher ratios have increased completed schooling, enrolment, and test scores. With data from Israel, Angrist and Lavy find that decreasing class size has had a significant positive impact on students' performance.

giving up on the possibility of modeling human behavior, the approach we are discussing considers a specific intervention as a black box which is not fully understood and that delivers certain effects that, with the right experimental data, can be statistically measured.

The use of structural models of economic behavior, on the other hand, relies heavily on assumptions about individual behavior and rationality, and also about the distribution of individual heterogeneity. Individuals are modeled as following specific models, and the parameters of these models are obtained under the null hypothesis that the maintained assumptions are valid. If they are not, the inferences drawn on the effect of the program can be seriously misleading.

The debate between the proponents of the two approaches is often very heated. In our opinion, both approaches can be useful. Most interesting questions require extrapolating observed variation to different contexts or different programs. Without a behavioral model this is impossible. However, when using structural models, one should be aware of the assumptions made in obtaining certain results. It should also be clear that the availability of quasi-experimental data should be welcomed by the users of structural models, as it allows them the estimation of richer models and the use of less stringent assumptions.

Some of these issues are well illustrated by the example of the evaluation of the effect of PROGRESA on school enrolment. As we mentioned above, the PROGRESA evaluation sample is made of 506 villages of which 186 were excluded from the program for two years. A simple comparison between treatment and control beneficiaries (by diff-in-diff to take into account pre-program differences) shows that PROGRESA has increased enrolment among secondary-school children by about 8 percentage points, which constitutes a substantial effect. The effect on primary school, instead, has been insignificant (see Skoufias, 2000). However, one should consider that, if control villages had been aware of the program and known that they would soon be incorporated — and they subsequently acted on the basis of these expectations — the simple comparison of treatment and control villages would give a distorted view of the effect of the program. Moreover, even if one would not believe in anticipation effect, one might be interested in knowing what the effect would be if one were to implement a slightly different program. For instance, one might want to reduce the subsidy to primary schools and increase that to secondary school children. Without a model to extrapolate, the comparison between treatment and control villages is not useful to answer these questions. With a structural model instead, one could address both issues above. However, the answers would all be conditional to having specified the correct model. Notice that, if one specifies a structural model, one could estimate the effect of a monetary transfer onto enrolment by considering the effect of other monetary incentives (such as children wages) on enrolment. In this sense, one could estimate the effect of the program using only pre-program data (see for instance, Todd and Wolpin, 2002). However, with the randomization data, one can allow the effect of the grant to be different from the effect of wages and therefore estimate a much less restrictive model (see the discussion in Attanasio, Meghir and Santiago, 2001).

The issues discussed in the paragraph above are at the heart of the debate on evaluation. It is obvious that what the World Bank has defined ‘scaling up’ is at the same time crucial and extremely difficult. ‘Scaling up’ has two important dimensions : one might wish to predict the effect of *changing* the parameters of a given program but keeping the context unchanged, or one might wish to predict the effect of a *given program (previously evaluated) in a different context*. As discussed in Attanasio, Meghir and Székely (2003), the second exercise is particularly difficult, even when using structural models. The reason is that it is very difficult to completely specify all the sources of variation. One can get away with structural modeling in a given context by using a flexible specification for the distribution of ‘unobserved factors’. However, there is no reason to believe that these unobserved factors stay the same in different contexts. These factors could, in all likelihood, affect the effects of the program.

3.2 The political economy of evaluations

In December 2000, *Reforma*, one of the largest newspapers in Mexico, carried a headline story on the front page that denounced the evaluation of PROGRESA as social engineering and compared the researchers running the evaluation and the officials managing the program to the doctors of the Nazi camp that experimented on humans. ‘How could poor households be excluded from a program that was proven to benefit their children ?’ While the argument of the specific article was very weak (it ignored the fact, for instance, that a limited number of communities could be covered by PROGRESA in the first two years of the program because of budgetary and logistic reasons, and that the evaluation exploited that fact — it randomized who would get it first, never changing the total number of individuals covered by the program at any point in time [16]), it is clear that evaluating social programs poses a number of ethical and political problems. Moreover, politicians often do not understand the meaning of evaluating a specific intervention and often confuse "evaluations" with judging the operation of a program.

There are often vested interests for or against programs, and this makes the design and the performance of an evaluation extremely difficult. For all these reasons it might be advisable to bring forward the evaluation work substantially.

It might be much easier to perform evaluations at the very early stages of development of a program. The design stage might be the right moment for pushing for evaluation work. At that stage the budget is probably reasonably small so that full coverage is out of the question. Moreover one might have the possibility of trying several versions of the program, therefore introducing variation that could be profitably used for evaluation purposes. Most importantly, in the early phases of a program, it is less likely that strong constituencies try to affect the outcome one way or another.

As they say, a week is a long time in politics, and evaluation results can only be obtained in a considerably longer time period. It might be also questionable to exclude poor households from much needed help. However, it should be remembered that resources for interventions are very limited and that without a proper evaluation one risks to waste them on policies that do not work.

16. Ironically the journalist used results from the evaluation study to show that the program was beneficial and therefore poor individuals should not have been denied it.

Not only should policy interventions be routinely evaluated, but one should not limit oneself to the standard on/off approach. While the effect of a specific program relative to the counterfactual of 'no program' is an interesting parameter to estimate, often it is also important to consider the relative effects of different programs or of different versions of the same program. This is particularly important when the program is supposed to trigger some discrete actions (such as school enrolment or investment in an expected high-return crop). If indivisibilities and borrowing restrictions are important it is well possible that a version of a program does not have any effect, while a small increase in the transfer would generate substantial effects. In such situations it is then crucial to have the possibility to experiment with different versions of the program. Given the nature of the political process behind the approval and design of many policy interventions, one can hope to evaluate these aspects only as pilots to be carried out before the program is fully fleshed out.

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Comment

by Christian Morrisson
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This paper by Orazio Attanasio and Chiara Binelli is very ambitious in that it covers two major themes at the same time—the relationship between inequality and growth, and redistribution policies. These two themes are distinct: for example, a redistribution policy may be desirable even if reducing inequality has no effect (positive or negative) on growth. Each theme has an abundant literature devoted to it, and large-scale redistribution programmes have been undertaken recently, using techniques and evaluations of results much more efficient than in the past. Section 1 is devoted to the first theme and presents a survey of the literature on the theoretical and practical aspects, along with comments by the authors on the second point. The second theme is tackled through an analysis of the policies (section 2) and an evaluation of the programmes (section 3). The authors make their own contributions to the drawing up of policies and provide their own evaluations.

Most of our commentary is devoted to section 2 (in II); we have completed this with brief comments in I on the empirical relationship between inequality and growth and an examination of "the political economy" of the evaluation (in III), an important point for all policy-makers.

(I) - The inequality-growth relationship

A few remarks need to be made on the survey of the empirical studies devoted to the inequality-growth relationship.

The first is the observation that there is a possible convergence of inequality in more or less large groups of countries. Ravallion[1] has observed a convergence of Gini towards 0.40 in a wide range of countries. In the European Union (excl. Luxembourg), a convergence towards 0.29-0.30 was observed between 1970 and 1998 [2]. It may be asked if a Gini much higher or much lower than the convergence value is not linked to slower growth. This would explain apparently contradictory results such as the more rapid growth both when inequality is reduced (for an initial Gini much higher than the convergence value) and when it is increased (for an initial Gini much lower than the convergence value). If such a relationship existed, we would not need to refer to the measured level of inequality in the inequality-growth relationship, but to the gap between the observed Gini and the Gini convergence.

The second remark concerns the quality of the estimates, which seems to me to be too pessimistic. We now have several estimates available for many countries of Latin America and Africa, arrived at by independent authors using different methods. Some rely mainly on budgetary studies, while others put together very simple social accounting matrices to break down populations and incomes, combining this data with others on the distribution of salaries, farming incomes, etc. In certain cases, margins of error for the total inequality level have been calculated because of the uncertainties involved

1. M. Ravallion, *Inequality convergence*, World Bank, working paper 2645, 2001.

2. C. Morrisson and F. Murtin, *History and prospects of inequality between Europeans*, 2003.

in measuring the incomes most difficult to assess. But when we examine all the estimates for each country we often find a convergence, which unfortunately means that the very wide inequality estimate seems to correspond to the reality.

With regard to the different levels of inequality between European countries, a nuanced approach is required (surprisingly high heterogeneity). In fact, if the Gini is chosen for the distribution of disposable income per person (taking into account the economies of scale linked to the number of persons per household), we get two opposing groups: the Scandinavian countries with a low Gini, 0.21-0.23, and the countries of southern Europe (Portugal, Spain, Italy and Greece) with a Gini of 0.32-0.34, which is 50% higher. The other countries of the European Union are situated between the two groups, except Ireland, which has the same inequality level as in southern Europe, and the United Kingdom, which joined this group at the end of the 1980s. While this Gini gap is quite considerable, the two comments that follow tend to reduce it.

Firstly, since 1970 there has been a convergence in inequality : the standard variance of the Gini coefficient dropped from 0.057 in 1970 to 0.044 in 1995.

Secondly, in 1970 the GDP variances per inhabitant were also wide. The Scandinavian countries had an average income twice as high as those of the southern countries. Hence it is preferable to compare countries whose GDP per inhabitant is close. Among the southern European countries whose GDP per inhabitant is similar, there is no significant difference in their Gini. Among the high-income countries, the United Kingdom and Sweden indeed show a wide gap, with a Gini 40% higher in the United Kingdom in 1998.

But it was almost the same as in Sweden in 1970. The recent widening of the gap can be explained by the much less progressive redistribution policy followed by the Thatcher government.

Finally, exogenous changes can sometimes be observed in income distribution that enable us to identify the effect of inequality on growth. In Europe, the German reunification in 1990 led to an increase in inequality in spite of the transfers, and the reduction of direct taxes and the transfers decided in the United Kingdom by the Thatcher government also produced an increase in inequalities in a short time. In contrast, the agricultural reforms implemented in Korea and Taiwan after the war considerably reduced the inequalities in these two societies.

These examples indicate that the positive or negative gap between observed Gini and Gini convergence may have a negative effect on growth. Before the reforms, Korea and Taiwan both had an inequality level higher than the convergence value. The reforms eliminated this gap and stimulated growth. Sweden and the United Kingdom in 1970 both had an inequality level lower than the convergence value. Sweden, where this gap has been maintained, achieved performance levels lower than the European average, whereas the United Kingdom, where this gap disappeared in the 1980s (and subsequently reappeared), experienced faster growth than Sweden.

(II) The redistribution policies

1) The description of the purpose of redistribution may be clarified by distinguishing between the following four concepts:

ASSET REDISTRIBUTION (AR)
ASSET TAXES (AT)
INCOME REDISTRIBUTION (IR)
INCOME/CONSUMPTION TAXES (IT)

Any measure that increases the earning capacity of an individual or a household comes under AR. Thus, all the financial inputs into the education system and the health services (including grants to parents to induce children to attend school regularly) come under this heading because they increase earning capacity. Similarly, any measure that increases the physical means of production is also a form of AR, such as land distribution (including the developments required to increase the land's productivity), the financing of individual companies or housing for a family. In each case, the increased earning capacity is obvious.

In contrast, any measure that does not increase this earning capacity comes under IR. For example, the unemployment benefit paid to a jobless person, which does not increase his earning capacity. But if a second transfer, on which the first is dependent, finances a training course leading to a job, this transfer is a form of AR. If a drought hits farmers, the help for survival comes under IR, but the financing of a dam that would eliminate this risk is AR. Poverty and sometimes destitution justify the IR redistribution for the shocks from which the victims have no way of protecting themselves, as indicated in the passages of the paper devoted to the market's imperfections in terms of credit and insurance. But the objective is still to increase as much as possible the share of AR because only this form of redistribution can definitively remove poverty by the accumulation of human and physical capital. Any evaluation of aid should include how transfers are made between AR and IR.

The redistribution may be financed by taxing the AT capital, or the IT income. The first could be a partial or total confiscation of the capital or a tax on the capital's income. The two aspects of redistribution are asymmetrical. In the choice between AR and IR, AR is the larger variable. Inversely, in the choice between AT and IT, IT counts for more. For the first choice, the IR aspect ought to be reduced because it transforms the beneficiary into a lifetime recipient of aid. For the second choice, the share of AT is necessarily much lower than IT, since the tax base is narrower.

In the OECD countries, the share of AR in AR+IR is growing increasingly, with the education and health services provided to the poor and the financing of training for the unemployed or to enable low-income households to have access to housing. In contrast, with regard to AT, confiscating capital has become very difficult owing to the international commitments and the opening up of these economies. For example, the French government was not able to undertake a partial confiscation during the nationalisations of 1982 as it had done in 1945 (when the shareholders' compensation was less than 50% or less than 30%). Moreover, high taxes on capital lead to the relocation of assets. Thus, redistribution in these countries increasingly takes the form of an investment process, or AR, which increases the overall investment rate. The state finances the accumulation of capital by poor families, who do not have the means to do so themselves, especially via taxes on the households with higher incomes, or IT, which reduces consumption more than investment. In conclusion, the essential part of redistribution consists of financing AR by IT.

The situation is different in the developing countries: poverty is so widespread that large transfers for survival, IR, are indispensable. Moreover, the tax base for levying the high incomes is much narrower and governments have often made total or partial confiscations, or AT. We have cited the redistribution of land in Taiwan and Korea, and we can add the many nationalisations in the 1960s and 1970s of countries achieving independence—the outstanding example being Algeria where the confiscations represented over half of the assets owned by households. An example nearer to us in time is the landowners forced off their farms in Zimbabwe. This kind of redistribution does not increase the country's stock of capital, and it also carries the risk of temporarily cutting off external finance. Therefore, the two objectives of redistribution in developing countries should be a decline in the IR transfers to the benefit of AR transfers, and a tax system financing this redistribution that does not reduce private savings and investment—by giving preference to taxing luxury consumer goods rather than a progressive income tax. For example, a tax on imported luxury cars to finance subsidies to poor families on condition that they send their daughters to school up to the age of 16 — a form of AR — is a very effective way of increasing the accumulation of capital (human and physical) and reducing inequality and poverty by transforming consumption into investment.

The authors put great emphasis on the imperfections of the insurance and credit markets that handicap the poor. They indicate the measures needed to reduce these imperfections. But the significance of these imperfections should not be exaggerated. Even if a well-organised credit system existed, many human or physical investments could not be made by poor families. The latter cannot take it upon themselves to borrow part of the costs of education and health (even though the school is free, the books and accessories have to be paid for, and the opportunity cost must be taken into account). The idea of families borrowing to finance secondary education is unthinkable (the same applies to many OECD countries, including France). Parents refuse to finance the education of girls because they will leave the family definitively when they marry, and even for boys, their extra earning capacity and the repayment of the investment in 10 or 15 years is a prospect that is too remote for poor families. In contrast, giving a small shopkeeper or tradesman access to credit can play a decisive role and take them out of poverty definitively.

2) Timing interventions

The choice between continuous intervention and one-off intervention is clarified by the link between the timing and the nature of the intervention: AR versus IR. Every IR intervention is by its nature continuous because it consists of helping the poor to survive, without increasing their earning capacity. The aid has to be endlessly provided, unless the conditions change: for example, when small farmers hit by several years of drought receive a normal season's rainfall again and no longer need aid.

In contrast, AR interventions can be undertaken on a one-off basis, at least when they are technically possible. Giving access to capital gives access to an activity that was impossible beforehand (cf. the comments on « occupational choices »), for example, when landless small farmers are able to acquire farming land and equipment that make them definitively independent. But if the measure is designed for the accumulation of human capital, this requires several years of intervention, so it needs to continue for 5 to 10 years. Thus it is the pace of capital accumulation that determines the timing of interventions.

3) « Growth responses to redistribution policies »

The heterogeneous effects of redistribution policies on growth are connected to the diversity of redistribution policies. In terms of the AR/AT/IR/IT reference system, two aspects need to be looked into.

- AR *versus* IR. In principle every AR policy must have a favourable impact on growth because it only finances the accumulation of human and physical capital by poor families (who have no way of doing so on their own) largely by reducing consumption and partly by reducing the investment savings of taxpaying households in the 5th quintile or 10th decile. But for IR, a negative affect on growth is possible: taxing the income or capital reduces invested savings and the transfer is entirely consumed.
- AT *versus* IT. The confiscation of capital has negative effects if it leads to the country's economic and financial isolation because this hinders growth. But this effect may be partly compensated if the redistributed capital henceforth becomes more productive

(for example, unused latifundia land cultivated with cash crops). The taxes on capital or high incomes have a negative effect on savings, whereas this effect is avoided if the taxes are raised on luxury goods.

- The effects of redistribution on growth depend on the balance between the negative effects on investments financed by the taxpayers, and the positive effects on the accumulation of capital by the poor or on the structure of demand of poor people in the case of IR (the consumption of poor households covers less imported goods than that of households in the 10th decile). The combination most favourable to growth is a tax on the consumption of luxury goods with AR because this tax finances the accumulation of capital by the poor.

4) The principle of self-targeting

This concept complements the analysis of the authors. Given the lack of administrative resources in the developing countries, particularly in rural areas, the possibilities of fraud or embezzlement, the risk of corruption, and the extent of the informal economy, as the authors indicate, the most effective interventions are those that are self-targeted in their nature. These interventions are designed in such a way that those who do not want aid can refuse to benefit from it. Self-selective interventions avoid the need to finance checks on the beneficiaries and ensure the best possible targeting. The articles cited by Besley and Coates give an idea of this : « the imposition of work and the low level of compensation make the scheme unattractive to…» . The juxtaposition of a public and free dental care service (with waiting times) with a private sector providing the service without waits means that nobody in the 10th decile will use the public service. The delays are not the sign of poor management but a means of excluding the people who can pay.

5) The fight against unemployment

The three programmes presented lead to the same conclusions as those of an OECD study on the means of reducing unemployment and poverty in the member countries [3], which proves that the problems and solutions are the same to a certain extent in spite of the large differences at development level. In the English-speaking countries of the OECD, the authorities consider that simply subsidising the unemployed is a mistake and they impose work as the condition for receiving this benefit; this work is a subsidised job, or the combination of a part-time job and training, or training on its own if impossible. For example, in Wisconsin the unemployed must work in the private sector or for a local authority (youth training schemes) to qualify for benefits. In these countries, the intervention policies are based on a double consensus :

- the employability of a jobless worker diminishes in proportion to the length of the period of unemployment. Even if the benefits that the unemployed person receives enable him to meet all his essential needs (this is the situation in the developed countries, but not always the case in the developing countries), each month of unemployment reduces his human capital (professional knowledge, qualifications, ability to work in a team). Hence, the first measure to be taken is to halt this process.

3. Fighting exclusion, vol. I 1998, vol. II, 1998, vol. III, 1999, OECD.

- Often there is no satisfactory immediate solution (return to a job similar to the one lost), and a transitional phase needs to be organised: a job that is less qualified and that pays less; a combination of work and training, which represents a kind of transition between unemployment and normal employment. It is through work that the unemployed recover their human capital and employability.

6) The role of the demand of poor families

It is also necessary to look at the recent progress made in analysing the demand for education or other services by families. It is important to understand the behaviour of families vis-à-vis the supply of education (including the price and quality) because, previously, the issue was approached solely in supply-demand terms and it was supposed that every supply created its own demand. But, even if the education offered is free, schooling involves costs (books, transport, and opportunity cost because the children who do not go to school work part of the time). A recent analysis by P. Glick on Madagascar [4] shows that the demand for primary education is sensitive to the costs, and poor families react more than the others. The demand is also sensitive to the quality (state of the buildings, one or more classes to a classroom) and the income of parents (the probability of sending a child to school doubles between the 1st and 4th quartile of households classified according to their average outlay). Simulations show that in these conditions a very low school fee (0.65 dollar per year) would not change the average school attendance rate, but would reduce this rate for the poorest 20%.

4. Education and health expenditures and poverty in East Africa; ed. by C. Morrisson, OECD, 2002.

These analyses of educational demand enable donors to draw up more efficient education development programmes that remove the negative effects for the poorest families, because the simulations indicate the effect of each measure on their demand for education and other services.

7) Redistribution and the condition of women

An essential feature of PROGRESA is the central role allocated to women.

All the transfers are paid to them, and the education subsidies are higher for girls than for boys. The effect is summed up in this comment : « the programme quite visibly shifts the balance of power within the household ». This choice improves the effectiveness of the programme because the extra income is not spent in the same way by women as by men (cf. note 13).

The priority given to women is an essential decision for the success of a redistribution policy. It will be noted that the condition of women is much worse in other countries than in Mexico. In the northern states of India, half of married women never have access to money. In these states, 80% of married women need the permission of their husband to go to the market. Even in other states where the condition of women is less unfavourable, such as Kerala, Punjab and Delhi, half of women need this permission. For their health needs, between one third and a half of women can do nothing on their own because the decision belongs to their husband [5].

5. K. Menon-Sen and A. Shiva Kumar “Women in India. How free? How equal?”, 2001, United Nations.

The condition of women in Mexico can also be examined in the light of an indicator of economic inequality between men and women [6]. This indicator consists of three variables that are coded from 0 to 1 to measure the growing inequality between men and women :

- the inheritance system as it affects male and female heirs
- women's freedom of movement and activity
- access to capital (landed property, assets, bank credit).

This indicator has very low scores in Latin America, East and South-East Asia, while it reaches about 0.50 in Southern Asia, Sub-Saharan Africa and the Middle East and North Africa. Hence, the situation of women in Mexico is much less unfavourable than in these three regions, even though it is not comparable to that of Western Europe.

In these three regions, the first condition for the success of aid programmes is to reserve the transfers to mothers as in Mexico, although this may lead to much more hostile reactions than in Mexico, owing to the weight of traditions and, in some countries, the bias of the legal system.

III) The political aspects of the evaluation

This point needs to be looked into because inadequate communication on a programme and its evaluation may have catastrophic consequences. Relations with the media, public opinion and politicians need to be handled carefully. This is very difficult for several reasons :

6. C. Morrisson and J. Jütting, "The impact of social institutions on the economic status of women in developing countries", OECD, 2003.

Firstly, owing to the opposition of vested interests (cf. the text on vested interests). The implementation of a programme like PROGRESA rouses the hostility of many groups. Granting direct aid to women when men have all the power annoys the latter, even when the family's situation is improved. Small enterprises and farms can no longer exploit a very poorly paid workforce of children because they are all now going to school. As the population emerges from ignorance thanks to this programme, the politicians and local feudal landlords who profited from this handicap foresee the changes in mentality that will undermine the clientalist system on which their wealth and votes is based. The richest taxpayers are hostile to this redistribution if their taxes are increased. Finally, groups with a revolutionary ideology exist in many countries, even after the fall of the communist regimes in Eastern Europe and in the USSR. The greater the inequalities in income, the more these groups will grow because these inequalities provide them with the best argument for convincing and attracting followers. Latin America has many more countries with a high rate of inequality than other regions, as was noted recently in a report of the World Bank [7]. It was precisely in Mexico that the Chiapas revolt broke out, with serious consequences for the country's political and financial stability. These groups have many supporters in the media and the universities and allies in certain European countries. They are the most determined opponents of aid because the redistribution programmes deprive them of their political justification. The worst enemy for a revolutionary is not a system based on inequality that benefits only the rich, but a programme that reduces poverty definitively and

7. "Inequality in Latin America and the Caribbean: breaking with history", 2003.

reduces inequalities. The assessors of aid programmes, who are in principle social scientists who respect morality and ethics, are up against adversaries who use all possible weapons in a political and media arena that is foreign to the social scientists.

The second reason is the technical nature of the evaluations. The application of the programme by phases in order to learn from the experience of the control groups is totally legitimate. The same applies to the application of several versions of the programme, which procures findings that are very useful for assessing it. The combination of structural models with experiments on sample groups enables donors to obtain a clearer view of the effects of the programme and to improve it. But it is very difficult to explain these technical methods to public opinion. A communication problem arises because only other specialists can judge whether these methods are viable and whether the rules are followed, while journalists and politicians claim to be able to evaluate them, which they would not dare to do with a physics experiment. So managers of programmes have to explain them in language that the general public can grasp. To defuse criticism that may be very dangerous and undermine the success of the operation, two solutions may be adopted :

- setting up a communication unit for each project to prepare public opinion before the operations begin, then providing information on each phase of the operations, particularly on why the programme is organised into phases and why alternative measures are applied. This way of handling the communication is more efficient. This paper illustrates the communication problems well by presenting all the recent progress made in analysing redistribution programmes, which happens to further widen the gap between specialists and the media.

- by reaching an agreement between the donor governments, the international organisations and the scientific institutes on a codified application of the programme and its evaluation. Codifications for making evaluations exist in other areas, such as medicine. The code would, for example, specify how to apply several alternative versions at the beginning. Provided that it is flexible, this code need not hinder the future managers of programmes, while giving them political backing because all they need to do to refute their critics is to show that they are following the directives.

Comment

by Erik Thorbecke
Cornell University.

The paper consists of two distinct parts: (1) the relationship between inequality and growth – theory and evidence; and (2) an evaluation of redistributive policies and programs. The first part contains a good survey of the literature on the impact of inequality on growth. The major theoretical models are surveyed, and this is followed by a review of the empirical evidence. In what follows, I suggest some possible and plausible additional paths linking inequality to growth, and I also make some critical comments on some of the theoretical models.

There are two contradictory theoretical strands relating income and wealth inequality to growth. The Classical approach best reflected by Kaldor argues that a higher marginal propensity to save among the rich rather than among the poor implies that a higher degree of initial income inequality will yield higher aggregate savings, capital accumulation and growth (see Panel A of Figure 1). Additional arguments in favor of the growth enhancing effect of inequality are based on the existence of investment indivisibilities and incentive effects.

One possible criticism of the Classical approach relates to the measurement of savings. For example, a small farmer in a developing country is likely to spend considerable time and energy on improving his land through such activities as land leveling, removing rocks and stones and building terraces, rudimentary irrigation ditches, and canals. These activities represent both saving and investment. In fact, the savings are directly converted into investment that, in turn, will increase land productivity. Neither national income accounts nor most surveys would include such activities under the heading of savings. Clearly, the imputed value of those activities should be counted as savings. In this sense, the propensity to save may often be underestimated at low income levels and in traditional settings.

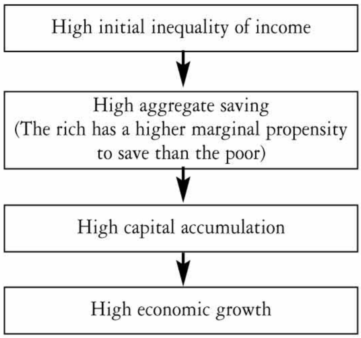
The contrasting theories linking greater inequality to reduced growth mentioned by the authors are (1) through the diffusion of political and social instability; (2) through the redistributive policies encouraged by income inequality that impose disincentives on the rich to invest and accumulate resources; and (3) inequality when combined with imperfect credit markets result in underinvestment by the poor - particularly in human capital.

Figure 1 that is adapted from Thorbecke and Charumilind (2002) depicts the various channels through which economic inequality can affect growth. In addition to the channels outlined above, there are at least two additional ones not mentioned by the authors. Perotti (1996) finds that a greater income share of the middle class has a strong negative effect on fertility, and this, in turn, has a significant and positive impact on growth (see channel 5 in panel B of Figure 1).

The other channel - designed as channel 1 in Panel B of Figure 1- operates through the impact of income inequality on encouraging unproductive rent-seeking activities that reduce the security of property rights (Benhabib and Russtichini, 1991 ; Keefer and

FIGURE 1
THE CHANNELS THROUGH WHICH INEQUALITY AFFECTS GROWTH

A - Classical Approach
Kaldor (1956)



Knach, 2000). Attanasio and Binelli might also have mentioned that Galor (2000) made an attempt to reconcile the two conflicting Classical and Modern approaches (see panel C of Figure 1). The essence of his « unified model » is that the Classical approach holds at low income levels but not at later stages of development. At an early stage of development, inequality would promote growth because physical capital is scarce at this stage and its accumulation requires saving. The rising share of the rich in the population would then result in higher saving and rapid growth. On the other hand, at a later phase of development, the increased availability of physical capital raises the return on investment in human capital. Faced with credit market imperfections, the poor might find the access to capital curtailed and therefore find it difficult to invest in human capital. Income inequality would then result in a poverty trap, and lower growth (see Thorbecke and Charumilind, 2002, for a critical assessment of this model).

It is also relevant to note that there is likely to exist a number of indirect paths (and more circuitous routes) through which inequality affects ultimately growth. Income and wealth inequality affect education, health and crime respectively. In turn, the educational, health and crime consequences of inequality can, under certain circumstances, have a bearing on growth. Thus, wide income disparities tend to coexist with underinvestment in human capital that translates into lower long run economic growth.

Furthermore, empirical evidence suggests that income has a positive and direct effect on health-supporting the absolute (as opposed to the relative) income hypothesis. There is a two way causality between these two variables: low income leads to poor nutrition, and poor health reduces earning potential. Malnourished workers are likely to be less productive, and this puts a damper on growth. Of course, the endogeneity problem makes it very difficult, if not impossible, to defend a robust relationship linking inequality to lower growth via health. However, there are a couple of mechanisms that have been proposed in support of the above causal chain. Income inequality may make it more difficult for people to agree on the provision of public goods such as health, water supply, waste disposal, education and police (Deaton, 2001). A highly skewed income distribution may reduce the provision of public goods and therefore worsen health. Secondly, Wilkinson (2000) argues that psycho-social stress (level of depression, isolation, insecurity, and anxiety) is another pathway through which inequality affects health. It is not unreasonable to assume that both of these mechanisms could ultimately have a negative impact on growth.

A final route through which inequality can influence growth is through its impact on crime at the micro level. Of the various causal mechanisms discussed in detail in Thorbecke and Charumilind (2002), two mechanisms deserve to be mentioned here. First, stress theory argues that, when faced with the relative success of others around them, unsuccessful individuals are frustrated - the greater the inequality the higher the strain and the greater the inducement to commit crime (Kelly, 2000). A high incidence of crime can lead to social disorganization and lower growth. Secondly, income inequality often reduces social capital, e.g. the degree of trust and mutual support among individuals. Since social capital is increasingly considered as a contributing factor of growth, lack of it could be an obstacle to growth.

The second part of the paper is interesting and raises important issues. It reviews a number of redistributive programs and draws a contrast between programs based on a quasi-experimental design - such as PROGRESA in Mexico - and structural and behavioral models. The former - as exemplified by PROGRESA - rely on the selection of target villages and control villages (which are at the end of the queue and could be eligible for benefits in future rounds). Program effects are estimated by comparing treated individuals or communities to control individuals or communities. The authors claim rightly that one limitation of this approach is that such a comparison provides only a precise and robust answer to a very narrow question, *i.e.* « what is the effect of a specific program in a specific context. »

In contrast, structural models of economic behavior rely heavily on imposed assumptions regarding individual behavior and rationality. Even when econometric results suggest that the imposed structure and behavior cannot be rejected, there is no guarantee that a better and still more general model might not exist and reflect observed behavior even more accurately.

It seems to me that a blending of those two approaches might be quite fruitful - as long as it could be done in a fair way consistent with the existing norms and political economy setting. A program that uses some randomization in selecting eligible recipients - while also gathering sample survey data on both target and control groups - could relax somewhat the non-transferability of purely randomized experiments to settings different from those prevailing in those same experimental programs.

FIGURE 1
THE CHANNELS THROUGH WHICH INEQUALITY AFFECTS GROWTH (CONTINUED)

B - Modern Approaches

1) Benhabib & Russtichni (1991), Keefer & Kanack (2000) - 2) Alesina & Perotti (1993) - 3) Alesina & Rodrik (1994), Bertola (1993), Persson & Tabellini (1991) - 4) Banerjee & Newman (1993), Aghion & Bolton (1997) - 5) Perotti (1996)

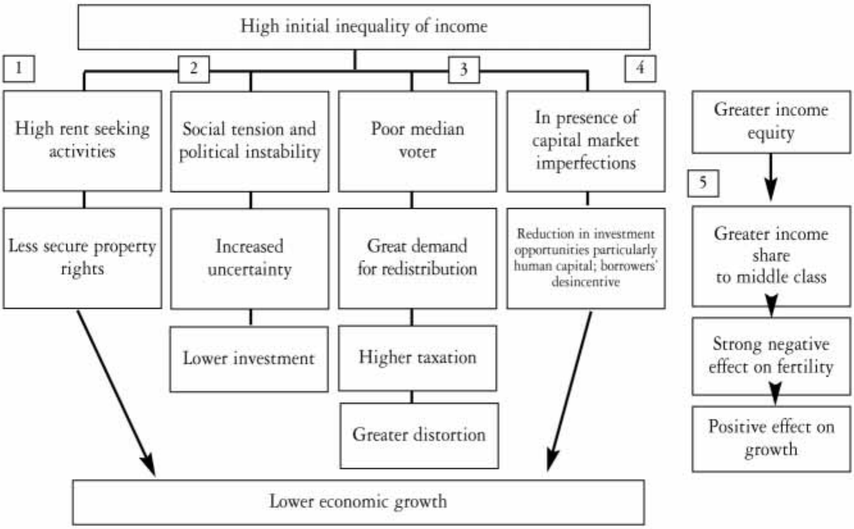
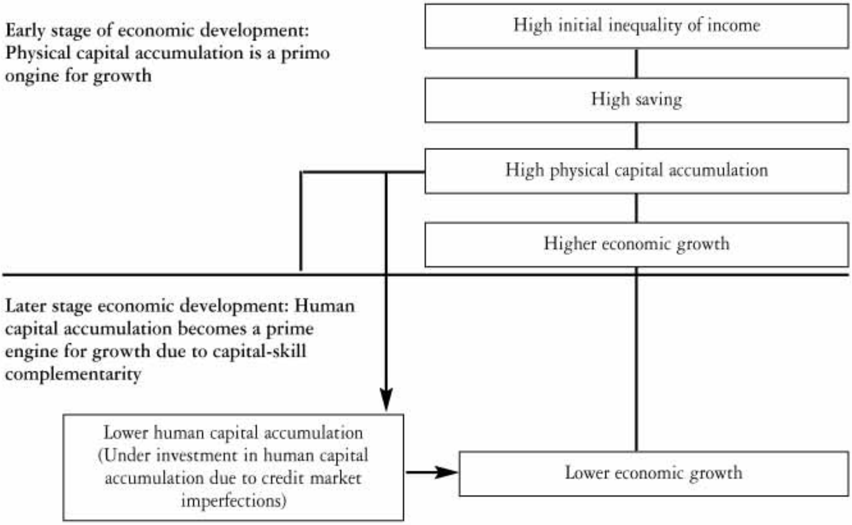


FIGURE 1
THE CHANNELS THROUGH WHICH INEQUALITY AFFECTS GROWTH (CONTINUED)

C - The "unified model"
Galor (2000)



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Decentralized Development as a Strategy to Reduce Poverty?

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1. Decentralized development as a new elixir to help poor countries?

The fact that aid is no longer constrained by strategic objectives since the Cold War has ended, the pervasive incidence of budget constraints in developed countries, and the surge in private capital flows to developing countries are among major factors that have led donors to rethink the importance and the impact of foreign assistance. Thus, whereas aid as a proportion of GNP has perceptibly fallen since the early 1990s in many developed countries, especially the United States, questions about aid effectiveness are being increasingly debated in the international donor community (World Bank, 1998: 7-9; Thorbecke, 2000). The latter is not surprising because a great number of development projects have fared poorly, particularly large-scale government-initiated projects (in sectors as varied as education, health, credit, and infrastructure), and because large chunks of aid budgets earmarked for the development of poor countries, especially those of Sub-Saharan Africa, have been left unspent, precisely due to a lack of sound project opportunities.

Interestingly, over the 1990s, ODA commitments of the European Union exceeded gross disbursements by more than US$1.6 billion each year, peaking at US$2.2 billion in 1994 (Heller and Gupta, 2002: 137). In 1996-97, for example, £4.5m of the budget of DFID (Department For International Development, UK) for Africa was unallocated. In 2000-1, that figure rose to £18m (*The Economist*, November 2nd-8th 2002, p. 39) ! The capability of poor countries to absorb aid effectively therefore appears as a major constraint limiting the possibilities of external support to local development. Moreover, worries have been increasingly expressed about the frequent misuse of aid by local elites and the consequent failure of aid flows to reach the intended beneficiaries and thereby allay poverty.

Recent studies have seriously questioned the past and present modalities of development aid, arguing that in many instances foreign resources have not succeeded in achieving their objectives. Thus, Richard Easterly has contended that none of the elixirs proposed by advanced countries to help their poorer counterparts (aid for investment, aid for education, aid for birth control, structural adjustment loans, debt forgiveness) has actually worked as promised, because not all the participants in the economy had the right incentives (Easterly, 2001). Patrick Chabal and Jean-Pascal Daloz, two political scientists, have even gone further by suggesting that « contrary to what has hitherto been assumed, development as we conceive it might in effect not be *the* priority for a majority of Africans… [therefore], it is reasonable to ask whether the continent is not following a different agenda » (Chabal and Daloz, 1999: 125).

One commonly heard critique against the dominant pattern of development aid is that it has mostly relied on a top-down approach as well as on massive and rapid disbursements effected within a rather rigid time framework (the so-called 'fiscal year' concerns) [1]. In many cases, indeed, the emphasis of donors, both bilateral and multilateral, is on disbursements and country allocations, and results are measured against volume figures, with no regard for the quality or sustainability of assistance programs (Tarp, 2000; Svensson, 2002; Platteau, forthcoming). This implies that funds have been channeled through governmental agencies and that aid beneficiaries have been treated as receptacles rather than as active partners asked to participate in the design and implementation of the projects intended for them. Thus faced with poor incentives, beneficiaries have not involved themselves much in these projects while official agents have not been induced to conceive them in the most effective manner. As a result, many projects have recorded disappointing results in terms of overall performance and poverty reduction.

Responses from the donor community to what can be called a crisis of development aid have included programs of debt forgiveness, the replacement of project aid by budgetary support, and the initiation of participatory — or so-called community-based — development interventions. Regarding the latter, it is noteworthy that most bilateral donors and big international organizations have started

1. 'Fiscal year' concerns refer to the fact that donors fear the consequences within their agencies of not releasing the funds in the fiscal year for which they were slated (Kanbur, forthcoming).

to include participatory elements in the design of their large-scale development assistance programs (think, *e.g.*, of the World Bank's Social Investment Funds, or of participatory development programs sponsored by IFAD, the International Fund for Agricultural Development), or to channel substantial amounts of aid money through international or local NGOs (Stiles, 2002).

The move to put participation and empowerment of the poor squarely on the agenda is especially noticeable in the case of the World Bank — which has made community-based development (henceforth called CBD) one of the cornerstones of its Comprehensive Development Framework. The World Development Report 2000/2001 (« Attacking Poverty ») duly reflected this shift of approach (Mansuri and Rao, 2003), and it is revealing that the share of IDA-financed projects with participation by primary stakeholders has increased significantly during the last decade (World Bank 2002: 55). According to a recent estimate, the amount lent by the Bank for CBD projects increased from $325 million in 1996 to $2 billion in 2003, and the latter figure is likely to be seriously underestimated (Mansuri and Rao, 2003).

That community participation leads to improved project performance and better targeting compared to top-down service delivery and poverty-reduction approaches has thus become a sort of received wisdom today. The idea is not new. On the one hand, it has been continuously advocated by development scholars during the last two decades (see, *e.g.*, Chambers, 1983; Hirschman, 1984 ; Cernea, 1985; Ostrom, 1990; Baland and Platteau, 1996). On the other hand, not only has it been attempted during the 1950s by the Ford Foundation and US foreign assistance programs (by 1960, as many as sixty countries were concerned by this community development thrust) before being abandoned (Holdcroft, 1984), but it is also purported to be the key approach of Non-Governmental Organizations (NGOs) working in developing areas.

Given the high hopes placed in CBD, and the determined attempts to scale up projects based on this new approach, it is important to assess the strength of the case that is made in support of it. Such an assessment is all the more necessary as the empirical evidence available, so far as we can judge from recent surveys (Conning and Kevane, 2002 ; Bardhan, 2002 ; Mansuri and Rao, 2003), does not unambiguously confirm the view that CBD projects are more effective than more conventional approaches in terms of efficiency, equity (reaching the poor), and sustainability. NGOs themselves, contrary to a widespread belief, have not produced impressive results, even with respect to alleviation of poverty and promotion of participation (Carroll, 1992; White and Eicher, 1999: 33). The same agnostic conclusion emerges from a recent review of empirical studies of decentralized delivery of public services. For the author, indeed, studies suggesting the generally positive effects of decentralization do not prevent one from noting that « it is hard to draw conclusive lessons » (Bardhan, 2002: 200). Caution is required because most studies are essentially descriptive and point to correlations rather than carefully tested causal relationships.

Too often, the success of CBD is almost taken for granted, and the arguments seem to be so evident that they do not even need to be spelt out and discussed. It is not surprising, then, that few reliable evaluations of participatory development projects (based on representative samples with treatment and control groups, as well as baseline and follow up data) have been undertaken, even among NGOs that have followed the approach for several decades (White and Eicher, 1999: 19). Regarding the latter, the evidence produced tends to be anecdotal or based on unqualified generalizations, and, more worryingly, whatever evaluations exist are almost never released for public scrutiny. As for the interventions funded by the World Bank, they have also been inadequately assessed, a fact deemed "inexcusable" by Mansuri and Rao (2003) [2].

In addition, when evaluations take place, they tend to be biased in a direction favorable to CBD projects. Indeed, a « praise culture » is pervasive among all the actors involved who have a tendency to « resist the presence of evaluators and make efforts to influence their work and present results that will provide a more favorable impression » (Mansuri and Rao, 2003 : 30-31). The consequence of this dearth of reliable evaluations is ineffective learning-by-doing where it is badly needed. The fact of the matter is that the available evidence simply does not justify the speed with which many agencies, especially large bureaucracies, have started to implement CBD. As pointed out by Bardhan (2002: 187), « the idea of decentralization may need some protection against its own enthusiasts ».

Since the aforementioned works provide recent and excellent surveys of the empirical studies available, and since the conclusions are essentially agnostic, this paper will concentrate on a different task. More specifically, its main purpose will be to discuss the

2. Thus, for example, one learns from the recent survey carried out by Mansuri and Rao (2003) that there are hardly any evaluations providing general findings on whether CBD is better than top-down methods in providing effective and sustainable public services; that is, on whether public goods provided through the decentralized approach are better designed, better maintained, or more equitable in their benefits.

ability of CBD projects to reach the poor effectively, which implies considering the risk of misappropriation of CBD aid funds by local elites. It will in fact be argued that the issue of whether CBD is more effective than centralized approaches to tackle poverty can be framed in terms of a trade-off between information advantages and the risk of 'elite capture'. If the former advantages outweigh the latter risk, the case in favor of CBD seems strong. Yet, if the risk of elite capture is important and the information advantages are not too significant, the ground for embarking upon CBD becomes shaky.

In Section 2, the above trade-off is described in more detail and theoretical contributions by economists are summarized. Section 3 will then appraise its practical relevance in the specific context of foreign aid relations, ending with an illustrative story that relies on a personal experience of the author with participatory development. The two following sections are policy-oriented. Section 4 turns to the question as to how entrenched local elites could be disciplined through a mechanism (labeled leader-disciplining mechanism) that relies on a sequential and conditional disbursement of aid funds in the context of decentralized bilateral relationships. This issue is addressed within the framework of aid projects financed by donor agencies from developed countries. As the discussion in this section will show, the issue is complex: there is a serious risk that in the competition prevailing among donor agencies to get access to local communities quickly, many resources transferred from rich to poor countries are eventually embezzled by local leaders. In the light of the inherent limitations of the leader-disciplining mechanism, Section 5 discusses the possibility of more sophisticated, multilateral control mechanisms operating at the level of the donor agencies, or mechanisms involving the highest tier in the aid chain, viz. the ultimate funding sources. Section 6 draws central lessons from experiences of decentralized development as they have occurred in a few developing areas. Finally, Section 7 concludes the paper by emphasizing the need for a prudent and gradual approach to CBD given the serious practical difficulties implied by the most desirable mechanisms for the detection and punishment of fraud.

2. Trade-off Between Information Advantages and « Elite Capture »: A Statement of the Problem

The main advantage associated with CBD lies in the better knowledge of local conditions and constraints (environmental, social, and economic) that communities or user groups possess, as well as the dense network of continuous inter-individual interactions that constitute community life (often labeled « social capital » in the recent literature). As a result of these two features, communities are assumed to be better able than a central government or an external donor not only to set up priorities, identify deserving beneficiaries, design projects, select techniques and inputs — but also to enforce rules, monitor behavior, and verify actions. Also, people's motivation to apply effort and to contribute resources is expected to be stronger when they are let free to choose their objectives and their ways to achieve them, rather than being told from above what to do and how to do it.

Note carefully that if, in theory, a central agent might procure for itself the same information advantage of proximity by posting local agents in the field, there is apparently no way in which it could avail itself of the « social capital » available in a community. Even the first possibility is likely to be thwarted by considerations of political accountability. As a matter of fact, « local politicians may have more incentive to use local information than national or provincial politicians, since the former are answerable to the local electorate while the latter have wider constituencies, where the local issues may get diluted » (Bardhan, 2002: 191). The political accountability argument, however, is less pertinent when applied to a context in which external donors rather than central governments are the purveyors of funds.

The other side of the coin is that local governments or communities may be more prone to capture, and thus less accountable than central governments (or external donors). If that is the case, decentralization can also be subject to misappropriation and targeting failures. In the words of Bardhan (2002: 192) : « Political accountability in poor countries is particularly affected by the likelihood of corruption or capture by interest groups. While local governments may have better local information and accountability pressure, they may be more vulnerable to capture by local elites, who will then receive a disproportionate share of spending on public goods ».

It is in fact plausible to argue that, at least in situations of high inequality, the poor and minorities are more easily oppressed by local power groups — which can easily collude beyond the control of higher-level institutions and the attention of the media. Moreover, social capital may be harnessed against, rather than used in favor of, vulnerable segments of the population. This is because

« …the multiplex interlocking social and economic relationships among local influential people may act as formidable barriers to entry into these cozy rental havens » (Bardhan, 2002: 194). Facing these strong collusive networks, the poor are often helpless, as their own networks, typically geared to cope with immediate subsistence problems, are not in a position to dispute the power wielded by the rich. It is in these circumstances that they may naturally look to the central state for protection and relief (ibidem: 188). And if the central government is not responsive to their needs, their predicament persists.

Such is therefore the conventional presumption: the lower the level of government, the greater the extent of capture by vested interests. If this is correct, the information advantage of CBD programs would be compromised by their greater diversion to the benefit of local elites (Bardhan and Mookherjee, 2000a : 135). The case for CBD would then hinge on the relative strength of the two opposing effects.

Bardhan and Mookherjee (2002) have developed a tight framework to analyze the trade-off between the two conflicting aspects of centralized versus decentralized systems of service provision and delivery (in the context of infrastructure services such as roads, water, electricity or telecommunications). In the centralized system, authority is assumed to be assigned entirely to bureaucrats whose objective is to maximize their net incomes, that is, bribes less the cost of delivery. These bureaucrats behave like unregulated monopolists. The effect of decentralization is to shift control rights to a local government which, under the pressure of electoral forces, seeks to maximize a weighted sum of the welfares of two types of local users: elites and non-elites. Two other assumptions are crucial to their theoretical exercise : elites value the service provided more than the non-elites, and the phenomenon of capture of local governments is reflected in the fact that the former class of beneficiaries receive a higher welfare weight. [3] What the authors show is that decentralization tends to expand service deliveries as authority is devolved to those most responsive to user needs. Yet, with local elite capture in the above-defined sense, there is a tendency for the local government to over-provide the service to local elites at the expense of the non-elites. The amount of such over-provision actually increases with the degree of fiscal autonomy granted to the local government. This is due to the fact that with local tax financing there is the risk that the captured local government may resort to a regressive financing pattern (the non-elite bear the tax burden of providing services to the elite). Therefore, restrictions on the ability of local governments to raise local taxes can be justified on efficiency and equity grounds. User fee mechanisms, on the other hand, ensure that decentralization welfare dominates centralization, irrespective of the degree of local capture. This is because no one being compelled to use the service, user charges mechanisms impose a limit on the extent of cross-subsidization of the rich by

3. Galasso and Ravallion (forthcoming) have likewise assumed that a community is maximizing a positively weighted sum of utilities featuring the situation of two population groups, poor and non-poor. Communities are thus assumed to be able to achieve an efficient allocation of the resources put at their disposal by a central agent (the so-called Project Office) which does not observe how much is going to the poor in each area, but takes the behavior of communities into account while setting the budget allocation between them. The weights on the utilities of the poor and the non-poor are interpreted as 'capture coefficients' arising endogenously in a probabilistic voting model with differences in voter information between the poor and the non-poor. The authors also postulate that the weights depend on characteristics of the poor and non-poor, as well as the local political and economic environment, and the program itself.

the poor. Here is an obviously distressing conclusion if the problem is to relieve poverty by catering to the poor's basic needs (food, health, and education). Indeed, the latter do not have the ability to pay for the services intended for them (or bribes to the bureaucrats). In such cases, as is shown in Bardhan and Mookherjee (2000b), the extent of elite capture at local level — relative to that occurring at the central level — is a critical determinant of the welfare impact of decentralization.

In still another paper, Bardhan and Mookherjee (1999) have investigated theoretically the determinants of relative capture of local and national governments in the context of a model of (two-party) electoral competition with probabilistic voting behavior and lobbying by special interest groups (the non-poor are organized in a lobby and can make campaign contributions). One interesting result is that relative capture depends on heterogeneity with respect to levels of local inequality and poverty: decentralization will tend to increase elite capture in high inequality localities (since higher inequality reduces the level of awareness of the poor, decreasing the level of their political participation) and lower it in low inequality ones. Nevertheless, while there are several factors that tend to increase the relative proneness to capture of local governments, other factors have the opposite effect. The contrasting roles of these diverse factors (cohesiveness of interest groups, degree of voter ignorance at the local level, relative extent of electoral competition, etc.) suggest that it is unlikely that local governments are universally vulnerable to greater elite capture. The extent of elite capture at the local level « may well turn out to be context- and system-specific », which creates the need for empirical research to appraise the potential pitfalls of decentralization in various settings (Bardhan and Mookherjee, 2000a : 139).

Theory, therefore, does not enable us to obtain clear-cut answers to the question of the relative desirability of decentralized versus centralized development. However, it has the merit of drawing our attention to crucial factors — such as within community heterogeneity — that impinge upon the comparative effectiveness (in both efficiency and equity terms) of the two approaches. One of the few serious attempts to test the sort of models discussed above, if we except the study by Galasso and Ravallion (forthcoming) to which I shall return later, is that of Foster and Rosenzweig (2002). These authors use a model of two-party (the poor and the non-poor) representative democracy with probabilistic voting, in which local governments must choose to allocate public resources among different public goods — for which the preferences of the poor presumably differ from those of the rich. A key prediction of the model is that, in villages with democratic governance, an increase in the population share of the landless should result in outcomes that are, *ceteris paribus*, more favorable to the poor, that is, greater road construction or improvements (which are relatively labor-intensive) and smaller public irrigation infrastructure (which benefits the landed households especially). The prediction is borne out by the econometrics applied to a twenty-year panel data set from 250 villages in rural India.

Caution is nevertheless needed in the interpretation of such results, in so far as they are based on a comparison of predicted and realized outcomes in the absence of strong direct testing of the underlying assumptions. In particular, there is doubt about whether improved roads benefit the poor more than irrigation infrastructure. Thus, « it is often the case that non-poor households corner most of the wage work opportunities within their home village, especially when this work is provided by government agencies at an official wage rate that is two to three times the traditional village rate » (Kumar, 2002: 776). Moreover, we would obviously like to know more about how village democracy works in actual practice. Indeed, in order to show that democratic governance enables the poor to express their preferences and make them prevail, there is no escape from analyzing the concrete process through which they raise their « voice » in the relevant institutions.

By relying on formal voting processes and formal rules of electoral competition, political economy models also ignore other, potentially effective local accountability institutions. It is thus revealing that in non-democratic countries such as China and Korea, ingenious mechanisms exist at local level to develop trust and cooperation within the ambit of incentive-based organizations and bureaucratic procedures, whereas in democratic countries such as India, local-level accountability mechanisms are often quite deficient (see, *e.g.*, Wade, 1985, 1990). In fact, because of the multiplicity of intervening factors (see Agrawal, 1999: Chap. 3, for other considerations), the abstract stylization of political economy models does not easily lead to reliable testable propositions.

Note finally that, when we contemplate decentralized or participatory development as practiced by external donors rather than by central governments, the picture appears to be somewhat neater. As a matter of fact, to the extent that external donor agencies can be deemed to be genuinely committed to relieving poverty, the risk of elite capture on the central level is unambiguously lower than the same risk on the local level. A trade-off between information advantages and the risk of elite capture is then certain to exist, and if the latter is high compared to the former, the desirability of CBD should be called into question.

3. Trade-off Between Information Advantages and 'Elite Capture': Discussion in the Context of Foreign Aid Relations

At this stage, it is useful to bring out a number of considerations that should help us assess, with special reference to relations between external donors and target communities, the relevance of the trade-off described in the previous section. Let us first consider the information argument.

3.1 The Information Advantage of Communities: Some Qualifications

While it is no doubt true that communities or user groups possess information advantages over an external donor agency, several problems may arise that are generally overlooked in the CBD literature. People may not have a clear perception about critical dimensions of poverty reduction strategies; their views may diverge from those held by donor agencies, especially if the poor have internalized the values of the local elites ; or, people's preferences may be heterogeneous, giving rise to conflicts of interest.

To begin with, members of a community may not have reached a consensus on some critical dimensions of an aid program. In particular, they may not agree on who is poor and who is not, or on the nature of the more important problems to be addressed and how best to do it. For example, Bergeron, Morris, and Banegas (1998) have shown that in Honduras when different randomly selected subgroups of community members were asked to establish wealth and food security ratings, the correspondence between the rankings obtained was quite weak. The author's own experiment with wealth and power rankings in fishing villages in South India (Kerala state) led him to a similar conclusion. Moreover, his experience with NGOs work in participatory development in West Africa has shown that villagers are not always clear or correct about the causes of their problems, what their priorities should be, and what strategies ought to be followed to meet those priorities. Confusion or ignorance is especially likely when the matter concerned is rather technical or complex.[4] These are the kind of circumstances that make people especially prone to being influenced by external agencies, in the sense that they tend to demand the sort of things that they know will appeal to these agencies, especially so if they are simply asked to answer an invitation to submit subproject proposals.

If participation is to mean anything in such a context, the intervention of outside facilitators is required. Their role should consist of initiating and supervising a process whereby a community can form an opinion about a list of valid objectives, a suitable sequencing of their realization over time, as well as a coherent and feasible action program to achieve them through appropriate methods. This process will be necessarily slow because it is essential that the facilitators do not impose their own ideas on the people. Instead, they must carefully listen and then make suggestions intended for stimulating discussions within the community that will drive the

4. On the basis of data collected on 132 community-maintained infrastructure projects in Northern Pakistan, Khwaja (2002) has shown that increased community participation positively effects performance for non-technical project decisions, yet has the opposite effect for technical decisions. Infrastructure maintenance is also better in non-complex projects, or in those made as extensions of old ones.

members to think of critical issues and eventually agree on some way to address them.

This is obviously highly subtle work that requires facilitators with the right kind of motivations and combination of qualities, as well as patient donor agencies ready to wait before disbursing funds. These two conditions are rarely met in reality. For one thing, facilitators are too often young, poorly paid and inexperienced individuals who are driven by incentives that are not well aligned with the needs of the CBD projects. For another thing, project implementers, especially (but not exclusively) when they belong to large aid bureaucracies, are typically concerned with showing rapid results, while increased participation does not necessarily improve project performances — at least in the short and medium term (White and Eicher, 1999: 18 ; Isham, Narayan, and Pritchett, 1995; Khwaja, 2002 ; Mansuri and Rao, 2003: 27-28) [5]. Too often, participatory planning is an ideal that exists in speeches rather than in reality. Aid agents initiate a process of analysis within the target community that ends up as soon as posters reporting the 'agreed upon' objectives and methods have been taken to the agency to form the basis of its project interventions (Vivian and Maseko, 1994; Birch and Shuria, 2001).

5. Such a tension is evident from the following excerpt of a recent evaluation report assessing the impact of the World Bank's Social Funds:

> "While social fund projects have been successful in channeling substantial external resources toward local development, disbursing rapidly and achieving their physical output targets, their impacts on outcome and welfare variables, and on community capacity building and social capital, have been mixed… Many social funds that were initially set up as emergency response mechanisms are now being called upon to shift their focus to longer-term development impact and institutional development objectives, but this transition is proving difficult to implement in some cases… social funds are liable to meet the same constraints as other kinds of interventions and may lose the strengths on which their reputation has been built. For example, building capacity and social capital at the community level are time- and human resource-intensive processes, making disbursements potentially slower and less predictable. Experience suggests that the constraints to accomplishing this transition should not be underestimated and the tradeoffs should be explicitly addressed" (World Bank, 2002 : 48; see also Edwards and Hulme, 1996; White and Eicher, 1999).

In contrast to the case considered above (although in actual practice the two situations may be rather hard to disentangle), community members may have a clear and consensual perception about who needs to be helped, what is the cause of their predicament, what is to be done and how it should be done. Yet their views and preferences may diverge substantially from those held by the donor agency. Thus, it is often observed that the intended beneficiaries pay much less attention to long-term, strategic considerations (including the building of autonomous organizational capacities), and attach much bigger weight to immediate improvements of life conditions, than external aid agencies. Also, they tend to place too much hope in externally-provided resources and to demand that the scale of development activities is increased beyond the limit of their own absorptive capacity. More fundamentally, meaning systems may differ so widely between donors and target groups that the very concept of development at the heart of the donors' approach may not be understood by these groups (Laurent, 1998).

Community members may also have an idea of eligibility that is not consistent with the one held by the donor agency. Thus, poor members deemed undeserving because they are known to be lazy, frequently drunk, or undisciplined, or because they have broken some local social norm (a son who has not shown respect to his father, or a daughter who has separated from her husband and returned to her native village against the wishes of her parental family) will be considered non-eligible to aid relief whereas the donor agency thinks contrariwise on the basis of other criteria or principles of justice. In so far as the undeserving members have internalized the values and norms prevailing locally, a community-versus-donor preference dichotomy is observed. When such is the situation, discussions are required in the hope that the stances of the two parties will converge without the donor imposing its will. But this is a time-consuming process (Birch and Shuria, 2001), and the danger always looms that the intended beneficiaries will again strategically adapt to the demands of the donors and pursue their own agenda while using the aid resources. In the words of an anthropologist with a long field experience in Mossi villages of Burkina Faso :

> « Confronted with the hegemonic 'project' of the donor, the local population, for fear of losing the aid offer, prefer to remain silent about their practices and aspirations. This is because these practices and aspirations are perceived to be so far away from those of the donor that they are better not disclosed. Such is the vicious circle of development cooperation : the fear of avowing the discrepancy between the two views because it could lead to the discontinuation of the aid relationship, has the effect of strengthening the donor's confidence in the validity of its approach » (Laurent, 1998: 212 -my translation).

A further complication arises when preference heterogeneity exists within the target community. Thus, rural communities are often concerned with preserving a sense of social inclusiveness that leads them to exclude certain segments of the poor while insisting on the eligibility of the rich (Conning and Kevane, 2002: 386). Immigrants of more or less recent origin, nomadic people, erstwhile slaves in caste societies, and/or widows may thus be precluded from benefiting from an external intervention. In a recent study of

Southern Sudan, it has thus been found that local views about who should benefit from famine relief efforts were very much at variance with those of the aid workers, which caused a lot of problems in the implementation of the project (Harragin, 2003). A similar difficulty emerges from another study dealing with a CBD project designed to promote community-organized and funded schools in Kenya (Gugerty and Kremer, 1999). A more optimistic conclusion has however been reached in still another study that found a good matching in rural Bangladesh between wealth-ranking judgments arrived at through a Rapid Rural Appraisal technique, on the one hand, and ratings obtained by using standard socioeconomic indicators from a household survey, on the other hand (Adams et al., 1999).

Tagging—*i.e.*, categorical targeting that offers eligibility to all members of a group defined by an easily identifiable characteristic or trait (Conning and Kevane, 2002: 380) — by the external agency seems to be the obvious manner to surmount such a divergence. Unfortunately, things may not be so simple. For one thing, there are many ways whereby community members can subvert a program if they think that it runs against some local social norm. These ways may not be easy to detect for the external observer, especially if the benefits received by, say, nomads or migrants, are not openly taken away from them but cancelled out through the withdrawal of some other benefit that they were previously enjoying. For another thing, by imposing eligibility or other criteria that are not compatible with the local culture, the external agency may cause tensions within the community that may hamper its ability to act collectively in other circumstances. Again, time is needed to overcome such differences.

Preferences can differ not only between community insiders and marginalized groups whose membership is questioned, but also among the community members themselves. The question as to how heterogeneous preferences are aggregated then comes to the fore. Rather than through majority voting, decisions tend to be made by the elite alone or, else, through unanimity voting (see Platteau and Abraham, 2002, 2003). In highly differentiated societies, mechanisms whereby a consensus is forged among contending parties are almost always a tool used by the elite to impose its own views behind a screen of democratic discussions. It is evident that when this happens the dominating community preferences will differ from those of the donor agencies. From a case study on the Jamaica Social Investment Fund (funded by the World Bank), Rao and Ibanez (2001) thus concluded that the overall quality of the match between local preferences and project achievements was poor. Only in two of the five communities studied was the project obtained consistent with the preferences of a majority in that community. Furthermore, better-educated and better-networked people were more likely to obtain projects that matched their preferences.

Because disadvantaged people can be easily manipulated by powerful and experimented elites, granting them reserved seats on a village council along the line of a positive discrimination strategy is likely to prove insufficient. In the presence of asymmetrical social structures, there is no other solution than empowering underprivileged groups, that is, mobilizing and organizing them in such a way that they can assert their rights to participate in decision-making even if that implies challenging existing social structures and antagonizing the elite. This is quite an arduous task, one that goes much beyond the usual understanding behind CBD. As aptly noted by Brett (1999: 12-13): « …participatory systems are rarely a response to demands from local people who may well be locked into hierarchical and deferential structures, but rather promoted in response to western values imported by donors. This obliges local communities to develop different kinds of organization from those they have used in the past, thus demanding new skills and the ability to overcome local opposition if they are to succeed ». Participatory development, therefore, « cannot be treated as a process in which facilitators merely 'enable' local people to do what they would have wanted to do anyway » (ibidem ; in the same vein, see Platteau and Abraham, 2002, 2003).

One may wonder, in particular, whether big bureaucracies with the kind of incentive systems that they have are really equipped to perform such a delicate job. In this respect, the evidence is worrying. Project facilitators tend to easily fall prey to the local elite either because they are in a rush to show results and therefore gloss over local power relations (Mansuri and Rao, 2003: 27-28), or because they are too weak to resist their pressure and the donor agency is not supporting them enough.

3.2 Elite Capture and Development Brokers

The problem of « elite capture » is especially serious as donor agencies are enthusiastically rushing to adopt the participatory approach because they are eager to relieve poverty in the most disadvantaged countries and/or because they need rapid and visible results to persuade their constituencies or sponsors that the new strategy works well. Clearly, such urgency runs against the requirements of an effective CBD since the latter cannot succeed unless it is based on a genuine empowerment of the rural poor (see, e.g., Rahman, 1993; Edwards and Hulme, 1995). If the required time is not spent to ensure that the poor acquire real bargaining strength and organizational skills, 'ownership' of the projects by the beneficiary groups is most likely to remain an elusive objective; such as has been observed in the case of the World Bank's Social Investment Funds (Narayan and Ebbe, 1997; Tendler, 2000: 16-17).

The perverse mechanism that risks undermining CBD is triggered by the temptation of donor agencies to skip the empowerment phase by asking intended beneficiaries to form groups or partner associations and to 'elect' leaders to direct them. As pointed out by Esman and Uphoff (1984: 249):

> « The most prominent members are invariably selected and then given training and control over resources for the community, without any detailed and extended communication with the other members about objectives, rights, or duties. Creating the groups through these leaders, in effect, establishes a power relationship that is open to abuse. The agency has little or no communication with the community except through these leaders. The more training and resources they are given, the more distance is created between leaders and members. The shortcut of trying to mobilize rural people from outside through leaders, rather than taking the time to gain direct understanding and support from members, is likely to be unproductive or even counterproductive, entrenching a privileged minority and discrediting the idea of group action for self-improvement » (Esman and Uphoff, 1984 : 249). [6]

6. In the light of this diagnosis, Cernea's contention that "NGOs insert themselves not as a third and different/independent actor, but as an emanation and representation of the community" (Cernea, 1988: 10), appears almost surrealist.

Confirming the prediction of Esman and Uphoff, several studies have concluded that the formation and training of village groups in community-based projects have the effect of encouraging the entry of wealthier and more educated people into leadership positions because of the attractiveness of outside funding (Gugerty and Kremer, 1999, 2000; Rao and Ibanez, 2001). In point of fact, a major problem confronted by the community development movement of the 1950s lay in its inability to effectively counter the vested interests of local elites (Holdcroft, 1984: 51). Being adept at representing their own interests as community concerns expressed in the light of project deliverables, local leaders often succeed in deluding the donors into thinking that their motivations are guided by the collective good (Mosse, 2001; Harrison, 2002; Ribot, 1996, 2002). Their demands are replete with the sort of pleas and vocabulary that strongly appeal to the donors and, in order to create the appearance of participation, they may go as far as spending resources to build community centers, hold rallies, and initiate showcase labor-intensive activities (Conning and Kevane, 2002: 383).

In lineage-based societies, local chiefs and elders from dominant lineages are ideally positioned to 'capture' the benefits of CBD projects. Instead of 'father figures' clinging to their traditional duties of guaranteeing people's livelihoods, redistributing wealth and settling conflicts in such a way as to maintain the existing social order, the erstwhile elite often become transformed into greedy individuals who show all the less restraint in enriching themselves at the expense of their community as they are actually legitimated by outside actors (Platteau and Abraham, 2002) [7]. As many NGOs working in

7. In some areas, they have been accustomed to doing just that since colonial or pre-colonial (slavery) times (see Bayart, 1989).

sub-Saharan Africa have experienced, local chiefs who are de facto 'elected' as representatives of their village community tend to require that any equipment or facilities made available through external assistance should benefit to them as a matter of priority. When the aid agency concerned resists such a demand, they often succeed in concealing their misbehavior from its scrutiny.

In Yalogo, in the northeastern part of Burkina Faso, where irrigated rice cultivation was introduced, villagers were asked to organize themselves into village-level peasant associations in order to manage the irrigation schemes (maintenance of water-control infrastructure, collective purchase of modern inputs, collective disposal of produce and the running of a credit scheme). In doing this, they were required to elect an executive committee comprised of a chairman, a secretary, and a treasurer. As the NGO soon discovered, the local chief was systematically chosen to act as the chairman of each association. Moreover, in the only village for which detailed information is available regarding the internal functioning of the local association, it appears that all important decisions are taken by the chief without consulting the members and the other persons in charge. The secret character of some of his dealings aroused serious misgivings about his honesty — in particular, his refusal to disclose the names of the persons to whom he claims to have granted loans as well as the amounts and repayment terms involved. Such an attitude is all the more unacceptable to the association members as the loans have never been repaid.

Another serious problem arose from the fact that the chief decided to sell the rice produced in the irrigation scheme to a trader who turned out to be his own brother — and who tried to cheat the farmers by underpaying them (setting purchase prices at levels much below the current market prices). Revealingly, the chief was unable or unwilling to compel his brother to pay the farmers their dues, in spite of the latter's grumbling. When asked as to why they do not react by removing their mischievous chairman, the members' typical answer is that such a step is inconceivable precisely because he is their chief (personal field observations).

Mismanagement of aid transfers can obviously occur in class- or caste-based village societies in which landed elites use their dominant economic, social, and political position to appropriate for themselves whatever portion of the resources that they need, and to let the poor have the leftovers only (Sara and Katz, 1997 ; Conning and Kevane, 2002 ; Bardhan, 2002). In their study of a decentralized food-for-education program in Bangladesh, Galasso and Ravallion (forthcoming) found that the program was mildly pro-poor, in the sense that a somewhat larger fraction of the poor received benefits than did the non-poor. They also found evidence of local capture, particularly in highly unequal or in remote villages.

The traditional elite are not the only category of persons to benefit from the newly channeled resources since they are frequently involved in tactical alliances with educated persons and politicians operating outside the village domain. Thus, in sub-Saharan Africa, it is a frequent practice for chiefs to co-opt new elites in their village 'associations', for example by creating neo-traditional titles that are then sold to the new rich eager to acquire a political base in the countryside (Geschiere, 1994 : 110; Bayart, 1989).

The urban, rather than the rural elite may be responsible for initiating the process that deflects CBD from its intended purpose.

Witness to it is the rapid multiplication of national NGOs that are created at the initiative of educated unemployed individuals, politicians, or state employees who may have been laid off — or deprived of access to key logistical resources — as a result of structural adjustment measures. Acting as 'development brokers', political entrepreneurs have been quick to understand that the creation of an NGO has become one of the best means of procuring funds from the international community (Bierschenk, de Sardan, and Chauveau, 2000). In the words of Chabal and Daloz (1999) :

> « …a large number of key political actors have now shifted their operations to the local level, which currently enjoys wide international favor and receives substantial assistance…[] a massive proliferation of NGOs … is less the outcome of the increasing political weight of civil society than the consequence of the very pragmatic realization that resources are now largely channeled through NGOs… Indeed, NGOs are often nothing other than the new 'structures' with which Africans can seek to establish an instrumentally profitable position within the existing system of neopatrimonialism… Above and beyond the new discourse of NGO ideology…, the political economy of foreign aid has not changed significantly. The use of NGO resources can today serve the strategic interests of the classical entrepreneurial Big Man just as well as access to state coffers did in the past… Furthermore, NGO-linked networks are inevitably intertwined with those emanating from the state » (Chabal and Daloz, 1999 : 22-24, 105).

Thus, in the case of Benin, a West African country especially spoiled by the donors, we learn that local NGOs and associations, which are often « empty shells established with the sole purpose of capturing aid », have multiplied within a short period of time to number several thousands. Many others wait to receive the approval of the ministry of interior (Le Monde, 26 February 2001). In non-African countries also, NGOs often constitute « an opportunistic response of downsized bureaucrats, with no real participation or local empowerment » and, inevitably, program officers themselves become involved in the creation of community institutions (Conning and Kevane, 2002: 383-84; see also Meyer, 1995; Bebbington, 1997 ; Gray, 1999). Such a risk is obviously high when self-conscious, organized local communities do not actually exist prior to the opening up of new development opportunities by state agencies or international donors (see Li 2001, for a well-documented illustration of this possibility), while the latter presume their existence on *a priori* grounds (McDermott, 2001).

Of course, not all local leaders are opportunists ready to divert foreign aid from the intended beneficiaries. Several studies actually point to substantial variations in targeting effectiveness across villages (Ravallion, 2000; Jalan and Ravallion, forthcoming). Interestingly, intra-village inequality is often found to be inversely related to this effectiveness (Galasso and Ravallion, forthcoming), confirming the prediction derived from Bardhan and Mookherjee's political economy model (see supra) and suggesting that unscrupulous leaders tend to have more margin of maneuver in highly unequal communities. It is true that, even in such communities, dedicated leaders may play a constructive role for the benefit of their people. Unfortunately, however, opportunistic leaders are numerous enough to constitute a serious threat to CBD in countries where the poor are not empowered. Before delving into this point, it is useful to provide some evidence of elite capture in the context of decentralized development experiences.

3.3 Misappropriation of funds by local governments

In Indonesia, the new devolution system has resulted in a situation where the provincial regents « exercise their new administrative and financial clout so imperiously that locals refer to them as 'little kings'. Stories abound of reckless extravagance or outright corruption… regents have simply seized companies belonging to the central government, or imposed arbitrary new rules on businesses. Fears of decentralization run amok are beginning to replace fears of Indonesia's disintegration » (The Economist, February 15-21, 2003: 54-55). In Nepal, decentralization created opportunities for elites to dominate decision making at the local levels (Bienen et al., 1990: 72-73). In India, as testified by one of the best documented studies available regarding one of the most comprehensive attempts at decentralization (Kumar, 2002), under present Joint Forest Management (JFM) arrangements, the poor are net losers and likely to remain so over a 40-year time horizon. If they participate in JFM, it is just to « state their loyalty to the village leadership ». In behaving thus, « the poor ensure that they can partake of at least some village institutions, and they build up their stocks of social capital » (ibid. 776). In Bangladesh, under Ershad's decentralization reforms, although people were mobilized at the local (Upazila) level, the decisions over allocation of resources continued to be made by elites of politically based factions that controlled the local governments (Westergaard and Alam, 1995; see also Das, 2000 and Véron, 2001 about the interference of patronage politics in the participatory planning programs of the Kerala state, India).

Turning our attention to sub-Saharan Africa, we learn that, in Senegal, municipal bodies or rural councils used the new prerogatives accorded them under the decentralization scheme to get involved in dubious dealings — such as sales of rural lands to touristic and other business interests without consulting the communities concerned as they should have done (Mosse, 2001). In Uganda, to take a last example, participatory planning appears to be « more a matter of form than substance ». As a matter of fact, local participation is reduced to a minimum, being « limited to counterfeit mechanisms of enfranchisement such as the 'Participatory Poverty Assessments' so alluring to Uganda's donors, which provide the desired facade of consultation » (Francis and James, 2003: 334-36). While important resources are channeled to local governments through conditional grants that leave little room for genuine people's participation in decision-making (such grants are essentially decided in a technocratic, top-down manner), other resources are made available through unconditional grants and locally generated revenue that create an ideal ground for the exercise of unfettered local patronage. Revealingly, Reinikka and Svensson (2001) found that in the period 1991-1995 only 13 percent of the total flow of educational funds granted by the central government for non-wage expenditures in schools (for textbooks, instruction costs, etc.) actually reached the schools after having transited through the local intermediary bodies. The majority of the schools did not receive any money on account of these non-wage educational expenditures. [8]

A rush for CBD does not only entail the risk of creating and reinforcing an opportunistic rent-seeking elite, but it also involves a

8. Note that problems of misaligned incentives, conflicts of objectives between higher-level principals and middle-level agents, manipulation of the rules of the games, and so on are not confined to developing countries. A recent example is a study of the Job Training Partnership Act in the U.S. (see Courty and Marschke, 1997).

serious bias in the selection of communities. Indeed, communities within easy reach tend to be privileged while they are not the most needy precisely because of their easy accessibility. They are better off since they have good access to markets, education facilities and all sorts of information. Note that their advantage in attracting donors' funds under participatory programs does not lie only in comparatively low transportation and other transaction costs, but also in their greater ability to set up an appropriate collective structure and 'elect' a leader speaking foreign languages.

3.4 An Illustrative Story from West Africa

In the late years of the 20th century, a Western European development NGO (whose identity is not disclosed for the sake of discretion) established a relationship with a village association in a Sahelian country. This association, which is a federation of several peasant unions, had been initiated by a young and dynamic school teacher, the son of a local chief. The NGO decided to follow a gradual participatory approach consisting of strengthening the association institutionally before channeling financial resources to it. This decision was the outcome of a carefully worked out diagnosis. It brought to light important weaknesses of the partner association that had to be corrected before genuine collaboration could take place : proclivity to view aid agencies as purveyors of money which can be tapped simultaneously; lack of analysis of local problems and of strategic vision for future action; loose and undemocratic character of the association (ill-defined objectives, ill-defined roles and responsibilities of the office bearers, absence of internal rules and reporting procedures, etc.).

After two years during which institutional support was provided in the form of guidance to improve the internal functioning of the partner association and to help define development priorities and the best means to achieve them, funds were made available for different types of investment. Within the limits of the budget set for each prioritized line of investment, the association could choose the project deemed most useful. A special committee was established to prepare rules regarding the use of the budget and enforce the abidance of such rules by different projects. In this way, the group could hopefully appropriate the process of decision-making, preparation of project proposals and programming of the activities involved (all aspects traditionally undertaken by the foreign donor agencies). Continued support at different levels (technical, administrative, organizational, and methodological) was found necessary to help in the effective implementation of the projects.

In spite of all these efforts to strengthen the partner association institutionally, things turned out badly. Thanks to the collaboration of two active members of the General Assembly (actually two animators) and the local accountant, the foreign NGO discovered serious financial and other malpractices that were committed by the main leader of the African association: falsifying of accounts and invoice over-reporting, under-performance by contractors using low-quality materials, etc. It reacted by calling on the local committee to sanction these manifest violations of the rules, yet at its great surprise no punishment was meted out and the General Assembly even re-elected their leader in open defiance of its request. The two dissident animators were blamed for being driven by jealousy and envy, while the accountant was fired. Here is a clear illustration of the support that poor people are inclined to give to an elite member: on grounds that they have benefited from his leadership efforts. That he appropriated to himself a disproportionate share of the benefits of the aid program is considered legitimate by most of them. They indeed think that without his efforts their own situation would not have improved at all. In particular, he created the village association which had to be formed in order to be eligible for external assistance.

In a context where the ability to deal with external sources of funding is concentrated in a small elite group, the bargaining strength of common people is inevitably limited — hence their ready acceptance of highly asymmetric patterns of distribution of programs' benefits. If the intervention of the elite results in an improvement of the predicament of the poor, however small the improvement may be, the latter tend to be thankful to their leader(s). The new outcome represents a Pareto improvement over the previous situation, and this is what matters after all. In the above example, it is thus revealing that the ordinary members of the association defended their leader on the ground that « everybody around him benefited from the project and, if he benefited [much] more than the others, it is understandable because he is the leader ». They think it is highly unfair on the part of the foreign NGO to have withdrawn their support to the existing team and to have « humiliated their leader » by depriving him of all the logistical means (jeep, scooters, etc.) previously put at his disposal.

As for the leader himself, he openly admitted (during a conciliatory meeting organized by the high commissioner of the province) to have used a significant portion of the money entrusted to him for his own personal benefit. Yet, he did not express any regret since it was his perceived right to appropriate a large share of the funds. Did he not devote considerable energies to the setting up of the local organization and the mobilization of the local resources as required by the foreign NGO ? By attempting to curb his power to allocate funds in the way he deemed fit, the latter exercised an intolerable measure of neo-colonialist pressure. This criticism was voiced in spite of the fact that the NGO paid him a comfortable salary to reward his organizing efforts.

Stories like this could be easily multiplied [9]. What must be stressed is that the attitudes involved partake of the logic of clientelistic politics characteristic of the African continent (and other poor regions, such as Bangladesh, Nepal, and Haiti, for example). In the words of Chabal and Daloz, indeed, « For those at the very bottom of the social order, the material prosperity of their betters is not itself reprehensible so long as they too can benefit materially from their association with a patron linking them to the elites » (Chabal and Daloz, 1999: 42). As a result, abuses of power are tolerated so long as the patron is able to meet the demands made by his clients who are concerned above all with ensuring their daily livelihood. It is ultimately because they overlook the genuine nature of the links between elites and commoners — the rulers and the ruled — in Africa that international donor agencies overestimate the capacity of the participatory approach to deliver development gains more effectively and equitably.

9. For example, in the case of a failed community association for forest management in Palawan Island (Philippines), we learn that the local leader mishandled the community resource and eventually succeeded in embezzling an NGO-provided fund. It is striking that "no one had the nerve to defy" him, a fact blamed on "a lack of community capacity"

4. Sequential and Conditional Disbursement Procedures in the Context of Decentralized Bilateral Relationships

4.1 Theoretical discussion

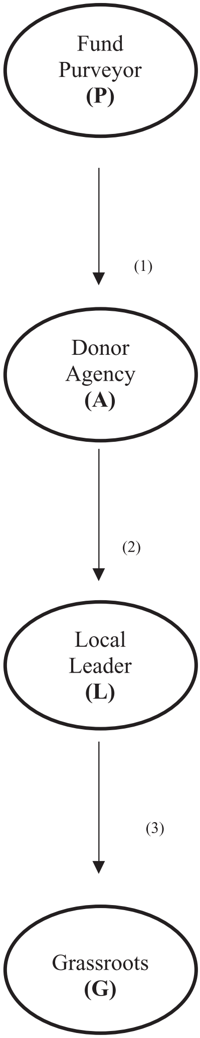
Consider the following analytical framework. We have four sets of actors, namely the ultimate purveyors of funds (denoted by *P*), such as the taxpayers or the general public in fund-raising campaigns, aid agencies (designated by *A*), local leaders or intermediaries (designated by *L*), and the grassroots (designated by *G*) who are the intended beneficiaries of the aid transfers.

To begin with, let us focus our attention on the last two steps in the sequence of aid disbursement, such as are represented by links (2) and (3) in Figure 1. In other words, we abstract away from the upper link between an aid agency and its ultimate fund purveyor. Following the logic of the CBD approach, *A* contemplates providing funds to a particular community or group of grassroots people, *G*, who do not have any alternative funding possibility. There is no direct contact between *A* and *G*, however, as A deals with a local leader or intermediary acting on behalf of the intended beneficiaries. Typically, *L* has organized *G* into a development association and has been elected president.

What *A* can do, however, is to check whether *L* is genuinely supported by *G*, say because *G* can be asked to confirm that *L* is their authentic leader, whether through a formal voting procedure or otherwise. As a matter of principle, *A* will not disburse funds through *L* unless it has received such a confirmation. How the money is being shared within the group or community is not observed by *A*, but *A* acts strategically taking the behavior of *L* into account while making its decision to support or not to support a given community.

Figure 1 :

The Sequence of Aid Disbursement



As for strategic interactions between *L* and *G*, if we believe the sort of story told in the previous section, they can be essentially depicted as an ultimatum game. That is, *L* has the first move and makes an offer to *G* regarding the apportionment of the aid fund. Then, *G* has to say whether they accept the offer or not, knowing that its rejection would mean the collapse of the group consensus required to receive aid from *A*. In such a game, as is well-known, it is in the interest of the second mover (*G*) to accept the proposal made by the first mover (*L*), and the latter's (*L*'s) interest is therefore to set the share accruing to the former (*G*) at as low level as possible. This is so because *G* does not wield sufficient leverage to dispute the self-asserted right of *L* to appropriate a large share of the aid proceeds. In fact, as illustrated in the above story, *G* may not resent *L*'s disproportionate share insofar as their own situation has simultaneously improved.

This is obviously a depressing result in view of the CBD's objectives. One would therefore like to conceive of some mechanism that could discipline local leaders in the absence of democratic governance within target groups or communities. The mechanism that comes immediately to the mind of economists is a stepwise process of aid transfer. Instead of releasing money in a single shot, aid funds would be disbursed in successive tranches, the disbursement of each of them being conditioned on *L*'s proper behavior regarding the use of previous tranches. Inherent in such a strategy is the recourse to a fraud detection technology without which local leaders would not be incited to behave. Detection is necessarily costly, yet it is in the interest of an aid agency to incur the related expenses since it can thereby hope to better achieve its own objective of poverty relief (fraud detection is incentive-compatible). As we know from repeated game theory, however, as long as the duration of the game is finite, and no matter how high the number of periods in the game, the equilibrium outcome will be the same as that obtained in the one-period game (Kreps and Wilson, 1982; Kreps, 1990: 536-43). The effort, including the monitoring resources, spent by the aid agency over the successive stages of the project will be of no avail. Assuming that the local leaders are selfishly rational, they will embezzle funds from the very beginning, and, knowing that, aid agencies should refrain from disbursing even the first tranche of money. True, if the aid agency interacts with communities over an infinite (or indeterminate) period of time, this awkward result can be avoided. But this is hardly a consoling thought inasmuch as CBD aid, in particular, is precisely aimed at making communities self-supporting after a certain period of time, and the limited duration of the external intervention is better made clear from the beginning.

That being said, the assumption of strategic rationality underlying the above reasoning is questionable. This is not only because actors may not perfectly anticipate the future consequences of their actions and the reactions of others, or because they may entertain doubts about the rationality of the persons with whom they interact (in which case we know that even in a finitely repeated game, cooperation may be established as an equilibrium), but also because some social norms may exist that have the effect of constraining rational calculations.

The existence of a norm of intertemporal fairness among G may thus make gradual, conditional disbursing of aid money effective even in the context of a finitely repeated interaction between *A* and *L*. The reason becomes evident if such a norm dictates that a division rule adopted during one period may not be changed at will by *L* during a later period, especially if the change is made at the expense of *G*. In other words, *L* is not allowed to reduce the share of aid transfers accruing to *G* over the successive stages of a project. In a two-period 'CBD game', he or she will thus be unable to strategically lower the share allotted to G between the first and the second rounds. As a result, since the granting of the second tranche is conditional upon *L*'s proper behavior in the previous round and since the probability of fraud detection can be assumed to increase with the extent of the embezzlement, the portion granted by *L* to *G* will be the minimum share compatible with an acceptably low risk of detection at the end of the first round, and this share will be applied again during the second round. Clearly, the norm of inter-temporal fairness serves the purpose of conferring a genuine bargaining power upon *G* during the second round.

This is not sufficient, however. For the mechanism to be effective, *G* must also be able to perfectly enforce *L*'s promise to pay them the agreed share of the aid transfer once *A* has released the money. The story told in the previous section seems to attest that enforcement is not the real problem: even though their leader embezzled substantial amounts of aid money, villagers did not feel cheated and actually voted for the predatory leader again even after his malpractices had been fully revealed and confessed. It therefore appears that *G* must be empowered enough to enforce *L*'s promise but not enough to actively debate the sharing rule with him (her). If *G* were not empowered enough even in the first sense, they would be doomed to be seriously exploited by *L* and there is not much that could be done to relieve their poverty until, through time-consuming conscientization and learning processes, they become better able to defend their rights and effectively participate in decision-making. On the other hand, if they were empowered enough in both senses, the sharing rule would be determined as the outcome of a bargaining process between *L* and *G*, and not by *L* only [10].

In the two-period game-theoretical model proposed by Platteau and Gaspart (2003b), *A,* which is altruistic, decides the way to allocate the available aid budget between two successive periods, as well as the amount of monitoring expenses on which the effectiveness of fraud detection partly depends. Given the amounts of the first and second aid tranches as well as the size of the monitoring effort made by *A*, *L* chooses the share of the aid transfers that he or she will hand over to *G*, among whom a norm of intertemporal fairness is known to prevail. While making its decisions, *A* faces the following trade-off : On the one hand, *A* would like to disburse as much money as possible during the first period because it is impatient to see the poverty of *G* alleviated. On the other hand, *A* wants to defer its disbursement of aid till the second period, since late payments serve to discipline *L*. Indeed, the higher the amount of the second tranche relative to that of the first, the more *L* is encouraged to use the aid transfers according to *A*'s prescriptions (that is, for the benefit of *G*). [11]

10. Provided that the bargaining strength of G is strong enough, disciplining L with the help of a stage-process of aid disbursing will not have the effect of raising the share of aid money accruing to the intended beneficiaries. To achieve its objective, the aid agency could therefore rely on the bargaining strength of the latter. To be sure, some embezzlement would still occur, but the agency would not be able to do better by using such a stage-mechanism .

One important result derived from the comparative-static of the model is the following: the more impatient the aid agency — that is, the more A discounts the benefits enjoyed by the target population during the second period — the smaller the amount of the second aid tranche relative to that of the first tranche (and the lower the share accruing to G). If A is very impatient, the share accruing to G will tend to a value as low as that obtained under a one-shot disbursement procedure. In other words, because the subjective cost of waiting is higher, A is less ready to use the leader-disciplining mechanism and to postpone disbursement of aid funds. As a consequence, L is less effectively induced to behave during the initial period, holding monitoring expenditures constant. At the new equilibrium, however, the amount of these expenditures is being increased. The net effect of these two opposite forces is nevertheless shown to be detrimental to G : the share appropriated by L increases and the absolute amount of aid money that will accrue to G if there is no detection of fraud by A is smaller. Bear in mind that monitoring expenses, which have been increased to substitute for the smaller use of the conditional mechanism of aid disbursement, are to be subtracted from the gross aid budget before transfers to G are made.

A second interesting comparative-static result is that the higher the cost of recycling aid funds — or the smaller the proportion of aid money earmarked for the second tranche that can be costlessly redirected to another group or association in the event of detected fraud in the initial project — the lower the relative amount of the

11. Note that the amount granted under the first tranche must be positive so as to ensure that L's behavior can be effectively tested before making a decision about whether or not to disburse the second tranche.

second aid tranche, the smaller the share accruing to *G*, and the lower the amount of aid money accruing to them in the absence of fraud detection. In other words, if it is more difficult to reallocate funds intended for a particular project, say, because of larger set-up costs, a donor agency will find deferment of their disbursement to be less attractive in equilibrium. As a result, *L* will be in a better position to appropriate the aid money. Aid agencies may therefore be tempted to avoid working in low density and remote areas where high set-up costs (arising from long distances to be traveled, low education levels, etc.) tend to reduce the effectiveness of their efforts to reach the poor.

4.2 An illustrative simulation

In order to illustrate the effects just described, let us now use a simplified version of Platteau and Gaspart's model in which monitoring expenditures are assumed to be exogenous : their level reflects the degree of control that aid agencies exert on the activities of their partner associations (see Platteau and Gaspart 2003a). The exercise consists of simulating the share of aid money accruing to the poor (henceforth called s), and the share of the total aid budget disbursed in the second round (labelled *g)* under different sets of assumptions regarding parameter values. Results are presented in Table 1 below.

Thus, for example, (a) if the level of effectiveness of the detection technology (denoted by ε) is minimum; (b) if, for the donor agency, one unit of aid money that reaches the poor in the second period is worth only 40 percent (a weight called μ) of the value associated with one unit of money going for immediate relief of

Table 1

Simulations of the outcomes of the leader-disciplining mechanism under various sets of assumptions

$\varepsilon = 1$

$\mu = \eta$	S	g	π
0.5	0.37	0.84	0.40
0.4	0.34	0.77	0.44
0.3	0.31	0.70	0.48

$\varepsilon = 3$

$\mu = \eta$	S	g	π
0.7	0.61	0.73	0.46
0.6	0.58	0.63	0.53
0.5	0.55	0.54	0.62
0.3	0.50	0.44	0.75

$\varepsilon = 8$

$\mu = \eta$	S	g	π
0.8	0.75	0.67	0.50
0.7	0.72	0.53	0.63
0.6	0.69	0.43	0.77

poverty (that is, which reaches the poor in the first period) ; and (c) if only 40 percent of the aid money can be recycled in the event of fraud detection followed by withdrawal of the second tranche (a parameter denoted by η), we find that s is just about 1/3 while *g* is as high as 77 percent. The probability of fraud detection (called π) is then equal to 0.44. If the values of the parameters mentioned under (b) and (c) are raised to 0.80 instead of 0.40, and if the effectiveness of detection is eight times as high as the minimum level, the portion *s* works out to _ while *g* is 2/3. As for the probability of detection, it rises to _.

Note that at equilibrium the leader unduly appropriates for himself a large share of aid money (see the second column of the table) and, as a result, there is a positive probability that fraud will be detected (see the fourth column). In the aforementioned example of a European NGO working in a Sahelian country (see Section 3), embezzlement has occurred and has been detected. The reaction of the grassroots to the withdrawal of aid by the funding NGO is revealing of the large measure of their agreement with, or understanding for, the leader's behavior. Informed they were, or they have become, yet knowledge about the extent and nature of the leader's misdeeds did not prevent most of them from siding with him against the alarmed NGO.

4.3 Local monopoly, monopolistic competition, and perfect competition as different market conditions governing the supply of aid funds

Let us now sum up the main lessons drawn from the foregoing discussion. If *A* adopts a sequential, conditional disbursement procedure, and if *G* wields enough power to compel *L* both to stick to his (her) promises and to maintain over time the sharing rule followed in the initial round, then *A* is able to discipline *L* so as to make him (her) share aid money more or less equitably with the intended beneficiaries. This said, it must be emphasized that the above model implicitly assumes that *A* enjoys local monopoly power in the supply of aid funds. In point of fact, the problem gets complicated once aid agencies compete among themselves for access to target groups or communities. If perfect competition prevails in a context characterized by an abundant supply of aid funds, *G* will only get crumbs. This is the worst scenario: in their attempt to lure local leaders 'representing' communities, aid agencies are ready to drop their safeguards against the appetite of these leaders. Money is disbursed quickly without paying much attention to the manner in which it is shared between *L* and *G*.

A less pessimistic scenario arises if we consider, perhaps more realistically, that aid agencies do not produce a homogeneous service but differentiated, multi-attribute services comprising the total aid budget on offer, the timing of its disbursement over the successive tranches, and the monitoring effort. Monopolistic competition would then prevail amongst donor agencies and Platteau and Gaspart's analytical framework could be adjusted accordingly. This would imply that an exit option now exists for *L*, and that two critical parameters of their model, namely *A*'s inter-temporal preference, and the cost of recycling aid funds, are re-interpreted as possibly reflecting the intensity of prevailing competition among donor agencies.

Regarding these latter two factors, the comparative static of the model indicates that acute competition is an unambiguously regrettable feature of the aid environment. As a matter of fact, by driving aid agencies to disburse funds quickly in order to prevent rival agencies from de-stabilizing a relationship with a particular local partner association or community, and by increasing the cost of recycling funds in the event of fraud detection, acute competition causes the share of aid funds appropriated by local intermediaries to increase at the expense of the intended beneficiaries. In other words, intermediaries can skillfully play on inter-agency competition since they know both that aid agencies are keen to find partners through whom to channel their aid budget and that this budget is more or less tied to the initially chosen project or community.

It is also evident that the emergence of exit options following the proliferation of aid agencies has the effect of raising the share that local leaders are allowed to appropriate at equilibrium — that is, the share that will deter them from pursuing a shifting strategy. A shifting strategy is a strategy whereby *L* does not care about staying with the same agency over the whole course of the aid project because he or she is ready, if caught cheating, to shift to another agency and start cheating again. What is at work here is a so-called bilateral reputation mechanism (BRM) : if caught embezzling funds, a local leader is punished only by the aid agency that has actually provided the funds embezzled. Note, however, that if exit options are too attractive, it will be impossible to discourage *L* from shifting partners continuously after stealing the whole amount of the first tranches of aid money. As a result, no agency will release money for CBD.

There are apparently two ways whereby the "elite capture" problem can be mitigated. Reducing competition through concentration of aid supply in the hands of fewer agencies is the first way. Indeed, by diminishing the exit options available to local intermediaries, especially if aid agencies are geographically specialized, such concentration in the market for aid would have the same effect as a reduction in the aggregate supply of aid. The presence of scale economies in the technology of fraud detection when projects are geographically concentrated would constitute an additional advantage for this first solution. The second solution consists of a coordination mechanism whereby aid agencies would mutually inform each other about fraudulent acts committed by intermediaries. While such a device — known as a multilateral reputation mechanism (MRM) — is apparently more feasible than reducing competition, it is not devoid of serious practical difficulties as will become evident from the discussion below.

5. Multilateral Reputation Mechanisms

5.1 Circulation of fraud-related information among aid agencies

The MRM has been documented by Greif (1989, 1994) with respect to relationships between traders (see also Platteau, 2000: Chap. 6 ; Aoki, 2001 : Chap. 4). Applied to our problem, the mechanism would work as follows: Operating within a repeated-game framework, an aid agency would adopt the strategy whereby its grants money to a local leader, but only provided that he (she) is not known to have cheated another agency some time in the past. If money is thus disbursed and the benefiting leader is later found to have cheated the agency, the latter dutifully reports the fraud and communicates the name of the malevolent leader to the other members of the donor community. Before embezzling funds, a leader would thus be incited to think twice because by cheating today he or she would spoil his (her) reputation for future interactions with the whole donor community. The multilateral reputation strategy can be shown to be an equilibrium strategy. That is, if a leader expects every donor agency to adopt such a strategy, his (her) interest is to share the aid fund equitably among the intended project beneficiaries. Knowing that reaction, the interest of all aid agencies is to cling to the multilateral reputation strategy. Honest behavior therefore gets established as a (Nash) equilibrium.

There are several problems with the MRM, however. The first one stems from the fact that the information conditions that must be fulfilled for it to work are extremely stringent: information must circulate perfectly between donor agencies. This is unlikely to be the case in reality, because they are large in number, scattered around the developed world, and very heterogeneous in terms of several key characteristics (size, ideology, methods, time horizon, etc.). These are hardly ideal conditions for a dense information network to exist.

Is the establishment of a private third party charged with centralizing information (as suggested, for example, in the Law Merchant system analyzed by Milgrom, North, and Weingast (1990), the solution to the problem caused by the costliness of generating and communicating information ? Such a system can effectively work only if donors have an incentive to detect fraud and report fraudulent experiences to the third party, so that the black list of dubious intermediaries in its hand is exhaustive and regularly updated (otherwise, donors would not be induced to consult it). Yet, in so far as the detection and reporting of a fraud once it has occurred entails costs but brings no benefits to the individual agency which has been cheated, such an incentive does not exist. Unless, of course, aid agencies are so genuinely committed to the cause of poverty relief that they are not concerned about whether poverty is reduced by themselves or by another aid agency.

To create the adequate incentive, the third party should be able to exercise pressure on the detected fraudulent leader so as to make him (her) return the stolen money. A provision requiring an aid agency to make appropriate queries with a third party about the reliability of its current partner — or else forfeit its right to use the system to obtain compensation — would also make it in the interest of donors to query about past dealings of the partner-leader considered before disbursing money. As a result, so the theory goes, the threat against potential leaders would be effective, and, if caught, a fraudulent leader would be prompted to comply with the third party by returning the money stolen (so that his name is removed from the black list). This said, Milgrom, North and Weingast have nevertheless shown that honesty will be established as a (symmetric sequential) equilibrium under the above mechanism only if a number of conditions are met—in particular, the cost of information query, the cost of appeal to the third party, and the cost for the latter to recover the stolen money from fraudulent local leaders ought not to be too high. Unfortunately, these assumptions are likely to be violated in the case under concern, especially because the headquarters of aid agencies are located at great distances from one another, and all kinds of information are costly to acquire—

including evidence of fraud in the opaque context of alien cultural environments. The mechanism is therefore not self-enforcing.

A second, equally important problem lies in the fact that local leaders may not be actually concerned with preserving their reputation because their time horizon is short and they could be quite happy with running away with the money stolen from one single project. In other words, the payoff from dishonest behavior is so large compared to the payoff from honest behavior that honesty cannot be induced at equilibrium.

5.2 Rating of aid agencies by ultimate fund purveyors

Up until now, one key actor has been missing from our discussion, namely the ultimate purveyors of funds from whom aid agencies obtain their financial resources. These ultimate fund-providers create a further link in the game (see link (1) in Figure 1), giving rise to a new space of strategic relationships. As far as disciplining of local leaders is concerned, their contribution may be positive or negative depending on the way they interact with aid agencies.

The latter possibility arises if aid agencies expect them to react adversely to news of embezzlement, for instance, through revocation of funds. In such circumstances, an aid organization has no incentive to report the acts of malfeasance detected in its projects. In the words of Alnoor Ebrahim (2003: 818), evaluations that reward successes while punishing failures « encourage NGOs to exaggerate successes, while discouraging them from revealing and closely scrutinizing their mistakes ». What we have here is a genuine Prisoner's Dilemma: an aid agency refrains from disclosing cases of embezzlement because it entertains the hope that other agencies would candidly reveal their own bad experiences — or because it fears that, should it convey the information, others might not have done it and would then exploit the situation to their own advantage. That the above risk is real is evident from the atmosphere of secrecy that surrounds the activities of many donor organizations, including NGOs. This atmosphere of secrecy is obviously detrimental to the effective functioning of a multilateral reputation mechanism such as discussed above.

On the contrary, ultimate fund-purveyors can play a positive role if their understanding of the complexity of CBD processes is sophisticated enough to make them aware of the inevitability of failures. Honest aid agencies that openly admit cases of cheating would then not be unfairly sanctioned to the benefit of more opportunistic ones. They could even be induced to reveal embezzlement cases, if the disbursement and monitoring procedures used by aid agencies — as well as the duration of their CBD projects — were used by fund-providers as a yardstick upon which ratings of these agencies are based. In this perspective, self-reported cases of fraud detection could be considered as indirect evidence of the effectiveness of monitoring activities rather than as signs of failure. Not only are such characteristics rather easy to observe, but they also offer the advantage of not creating perverse incentives for the rated agencies.

The same cannot be said of other, more conventional criteria used to evaluate the work of aid agencies. Resorting to measures of outputs — such as improvements in the levels of living of the poor inside the communities chosen — is an ideal procedure but is most likely too costly to be feasible, especially in the case of NGOs, which have typically diverse and long-term objectives (see Edwards and Hulme, 1996; Ebrahim, 2003). Moreover, such measures could introduce biases in the selection of communities by the rated agencies. As a matter of fact, the latter would be induced to choose communities in which poverty can be more easily reduced for other reasons than the prevailing power structure *(e.g.*, easy accessibility).

The need for a proper evaluation of aid agencies is all the more pressing, as, side by side with serious agencies, there exist careless organizations that do not implement sequential disbursement mechanisms with a view to disciplining local leaders. Such organizations tend to disburse funds quickly either because they do not have a proper understanding of the one-period game being thus played[12], or because they are not single-mindedly pursuing the objective of poverty alleviation. (For example, in spite of all their pro-poor rhetoric, they are also concerned with reproducing themselves as job- and income-providing organizations in the West). Their presence further complicates the problem of 'elite capture' not only because it has the effect of increasing the exit options available to local intermediaries but also because it makes the establishment of a MRM among all donor agencies impossible. In fact, in the same way that « bad money chases good money », the operation of these opportunistic aid agencies risks driving 'good' agencies out of business or, else, it will force them to relax or altogether give up their gradual and conditional disbursement procedures. Indeed, if offered the choice, local leaders will normally prefer to work with "bad" agencies. And if the latter are numerous enough, 'good' agencies

12. Imperfect knowledge of the game typically arises when aid agencies tend to underestimate the leverage of the local leader within the group, or to overestimate his or her degree of altruism, either as a result of the leader's cunning ability to deceive them, or of their own naivete.

will not be able to attract partner communities unless they soften their approach to aid disbursement.

A crucial difficulty remains. As a matter of fact, it is easier for central funding bureaucracies (such as the European Community or the cooperation administrations of national governments) than for the scattered contributors to fund-raising campaigns organized by NGOs to use the sort of evaluations envisaged above — and to condition their financial support on the results of these evaluations. The crux of the problem lies in the fact that many donors in the general public have a poor understanding of development issues, partly as a result of distortions carried through the media and the deceiving messages conveyed by aid agencies themselves. There generally prevails the simplistic idea that failures in development projects are necessarily the outcome of incompetence and mismanagement on the part of the aid agency concerned, all the more so if many other agencies claim repeated successes.

Development aid is seen by many as a simple transfer of equipment and know-how to those in need. The important role of institutional arrangements, power relations, and organizational learning tends to be underestimated. Therefore, failing projects are seen as an anomaly. Such a lack of proper understanding of the complexity of community-based development processes is actually worrying — in so far as leaks about even a few cases of failure may cause public opinion to easily swing from an attitude of general optimism to one of general pessimism and distrust in aid agencies. If that happens, all aid agencies will lose. To get out of this dangerous situation created by the versatility of public opinion, there is no other way than to educate the public about the real challenges and difficulties involved in CBD. Development education is clearly a public good. Aid agencies that free ride on this effort by claiming easy successes may, in the end, do it at their own peril.

5.3 Alternative accountability mechanisms

It could be argued that, of late, there has been a tendency among some aid agencies to organize collectively with a view of ensuring better conduct in the profession in mind (Edwards and Hulme, 1996). In the United States, for example, a set of standards was developed in 1993 by Inter-Action, a membership association of US private voluntary organizations. « These standards lay out, in some detail, requirements concerning governance, organizational integrity, finances, public communication and disclosure, management and hiring practices, programs, and public policy involvement… Implementation of these standards is based on self-certification, subject to review by a Standards Committee which is also empowered to investigate complaints about noncompliance » (Ebrahim, 2003 : 820). In Bangladesh and India, likewise, associations of development agencies have come to life which have adopted their own code of ethics. Other mechanisms of accountability are also being tried, such as social auditing, which involves « a shift from highly circumscribed evaluations of individual projects or programs to a broader assessment of the organization as a whole » (ibidem : 823; see also Zadek and Gatward, 1996). External verification of social audits seems essential if they are to be an effective means of tempering exaggerated claims by non-profit organizations about their own achievements.

Problems with such endeavors ought not to be underestimated, however. As a matter of fact, codes of conduct are typically statements about general principles that are not easily translated into operational guidelines and enforceable standards. It is hard to deny that lack of satisfactory evaluative mechanisms is a serious drawback when it comes to NGO accountability, and that indicators of the quality of their work are very rare — especially if their main aim is the empowerment of the poor (Edwards and Hulme, 1996 : 11). This situation often arises because it is easier to agree on general ideas than to converge on strict and externally verifiable rules. And if a satisfactory agreement is eventually reached, it is most likely adopted by only a restricted number of operating agencies. Devising and enforcing NGO codes at an international level appear to be fraught with particularly awkward problems of coordination. Note also that, as pointed out above in connection with the MRM, uncertainty regarding the impact of social audits on the ultimate purveyors of aid funds is bound to make many NGOs reluctant to adopt them even though they may agree on their necessity in principle.

5.4 Fraud detection and impact assessment studies

It is evident from the whole analysis proposed in this paper that mechanisms of fraud detection have a key role to play in the disciplining of local leaders acting on behalf of target communities. Whether in the framework of bilateral reputation mechanisms based on sequential and conditional disbursement of aid money, or in the framework of multilateral reputation mechanisms based on good dissemination of information among aid agencies, local leaders cannot be induced to behave if the probability of their being caught and thereafter punished is too low owing to ineffective fraud detection. Platteau and Gaspart (2003b) have shown rigorously that the share of funds reaching the grassroots decreases with the ability of an aid agency to detect fraud. Moreover, a low intrinsic ability to detect fraud (because the fraud-detection technology used is rather inefficient) can be compensated only partly by the positive effect of an increase in monitoring expenditures. Bear in mind: the larger such expenditures, the smaller the net amount of aid funds available for the project's objectives proper. It is therefore essential to devise and put into use satisfactory procedures aimed at assessing the extent to which the grassroots have benefited from CBD projects.

For well-focused interventions the outputs of which are easily observable (think, for example, of projects intended for distributing school manuals to rural pupils), such assessment does not raise many problems and a careful impact study can show whether the aid transfer has reached the intended beneficiaries. Yet, in the case of more complex interventions, it may be more difficult to arrive at a sound judgment about the real destination of aid resources. There are actually many subtle ways in which astute local leaders can divert funds destined for a collective project; unmasking these ways may prove quite tricky. Usually, the truth cannot emerge unless villagers are willing to speak out to agency's mission staff or to external evaluators. It is here that the main source of the problem lies. In point of fact, it is often in the villagers' best interest to remain silent about malpractices committed by the rural elite because, being in a dependent position, they have more to lose than to gain from revealing fraud.

Indeed, whereas they are involved in continuous long-term relationships (they play infinitely repeated games in various walks of their ordinary life) with their local patrons, the duration of an external intervention is necessarily of limited duration. In other words, the long-term cost of antagonizing a patron who can punish a noncompliant client in diverse ways is likely to exceed by a wide margin the short-term benefit of revealing facts about the sharing of aid proceeds. It is a rule that external donors are considered by local beneficiaries as ephemeral actors who carry much less weight than powerful local figures.

As the case study material presented in the latter part of Section 3 attests, factional competition within rural communities may incite some people to reveal facts of malfeasance if they have been committed by rival leadership figures or patrons. Confronted with the threat of such revelations, local leaders could thus be hopefully disciplined in their handling of CBD funds. This said, one must also reckon with the negative externalities of a mechanism that fosters intra-elite competition rather than cooperation when collective endeavors are necessary for local development. There is clearly a dilemma here: not-too-good relations between local leaders are necessary for effective fraud detection, yet they are a liability threatening collective action at village or community level.

6. Decentralized development under the aegis of the state

Resources channeled to local organizations-or to local governments for that matter — may come from national or state governments rather than from foreign donor agencies, even if part of the required resources may ultimately be provided by the latter. Note that, when aid transfers to communities are anchored in a framework of fiscal decentralization — in many low-income countries, decentralization is « primarily about providing centrally collected tax revenue to lower levels of government, rather than seeking to empower lower levels of government to collect taxes » (Bardhan, 2002 : 189)[13] — there is an endless round of disbursement periods. The situation would therefore correspond, explicitly, to an infinitely repeated game. Because this framework is now explicit, the norm of inter-temporal fairness and the ability of the beneficiaries to perfectly enforce the leader's promise need not be assumed any more: the infinite (or indeterminate) duration of the game played between the beneficiaries and the leader-intermediary is sufficient to discipline the leader.

If there are continuous interactions between L and G, the share accruing to the latter will be endogenously determined as the equilibrium outcome of such strategic interactions. If the equilibrium share thus obtained is larger than the one resulting from the leader-disciplining mechanism, then it will prevail. In the opposite case, the share induced by such a mechanism would be established. As a countless number of equilibria exist in an infinitely repeated game, no fresh insight can be gained from theorizing this case further.

Moreover, the cost of recycling funds when a local government has been found guilty of embezzlement is low if the central government is the only source of finance for the communities (or municipalities) and the central government can easily redirect its resources following punishment of the fraudulent locality (whether punishment involves a definitive or a temporary cessation of transfers). As we know, a low cost of recycling causes local leaders or governments to be well disciplined with fortunate consequences for

13. To put it in another way, "the focus is on public expenditure assignments, unaccompanied by any significant financial devolution" (Bardhan, 2002: 189).

the ordinary citizens. Here is therefore an additional reason why, in theory, fiscal decentralization would operate effectively in favor of the poor: to the extent that the central government monopolizes the resources to be put at the disposal of local groups, it prevents competition between alternative financing sources from increasing the cost of recycling funds[14].

In the light of some of the evidence available, it is now interesting to examine whether 'elite capture' is a serious problem in decentralized development programs and how the lessons that can be learned from such evidence can be related to our discussion of the leader-disciplining mechanism.

One of the central conclusions that we can draw from the experience of such programs is the following: in order to curb the obnoxious influence of vested interests of local power-holders, a strong and effective central government must exist — one that is determined to confront the clientelism of rural areas in an environment rife with rent-seeking opportunities. Thus, Tendler's detailed inquiry into the reasons underlying Brazil's success in decentralization of public service from state to municipal government (in the state of Ceara in the Northeast) lays emphasis on the fact that « it had at its core a strong and new role played by central government » (Tendler, 1997: 73). More precisely, the (state) government

14. Note that, in the case where the long-term relationship between the central and the local governments implies that new programs will be launched in the future, the threat of punishing fraudulent local powers is automatically credible. Indeed, if the threat was not carried out, a fraudulent local leader would appropriate the whole transfer in the new program, knowing, on the basis of past experience, that no sanction will be meted out to him. On the other hand, if the repeated game consists of an indefinite series of disbursement periods within a transfer framework set once and for all, the credibility of the punishment threat would have to be based on considerations outside the model as though the game were played only once.

'kept an iron hand' on some crucial components of the decentralized programs so as to substantially reduce the opportunities for mayors and local power-holders (especially large landowners) to exercise patronage. Simultaneously, it worked actively (through educational and information-spreading campaigns) to raise the hopes of rural communities about what to expect from their government. The result was a profound change in the dynamics of patronage politics as it related to public service at the local level.

That the ability of the central government to set directions and strictures regarding how programs of decentralized development should operate locally can create much-needed constraints on rent-seeking behavior by local elites (and government workers) is also evident from the experience of Bolivia's Emergency Social Fund (ESF). Here, we are told that « Decentralization worked because centralization worked. The ESF centralized the appropriate things: information, negotiations with international donors, and incentive systems for ESF employees. This in turn enabled it to decentralize the design and construction of rural projects » (Klitgaard, 1997: 1965-67 ; see also Stavis, 1982-83, for Taiwan) [15].

By contrast, in Jamaica, where the government does not exercise a significant measure of control over the mode of functioning of the Social Investment Fund at the local level — the Fund just screens the applications on the basis of its target criteria which mandate a focus on the poorest communities and the selection of projects within a rather flexible list of priorities — the whole process appears to be elite-driven and decision-making to be dominated by a small group of better-educated and better-networked individuals (Rao and Iba-

15. Nevertheless, not everybody agrees that the Bolivian experience was such a success (see, e.g., Graham, 1998).

nez, 2001). In Senegal (in the Petite Côte and Casamance, in particular), likewise, municipal bodies or rural councils used the new prerogatives accorded them under the decentralization scheme to get involved in dubious dealings — such as sales of rural lands to touristic and other business interests without consulting the communities concerned as they should have done (Mosse, 2001).

The experience of Kerala (a state located in southwest India) is especially instructive. Here is a state that embarked upon the decentralization experiment with particular boldness. In 1996 that the ruling left-coalition government decided to allocate 35-40% of its annual budget for new development plans to projects designed by the local bodies themselves (Véron, 2001 : 606). Furthermore, the government (the State Planning Board, more precisely) is ultimately responsible for setting the national and regional priorities under which the program is to operate (e.g., priority to productive investments), defining the eligibility criteria, fixing the representation of various population groups or strata in the local decision-making bodies as well as their mode of operation, providing guidelines on what village reports should contain, etc. (Isaac, 1998 ; Isaac and Harilal, 1997; Véron, 2001).

What is remarkable about Kerala is that, following a long period of intense social struggles (starting in the 1930s) led by the Communists and an intensive literacy and conscientization campaign, the weakest sections of the rural population — especially agricultural laborers (always belonging to the lowest castes) and women—learned to articulate and express their aspirations, assert their rights, and bargain with local power-holders. The active participation of the poor and the oppressed in these struggles was facilitated by the fact that the political movement (especially in the Malabar district) was based on village-level organizations, with village- and taluk-level committees playing a critical role (Kannan, 1988; Ramachandran, 2000 ; Ramanathaiyer and MacPherson, 2000; Heller, 2000, 2001)[16]. These achievements create particularly favorable conditions for the successful implementation of a participatory approach to rural development as seems to be attested by significant success stories (Das, 2000). As a matter of fact, it is almost a trivial observation that when the poor are strongly organized they are better able to oppose the attempts by the elite to capture the benefits of decentralization (see, *e.g.*, Galasso and Ravallion, forthcoming).

Unfortunately, the initial conditions prevailing in Kerala were not all favorable to an effective working of decentralized development. One condition, in particular, was to prove especially damaging ; namely, the excessive party-politicization down to the local level, as a result of which the program quickly became a platform for political favoritism [17]. As a matter of fact, political parties have emerged as the most important intermediaries between people and the state,

16. It is not surprising that, when the Communist Party (CPM) embarked upon the decentralization program, it had undergone the strong influence of some key leaders of the KSSP (the Kerala Sastra Sahitya Parishad, or Kerala People's Science Movement), an autonomous mass-based organization aimed at empowering the grassroots, particularly in rural areas (for more details, see Heller, 2001). As will be seen later, however, the commitment of the CPM to the program was far from faultless, and considerations of political expediency on the part of a party with a deep-rooted tradition of centralized management may have been rather shallow, after all.
17. Politicization takes on worse forms in countries which have an authoritarian past. This certainly applies to Vietnam, where most NGOs are run by state employees who may also be members of the Communist Party. Moreover, "they are growing in an incubator, and the government retains the authority to close down any groups that challenge the state's ideological hegemony over the public sphere" (Gray, 1999: 711).

replacing traditional mediation channels, whether based on caste, religion, or community. In spite of elaborate objective procedures for the selection of program beneficiaries, development activities organized through local panchayats have turned out to be a battleground used by political parties to maintain or enlarge their clientele. When a party dominates a panchayat, it thus tends to reward its sympathizers exclusively.

It is a heartening sign that such political favoritism has backfired in the last panchayat election. The main loser has indeed been the Communist Party (CPM), which was the actual protagonist of the decentralized development program. In the last election, tickets were cynically denied « to almost all those who had worked tirelessly for the success of the people's plan » and were largely responsible for significant achievements wherever they occurred. Revealingly, they were dedicated and courageous panchayat presidents and other office-bearers who « refused to play to the party's diktat, particularly in the matter of the distribution of patronage » (Das, 2000: 4303). Resistance against decentralization within the CPM is partly explained by the fact that government employees, who form an important constituency of this party, actually oppose the devolution of powers to local bodies because this process has the effect of fragmenting bureaucratic prerogatives. Owing to their obstructionism, the kind of support systems and expertise envisaged at the gram, block, and district panchayats under the people's plan program could not be provided to the extent required (ibid. : 4302).

As a consequence, the whole exercise of preparing local plans reflecting the actual needs and requirements of the people — as well as fulfilling the primary objective of the program, namely asset creation for the poor — « ultimately came to rest in the hands of people who had had no experience of the planning process » (Das, 2000: 4302), and who could easily be manipulated by local political bosses and private contractors driven by vested interests[18]. In so far as funds' beneficiaries were often selected on the basis of political considerations, and new project proposals were arbitrarily included just before finalization of the plan, many villagers became disillusioned with the whole process and soon started to distance themselves from the experiment. It is therefore not surprising that absenteeism quickly rose in the gram sabhas, in sharp contrast with the initial days where « these sabhas had incredible attendance » (Das, 2000: 4302).

What the aforementioned experiences suggest is that decentralized development cannot succeed unless the central government is able and willing to use an effective fraud detection mechanism to control local-level opportunism (such as was the case in Brazil). As pointed out by Heller, a critical precondition for decentralization is « a high degree of central state capacity ». Decentralization cannot work in a country characterized by a weak state because, « when a weak state devolves power, it is more often than not simply making accommodations with local strongmen rather than expanding democratic spaces » (Heller, 2001: 139). In other words, decentralization needs to be accompanied by « serious attempts to change the existing structures of power within communities and to improve opportunities for participation and voice and engaging the hitherto disadvantaged or disenfranchised in the political process »

18. Thus, if the rules for representation regarding women and backward communities have been religiously adhered to, their effectiveness is seriously undermined because enough attention has not been paid to the capacity of the candidates to adequately perform their duties.

(Bardhan, 2002: 202). In some circumstances, the achievement of these objectives requires the central state to play activist roles (ibidem).

Finally, when decentralization is excessively politicized and favoritism and nepotism are the guiding principles of politics, such as was observed in Kerala, the leader-disciplining mechanism is also doomed to failure. In this case, mismanagement of the decentralization program is not to be blamed on local strong men who are having their own way because they escape the control of the central state. It results instead from the active collusion between the former and the latter. In these circumstances, the central state is unwilling rather than unable to use a fraud detection mechanism.

7. *Conclusion*

There are three main conclusions emerging from the above analysis. First, 'elite capture' is a serious problem for the CBD approach, at least in all the areas where the poor are not empowered enough to withstand the pressures and influence of the local elite. It must therefore be addressed explicitly lest this approach should yield disappointing results in the sense of proving unable to increase the effectiveness of aid absorption and to better reach the poor than past approaches to development.

Second, sequential and conditional release of aid funds is a useful approach to participatory development since it can help discipline local leaders or intermediaries. It obviously implies that fraud can be possibly detected ex post, which requires aid agencies to devote substantial resources to project monitoring, thereby substituting external control for missing internal democratic governance. If things go well, one might entertain the hope that in the process the poor will gradually learn to better defend their rights, monitor the actions of their leaders, compel them to enforce their promises, and, hopefully, spawn new, alternative leadership figures able to compete with the existing elite.

For conditionality to work out its effects, however, it is important that competition amongst donor agencies does not operate in an anarchic manner. As a matter of fact, by driving aid agencies to disburse funds quickly in order to prevent rival agencies from destabilizing a relationship with a particular local partner association or community, and by increasing the cost of recycling funds in the event of fraud detection, acute competition causes the share of aid funds appropriated by local intermediaries to increase at the expense of the intended beneficiaries. Also, the emergence of exit options following the proliferation of aid agencies has the effect of raising the share that local leaders are allowed to appropriate at equilibrium, that is, the share that will deter them from pursuing a shifting strategy.

Clearly, some coordination mechanism is required at the level of either aid agencies or ultimate purveyors of funds to minimize these sorts of negative externalities. This is all the more so true as it is unrealistic to assume that all aid agencies will rigorously apply a leader-disciplining mechanism, if only because some of them are opportunistic or ill-informed and inexperienced about field realities. And since coordination mechanisms, such as multilateral reputation mechanisms, are difficult to establish and implement effectively amongst aid agencies — due mainly to their large number and great heterogeneity — disciplining local leaders in the framework of CBD projects will actually require action on the part of the ultimate purveyors of funds. To send the right signal to aid operators, fund providers should carefully avoid systematically rewarding successes and punishing failures. As a matter of fact, detection of aid embezzlement may reveal a high degree of competence and rigor on the part of the aid agency involved. Since the general public provides substantial aid resources through various fund-raising campaigns organized by NGOs, it is also important that the population in donor countries be conscientized about the inevitable difficulties of external aid interventions in general — and the pitfalls of CBD projects in particular.

Third, and this directly follows from the above two conclusions, the problem as to how to best detect fraud in CBD projects is a critical dimension of the CBD approach, and, unfortunately, one which has received only scant attention so far. The potential role of impact assessment studies in this regard ought to be thought over. More precisely, given the difficulty of getting people speak about the misdeeds of local elites, it is important to devise questions and measurements that are susceptible of revealing fraudulent acts in a roundabout manner. The natural way of doing this is by measuring what the poor got from a CBD project and then check out whether this more or less matches expectations derived from the project's design. In the case of simple interventions focused on easily observable outcomes, this should not be too difficult. In more complex cases, however, even to assess the benefits that the poor derived from a specific project may be an arduous task, if only because facts may be distorted in order to keep wrongdoings of the local elite away from sight. The issue is obviously a difficult one, all the more so if detection of fraud is to occur in the course of a project's cycle before the next tranche of money is being disbursed. For all these reasons, it is essential that best practices are well disseminated among the agencies concerned.

One thing is certain: evaluations need to go much beyond « bureaucratic » reports presenting financial accounts and « physical » achievements of CBD projects, such as they are required by many funding organizations (such as the European Commission and bilateral aid agencies). As a matter of fact, this kind of reporting tends precisely to encourage and allow distorted presentations of achievements that emphasize successes and minimize failures.

A final remark is in order. From many aforementioned considerations, it is evident that several important features of the aid environment to which economists attribute the poor effectiveness of past development assistance are also likely to undermine the effectiveness of CBD programs. Particularly worth pinning down are the mode of disbursing aid money which tends to be allocated within a rigid time framework and on a per country basis, and the practice of measuring results against volume figures, with little concern for quality and sustainability. Whether aid is channeled through decentralized conduits or through official agencies, it needs to be subject to some coordination mechanism, in the absence of which it will unavoidably be misused (Kanbur, Sandler, and Morrison, 1999; Kanbur, forthcoming).

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Comment

by Finn Tarp and Thomas Barnebeck
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Professor Jean-Philippe Platteau has prepared a challenging and interesting paper for the AFD/EUDN conference (Platteau, 2003). Written in his particular style where empirical observations from all over the developing world and theory are blended in an intricate manner, it takes a micro-perspective on the question of how to improve the effectiveness of foreign aid. This is a welcome approach. After all, poverty is in large measure a micro-economic phenomenon,[1] even if this fact was often overlooked in the macro-inspired aid debate among academics and development practitioners during the past decade or so. On this background, we fully endorse the general approach taken by Platteau in his attempt at pushing the research agenda forward.

The key argument of Platteau's paper is that disappointment with centralized, top-down, state-led development efforts should not lead to a rush to the opposite extreme. It may well be true that local actors possess information advantages, which can help reduce poverty, provided they can be mobilized through decentralization in an incentive compatible manner. However, Platteau obviously agrees with Pranab Bardhan,[2] who has recently argued that the idea

1. See Ravallion (2001) for an excellent account.
2. See Bardhan (2002, p. 187). While different in focus, Platteau's contribution to this conference is in many ways similar in spirit to the article by Bardhan, and the two papers supplement each other in an excellent manner.

of decentralization may need some protection against its own enthusiasts. Bardhan refers here both to free market advocates, who see decentralization as an opportunity to cripple the state, and to so-called anarcho-communitarians, who ignore community failures. They may, as Bardhan asserts, be as serious as the market failures or government failures that economists commonly analyze. The community failure, on which Platteau puts focus in his paper, is the risk of elite capture, or resource misappropriation by local leaders, including in particular local NGOs. He argues from beginning to end that there is a trade-off between local informational advantages and the risk of elite capture. The empirical frequency or economic importance of elite capture as defined by Platteau is not studied in the paper. Instead, illuminating case stories are provided, and reference is also made to the finding by Reinikka and Svensson (2001) that only a limited share of public educational funds found their way to the local level. One is clearly left with the suggestion that much was siphoned off on the way, and Platteau asserts:

> *It is ultimately because they overlook the genuine nature of the link between elites and commoners, rulers and ruled in Africa that international donor agencies overestimate the capacity of the participatory approach to deliver development gains more effectively and equitably.*

Two influential development researchers, *i.e.* Bardhan and Platteau, have sent a warning signal to the aid and development community, which has in recent times been in a rage to decentralize and promote community-driven development at an impressive speed involving considerable financial resources. It is pertinent to pay attention to this in the quest to improve the effectiveness of foreign aid, and Platteau deserves credit for pointing to a series of complex conflicts of interests which are often either not understood or simply ignored in the aid process. His paper certainly provides a good general analysis of capture by local elites, particularly for the case where the local community receives aid through a local NGO.

It is also fair to note that the Platteau paper is not an easy one to digest. It contains an exiting — but overwhelming and not altogether transparent — mix of empirical observations, theoretical arguments, and conclusions. So, the strength of Platteau's paper is also its weakness. It touches upon many aspects of decentralization, but remains somewhat on the surface. It focuses on one particular type of decentralization in a specific setting, and it is not entirely clear whether this is indeed the most relevant case from the perspective of increasing the effectiveness of foreign aid. Many other dimensions of decentralization, including in particular the role of local government, are somehow neglected, or their importance is minimized by not integrating them into the analysis.

This note is structured as follows : Section 1 outlines our point of departure as far as the aid effectiveness literature is concerned. Section 2 puts decentralization and service delivery mechanisms into a broader institutional and empirical context. This is done to help situate Platteau's work, since he focuses squarely on one particular type of decentralization. Section 3 discusses theoretical aspects in more direct terms, while Section 4 concludes.

1. Aid Effectiveness and Growth

The effectiveness of foreign aid has been an area of controversy ever since development economics appeared as a separate subdiscipline of economics after the Second World War. During what is sometimes referred to as the golden years of the 1960s and 1970s,[3] foreign aid was in large measure channeled to developing countries in the form of project aid, often with well defined investment objectives in mind. Micro-economic cost-benefit analysis (CBA) had an important role to play in the evaluation process, and many projects got good to excellent grades. Optimism about the potential impact of aid in promoting growth and reducing poverty was characteristic. However, this period came to an abrupt end after the second oil crisis in 1978-80. It soon became evident that the downturn was of a more permanent nature, not temporary as in 1973; it was also gradually recognized that the development strategies of the previous decades were no longer sustainable.

Adjustments were needed in economic policies. Achieving macro-economic balance (externally and internally) appeared as an essential pre-requisite for renewed development ; macroeconomic stabilization and adjustment also became important, and, in much of the rhetoric of the day, nearly synonymous with economic transformation and development. Reliance on market forces, outward orientation, and the role of the private sector — including international and national NGOs — were emphasized. In parallel, poverty alleviation somehow slipped out of view for a while in mainstream agendas for economic reform.

In parallel, bilateral donors and international agencies such as the World Bank grappled with how to channel resources to the developing world. By the late 1970s it had become increasingly difficult to channel fresh resources to many developing countries. The various kinds of macro-economic program assistance (such as balance of payments support and sector budget support), which

3. See for example the excellent historical overview by Adelman in Tarp (2000).

were not tied to investment projects, and which could be justified under the headings of stabilization and adjustment, appeared an ideal solution to this dilemma. Financial program aid and adjustment loans became fashionable and 'policy conditionality' widespread.

In parallel with all this, aid fatigue was spreading, and nobody objected when Paul Mosley and his colleagues formulated the so-called micro-macro paradox in the late 1980s.[4] This thesis suggested that while aid seemed effective at the micro-level, it was harder — or actually impossible—to identify any positive impact of aid on the macro-economy. Much of this was spurred by the focus of the 1980s in uncovering the economic impact of the stabilization and structural adjustment packages. As a corollary of the adjustment programs in many countries, the use of a wider variety of analytical tools in aid impact assessment became common. Evaluation methods such as CBA came under severe criticism, as the perception that aid (channeled through sovereign governments) is fully fungible spread. Instead macro-economic evaluation started taking center stage, and methodological issues gradually came to play an important role in the aid effectiveness debate.

We know today that the underlying structural model used in the formulation of the micro-macro paradox was incomplete. We also know that the academic literature available up to the mid-1990s does not justify the view that aid has no impact on growth (see Hansen and Tarp, 2000). The impact of aid on savings and investment is clearly less than 1:1 as suggested in the simple Harrod-Domar inspired macro-economic aid impact model. Yet, the impact is greater than nil.

4. See for example Mosley (1987).

Additional analytical work on the aid-growth relationship started appearing after 1995, relying on macro-economic cross-country regression analyses. This was facilitated in part by the availability of much better data and in part by insights emerging from new growth theory, associated with a rapidly increasing number of empirical studies of growth. Early work in this vein by Boone (1994, 1996) suggested that aid does not work and is simply a waste of resources. However, this contribution soon slipped into the background. One reason was the underlying theoretical model, but it is equally important that an analysis by Burnside and Dollar (1997, 2000) took center stage.[5] They argued that some aid does work, and provided an attractive and seemingly self-evident solution to the 'micro-macro' paradox. Aid works, but only in countries with so-called 'good policy'. They based this on an aid-policy interaction term that emerged as statistically significant in their macro-econometric analyses of the aid-growth relationship.

Burnside and Dollar, and more recently also Collier and Dollar (2001, 2002), have used the above framework as basis for suggesting that aid should be directed to 'good policy' countries to improve aid's impact on poverty alleviation. This is in part justified by reference to the seeming inability of aid to change policy, emerging from other Bank funded research edited by Devarajan, Dollar and Holmgren (2001).[6] While these policy recommendations were considerably toned down in the Bank's Monterrey document (see World Bank 2002), the selectivity message inherent in the above work remains influential.

5. The Burnside-Dollar study formed the analytical core of the World Bank (1998) study on the subject.

6. See Tarp (2001) for a review.

The Burnside-Dollar study has had many critics, [7] and discussions have *inter alia* centered around what can be learned from the kind of cross-country growth regressions that underlie much of the recent empirical work on aid effectiveness.[8] Generally speaking, robustness to methodological choices and data has remained a thorny issue throughout, and we would argue that this fact has not been taken sufficiently into account when research has been used for formulating policy. The borderline between research and policy advocacy has not always been respected. However, the academic debate on aid effectiveness and growth has certainly covered new and important territory when it comes to issues of empirical methodology and interpretation.

As regards the present state of the macro literature, a recent survey by David Roodman (2003) provides an overview and assessment. [9] He reports the results of systematic robustness testing of the regressions run by the various contributors to the debate. Roughly speaking, Roodman find three main stories of macro-economic aid effectiveness in the literature :

1. Aid works in a good policy environment.
2. Aid works best in countries with difficult economic environments (low population, volatility of terms of trade, etc.).
3. Aid works in general (on average), but with diminishing returns.

7. See for example Hansen and Tarp (2001), Dalgaard and Hansen (2001), Guillamont and Chauvet (2001), Lensink and White (2001), Lu and Ram (2001) and Mosley, Hudson and Verschor (2003). Easterly, Levine and Roodman (2003), Easterly (2003) and Dalgaard, Hansen and Tarp (2003) are up-to-date accounts. Hiebert (2003) and Itano (2003) are also interesting on the allocation of aid.
8. Solow (2001) suggests there is a case for focusing more directly on total factor productivity or factor augmentation functions as the proper left-hand-side variables in empirical work and thinking more seriously about legitimate right hand side variables. Current practice is in his view much too haphazard.
9. See Roland-Holst and Tarp (2002) for further background.

The tests applied by Roodman include altering definitions of aid, good policy, and shock, changing period lengths, removing outliers, and using an expanded and revised version of the data set first used in Easterly, Levine, and Roodman. The conclusion is that support is weakest for story 1, and strongest for story 3.

In sum, a measure of consensus has indeed emerged from the macro-economic aid debate. Aid impacts positively on growth. Arguably, it is time to move on and draw on micro-economic theory in our search for insights about how aid and growth can help reduce poverty more effectively than in the past.

On this background, the paper by Jean-Philippe Platteau is both timely and welcome. He brings into play a much needed micro-economic perspective as well as a success criterion that differs from both the internal rate of return in CBA analyses and the contribution of aid to growth inherent in the macro-econometric literature. More specifically, Platteau aims at uncovering how foreign aid can be designed so as to maximize the amount (or share) of aid resources that reaches the grass root level instead of being siphoned off along the way within one specific type of decentralization: Community Based (or Driven) Development (CBD).

2. Decentralization and Service Delivery

When the reader embarks on the analytical framework put forward by Platteau, many questions about how to situate his contribution in a broader context of decentralization and aid delivery come to mind. We therefore provide in this section a few background notes in order help clarify what decentralization means, why decentralization may be desirable, why the characteristics of the services delivered at grass root level are important for the analysis, and which are the alternatives to promote participatory development. We finally provide a brief overview of what we see as a balanced view of the empirical results of CBD.

Decentralization

In his study of decentralization, Bardhan (2002) works with the following concept of decentralization: the devolution of political decision-making power to local level, small-scale entities. That is, decentralization is meant to strengthen the governing authority at the local community level (village, municipality or county levels of administration). This is broader than Platteau's focus on CBD, and it suggests that it is in general wise to be specific about what kind of decentralization is being addressed and what kinds of local institutions are involved. Otherwise, it is easy to miss important and relevant aspects of the decentralization and development process. More specifically, it suggests that Platteau may be missing much of the action. For most countries, it is hard to imagine that funding through NGOs (or local leaders) which are in focus in Platteau's analysis would exceed funding through the government, for example in the case of health or education. So although development funding through NGOs may be on the rise, it represents only a fraction of the total aid budget.

Given the title « decentralizing development as a strategy to reduce poverty », it is useful to keep this in mind: the government is after all still the major actor in fighting poverty. Moreover, Platteau puts focus on CBD, but he does not elaborate on the more specific characteristics of the local communities in his analytical framework. Likewise, there is very little in the paper on how service delivery can be made accountable to local communities.

Finally, we recall that the conventional wisdom states that decentralization is to be preferred when preferences are heterogeneous and there are no spillovers across jurisdictions. With spillovers and no heterogeneity, centralization is efficient, while decentralization leads to under-provision. Centralization can exploit economies of scale, but these are less important in local management and maintenance, in which case decentralization becomes more attractive. Platteau abstracts from this kind of complexity.

Types of services

The above suggests that it is hard to establish the optimal balance between centralization and decentralization without reference to the kind of services involved. Some services are more suitable to become decentralized than others since they may not be associated with economies of scale. On this background, Prichett and Woolcock (2002) have developed a more detailed framework in which public services are categorized according to whether they are key, discretionary, and transaction-intensive.

By way of definition, 'key' refers to services for which there is consensus on the necessity of some government provision. Services are discretionary to the extent that their delivery requires decisions by providers to be made on the basis of incomplete information, which renders them unfit for standardization (mechanization). Finally, transaction intensiveness refers simply to the extent to which the service requires a large number of transactions. Discretionary services, which are at the same time transaction intensive, are the most obvious candidates for decentralized provision.

To see how the above classification works, consider irrigation. This service is basically composed of (i) decisions on the location of the main channels, (ii) allocation of water flows and maintenance, and (iii) provision of standpipes in villages. (i) is discretionary, but not transaction intensive; (ii) is discretionary and transaction intensive; (iii) is not discretionary, but transaction intensive. Clearly, (ii) is best fit for decentralized implementation, and such services which are both discretionary and transaction-intensive are central to development debates. The issue is that the necessary human and institutional capacity for delivering them is regularly not in place. Platteau does not—for good reasons—pursue what can or needs to be done in such cases, but it is of course an intricate issue, which is relevant when decentralization is being discussed.

In describing the typical case of water supply, Prichett and Woolcock find that location decisions have often been made purely on a technocratic and expert basis, with little effort to incorporate local knowledge. Typically, a complete lack of attention to what people actually want has been common, and it is widely recognized that providers have in these cases been able to abuse their discretion, siphoning funds off in various ways. As just one example, governments have attempted to launch discrete projects (often donor funded) to create public standpipes with only limited success due to their top-down nature. However, one recent review reported by Prichett and Woolcock shows that for a supply of 12,000 standpipes, breakdown rates fell from 50% (when maintenance was the responsibility of the national water corporation) to only 11% (when it was under community control). This suggests that ownership is important and demonstrates the potential strengths of greater emphasis on a more participatory approach involving beneficiaries. The next section provides further detail on a number of ways in which one can approach the participation goal. From this perspective, it is clear that Platteau's model is a stylized case of CBD, which is only one type of participatory decentralization. Donors are in reality involved in a much wider set of activities and have to consider a wider menu of options.

Participation

Single Sector Participatory: Resources flow from the center directly into sectors (the budget decisions across sectors are not made at the community level) but users and beneficiaries usually bear more of the capital and recurrent costs. In the implementation of individual projects and in the operation of these projects, local communities or user groups are involved in more decisions, so there are greater information flows from the agency to citizens and back. Delivery mechanisms are in the purview of the sector line agencies, but decision-making is allowed to be more local and a menu of options is presented rather than the single 'technologically best' option. Accountability flows from citizen to service provider, often via newly created groups which are selected at the local level and responsible for certain functions (e.g. maintenance).

Demand-side Financing: In the literature on schooling this approach is called 'vouchers', or in health care financing, 'single payer'. The individual chooses the providers and the government reimburses the citizen (or provider) in whole or part for this service. In this model, resources flow directly from the government to individuals/households, with information flowing horizontally among users. All decision-making about service provision is decentralized, and the primary delivery mechanism is via private sector (for profit or non-for-profit) providers. Accountability is through 'exit'; unsatisfied users simply choose another supplier.

Social Funds: In a social fund, resources are delivered to local communities (with or without the involvement of NGOs) to help them engage in their own decision-making — which pertains to the design, delivery mechanisms, and maintenance of projects most appropriate for their needs, interests, and aspirations. The flow of information is largely 'out' to potential users of the fund. Governments (national and local) are largely financial conduits, not providers, and the social fund itself is held accountable (both by the government and clients) for how resources are utilized.

Community Driven Development (CDD): Donors (or governments) give resources directly to 'community groups' (not necessarily synonymous with NGOs), bypassing some levels of government altogether (though their tacit 'approval' may be sought for the project). Information flows horizontally, on the explicit assumption that community groups themselves are the most efficient (minimizing wastage, maximizing marginal benefits) and effective (assigning finite resources to their most useful common purpose) purveyors of that information. Decision-making regarding both which projects to undertake and whom they will benefit is left to the community; the delivery mechanism is usually the community itself, supported by small grants for any necessary technical assistance in the design and implementation phase. The goal is "empowering" the poor by enhancing their capacity to be more effective agents of "bottom-up development" (which in turn leads to local governance reform). CDD is sometimes distinguished from CBD when—in addition to community groups making decisions in planning, implementation, and management—they also manage investment funds. Thus, Platteau's concept of CBD and CDD are equivalent. In any case, it is in this specific type of setting that Platteau's discussion is grounded.

Monitoring service delivery

In Platteau's analysis, focus is on self-enforcement. There is no service delivery contract involved, and monitoring (in the sense of third party verification) is absent. This hardly reflects reality, where donors do indeed rely on such measures. Also, even if contracts may not be complete, they still retain value. The challenge as we see it is to align the incentives among the different parties. In a principal-agent model, the right incentive mechanism can be designed to ensure that the delivered services satisfy local needs, and we believe this deserves more attention than Platteau seems to attach to it.

Empirical results

Reading Platteau's paper it is easy to get the impression that decentralization does not work. However, Mansuri and Rao (2003), in their review, provide the following tentative and probably more balanced conclusions :

- There is some evidence that CDD create effective community infrastructure and improve welfare outcomes.
- The limited quantitative evidence suggests that participation in decision-making and project implementation have a beneficial effect on service delivery.

- Involving the community in choosing, constructing and managing a public good is a process that will almost always be dominated by elites because they tend to be better educated, have fewer opportunity costs, and have the greatest net benefit from participation. It is not clear, however, that this represents 'capture'. A distinction should be made between benevolent capture and malign capture.
- It seems reasonable to conclude that CDD is more effective in cohesive and better-managed communities.
- Since the success of CDD is crucially conditioned on local culture and social systems, it is best done not with a wholesale application of 'best practices' applied from projects that were successful in other contexts.
- One of the most worrying aspects is that most CDD projects lack careful evaluations with good treatment and control groups. This must be urgently rectified, and the existing popularity of program evaluation efforts will hopefully help stimulate this process. A good example is King and Berk (1998), who study actual school autonomy in Nicaragua. They find that schools with greater autonomy with respect to teacher staffing and the monitoring and evaluation of teachers appear to be more effective in raising student performance.

It should be clear by now that the decentralization case considered by Platteau is one among several ways in which donors can approach decentralized aid delivery. It should also be clear that the available empirical evidence suggests that CBD does indeed seem to help enhance local service delivery. In sum, CDD or CBD does — based on the general evidence—come across as an approach to local development with which the aid community should continue to experiment.

3. The Platteau Model

The basic set-up put forward by Platteau consists of three actors : the donor (*A*), the local leader *(L),* and the grassroots *(G)*[10]. *A* contemplates providing funds to *G* through *L*. As such, *L* acts as an intermediary between *A* and *G*. [11] It is assumed that *G* does not have any alternative funding possibilities. It is also assumed that *A* and *G* do not have any contact, but *A* can check whether *L* really represents *G*. [12] *A* does not observe how the funds are being shared between *L* and *G*, but does have access to some costly verification technology.

The stage game is such that in stage 1, *L* makes an offer to *G* regarding the split of the funds between *L* and *G*. In stage 2, *G* has to accept or reject the offer by *L*. If *G* rejects, no funds are allocated by *A*. In this ultimatum game the only subgame perfect strategy by *G* is to accept anything *L* offers, and *L* offers the lowest split possible. This is the major concern of Platteau, and he looks for ways and means to avoid such a situation, which is undesirable for *G* (as well as *A*). The way out suggested by Platteau is to find a mechanism that disciplines *L*. Alternative mechanisms (based on accountability and incentives) to ensure a higher share of aid resources for *G* are not considered. This is somehow paradoxical since Platteau himself actually introduces the notion of a social norm in order to

10. We ignore in this discussion the ultimate purveyors of funds (P).

11. One story is that L has organized G into a development association and has been 'elected' president, but L can also be a local NGO.

12. It is not entirely clear how this works since A and G have no contact.

avoid that *G* receives nothing. Another question is whether this assumption is necessary in theory. Arguably, this is not the case.

Assume that A chooses to release funds in a step-wise manner conditioned on L's previous behavior (i.e. the split in the previous period). Would that discipline *L* ? The answer is, as Platteau rightly points out, that it depends on the nature of the repeated interaction. Indeed, if the horizon is infinite (the relationship is infinitely repeated) or indeterminate, then *L* can in theory be disciplined. Platteau discards the possibility of an infinite (or indeterminate) game, arguing that (i) CBD aid is precisely aimed at making communities self-supporting after a certain period of time, and (ii) the limited duration of the external intervention is better made clear from the beginning. Yet, if one assumes that there is a probability that the game goes on, depending on past behavior, and at the same time notes that an infinitely repeated game can be represented by a game that is finite (i.e. terminates at a certain point in the future with probability 1) (Fudenberg and Tirole, 1991), the social norm is not required. Be that as it may, in a repeated setting, disciplining *L* should definitely be possible as suggested by the evidence reviewed in Section 3. The question with which donors should be concerned is how this is done most effectively.

A thorny problem in this context is if several aid agencies compete for access to the same communities. Clearly, in such cases L gains more leverage in dealings with any individual donor A, and it becomes harder to discipline *L*. This is reinforced if donors have different objectives (a common agency problem along the lines of Bernheim and Whinston, 1986). This points to the importance of aligning the objectives and behavior of different donors, and concentrating aid in the hands of a few donor agencies is one option. As correctly noted by Platteau, if there are scale-economies in fraud detection (split verification) this approach would come with the added side benefit of reduced costs. Therefore, concentrating aid (through mechanisms such as the lead donor principle), with which donors are already experimenting, is theoretically justified.

In his search for a disciplining mechanism, Platteau first analyses the notion of a multilateral reputation mechanism (MRM), which is an information network operated by donors. The idea is that *L* will only get funds if *L* has never cheated in the past. Any *L* caught cheating would be reported to the MRM. This would serve to further discipline *L*. Yet, as rightly noted by Platteau, this network is not without its problems, so further study is needed.

Arguably, the most important aspect in disciplining L emerging from Platteau's analysis is the fraud detection technology (FDT), even if this is really nothing more than a specific type of monitoring. An ineffective FDT clearly makes it difficult to discipline *L*. We reiterate that the effectiveness of FDT depends on the nature of the services involved. For certain types of outputs — which by their nature are easily observable — monitoring and evaluation should be a relatively straightforward endeavor. They should come high on the list of priority actions when the risk of rent capture is high. For other types of outputs, detection of fraud is more complex and it must ultimately rely on community members' willingness to reveal any misbehavior. Platteau notes that such 'whistle blowing' is often not in their best interest because they depend on L to get aid. They have, Platteau argues, more to loose than to gain from revealing fraud. Be that as it may, we would argue that one can design mechanisms to overcome this, including hiring independent monitors with local knowledge.

Finally, reflecting on alternative mechanisms to discipline *L*, it is in our view notable that Platteau hardly touches upon the potential merits of competition among different local leaders. He quickly dismisses this option referring to the negative effects of competition on social capital. However, consider the branch of game theory known as tournament theory. Assume that A designs a tournament each period in which a set of local leaders (in different villages) compete for a fixed set of prizes. There is empirical evidence which shows that in such tournaments, greater prizes lead to greater effort (Ehrenberg and Bognanno, 1990 ; Knoeber and Thurman, 1994). Assuming that social capital is particularly important within villages, organizing a competition among their leaders does not necessarily erode social capital at that level.

We recognize that trust between villages may also be important, for example for trade. However, explicit attention must be paid to balancing greater efforts against lower social capital, and the tournament should be organized at the level where the potential damage to social capital is minimized, e.g. district or province instead of village. A problem more difficult to overcome with tournaments and competition among leaders is that players are unlikely to help another player who is in need (see Raffi and Zemsky (1997) for a theoretical treatment and Drago and Garvey (1997) for empirical evidence). We would argue that this has more to do with marginalization of the loser than erosion of social capital, and has to be addressed accordingly. In sum, due to the potential (theoretical) merits of competition, outright, general rejection of this option does not come across as justified given the present state of our knowledge.

4. Final Remarks

We agree that on the side of donors there is a need for improved coordination, less competition, improved impact assessment, and more patience. This would help create an environment where it is easier to discipline local leaders and hence enhance the effectiveness of foreign aid. This is, however, not particularly new, and the critical challenge for these problems is to turn the insights into practice. Further research is unlikely to contribute much in this regard. However, when it comes to issues that are related to the very core of decentralization — such as local ownership and government, accountability and monitoring — the existing theoretical and empirical basis is still weak. The same goes for the desirability of clarifying the pros and cons in a developing country context of innovative approaches, such as the tournament idea mentioned above.

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Comment

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The paper provides an insightful discussion of the problems of reaching the poor through decentralized aid delivery mechanisms. A strength of the paper is a well-defined conceptual framework through which to interpret empirical examples of decentralization in action.

The paper sounds a necessary note of caution regarding decentralization, while the latter has been in vogue (along with the related notion of 'participatory development') since the 1990s. In particular the paper develops convincing arguments as to why local elites may capture some (and sometimes virtually all) of the aid transfer intended for poor communities. Indeed, the poor may cooperate in such capture if they derive at least some absolute gain compared to a situation in which there is no transfer at all. The author cites a number of examples of this, including one from West Africa with which he is directly familiar.

As the author points out, this leads to an important paradox: a high degree of central state capacity may be a critical precondition for decentralization to work for the poor. That is, strong central state institutions must effectively monitor the use to which funds are put, and contain efforts by local elites to siphon off the transfer to their own ends. This is, to say the least, a very uncomfortable conclusion for the donor community, since many donors have come to see decentralization as a panacea for weak central state institutions—especially in Sub-Saharan Africa where the capacity of many states has weakened alarmingly over the last two decades.

The author emphasizes the importance of empowering local poor communities, for: "… when the poor are strongly organized they are better able to oppose the attempts by the elite to capture the benefits of decentralization" (p.37). And those empowered communities need information as well. In Uganda, the central government — having discovered that much of the money intended for rural primary schools was not reaching its intended destination (following the introduction of innovative expenditure tracking surveys with World Bank assistance) — has mounted a successful information campaign to inform communities of their rights. It would be useful to look at this in more detail, in part because it does not yet seem to have been extensively replicated.

The role of formal systems of local level democracy is somewhat underplayed in the paper (although discussed in the case of Kerala). One reason why a local elite leader may capture a disproportionate share of the transfer (either from central government or an aid agency) is that he/she faces no political competition. For sure, the existence of local level voting may not yield an improved outcome (an increase in the share of the transfer going to the poor) if local political leaders collude among themselves. And evidence from developed countries shows very mixed experiences in local democracy's effectiveness (see for instance the UK debate about local democracy and its effectiveness in delivering better local level services). It would be useful for the paper to consider positive and negative examples from the history of developed countries as regards the development of effective decentralization. For instance the Scandinavian countries appear to have created effective and democratic local government at an early stage in their development (although this may in part be due to monitoring mechanisms operated by highly effective central state institutions — as in the Swedish case, perhaps).

The author suggests a more sequential and conditional release of aid funds to participatory development in order to discipline local leaders or intermediaries. This has considerable merit. But it may face problems in 'post-conflict' countries, where there is an urgent need — from a humanitarian perspective—to deliver large and immediate benefits up front. This will push donors away from sequencing and conditionality (*i.e.* Afghanistan at present). In addition discount rates may be so high in conflict countries that everyone at local level (from warlord elites to poor communities themselves) may be willing to forego future gains (even if substantial) for what is available from donors in the short run. Then the poor will be willing to collude with the local elite, and indeed may have little choice when violence by the elite is a more than credible threat (and certainly more persuasive than anything the donors can offer).

Finally, the paper places much emphasis on competition between aid donors, which leads to sub-optimal outcomes. In particular, an elite or NGO, having misbehaved with one aid donor, knows that it can get away with this again with another donor (because of lack of co-operation between donors). But it would be good to have some more evidence on the scale of this problem, which one suspects varies across different donors, and indeed across different types of country.

In summary, the paper makes a valuable contribution to the literature on poverty reduction, and sounds some very necessary warnings about what we can expect from decentralized development models. At the end of the day, the quality of state institutions at central level appears to be critical — hence the paradox of decentralization.

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