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VIEWPOINT

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WHY ECONOMIC GROWTH IS GOOD FOR THE POOR

By Vincent Geloso

It is popular in certain circles to attack the very idea of economic growth. This series[1] of brief studies examines some common misconceptions behind these attacks.

One criticism sometimes made is that economic growth often leaves the poor behind. The assumption is that the fruits of economic growth are disproportionately enjoyed by the rich. However, the evidence for such a claim is weak. Economic growth does tend to benefit the poor, especially in open economies.

GROWTH AND THE POOR

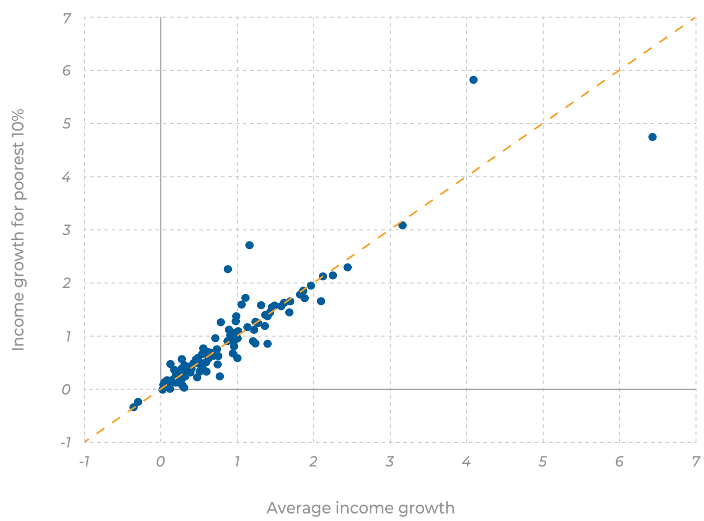
The belief that the poor do not benefit from growth was more prevalent before the rise of big data, which made it easy to assemble large datasets (needed to estimate income distribution) for a large number of countries over long periods of time. It has also become easier and easier to access the data produced by multiple sources. As a result, several efforts have been made to assess the validity of the claim that the gains from growth are not well-distributed.

The first such large study was carried out by two economists from the World Bank in 2002. Using data for 93 countries from 1950 to 1999, they found that a 1% increase in average incomes was associated with roughly a 1% increase in the income of the average person in the poorest 20% of the population.[2] A 2016 study replicated and updated their results, this time for 121 countries. Their findings again suggest that the poor benefit from economic growth as much as the average person does.[3]

Figure 1 uses the available distributional data regarding the growth of income per capita and growth of income per person in the poorest 10% of the population for 113 countries between 2000 and 2015.[4] The horizontal axis indicates the growth rate of average incomes during the period, while the vertical axis indicates the growth rate of average incomes for the poorest 10% of the population.

Figure 1

Income growth, average vs. poorest 10%, 113 countries, 2000-2015



Note: On both axes, "1" corresponds to 100% growth, "2" to 200% growth, etc., over the 15-year period.
Source: Data from Justin T. Callais and Andrew T. Young, "A rising tide that lifts all boats: An analysis of economic freedom and inequality using matching methods," *Journal of Comparative Economics*, 2023, pp. 8-13. The author thanks Justin Callais for sharing his data.

The diagonal line depicts a one-for-one relationship, whereby the poor would benefit exactly as much as the average person. A point below that line represents a country where average incomes grew faster than incomes for the poorest 10%, while a point above the line means incomes for the poor grew faster than average incomes in that country. As can be observed, most points are clustered around the line. This suggests that most countries enjoyed comparable growth across the income distribution, and growth was essentially inclusive.

Some researchers, though, have found that the relationship is not one-for-one.[5] However, even here, the claim is not that the poor do not benefit from economic growth, merely that they do not benefit as much as the average person (or the very rich).

ECONOMIC FREEDOM BENEFITS THE POOR

Other studies show that increases in economic freedom are associated with increases in income at all decile levels.[6] But they find that the gains are larger in the higher income deciles, so that the share of income that goes to the poorer slices of the population falls.[7] Every decile thus enjoys higher incomes, but not proportionally so. At first glance, this seems to suggest that the growth generated by economically free societies tends to favour richer individuals more (albeit without hurting the poor).

First glances, however, can be deceiving, and this result is contested in the literature.[8] Moreover, individuals do not necessarily stay in the same deciles over time. In fact, there is substantial movement *between* deciles. Statistics Canada has been tracking workers over five-year windows since 1982. In the latest window, from 2015 to 2020, we see for example that Quebecers who were in the poorest decile in 2015 ended up on average in the third decile in 2020.[9] Moreover, workers enter (youths taking a first job, immigrants) and leave (older individuals retiring or dying) the income datasets. For an accurate picture, we must take into account movements between deciles over time, as well as entries and exits from the data.

How can we make sure that the poor benefit from economic growth? The answer boils down to the role of economic policy and the importance of promoting economic freedom (which is to say: limited government regulation, small government, strong property rights, open trade, and sound money).

There are studies that test the extent to which income mobility—movements along the income ladder, from one decile to another—increases both directly and indirectly with greater economic freedom. Mobility increases directly because of the absence of government hurdles.[10] It increases indirectly because freedom promotes economic growth, which matters more to expanding the choices available to the poorest families—choices such as acquiring new skills, accessing capital to start businesses, etc.[11] Both channels matter, but when compared, the indirect effect matters far more.[12] By stimulating income growth for all, economic freedom allows the poor to rise far above the socio-economic conditions into which they were born. As such, the poor benefit more from economic freedom and growth because it gives them more chances to lift themselves up.

Simply put, one cannot disentangle the institutions that generate economic growth from those that generate improved opportunities for the poor to rise up above their conditions at birth.

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This Viewpoint was prepared by **Vincent Geloso**, Assistant Professor of Economics at George Mason University and Senior Economist at the MEI. The MEI's Taxation Series aims to shine a light on the fiscal policies of governments and to study their effect on economic growth and the standard of living of citizens.

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910 Peel Street, Suite 600, Montreal QC H3C 2H8 - T 514.273.0969
150 9th Avenue SW, Suite 2010, Calgary AB T2P 3H9 - T 403.478.3488

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