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Growth with Equity for the Development of Mexico: Poverty, Inequality, and Economic Growth (1992–2008)

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Summary. — This paper constitutes an attempt to determine the relative contribution of changes in economic growth and in the distribution of income to changes in poverty in Mexico. Our findings clearly indicate that growth with redistribution (lower income inequality) was the key to reducing poverty continuously and in an important manner during 2000–2006. However, after 2006, decreasing per-capita income, coupled with the persistently high inequality (Gini of 52%), caused the reversal of the favorable trend observed since 1996, raising poverty to pre-2002 levels. Consequently, it is argued that, for Mexico, a middle-income country exhibiting quite low growth rates and high inequality levels, the further improvement in its distribution of income and assets is essential if the economy is to succeed in making a real dent in poverty. For that purpose, the implementation of an active pro-poor growth policy should be strongly encouraged.

Key words — poverty, inequality, redistribution, pro-poor growth, Mexico, Latin America

1. INTRODUCTION

Poverty reduction is considered one of the most important development goals for developing and developed countries alike (United Nations, 2000). Progress on the realization of this goal is what many policy makers, especially in developing countries, have sought to attain in the past decades, by promoting economic growth, by implementing redistribution policies, or by a combination of the two. However, the poverty outcomes have varied widely across countries depending on the particular success of their development strategies.

By focusing on the specific impact of inequality and growth upon poverty, several studies have shown that the distribution of income indeed matters for the poor (Bourguignon, 2004; Datt and Ravallion, 1992; Deininger & Squire, 1998; Lopez, 2006; Ravallion, 1997, 2001, 2005; Ravallion & Chen, 2003 among others) and that higher initial inequality tends to reduce the positive, decreasing impact of growth upon absolute poverty (Lopez, 2006; Lopez & Serven, 2006; Ravallion, 1997, 2005). In addition, it is widely agreed that economic growth alone is not a sufficient condition for successfully achieving the goal of poverty reduction (Addison & Cornia, 2001; Oxfam, 2000; Ravallion & Datt, 2002). [1]

Regarding the relationship between inequality and poverty, there are two arguments as to why the level of inequality matters for poverty reduction (Ravallion, 1997). First, the induced-growth argument formalizes the long-standing view that inequality inhibits growth (Alesina & Rodrik, 1994; Banerjee & Newman, 1993; Benabou, 1996; Berg & Ostry, 2011; Deininger & Squire, 1998; Easterly, 2007; Galor & Zeira, 1993; Ravallion, 2005; Ravallion & Datt, 2002; Stiglitz, 2012 among others) [2] and, therefore, impedes progress in reducing absolute poverty. Second, the growth-elasticity argument states that, even if the distribution of income is irrelevant to the rate of growth, inequality per se, or its decline, is indeed important in order to guarantee that the distributional gains from growth are more proportionally shared by the poor and do not benefit mostly the rich (Ravallion, 2005, 2007; Stiglitz, 2012). Thus, redistribution also contributes directly to the reduction of poverty by allowing the poor to have a bigger share of the benefits, in the form of a better payment for their work (higher salaries), for instance, or by transferring income and/or assets from the upper to the lower and middle parts of the distribution through the tax and transfer system. [3]

This study supports mainly the second of the arguments, presenting clear evidence of the strong, poverty-reducing impact of more equality in the distribution of income. As discussed in Bourguignon (2004), Dagdeviren *et al.* (2004), and Lopez (2006) among others, poverty is determined invariably by income growth and its distribution. Consequently, it is possible to predict with great accuracy and even predetermine the poverty changes induced within a specific period given the growth and distributional shifts that occur through the development process. Hence, on the one hand, economic growth reduces poverty, [4] and an economic downturn or recession increases it generally. On the other hand, an improvement along the distribution of income (inequality decline) reduces poverty, while an inequality rise increases the poverty level correspondingly. [5] Eventually, the combination of these economic forces brings about a reduction, increase, or maintenance in/of the level of poverty.

The previous statement means that, to improve the well-being of the poor on a constant basis and thus attain the goal of poverty elimination, a country has to focus on two possible, non-mutually exclusive types of policies: those that spur growth and those that reduce the level of inequality. Ideally, win–win types of policies, leading to faster growth and lower inequality, should be pursued when the overarching policy objective is the reduction of poverty. In this respect, it should be noted that, in the past, there existed the belief of a supposed, endless trade-off between equity and efficiency that im-

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peded the realization of actions, on the part of the government, towards reducing inequality more freely to improve the condition of the poor. However, that assumption has been proven wrong with time and there are more and more people and studies supporting the well-established view that inequality can be destructive for growth (Aghion *et al.*, 1999; Stiglitz, 2012), due to its adverse effects on the economy, [6] and because the price paid for a high level of inequality may even exceed the overall benefits (Berg & Ostry, 2011; Stiglitz, 2012). Accordingly, if less inequality is good for both growth and the reduction of poverty, then equity considerations should be promoted to encourage the sustainable growth and development of an economy.

In the case of Mexico, there are a few studies analyzing the relationship between the above-mentioned variables, particularly that of the relative roles of growth and inequality for poverty reduction. Szekely (1995), in a seminal paper, showed that the increase in poverty in the years 1984–1989 was primarily the consequence of the sharp inequality rise in Mexico during that period, and ran simulations which indicated that improvements in the distribution of income were at least as important as growth for the increase in the welfare of the poor. Cortes, Hernandez, Hernandez-Laos, Szekely, and Vera (2002) analyzed poverty in 1992–2000 by using the methodology proposed by Datt and Ravallion (1992). The authors concluded, first, that the increase in average income affected positively the poverty level and, second, that distributional changes were unimportant at the national level but played an important role in the rural sector (reducing poverty in 1992–1996 and increasing it in 1996–2000).

The present study extends the poverty analysis for Mexico along the previous lines, providing further insights regarding the relationship between income inequality and poverty. As these important issues have been insufficiently addressed in the international literature, with only Szekely's paper analyzing it for the 1980s, we intend to update earlier conclusions by using the most recent and comparable data for Mexico, covering the last two decades (1992–2008), and by applying standard decomposition techniques and other methodologies that have been developed to analyze the, sometimes, overlooked and underestimated impact of inequality on poverty.

Our main results confirm the importance of income inequality (redistribution) for achieving poverty reduction in Mexico. We can, therefore, conclude that the high and persistent levels of income inequality during the 1990s counteracted the positive impact of growth and prevented the further decline of poverty, especially in 1996–2000. Moreover, we find that the improvement in the distribution of income after 2000, contributed in an important manner to the reduction of poverty in 2000–2006 but was unable to offset the strong, poverty-augmenting effect of decreasing per-capita income in 2006–2008, which eventually led to the reversal of the favorable trend observed since the mid-1990s, raising poverty to pre-2002 levels by the end of the decade (CONEVAL, 2011).

Thus, we argue that the further decline in income inequality in Mexico through redistribution, along with the urgent economic development of the rural sector indicated in McKinley and Alarcon (1995), should be regarded as a top priority for policy makers aiming at eliminating extreme and moderate poverty. Clearly, this points towards the adoption of an inclusive development strategy that focuses on pro-poor growth as the main engine of Mexico's development and considers all sectors of the population, particularly the agricultural one, as being equally important.

This paper is organized as follows. The next section briefly discusses the data and the poverty lines and measures that were used, provides a poverty profile of Mexico, and gives an account of the trends in poverty, inequality and economic growth over the past decades. We then explain briefly the applied methodologies, followed by a discussion of the results. Finally, we offer some conclusions and policy recommendations.

2. POVERTY, INEQUALITY, AND ECONOMIC GROWTH IN MEXICO

(a) *Data*

The information that will be used corresponds to the Household Income and Expenditure Survey (ENIGH) for the years 1992, 1994, 1996, 1998, 2000, 2002, 2004, 2006 and 2008. ENIGH is a nationally representative sample, covering both the rural and urban populations in the 32 Mexican states, conducted by the National Institute of Statistics, Geography and Informatics (INEGI). All the surveys were carried out during the same months of the year, using similar questionnaires and identical sampling techniques. Thus they are fully comparable between them. Additionally, the data are set in constant prices of August 2011, using the national consumer price index, in order to get comparable figures across time.

It should be noted that poverty is calculated by using the official methodology proposed by the Technical Committee for the Measurement of Poverty in Mexico (CTMP, 2002). However, the welfare indicator that is used throughout this study corresponds to current total per-capita income, which differs from the one used in official poverty calculations ("net current per-capita income") in that gifts and in-kind transfers given to and received from other households are not subtracted.

(b) *Poverty measures and lines*

The poverty measures and lines considered in this study are the following:

(i) *Poverty measures*

- Headcount (H) index: Measures the proportion of households (people) that are considered poor in a society. It is a measure of the incidence of poverty that does not indicate how poor the poor are.
- Poverty-gap (PG) index: Measures the extent to which individuals fall below the poverty line (the poverty gaps) as a proportion of the poverty line. It is an indicator of the depth of poverty that does not reflect changes in inequality among the poor.
- Squared Poverty-Gap (SPG) index: Also known as the poverty severity index, which averages the squares of the poverty gaps relative to the poverty line, assigning then higher weights the poorer a household is. This measure corresponds to the index proposed by Foster, Greer, and Thorbecke (1984).

(ii) *Poverty lines* [7]

- Food Poverty: Official poverty lines in Mexico that consider the minimum, monthly household per-capita income ($796.23 & 1,069.67 Mexican pesos, or equivalently USD $2.14 & 2.87 daily American dollars) to satisfy food necessities in the rural and urban sectors respectively in 2008.
- Capacities (Extreme) Poverty: Official poverty lines in Mexico that consider the minimum, monthly household per-capita income ($941.38 & 1,311.95 Mexican pesos, or