INTERNATIONAL Poverty Centre

One pager

September, 2008 Number 65

The New Global Poverty Estimates – Digging Deeper into a Hole

by Sanjay G. Reddy, Barnard College and School of International and Public Affairs, Columbia University

Recently, the World Bank released "updated" global poverty estimates. These new numbers are based on a new price survey and a new benchmark international poverty line of $1.25 in 2005 purchasing power parities (PPPs). The new figures purport to describe world poverty since 1981, and thus affect our understanding of the world over the last quarter century of globalization.

The new estimates also suggest that the number of poor is almost fifty per cent more than previously thought. Can the new estimates be trusted? Unfortunately, the numbers are based on the same methods used earlier and are undermined by the same problems as the earlier estimates.

The new international poverty line is too low to cover the cost of purchasing basic necessities. One could not live in the US on $1.25 a day in 2005, nor therefore on an equivalent amount elsewhere. One's daily income can be a great deal higher than $1.25 and still leave one unable to fulfill basic nutritional requirements. Since the international poverty line is defined in equivalent purchasing power units, this incoherence is not easy to overcome.

Another problem is using inappropriate PPPs to convert poverty lines across currencies. Consider the question of how many *rupiahs* are needed in Jakarta to possess the purchasing power of a dollar in Washington, DC. The question cannot be answered without first establishing the purpose to which the money is to be put. If the purpose is to purchase the goods needed to escape severe poverty (such as staple foodstuffs, which are internationally tradable and the prices of which tend more closely to reflect market exchange rates) the rate of equivalence may be different than if the purpose is to buy domestic services (which are relatively cheaper in poor countries as labour is less mobile). The PPPs calculated for each country also inappropriately reflect irrelevant information about the pattern of consumption in third countries other than the country in which the price level is being assessed and the base country with which prices are compared (the US). This is because the worldwide pattern of consumption determines the weights placed on different commodities when assessing the price level in each country.

The new poverty line is itself allegedly based on an average of poverty lines used in poor countries. However, many of these poverty lines have been defined by the Bank itself and they are translated into common units using the very PPPs the application of which is in question. The underlying source of the problems is the lack of a clear criterion for identifying the poor. We have no basis to conclude that the new set of PPPs generate poverty estimates which are closer to the "truth".

Even if the latest PPPs present a better picture of relative prices in 2005, that does not make them a better basis to judge poverty across countries in the previous years in which poverty must also be estimated to assess trends. The relative extent of poverty in different countries and years, and the estimated trend, is dependent on the base year chosen for the exercise and there is no convincing basis to pick the estimates corresponding to one base year over those corresponding to another.

PPPs reflect the relative costs for a worldwide pattern of consumption prevailing at only one moment in time, and this pattern is constantly changing. They merely present a snapshot of relative prices across countries at a point in time, which is no more authoritative than similar snapshots of the relative prices taken at other points in the time period being examined.

The use of national consumer price indices to identify the local equivalent of the international poverty line in years other than the base year further diminishes comparability across country-years. This is because each such index refers to the price of a basket of goods with a composition entirely different from the pattern of world consumption, which is used to calculate price differences across countries in the base year. The Bank implicitly admits this by substituting the new $1.25 international poverty line for the 2005 equivalent of its earlier $1.08 1993 poverty line as judged by the US CPI (which is close to $1.45 in 2005 prices).

The only region that appears to have had a faster rate of poverty reduction under the new estimates, regardless of whether the period is taken to begin in 1980 or in 1991, is Latin America. Moreover, if the final year of the comparison is moved backward by just three years to 2002, the rate of reduction of world poverty appears notably less favorable under the new estimates. The estimated reduction in poverty since may be due to misattribution of aggregate growth to the poor rather than to new information from surveys.

Two revisions have already been undertaken of the base year. The next global price survey is scheduled for 2011. The Bank can at that point choose between pulling the rug from underneath itself again by updating the PPPs used, continuing to use the same PPPs, or admitting that its method is wholly wrong.

There exist alternative methods. These involve careful coordination of household surveys and poverty line construction across countries, ensuring comparability from the first. Such an effort would be along the lines of the coordination of national accounts—a previous crowning achievement of the United Nations.

Reference:

Sanjay Reddy and Thomas Pogge (forthcoming). "How Not to Count the Poor", in Stiglitz, J., Anand, S. and Segal, P. ed., *Debates on the Measurement of Global Poverty*, Oxford University Press.

Click here to see the World Bank's New Poverty Estimates: <http://econ.worldbank.org/external/default/main?menuPK=469435&pagePK=64165236&piPK=64165141&theSitePK=469382>.

The content of this page does not necessarily reflect the official views of the International Poverty Centre, IPEA or the United Nations Development Programme.