Foreign Direct Investment and Poverty Reduction

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Definition and measurement of poverty

1. Definition

There is no single universally accepted definition of poverty. The fact that there are so many different ways of thinking about poverty means that debates often generate more heat than light. There is also a political dimension since the term “poverty” carries with it an implication and moral imperative that something should be done about it. Moreover, and at the academic level, textbooks aften start with the distinction between “absolute” and “relative” poverty. Absolute poverty refers to a lack of the needs for physical subsistence, which means the necessary for the maintenance of physical health and physical efficiency. Relative poverty extends the concept of poverty to consider individuals as social beings, who have psycological needs to participate in a society and share in its customs and norms.

Poverty can be defined as an economic condition of lacking both money and basic necessities needed to successfully live, such as food, water, education, and shelter. There are many working definitions of "poverty," with considerable debate on how to best define the term. Income security, economic stability and the predictability of one's continued means to meet basic needs all serve as absolute indicators of poverty. Poverty may therefore also be defined as the economic condition of lacking predictable and stable means of meeting basic life needs.

Poverty can also be confirmed by a great variety of statistical measures. One might look at figures on life expectancy, calories in the diet, number of teachers or doctors per head of population, steel output or electrical power output per capita, percentage of the population living in rural areas or working in the agricultural sector, number of automobiles, miles of road, plumbing facilities and so on.

Poverty is the state for the majority of the world’s people and nations. Terrible facts and statistics are published by various international institutions. Such publications show that :

- Half the world — nearly three billion people — live on less than two dollars a day.

- The GDP (Gross Domestic Product) of the poorest 48 nations (i.e. a quarter of the world’s countries) is less than the wealth of the world’s three richest people combined.
- Nearly a billion people entered the 21st century unable to read a book or sign their names.
- Less than one per cent of what the world spent every year on weapons was needed to put every child into school by the year 2000 and yet it didn’t happen.
- 1 billion children live in poverty (1 in 2 children in the world). 640 million live without adequate shelter, 400 million have no access to safe water, and 270 million have no access to health services. 10.6 million died in 2003 before they reached the age of 5 (or roughly 29,000 children per day).

2. Measuring poverty

When measuring poverty it is necessary to be guish between the poor and non-poor.The traditional approach involves establishing an income threshold and calculating how many individuals fall below it. A wide range of methods on how to establish the income threshold has been used in different countries and at different times. A common approach, used by international bodies such as European Union and the OECD, involves using an income threshold set at a particular *fraction of mean or median* income. In addition to that, there are many other different appoaches used in the same field such as, the *budget standard* approach, the *subjective poverty line* approach, the *deprivation indicator* approach. Although there are a number of other approaches to measuring poverty in addition to those outlined above, there is no single correct approach, all have potential drawbacks.

Dimensions of Poverty

As stated in many of the World Development Report poverty is multidimensional. Its persistence is linked to its interlocking multidimensionality: it is dynamic, complex, institutionally embedded, and a phenomenon that is specific to gender and location. The pattern and shape of poverty vary by social group, season, location, and country. Some of the most important dimensions are the lack of opportunity, low capabilities, low level of security and empowerment.

In terms of lack of opportunity we find low level of consumption and income, which are usually relative to a national poverty line. This is generally associated with a level and distribution of human capital and social and physical assets, such as land and market opportunities that determine the returns to these assets. Another dimension of poverty is low capabilities which consist of little or no improvements in health and education indicators among a particular socioeconomic group. In addition to that, we find low level of security defined as the exposure to risk and income shocks, which may arise at the national, local, household, or individual levels. Moreover, empowerment which refers to the capability of poor people and other excluded groups to participate in, negotiate with, change, and hold accountable institutions that affect their well-being.

The empirical correlations between these different dimensions of poverty are overwhelmingly positive. Using multiple dimensions to analyze poverty will not always increase the number of people considered to be poor, but it will highlight the fact that the poor suffer from multiple deprivations.

In practice, poverty reducing interventions will focus on improving income security, education, and health capabilities, and empowering those population groups living in poverty or near the poverty line in addition to those at relatively high risk of falling into income poverty.

The analysis of poverty, its determinants and poverty-reducing interventions therefore requires a focus on poverty information that is further geographically disaggregated. In addition, poverty and inequality are multidimensional- consumption and income, education, health, opportunities, voice, etc...- and have multiple determinants- geographic and agro-climatic factors, services, infrastructure, etc...

Causes of Poverty

It is very difficult, if not impossible, to define the exact causes of poverty. One of the major causes of poverty is the structural adjustment policies prescribed by the International Monetary Fund (IMF) and the World Bank, as condition of loans and repayment, give the result of cutbacks in

health, education and other vital social services around the world. To attract investment, poor countries enter a spiraling race to the bottom to see who can provide lower standards, reduced wages and cheaper ressources. This has increased poverty and inequality for most people. As a result, it maintains the historic unequal rules of trade. Moreover, inequality is increasing around the world while the world appears to globalize. In many cases, international politics and various interests have led to a diversion of available resources from domestic needs to western markets. Historically, politics and power play by the elite leaders and rulers have increased poverty and dependency. Poverty is therefore not just an economic issue, it is also an issue of political economics. Another cause of poverty is corruption. We often hear leaders from rich countries telling poor countries that aid and loans will only be given when they show they are stamping out corruption. While that definitely needs to happen, the rich countries themselves are often active in the largest forms of corruption in those poor countries, and many economic policies they prescribe have exacerbated the problem. Corruption in developing countries definitely must be high on the priority list, but so too must it be on the priority list of rich countries. Moreover, while the world is globalizing and the mainstream media in many developed nations point out that economies are booming, there are an increasing number of poor people who are missing out on this apparent boom, while increasingly less people are becoming far more wealthy. Some of these facts and figures are an eye-opener to say the least.

Foreign Direct Investment and Growth

There is a substantial literature linking trade to economic growth and growth to poverty reduction. Lindert and Williamson, 2001, argue that there is a preponderance of evidence to suggest that on average greater participation in international trade raises long-run individual country growth rates. Moreover, Dollar and Kraay showed in their paper published in 2001, that provided that there are no major changes in income distribution, faster rates of per capita GDP growth lead to higher rates of poverty reduction. Since there is no systematic evidence to show that greater integration with the world economy changes the distribution of income, more trade on average results in more rapid poverty reduction.

As growth is believed to be the single-most important factor affecting poverty reduction, foreign direct investment (FDI) is central to achieving that goal, Since FDI is considered as a key ingredient for successful economic growth in developing countries. This is because of the very essence of economic development is the rapid and efficient transfer and adoption of “best practice” across borders. FDI is particularly well suited to affect this and translate it into broad-based growth, not least by upgrading human capital. In addition to that, FDI has other potentially desirable features that affect the quality of growth and assist with poverty reduction. It helps reduce adverse shocks to the poor resulting from financial instability as during the Asian crisis and helps improve corporate governance. In addition to that, FDI can help improve environmental and labor standards, because foreign investors tend to be concerned about reputation in markets, where high standards are seen as desirable. Moreover, FDI generates taxes that support the development of a safety net for the poor, for example, water supply.

Experts agree on several points regarding FDI, where capital is not raised locally, it adds to the local capital stock and can increase a country’s output or productivity through a more efficient use of existing resources or by absorbing unemployed resources. FDI also stimulates the development and dispersion of technological skills, particularly through transnational corporations, internal transfers and through linkages and spillovers to firms and institutions outside the TNC system; and capital provides expanded market access for local capabilities and products.

However, FDI will not automatically reduce income inequality, and will not deal with all dimensions or poverty. The key alternative approaches that might direct more of the fruit of growth

to the poor are government-led programs that improve social safety nets and explicitly redistribute assets and income. But growth is needed to fund these programs. In conclusion, we can say that among the tools available, FDI remains among the most effective ones in the fight against poverty. Hence, the wide agreement among analysts about the usefulness of FDI, including prominent critics of growth oriented policies (Stiglitz, 1998b).

FDI is believed to be the most effective means of transferring best practice across borders. Imported capital goods may embody improved technology. Technology licensing allows countries to acquire innovations. FDI tends to raise productivity in the recipient economy. There is a large number of ways by which productivity is raised ranging from better worker training to deployment of advanced technology. Several studies show that effective diffusion of best practice is possible and works, for example, through subcontracting arrangements.

Overall, whether the potential for domestic diffusion of best practice can be exploited depends on the absorption capacity of the host economy. Adequate levels of education and infrastructure are required to fully benefit from FDI (Borenzstein, De Gregoria and Lee, 1998) as well as competition in domestic markets.

In conclusion, we can say that FDI has the potential to improve the quality of growth by

1. reducing the volatility of capital flows and incomes
2. improving asset and income distribution at the time of privatization
3. helping improve social and environmental standards
4. helping improve social safety nets and basic services for the poor.

POVERTY IN ALGERIA

Like many centrally planned economies, Algeria tried, from independence in 1962, to guarantee the living standard of the population through employment generation in the public sector and extensive social sector investment and social protection schemes. This was possible when oil prices were high, from 1973 to the early 1980s, and during this time progress in social indicators was impressive. But the decline in world oil prices in the 1980s made manifest the economy's fragility. The inefficient publicly dominated industrial structure and the drop in oil revenues led to economic stagnation and to deterioration in living standards, high unemployment, and an increase in the incidence of poverty.

The incidence of poverty increased significantly between 1988 and 1995. The main causes of this increase were the lack of economic growth and the resulting decline in employment opportunities. Broad-based economic growth is crucial for reducing poverty in Algeria. It can both directly raise the income of the poor by creating income-earning activities in which they can participate, and it will help them indirectly by freeing financial resources, which can be directed to productive investments and to priority social sectors. The latter are also important determinants of growth. Further delays in structural changes, which are needed to restore the level of sustainable growth, are likely to increase the social costs. International experience indicates that, during a transition from a centrally planned to a market economy, the private sector is the most sustainable engine of growth and of new jobs. Therefore, while deepening the process of structural reform, achieving and maintaining macroeconomic stability, and promoting private sector development, Algeria needs to redefine its strategic objectives in such fields as education, health, and economic infrastructure so as not to undermine a broad-based economic recovery and to be able to fully meet the challenges of the future. To assist those who will be hurt by structural reform and facilitate the adjustment of vulnerable groups to the new economic environment, the government should continue enhancing safety net programs that will rely on more self-targeting.

The macroeconomic stabilization and structural reforms undertaken since 1987 failed to reverse the economic decline that began in the mid-1980s: all basic macroeconomic indicators continued to deteriorate from 1987 to 1995. Important reversals in economic policy during the first phase of transition to a market economy (1989-94) resulted in prolonged economic recession, accompanied by increasing inflationary pressure, high external debt, growing unemployment, and mounting social discontent. During the second phase of the transition, beginning in 1994, Algeria introduced radical structural reforms, relaunched the stabilization and adjustment programs, and restored macroeconomic balances.

In 1995, Algeria signed a three-year program for debt rescheduling with the International Monetary Fund (IMF), and rescheduled $13 billion of debt with the Paris Club. These programs resulted in an improved balance of trade, lowered government expenditures, and a government surplus. The government did not renew its programs with the IMF in 1998, saddling the economy with a total debt in 1998 that amounted to $31 million, and capital expenditures reaching almost 10% of the GDP.

Seeking to diversify and modernize the Algerian economy, the Algerian government has embarked on an aggressive liberalization program to attract foreign direct investment. New legislation continues to affect nearly all sectors, including mining, power, banking, telecommunications, pharmaceuticals, transportation, and tourism. While there are still many bureaucratic hurdles to starting a business in Algeria, the investment code clearly lays out the rules for investors . In This connection, in 1995, the Algerian government set up the National Agency of Investment Development (Agence de Promotion, de Soutien, et de Suivi des Investissements—APSI) and regional investment promotion agencies to serve as a network of regional one-stop shops to eliminate layers of bureaucracy for investors.

Summary of FDI in Algeria
(Millions of dollars)

Variable	Inward	Outward
- FDI flows, 1998-2002 (annual average)	741.4	35.0
- FDI flows as a percentage of GFCF, 1998-2002 (annual average)	5.9	0.3
- FDI stock, 2002	5 702.4	451.7
- FDI stock as a percentage of GDP, 2002	10.5	0.8

Sources: UNCTAD, FDI/TNC database.

The following table lists countries sorted by the percentage of the poorest population living under 2 and 1 dollar a day. The sourced data refers to the most recent year available during the period 1990-2003:

Population living under 2 and 1 dollar a day

No.	Country	Population (%) < $2	Population (%) < $1
01	Nigeria	90.8	70.2
02	Mali	90.6	72.3
03	Burundi	89.2	58.4
04	Zambia	87.4	63.7
05	Niger	85.3	61.4

06	Madagascar	85.1	61
07	Central African Republic	84	66.6
08	Rwanda	83.7	51.7
09	Zimbabwe	83	56.1
10	Gambia	82.9	59.3
11	Bangladesh	82.8	36
12	Nepal	82.5	37.7
13	Burkina Faso	81	44.9
14	Ethiopia	80.7	26.3
15	Nicaragua	79.9	45.1
16	**India**	**79.9**	**34.7**
17	Ghana	78.5	44.8
18	Mozambique	78.4	37.9
19	Cambodia	77.7	34.1
20	Malawi	76.1	41.7
21	Mongolia	74.9	27
22	Sierra Leone	74.5	57
23	Laos	73.2	26.3
24	Senegal	67.8	26.3
25	Pakistan	65.6	13.4
26	Mauritania	63.1	25.9
27	Tanzania	59.7	19.9
28	Kenya	58.3	22.8
29	El Salvador	58	31.1
30	Lesotho	56.1	36.4
31	Namibia	55.8	34.9
32	Indonesia	52.4	7.5
33	Sri Lanka	50.7	7.6
34	Cameroon	50.6	17.1
35	Botswana	50.1	23.5
36	People's Republic of China	46.7	16.6
37	Philippines	46.4	14.6
38	Yemen	45.2	15.7
39	Honduras	44	20.7
40	Egypt	43.9	3.1
41	Ecuador	40.8	17.7
42	Trinidad and Tobago	39	12.4
43	Côte d'Ivoire	38.4	10.8
44	Peru	37.7	18.1
45	Guatemala	37.4	16
46	Bolivia	34.3	14.4
47	South Africa	34.1	10.7
48	Paraguay	33.2	16.4
49	Thailand	32.5	<2
50	Venezuela	32	15
51	Mexico	26.3	9.9
52	Colombia	22.6	8.2
53	Brazil	22.4	8.2
54	Panama	17.6	7.2
55	**Algeria**	**15.1**	**<2**

56	Argentina	14.3	3.3
57	Morocco	14.3	<2
58	Jamaica	13.3	<2
59	Turkey	10.3	<2
60	Chile	9.6	<2
61	Costa Rica	9.5	2
62	Malaysia	9.3	<2
63	Jordan	7.4	<2
64	Iran	7.3	<2
65	Tunisia	6.6	<2
66	Uruguay	3.9	<2
67	Dominican Republic	<2	<2
68	South Korea	<2	<2

Source: 2005 United Nations Human Development Report

The second table lists countries sorted by the percentage of the population living below the national poverty line. National estimates of the percentage of the population falling below the poverty line are based on surveys of sub-groups, with the results weighted by the number of people in each group. Definitions of the poverty line vary considerably among nations. For example, rich nations generally employ more generous standards of poverty than poor nations.

Population living below national poverty line

No.	Country	Population %	Year
01	Liberia	80	*
02	Moldova	80	2001 est.*
03	Zambia	72.9 / 86*	1993*
04	Madagascar	71.3 / 50*	2004 est.*
05	Angola	70	2003 est.*
06	Suriname	70	2002 est.*
07	Mozambique	69.4 / 70*	2001 est.*
08	Burundi	68	2002 est.*
09	Sierra Leone	68	
10	Malawi	65.3 / 55*	2004 est.*
11	Haiti	65 / 80*	2003 est.*
12	Chad	64 / 80*	2001 est.*
13	Colombia	64 / 49.2*	2005*
14	Gambia	64	
15	Mali	63.8 / 64*	2001 est.*
16	Niger	63	
17	Bolivia	62.7 / 64*	2004 est.*
18	Comoros	60	2002 est.*
19	Tajikistan	64	2004 est.*
20	Turkmenistan	58	2003 est.*
21	Guatemala	56.2 / 75*	2004 est.*
22	Uganda	55 / 35*	2001 est.*

23	Georgia	54	2001 est.*
24	São Tomé and Príncipe	54	2004 est.*
25	Afghanistan	53	2003*
26	Eritrea	53 / 50*	2004 est.*
27	Honduras	53	
28	Rwanda	51.2 / 60*	2001 est.*
29	Vietnam	50.9 / 19.5*	2004 est.*
30	Namibia	50	2002 est.*
31	South Africa	50	2000 est.*
32	Bangladesh	49.8 / 45*	2004 est.*
33	Lesotho	49.2 / 49*	1999*
34	Azerbaijan	49	2002 est.*
35	Peru	49 / 54*	2003 est.*
36	Guinea-Bissau	48.7	
37	El Salvador	48.3 / 34.6*	2004 est.*
38	Nicaragua	47.9 / 50*	2001 est.*
39	Mauritania	46.3 / 40*	2004 est.*
40	West Bank	46% including Gaza Strip	2004 est.*
41	Burkina Faso	45.3 / 45*	2003 est.*
42	Djibouti	45.1 / 50*	2001 est.*
43	Ethiopia	44.2 / 50*	2004 est.*
44	East Timor	42	2003 est.*
45	Kenya	42 / 50*	2000 est.*
46	Nepal	42 / 31*	2003-2004*
47	Yemen	41.8 / 45.2*	2003*
48	Cameroon	40.2 / 48*	2000 est.*
49	Guinea	40	
50	Iran	40	2002 est.*
51	Kyrgyzstan	40	2004 est.*
52	Sudan	40	2004 est.*
53	Swaziland	40 / 69*	2005*
54	Ghana	39.5 / 31.4*	1992 est.*
55	Laos	38.6 / 40*	2002 est.*
56	Argentina	38.5	June 2005*
57	Papua New Guinea	37.5 / 37*	2002 est.*
58	Panama	37.3 / 37*	1999 est.*
59	Côte d'Ivoire	36.8 / 37*	1995*
60	Philippines	36.8 / 40*	2001 est.*
61	Mongolia	36.3 / 36.1*	2004 est.*
62	Cambodia	36.1 / 40*	2004 est.*
63	Tanzania	35.7 / 36*	2002 est.*
64	Ecuador	35 / 52*	2006*
65	Guyana	35	

66	Zimbabwe	34.9 / 80*	2004 est.*
67	Nigeria	34.1 / 60*	2000 est.*
68	Senegal	33.4 / 54*	2001 est.*
69	Belize	33	1999 est.*
70	Benin	33	
71	Pakistan	32.6 / 32*	Fiscal year 2000-01 est.*
72	Togo	32.3 / 32*	1989 est.*
73	Grenada	32	2000*
74	Venezuela	31.3 / 47*	1998 est.*
75	Botswana	30.3	2003*
76	Cape Verde	30	2000*
77	Dominica	30	2002 est.*
78	Serbia and Montenegro	30	1999 est.*
79	Macedonia	29.6	2004 est.*
80	Ukraine	29	2003 est.*
81	Dominican Republic	28.6 / 25*	
82	**India**	**28.6 / 25***	**2002 est.***
83	Lebanon	28	1999 est.*
84	Uzbekistan	28	2004 est.*
85	Belarus	27.1	2003 est.*
86	Indonesia	27.1	
87	Federated States of Micronesia	26.7	*
88	Fiji	25.5	1990-91*
89	Albania	25	2004 est.*
90	Bosnia and Herzegovina	25	2004 est.*
91	Burma	25	2000 est.*
92	Romania	25	2005 est.*
93	Sri Lanka	25 / 22*	1997 est.*
94	Anguilla	23	2002*
95	Guam	23	2001 est.*
96	Costa Rica	22 / 18*	2004 est.*
97	Uruguay	22% of households	2004*
98	Paraguay	21.8 / 32*	2005 est.*
99	Israel	21	2005*
100	Slovakia	21	2005
101	Trinidad and Tobago	21	
102	Syria	20	2004 est.*
103	Turkey	20	2002*
104	Bermuda	19	2000*
105	Morocco	19	
106	Kazakhstan	19	2004 est.*
107	Jamaica	18.7 / 19.1*	2003 est.*
108	Russia	17.8	2004 est.*

109	Brazil	17.4 / 22*	1998 est.*
110	Chile	17 / 18.2*	2005*
111	Poland	17	2003 est.*
112	United Kingdom	17	2002 est.*
113	Egypt	16.7 / 20*	2005 est.*
114	Canada	15.9	2003*[1]
115	Malaysia	15.5 / 8*	1998 est.*
116	South Korea	15	2003 est.*
117	Bulgaria	13.4	2002 est.*
118	Thailand	13.1 / 10*	2004 est.*
119	Armenia	13	2006 est.*
120	**Algeria**	**12.2 / 25***	**2005 est.***
121	United States	12	2004 est.*
122	Jordan	11.7 / 30*	2001 est.*
123	Croatia	11	2003*
124	Mexico	10.1 / 40*	2003 est.*
125	Ireland	10	1997 est.*
126	Mauritius	10	2001 est.*
127	The Bahamas	9.3	2004*
128	Hungary	8.6	1993 est.*
129	Tunisia	7.6 / 7.4*	2005 est.*
130	France	6.5	2000*
131	Austria	5.9	2004*
132	People's Republic of China	4.6 / 10*	2001 est.*

Note (*): Provided by CIA World Factbook

Conclusion

This article presented a comprehensive study of poverty and its causes and the different ways to measure it. It has been shown that growth is the single-most important factor affecting poverty reduction, and thus, foreign direct investment (FDI) is central to achieving that goal, Since FDI is considered as a key ingredient for successful economic growth in developing countries. This is because of the very essence of economic development is the rapid and efficient transfer and adoption of "best practice" across borders. FDI is particularly well suited to affect this and translate it into broad-based growth, not least by upgrading human capital.

As far as Algeria is concerned, and in the absence of a strong growth, poverty will remain high reflecting the inability of current reforms in addressing the poverty problem in Algeria. Strong growth in Algeria is up to now associated with oil windfalls and does not necessarily mean good growth in non-hydrocarbon sectors. We can say that strong growth is a good devise for fast reduction in poverty. Thus, the big challenge for the Algerian government is how to use oil windfalls in generating pro-poor growth through employment generation and consolidating the social safety net for the unable to work.

Generally speaking, and through the Millennium Development Goals the world is addressing the many dimensions of human development, including halving by 2015 the proportion of people living in extreme poverty. Developing countries are working to create their own national poverty eradication strategies based on local needs and priorities.

UNDP advocates for these nationally-owned solutions and helps to make them effective through ensuring a greater voice for poor people, expanding access to productive assets and economic opportunities, and linking poverty programmes with countries' international economic and financial policies. At the same time, UNDP contributes to efforts at reforming trade, debt relief and investment arrangements to better support national poverty reduction and make globalisation work for poor people. In doing so, we sponsor innovative pilot projects; connect countries to global best practices and resources; promote the role of women in development; and bring governments, civil society and outside funders together to coordinate their efforts.

UNDP promotes the concept of human poverty as a complement to income poverty, emphasizing that equity, social inclusion, women's empowerment, and respect for human rights matter for poverty reduction.