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Is Governance Associated with Poverty Reduction Independent of Economic Growth?

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White Paper:

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In this paper we examine the relationship between three important development goals: **good governance**, **poverty reduction** and **economic growth**. Specifically, we look at whether good governance as measured by the Millennium Challenge Corporation (MCC) Country Scorecards has an independent relationship with poverty reduction when controlling for economic growth. We find that improvements in MCC's Civil Liberties indicator, Control of Corruption indicator, and the MCC Country Scorecards overall are associated with large decreases in the number of people in extreme poverty even when no GDP growth is realized. The relationship between MCC's Political Rights indicator and poverty reduction controlling for GDP is not as statistically significant. These results are supported by our literature review which finds strong evidence that growth translates more effectively into poverty reduction in well-governed countries.

I INTRODUCTION

Credit: Millennium Foundation Kosovo

International development organizations seek to achieve a wide variety of different goals, including economic growth, poverty reduction, governance reform, improved quality of life, sustainability of projects, contributions to global public goods, country ownership in decision making, conflict stabilization, self-sufficiency and many more.[1] These goals can be mutually reinforcing. Economic growth has been shown to be positively correlated with poverty reduction.[2] Democratization and governance reform lead to reduced conflict.[3] Country ownership over assistance has been claimed to contribute to project sustainability.[4]

But these goals can also be in tension with each other. Economic growth is inversely correlated with global public goods of preserving biodiversity and mitigating climate change.[5] Many of the world's extreme poor live in autocracies, but partnering with unelected autocrats can weaken prospects for democracy and undermine ownership by the people.[6] Subnational regions, where there is the greatest potential for economic growth, may differ from regions where there is the greatest opportunity for poverty reduction.[7] Understanding these tradeoffs and relationships between these aims is crucial for organizations that want to achieve these varied goals. In this paper we focus specifically on a subset of goals: the relationship between economic growth, poverty reduction, and good governance.

Different development organizations (such as multilateral development banks, international NGOs, and bilateral development agencies) seek to address the tensions between good governance, poverty reduction, and economic growth through different

1 UNDP 2024; Gates Foundation 2024; World Bank, 2024a; Foreign Assistance Act, 2024; Reynolds et al, 2017; Biscaye et al., 2016; Lucas, 2011; Phillips-Mandaville, 2009.

2 Marrero & Servén, 2022; Fosu, 2017; Škare & Družeta, 2016; Dollar & Kraay, 2004; Roemer & Gugerty, 1997.

3 Rummel 2017; Hegre & Nygård 2015; Walter, 2015; Hegre 2014; Bremer, 1993

4 Dornan, 2017; Phillips-Mandaville, 2009; Wright 2008; Lucas 2011; Khan & Sharma, 2001

5 Wiedenhofer et al. 2020; Chen et al. 2016; Li et al., 2016; Ansuategi & Escapa 2002;

6 Pande, 2020; Dutta et al. 2013; Phillips-Mandaville, 2009;

7 For example: extreme poverty is more than three times higher in rural areas than urban ones (United Nations, 2019), but over 80% of global GDP is generated in cities (World Bank, 2023).

policies. Each of these policies are underpinned by different models of the relationships between these varied goals. Some rely on technocratic components of good governance and top-down notions of country ownership when making determinations to fund autocracies.[8] Others fund non-governmental organizations instead of supporting governments directly in countries where governments are deemed too authoritarian.[9] Still others work only in countries where governance is already strong, or give progressively more assistance to countries as they become better governed under the view that assistance is more effective in well-governed countries.[10] In this paper we will focus on assessing the justification underpinning the model of the Millennium Challenge Corporation (MCC), which has a mandate to reduce poverty through economic growth, by working only in the best governed of the world's poorest countries.[11]

MCC is a US government bilateral development assistance agency that was founded in 2004 with a mission to reduce poverty through economic growth. MCC works only in countries with demonstrated development need that are the best governed as measured by MCC's country scorecards.[12] The scorecards assess a country's policy performance on 20 different facets of good governance including a country's commitment to ruling justly, investing in its people, and promoting economic freedom as defined by MCC's founding statute.[13] In order to be considered for a compact program (large, 5 year grant agreements), a country must pass the scorecard. This process allows for MCC to have greater confidence that sectors and projects proposed by partner governments will reflect the needs of the populace.[14] It also provides the people of a country the ability to engage with MCC and the government on their needs, as the scorecard filters out countries that lack sufficient democratic institutions and may not be responsive to the will of their populations.

Two of the propositions behind the creation of MCC's unique model are the ideas that economic growth translates more effectively into poverty reduction in well governed countries with sound policy environments and the claim that good governance has a positive impact on poverty reduction independent of growth.[15] Given the criteria discussed above, MCC partners only with relatively well governed democracies as measured by MCC's scorecard. Theoretically, well-governed democracies could be better at translating economic gains into broad-based poverty reduction as the poor are able to have influence over their leaders at the ballot box, a free press does a better job of connecting leaders with the concerns of the poor, and democracies tend to provide more public goods,[16] while autocracies could be more likely to concentrate

8 This can occur with some "donor darling" countries: often authoritarian regimes that maintain ownership over their autocratic policies while donors justify continued funding due to strong performance on measures of technocratic governance (Cheeseman et al., 2019; Fletcher et al. 2017; Marriage, 2016; Hagmann & Reyntjens, 2016; Brautigam 2012).

9 The US Government cannot provide direct assistance to governments (with some exceptions) that have undergone a coup d'etat, but various agencies continue to fund NGOs in those countries (CRS 2023; Harrison, 2022; de Felice, 2014; Ombok, 2014). The UK and EU Countries often condition aid on continued support for human rights and can shift assistance to NGOs when they are not respected (de Felice, 2014; Ombok, 2014; Al Jazeera 2014; Tran, 2011; Crawford, 1996).

10 MCC, 2023a; World Bank, 2022; Parks & Davis, 2019; Reynolds et al, 2017; Reinsberg, 2015; Parks & Rice 2013; World Bank 2010.

11 MCC, 2019; Hayes-Birchler & Staats, 2014

12 MCC, 2023a;

13 Millennium Challenge Act of 2003;

14 Lucas, 2011; Phillips-Mandaville, 2009

15 Bush, 2002

16 Kaidi & Mensi, 2020; Ghobarah et al., 2004; Boix, 2001; Lake & Baum, 2001; Bueno de Mesquita & Root, 2000; Sen, 1999; Sen, 1981.

gains in the hands of the few. As countries become better governed, benefits will accrue more to the poor even if overall economic development remains the same. In this paper, we review the literature on the claim that growth translates better into poverty reduction in well-governed countries and empirically test the hypothesis that good governance, as measured by the MCC scorecard, impacts the level of poverty in a country when economic development is held constant.

This paper does not assess other justifications for the use of this model such as: the ethical claim that democracy and human rights are goods in themselves, independent of growth or poverty reduction;[17] the claim that foreign assistance is more effective at achieving growth in well-governed countries;[18] or the claim that country ownership is only effective when governments are democratic and therefore responsive to the needs of their people.[19] Instead, it addresses the claim that good governance contributes to poverty reduction independent of economic growth.

We begin with a literature review examining the relationship between growth, poverty reduction, and good governance, including a systematic literature review of recent studies on the subject. We next provide a description of the data to be used in this analysis, how each of the concepts of growth, governance, and poverty will be quantified and some initial observations about these data. This is followed by a section providing the empirical analysis of the relationships between these indicators, including the model used, and the results observed. The penultimate section includes an assessment of the robustness of these results to different parameters and an exploration of the limitations of the analysis. The final section includes an analysis of the result and conclusions for policymakers based on this research.

17 For more on this see: Crocker, 2010; Alexander, 2004; Nussbaum, 2006; Goulet, 1989.

18 For more on this see: Grover, 2023; Rady, 2013; Bjella, 2012; Michaelowa & Weber, 2007; Kosack, 2003; Svensson, 1999.

19 For more on this see: Lucas, 2011; Faust 2010; Mkandawire, 2010; Phillips-Mandaville, 2009.

II LITERATURE REVIEW

II.1 GENERAL LITERATURE REVIEW

The general consensus in the recent literature is that democracy and good governance increase the poverty reducing effects of growth as hypothesized here. There are also several studies that find direct impacts of democracy and governance on poverty reduction, as well as some that find a threshold effect of good governance (that governance above a certain level has an impact on reducing poverty).

A range of articles find that democracy and good governance strengthens the link between growth and poverty reduction.[20] For example, results from Kaidi & Mensi (2020) show that financial development and strong institutions do not lead to poverty reduction in autocracies, but independently contribute to poverty reduction in democracies. Similarly, Appiah-Otoo et al., (2022) reveal that while growth and investments lead to poverty reduction, the relationship is stronger in the presence of good governance. Kouadio & Gakpa (2022) find that, in West Africa, low corruption and rule of law are prerequisites for growth to translate into reduced inequality and that economic growth is more impactful at reducing poverty in democracies. Fosu & Gafa (2022) find that good governance matters in its ability to translate income increases into poverty reduction. Colagrossi et al. (2020) review 2000 regressions and find that democracy has a positive direct impact on growth and human capital.

Another selection of articles demonstrates a direct impact of democracy and good governance on poverty reduction.[21] Gao & Zang (2021) examine this relationship and find that democracy does lead to poverty reduction on a global scale over two decades. Many studies corroborate this finding including Fosu (2021) and Dankumo et al. (2021), which verify the pro-poor nature of democracy in Sub-Saharan Africa, as well as Chhabra et al.

20 Dörffel & Freytag, 2023; Appiah-Otoo et al., 2022; Fosu & Gafa, 2022; Kouadio & Gakpa, 2022; Colagrossi et al., 2020; Kaidi & Mensi, 2020.

21 Chhabra et al. 2023; Dankumo et al., 2021; Gao & Zang, 2021; Fosu, 2021; Pande 2020.

(2023) which does so in the BRICS countries. Older studies find direct impacts between democracy and positive outcomes for other social welfare outcomes like infant mortality.[22]

A final assortment of studies found that democracy and good governance above a certain level contribute to poverty reduction, presenting democracy as having a threshold effect, in other words democracy must surpass a particular threshold to reduce poverty.[23] Ochi et al., (2023) illustrates that there is a threshold above which good governance reduces poverty. Kabir & Alam (2021) find globally that personal freedom harms growth for societies that only have limited personal freedoms but actually enhances growth once personal freedoms reach a critical threshold.

The conception of good governance in many of these papers is narrow, focusing only on governance defined in terms of democracy, rule of law, and control of corruption. The MCC scorecard includes these measures, but also broader measures of good governance including the share of resources committed to health and education and access to financial institutions.[24] so our paper is able to fill a niche with scorecard data points and MCC's broader conception of good governance.

II.2 SYSTEMATIC LITERATURE REVIEW

In order to show that the results above are not subject to selection bias, we conduct a systematic literature review capturing all articles that address the relationships between these concepts recently published in top journals on development. While none address the exact question of this paper, they all find positive relationships between governance and measures of welfare with varying levels of statistical significance. Specifically, we conduct a systematic literature review of all recent articles in the five top performing journals in development economics by impact factor as of June 2024.[25] Using Google Scholar, we review all articles published since January 2023 in these journals containing the phrases "democracy," "growth," and "poverty reduction." We find 231 unique articles. We then screen these articles to focus only on those that contain new or original empirical research on the relationship between good governance, growth and poverty reduction.

Of the 231 articles, only thirteen meet these screening criteria. Seven of these studies examine the issue on a global level,[26] while the rest focus on one country or a small set of countries. Five investigate the connection between institutional strength and inequality and poverty.[27] Three focus on the impact of corruption on natural resource exploitation and consequently, growth.[28] Two articles test the effect of democratization on poverty and growth. The remaining three articles examine other aspects of good governance as they relate to a country's successful economic development.

None of these articles test the exact question we are asking in our paper. However, they test

22 Zweifl & Navia, 2000; Boone, 1996; Moon & Dixon. 1985.

23 Ochi et al., 2023; Kabir & Alam, 2021.

24 MCC 2023a.

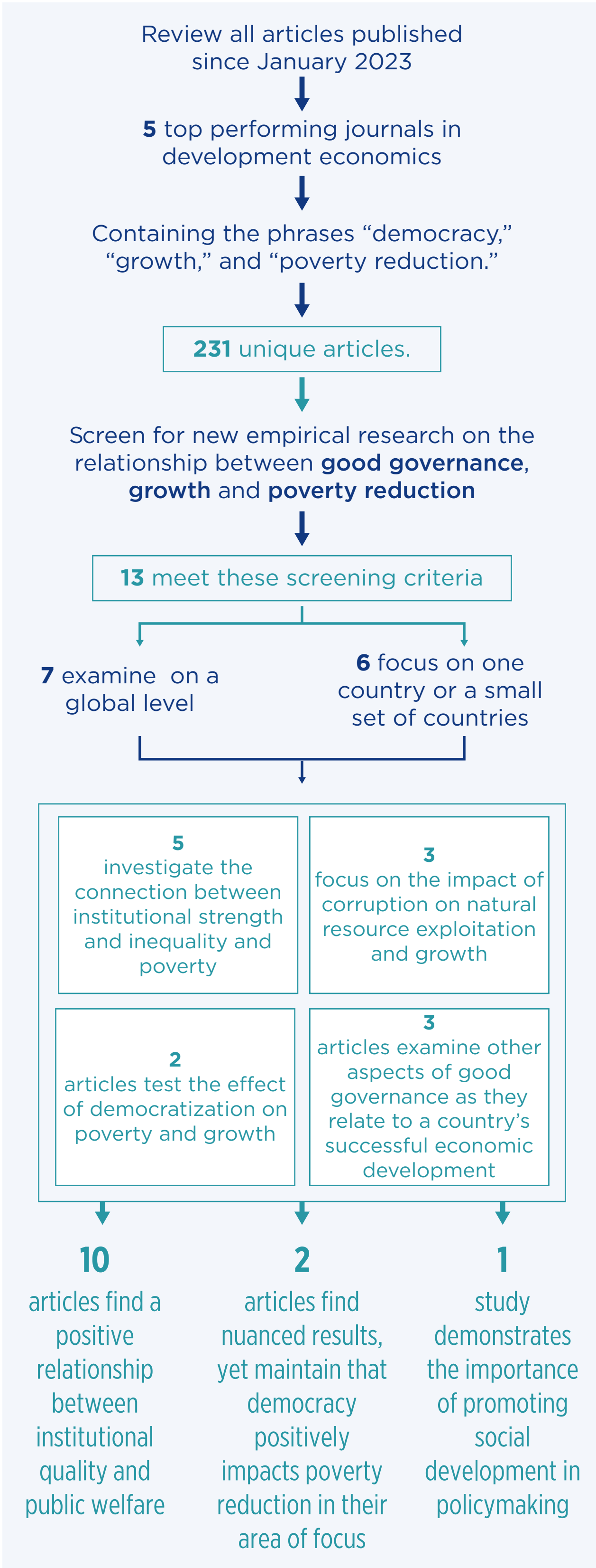
25 OOIR, 2024.

26 Wang et al., 2024; Dima et al. 2024; Ajide & Ojeyinka 2024; Dörffel & Freytag, 2023; Kumar, & Jie, 2023, Kinda & Mien, 2024; Gomez-Gonzalez et al., 2023.

27 Wang et al., 2024; Işık et al., 2024; Dima et al., 2024; Gomez-Gonzalez et al., 2023; Ajide & Ojeyinka, 2024.

28 Zhang, et al., 2024; Kinda & Mien, 2024; Bornschier & Vogt, 2024.

Chart 1 | Systematic Lit Review



relationships that are related and generally find that mechanisms of good governance have a positive impact on poverty reduction and growth. Ten articles find a positive relationship between institutional quality and public welfare at varying levels of statistical significance. Such "quality" is represented by institutional and regulatory strength, specific anti-corruption measures, and democracy. Two articles that examine the relationship between democratization and growth find nuanced results yet maintain that democracy positively impacts poverty reduction in their area of focus. Finally, one study demonstrates the importance of promoting social development in policymaking rather than solely focusing on growth in effectively reducing poverty. For a more in-depth review of the studies identified, please see Appendix A.

III DATA

To address this question of whether governance has an empirical association with poverty independent of economic development, we look at the relationships between data on governance, economic development, and poverty for over 180 countries over 8 years from 2015 to 2022 as outlined below. We test several different formulations of each key variable to assure that the relationships are not an artifact of a particular dataset. This section reviews the datasets used, why those particular datasets are chosen, and some basic summary statistics about those datasets.

III.1 POVERTY

There are several methods that are often used to measure poverty. The World Bank produces a poverty headcount ratio at various levels ($2.15 per day, $3.65 per day, and $6.85 per day for LICs, LMICs, and UMICs, respectively).[29] However the country-level data for these indicators is often inconsistent due to infrequent collection, making them less desirable for the present analysis. Many other measures of poverty or need already include some component of governance, when conceived to include questions of the management of health and education services, as MCC does.[30] For example, the Multidimensional Poverty Index includes measures of child mortality and school attendance, which MCC includes as governance indicators on the scorecard.[31] These measures of poverty are not used in this analysis in order to avoid explicitly including components of the predictor variables (governance) in the outcome variable (poverty).

Due to the limitations of these other datasets, we use a dataset including estimates and future projections of poverty levels created as part of the original data for the World Poverty Clock included in the

29 Hasell, 2022; Schoch et al. 2022

30 MCC, 2023a; Fletcher, 2023

31 UNDP 2023; MCC, 2023a;

replication file of Cuaresma et al. (2018).[32] This dataset uses Beta-Lorenz curves to create estimates and projections of the total number of people in extreme poverty (below $2.15 per day) at the country-year level. Cuaresma et al. provide estimates for several different Shared Socioeconomic Pathways (SSPs). For this analysis, we use SSP2 which assumes the continuation of present socioeconomic trends, however for the years that we are including all of the SSPs are identical.

To match with the data available from other sources, we use only 1,432 country-year observations from this dataset from 2015-2022, ranging between 182 and 174 countries per year. Values range from 159 million people in extreme poverty to zero people in extreme poverty, with the median observation having just under 100,000 people in extreme poverty.

III.2 GROWTH AND ECONOMIC DEVELOPMENT

Many argue that Gross Domestic Product (GDP) and Gross National Income (GNI) are some of, if not the key measures of economic development.[33] However these measures have been critiqued as imperfect measures of overall well-being of a society.[34] Some have critiqued these measures due to a lack of focus on real improvements to health, environmental, and educational outcomes.[35] Others have argued that they fail to take into account differential distributional benefits in more or less equal societies.[36] Still others have argued that a true measure of well-being should include components of political freedoms and capabilities.[37] These critics often propose their own measure of societal well-being including the Human Development Index, the Genuine Progress Indicator, measures of happiness or life satisfaction, and more.

We use GDP in the present analysis not in spite of the many critiques of GDP, but because of them. This analysis aims to separate out the relationships between multiple components of more complete measures of well-being, i.e. separating the GDP component of well-being from the poverty and governance components. Including indicators that are a part of either of MCC's measures of governance or the measure of poverty used in this paper would obscure the results. We do not focus on the Human Development Index because it includes measures of health and education that are included in MCC's measures of governance. We also do not include a measure of well-being that focuses on distributional impacts as these are included in the measure of poverty used as an outcome variable in our analysis. Further, we do not use a measure of growth that includes civil capabilities because those are a key component of the measures of democratic governance that MCC uses. As such, we use GDP instead of the similar measure of GNI given its broad-based use (though, as shown in section V, our results are robust to using GNI instead of GDP). The goal is not to treat GDP as an ultimate outcome to pursue, but rather to see how economic

32 Grover 2023; Cuaresma et al., 2018; Cuaresma 2018;

33 Fraumeni, 2022; McKee et al., 2020; Dynan & Sheiner, 2018; Crosswell 2015

34 Shrotryia & Singh, 2020; Dynan & Sheiner, 2018; Coyle, 2017; Kubiszewski, 2013; Stigliz et al. 2010; Costanza, 2009; Nussbaum, 2000;

35 Shrotryia & Singh, 2020; Schuller, 2014; Stigliz et al. 2010; Thomas & Evans 2010;

36 Schuller, 2014; Kubiszewski, 2013; Stigliz et al. 2010; Nussbaum, 2000;

37 Costanza, 2009; Nussbaum, 2000; Sen 1979; Sen 1974

growth independent of governance interacts with poverty reduction.

In some cases, GDP is measured by the economic resources available per person in a population, such as by calculating the GDP per capita of a particular country. This is justified by the claim that the most accurate measure of wellbeing is the amount of economic resources available for each person in a society. For this analysis we address this concern by using total GDP, but controlling for Population in our analysis. Since our data for economic development and number of people in poverty are both absolute numbers, we are able to use data on country population size from the World Bank to control for the number of people in a given country instead of calculating GDP per capita or a poverty headcount ratio.[38] This also has the benefit of allowing us to state effect sizes on the total number of people in extreme poverty.

Specifically, we use the measure of total GDP in current USD as calculated by the World Bank.[39] In section V we show that our results are robust to other formulations of growth including GNI using the Atlas method, GNI calculated using PPP, and GDP calculated using PPP.[40] As with the data on poverty, there are 1,432 observations used in the regressions ranging from 2015 to 2022. The wealthiest observation in the dataset has a GDP of $25 trillion, while the poorest observation has a GDP of just $170 million. Some may be interested in only looking at developing countries for the purpose of answering questions around development assistance allocation, while others may be interested in general trends around democracy globally. We conduct our main analysis using all countries covered by the data, but conduct a sensitivity analysis in section V that shows these results are robust when only including lower income countries.

III.3 GOVERNANCE

There are a wide range of different ways to conceptualize good governance and how to measure it. Some focus strictly on good governance conceived of as democracy and human rights.[41] Others add to this a greater focus on the related issues of the rule of law and limitations on corruption.[42] More expansive definitions include economic liberalization,[43] or support for and effective implementation of social services around health, education and the environment.[44] Within each of these definitions, there are many competing indicators that strive to quantify these comparatively abstract concepts into tools for measuring the level of good governance in a society.

In this paper we focus on the measures of good governance used by MCC on the country scorecards as they capture all of these different components of good governance, while maintaining a focus on democratic governance and controlling corruption.[45] In order for a country to pass the MCC scorecard they must: pass at least 10 of the

38 World Bank 2024f

39 World Bank, 2024b

40 World Bank, 2024c; World Bank, 2024d; World Bank, 2024e;

41 Freedom House, 2024; Nord et al, 2024;

42 Transparency International, 2024; Kaufman & Kraay, 2023; Kaufman et al., 2010

43 Kim, 2024; Legatum, 2023; Vásquez et al., 2023; World Bank, 2020;

44 Block et al. 2024; Legatum, 2023; Neelsen et al., 2022; Pinheiro et al., 2020; World Bank, 2019;

45 MCC, 2023a

20 indicators show a commitment to Democratic governance by passing either the Political Rights or the Civil Liberties indicators, and pass the Control of Corruption indicator.

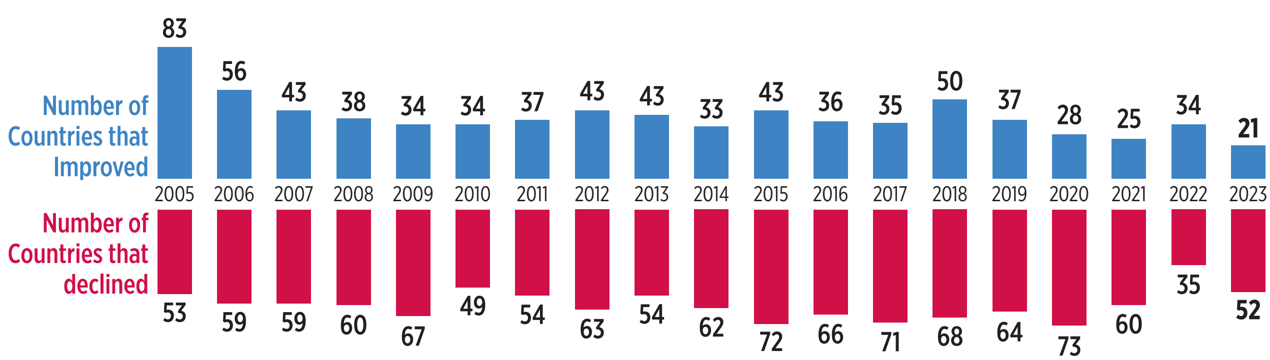
To pass most indicators on the scorecard, a country must score better than half of its income peers (i.e. score above the median in its scorecard income category). To pass the Political Rights and Civil Liberties indicators a country must score above a static level. Details of how these indicators are calculated and how the income pools are set can be found in MCC's Guide to the Indicators.[46] Political Rights and Civil Liberties are sourced from Freedom House's Freedom in the World Report.[47] The Control of Corruption indicator is sourced from the World Bank's Worldwide Governance Indicators.[48]

III.3.A Freedom House

Freedom House conducts annual expert assessments of the level of freedom and democracy in countries around the world, the findings of which are published in their annual Freedom in the World Report. Countries receive scores on two sub-indicators: Civil Liberties and Political Rights. Civil Liberties includes expert assessments of freedom of expression, freedom of association, rule of law, and personal autonomy; it is scored out of 60 possible points. Political Rights includes expert assessments of the electoral process, political pluralism, and government functioning; it is scored out of a possible 40 points, though countries may score as low as -4 points. In order to pass these indicators on MCC's scorecard, a country must score at least 18 points on Political Rights and at least 26 points on Civil Liberties. Higher scores correspond to more free and democratic societies. The two indicators are very well correlated with each other (r-squared 0.92). Both are positively correlated with GDP and negatively correlated with the number of people in extreme poverty.

Freedom House has been tracking a steady decline in freedom and democratic rights globally over the last decade, a decline observed by others as well.[49] The average score on Political Rights was 23.5 in 2012, but only 21.4 in 2023. The average Civil

Chart 2 | Number of Countries that Improved and Declined on Freedom House's Index



Source: Freedom House

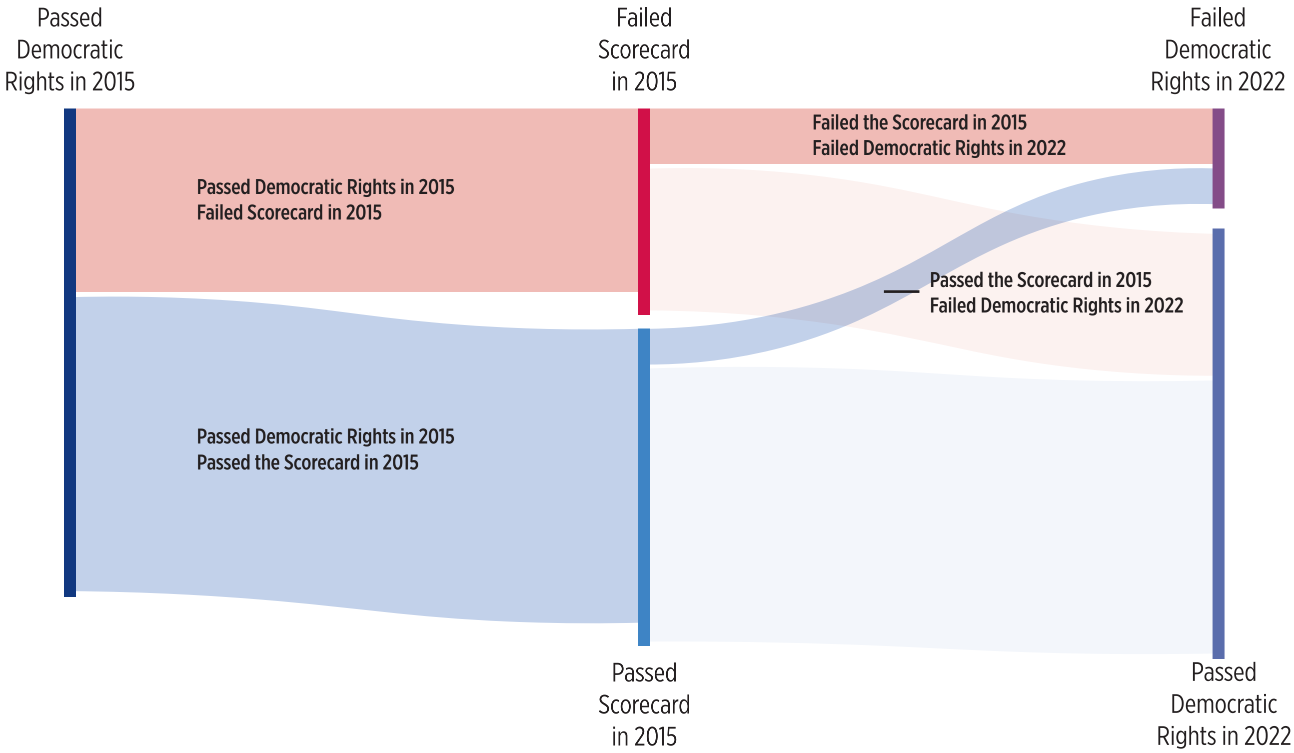
46 MCC, 2023b

47 Freedom House, 2024

48 Kaufman & Kraay, 2023

49 Freedom House, 2023; Papada et al. (2023); Repucci, (2020)

Chart 3 | Impact of Scorecard Passage on Future Democratic Rights Passage



Liberties score has declined from 35.9 to 33.6 over the same time period. Looking only at the years of data used in this analysis (2015-2022), the share of countries passing these indicators on MCC's scorecard has also declined over the same period of time, with 54% of current Low and Lower Middle income countries passing at least one of the two indicators based on data from 2015, but only 49% passing in 2022. This decline was particularly pronounced in Political Rights which declined from 51% passing in 2015 to 41% passing in 2022. Over the same period, the share of countries passing MCC's scorecard remained largely the same, declining from 36% to 35% of current Low and Lower Middle income countries.

This indicates that the decline in democratic rights has been concentrated in countries with weaker governance environments overall, as countries that were failing the scorecard overall are more likely to be those that have declined on these indicators. That hypothesis is backed up by the data, which shows countries that passed either Political Rights or Civil Liberties in 2015 but failed both in 2022 were almost twice as likely to be failing the scorecard (67% failed the scorecard) in 2015 than all countries that passed Political Rights or Civil Liberties in 2015 (38% failed the scorecard). Framed another way, only 7% of the 2015 democracies (passing either Political Rights or Civil Liberties) that passed the scorecard in 2015 became autocracies (failing both) by 2022, while 22% of the 2015 democracies that failed the scorecard in 2015 became autocracies by 2022. To pass the scorecard overall, a country must pass Control of Corruption at least 10 of the 20 indicators, and either Political Rights or Civil Liberties. This means that countries that passed either Political Rights or Civil Liberties but failed the scorecard were those with weaker overall policy environments, and these were the countries more likely to experience democratic decline. Democracies that passed the scorecard (and therefore had stronger overall policy environments) were more likely to stay democracies.

As with the other variables we focus only on the 1,432 observations shared by the different datasets from 2015-2022. For the purpose of this analysis, the years assigned to the Freedom House indicators are the years of data collection (e.g. Freedom House's Edition 2024 is measuring the state of the world in 2023), not the year of report publication.

III.3.B Control of Corruption

The Worldwide Governance Indicators are produced annually by the World Bank. These include data aggregated from a range of underlying data sources including household and firm surveys, commercial business risk assessments, and expert analyses from public sector and non-governmental organizations. The World Bank normalizes the underlying data and uses an unobserved components model to construct a composite indicator that ranges from approximately -2.5 to 2.5, with greater values indicating better governance. MCC uses four of the six indicators that are produced, including the Control of Corruption indicator.[50]

To pass the Control of Corruption indicator on MCC's scorecard, a country must score better than the median for its income group. MCC currently has two income groups for its scorecards, one including all the countries with a GNI per capita below the historic ceiling for IDA eligibility set by the World Bank, and the other including all countries with GNI per capita between the historic ceiling for IDA eligibility and the dividing line between lower middle-income countries and upper middle income countries.[51] When looking at the raw scores, we focus on the 1,432 observations shared by the datasets. However, when looking at indicator passage, we only include countries that received MCC scorecards, limiting the pool of observations to 605 countries (ranging from 80 countries to 76 countries per year from 2015 to 2022). Control of Corruption is positively correlated with GDP and negatively correlated with the number of people in extreme poverty.

Control of Corruption is well correlated with the Freedom House indicators (r-squared 0.44 with Political Rights and 0.54 with Civil Liberties). These correlations have increased over time for low and lower middle income countries (r-squared with Political Rights was 0.37 in 2015, and 0.44 in 2022, with Civil Liberties it was 0.41 in 2015 and 0.48 in 2022). This is consistent with the hypothesis noted above that democratic decline has been concentrated in countries with weaker governance environments overall as indicators of democracy are becoming more closely corelated with other measures of good governance.

III.3.C Number of Indicators Passed

MCC's scorecard includes twenty indicators of good governance drawn from publicly available, third-party sources.[52] Sources for these indicators include the World Bank, the United Nations, the International Monetary Fund, and a range of non-profit organizations. Some of them assess inputs to good governance, such as legal protections for gender equality or the share of the country's resources spent on health or education. Other indicators measure the outcomes of good

50 Kaufman & Kraay, 2023

51 MCC, 2023a

52 MCC 2023b

governance such as the share of the population with access to a bank account or the share of children that have received immunizations. To pass most indicators a country must perform better than the median for its income peers.[53] MCC's Guide to the Indicators offers a full explanation of the datasets that are used, how the data is processed, and how indicator passage is determined for each country.[54]

Instead of using data from each of the indicators themselves, in this analysis we look at the question of how many indicators a country passes on the scorecard in a given year, as this is the metric that MCC uses to determine scorecard passage. While in theory values could range from zero to twenty, in practice the greatest observed value in the dataset is 19 indicators passed. Only countries that received scorecards are included in this dataset, which limits the assessment to only 605 observations. The median country passes 11 indicators, while the average country passes 9.98. Number of indicators passed is not statistically significantly correlated with GDP, but is negatively correlated with the number of people in extreme poverty.

53 Note that by using the median for the income pool, we are including an element of GDP in the binary indicator on whether a country passes or fails Control of Corruption as well as the number of indicators passed. However, this should reduce the relationship between the measure of governance and poverty reduction, by making poorer countries appear slightly better governed and richer countries appear slightly worse governed. Therefore, the estimates presented here may be underestimates of the true impact of good governance on extreme poverty.

54 MCC, 2023b

IV METHODS & RESULTS

Credit: MCA-Niger

IV.1 METHODOLOGY

The methods for this analysis are fairly simple and to not attempt to demonstrate causality in any of these relationships. Rather, the analysis examines associations between the number of people in extreme poverty and the level of governance in a country when GDP and population are held constant. The goal of this is to try to isolate the independent impact of good governance on poverty reduction separate from the relationship between any impact of GDP or population on poverty and any impact of good governance on GDP.

To do this, we conduct two sets of regressions. The first looks at the incremental relationship between good governance and poverty reduction when GDP is held constant. In other words, what is the impact of a marginal improvement in governance on the number of people in extreme poverty without change to GDP. The second looks at the question of whether governance shifting over a certain threshold has an impact on the number of people in extreme poverty with GDP held constant as hypothesized in two of the papers reviewed.[55] The threshold we use is the threshold for passing MCC's scorecard (18 or above for Political Rights, 26 or above for Civil Liberties, 10 or more indicators passed for Number of Indicators passed, and above the income pool median for Control of Corruption).

$$\textit{People In Extreme Poverty} = \beta_1(\textit{GDP}) + \beta_2(\textit{Population}) + \beta_3(\textit{Governance}) + \textit{Constant}$$

The equation above shows the general formulation for each regression, though in each the variable representing governance is changed. We conduct separate regressions for each of Civil Liberties, Political Rights, Control of Corruption, and the Number of Indicators passed, including each individually.

55 Ochi et al., 2023; Kabir & Alam, 2021.

IV.2 RESULTS

IV.2.A Incremental Relationship

Table 1 below shows the results of the first set of regressions using the incremental measures of governance. The first column shows the results of a regression without any measure of governance included. This shows that, holding population constant, an increase in GDP of $1 leads to an average of 0.00000167 people out of extreme poverty, or, in other words, an increase to GDP of around $600,000 is associated with moving one person out of extreme poverty. This serves as a baseline to show how GDP does have a relationship with poverty reduction. Both this relationship and the relationship between Population and total people in poverty are statistically significant above the 99% level.

Column 2 runs the same analysis but adds in the Civil Liberties variable from Freedom House. The Coefficient here shows that an increase of one point (out of 60) on Civil Liberties is associated with reducing the total number of people in extreme poverty by 55,254 for countries with the same population and GDP. This coefficient is significant at the 99% level. Column 3 shows the same analysis for

Table 1 | Incremental Relationship with Extreme Poverty

	No Governance	Civil Liberties	Political Rights	Control of Corruption	Indicators Passed
Constant	2247970 (255328.4)	4217646 (602997.4)	3122229 (514939.3)	2102493 (252291.8)	8294969 (1225060)
GDP	-1.67e-6 *** (1.50e-07)	-1.58e-6 *** (1.52e-07)	-1.63e-6 *** (1.51e-07)	-1.41e-6 *** (1.53e-7)	-5.66e-5 *** (5.63e-6)
Population	0.0426 *** (0.00197)	0.0413 *** (0.001996)	0.0422 *** (0.00198)	0.0401 *** (0.00198)	0.171 *** (0.012)
Civil Liberties		-55253.81 *** (15338.06)			
Political Rights			-37180.19 * (19023.61)		
Control of Corruption				-1739723 *** (255915.5)	
Indicators Passed					-386504 *** (109277.6)
R-Squared	0.2474	0.2542	0.2494	0.2710	0.4385
Number of Observations	1432	1432	1432	1432	605

Standard errors are reported in parentheses.
*, **, *** indicates significance at the 90%, 95%, and 99% level, respectively

Political Rights. In this case, improving one point (out of 40) on Political Rights is associated with bringing 37,180 people out of extreme poverty if Population and GDP are held constant. This coefficient is only significant at the 90% level.

Control of Corruption is added to the model in place of the governance variable in column 4. As with Political Rights and Civil Liberties, Control of Corruption appears to have an impact on poverty reduction independent of its relationship with GDP. Holding GDP and Population constant, a single point increase on Control of Corruption is associated with reducing extreme poverty by 1,739,723. This should not be interpreted as claiming that Control of Corruption has a much greater impact on poverty reduction than democracy as the scale for this indicator is smaller by around a factor of ten (most values fall between -2.5 and 2.5). This coefficient is significant above the 99% level.

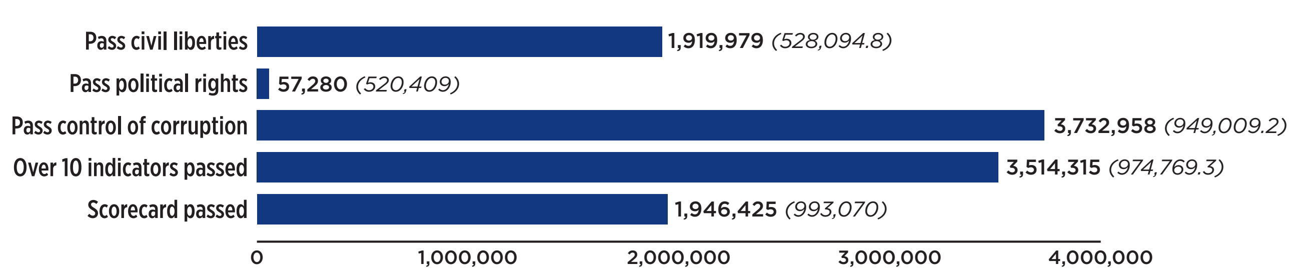
Finally, in column 5, the number of indicators passed is used to represent good governance. This column shows that, even holding GDP and Population constant, newly passing one indicator (out of 20) on the MCC scorecard is associated with bringing 386,504 people out of poverty. This coefficient is also significant above the 99% level. While the r-squared increases for this regression, this is likely due to the smaller sample size (since this only includes countries that receive scorecards) and therefore not something unique about this particular measure of governance.

IV.2.B Binary Relationship

Some have argued that a particular level of governance is required to increase the impact of economic growth on poverty reduction (the "threshold effect" discussed above). To test this hypothesis and to eliminate confusion arising from the different scales of the governance indicators, we conduct a second set of regressions, depicted in Table 2 below, focused on the binary relationship between governance and poverty reduction, converting each of the governance variables into a zero or a one, representing poorly governed and well governed respectively. The cutoffs for these indicators are based how a country performs on each of the conditions for passing the MCC scorecard: scoring at least 18 on Political Rights, at least 26 on Civil Liberties, above the income group median on Control of Corruption, and passing at least 10 indicators. We also include an assessment of overall scorecard passage as a binary variable. As noted above, passing the scorecard overall requires passing either Political Rights or Civil Liberties, passing Control of Corruption, and passing at least 10 indicators overall.

In the first column of Table 2 we can see that moving from failing to passing Civil Liberties while maintaining the same GDP and Population is associated with 1,919,979 fewer people in extreme

Chart 4 | Number of People Brought Out of Extreme Poverty by Governance Improvements



Standard errors in parentheses

poverty. This result is significant above the 99% level. The second column shows the same analysis with Political Rights, while the result shows a relationship between becoming an electoral democracy lowering levels of extreme poverty, it is not statistically significant.

The third column of Table 2 shows that passing Control of Corruption is also related to reducing poverty, independent of GDP, with 3,732,958 fewer people in extreme poverty in a non-corrupt country than a corrupt country with similar levels of GDP and Population. This is very close to the coefficient for whether a country passes at least 10 indicators on the scorecard, shown in column four: 3,514,315 fewer people in a well governed country than a poorly governed country with the same GDP and Population. Both coefficients are significant above the 99% level.

Finally, the fifth column shows that passing Civil Liberties has a similar effect size to passing the scorecard overall: holding GDP and Population constant, countries that pass the scorecard are able to bring 1,946,425 more people out of poverty. This is statistically significant at the 95% level.

Table 2 | Binary Relationship with Extreme Poverty

	Civil Liberties	Political Rights	Control of Corruption	Indicators Passed	Scorecard Passed
Constant	3573077 (444388.6)	2286096 (430373.8)	6201820 (685695.6)	6449973 (768311.5)	5025786 (611711.5)
GDP	-1.62e-6 *** (1.5e-7)	-1.67e-6 *** (1.5e-7)	-5.86e-5 *** (5.60e-6)	-5.62e-5 *** (5.64e-6)	-5.76e-5 *** (5.66e-6)
Population	0.0418 *** (0.00198)	0.0426 *** (0.00198)	0.1759 *** (0.01184)	0.1703 *** (0.0119)	0.1733 *** (0.0119)
Pass Civil Liberties	-1919979 *** (528094.8)				
Pass Political Rights		-57280.86 (520409)			
Pass Control of Corruption			-3732958 *** (949009.2)		
Over 10 Ind. Passed				-3514315 *** (974769.3)	
Scorecard Passed					-1946425 ** (993070)
R-Squared	0.2543	0.2474	0.4412	0.4389	0.4304
Number of Observations	1,432	1,432	605	605	605
Standard errors are reported in parentheses. *, **, *** indicates significance at the 90%, 95%, and 99% level, respectively					

V SENSITIVITY TESTING & LIMITATIONS

Credit: Millennium Foundation Kosovo

V.1 CONCEPTUAL LIMITATIONS

There are a range of limitations to the analysis presented here. This analysis is focused on the relationships between the different concepts and does not evaluate causality. We find that good governance has an independent association with poverty reduction beyond its relationship with GDP. While intuitively we can speculate that governments that are democratic or non-corrupt do a better job of distributing the benefits of increases to GDP to their populations, this paper does not demonstrate what those mechanisms might be (e.g. decreased inequality, decreased losses to corrupt actors etc.). More research is needed to identify the causal linkages and the drivers of the relationships identified here.

Another challenge with this analysis is the small sample size which makes it difficult to generalize conclusions. The data used are from 2015 to 2022, meaning that any conclusions are only based on recent trends. At most, only 1,432 observations are captured. Looking at countries that receive scorecards, only 605 observations are used. As more data becomes available, additional analyses should be conducted to determine if these relationships continue to hold.

A key challenge of this analysis is that data on poverty are very limited. This factor limits both the number of observations, as well as opportunities to conduct sensitivity analyses on these results using different datasets measuring poverty. A different measure of poverty might turn out different results, however without sufficient coverage from other datasets, due to infrequent data collection, particularly in Low and Lower Middle income countries we cannot assess robustness to a different measure of poverty. More work needs to be done to regularly measure extreme poverty especially in lower income countries to better be able to understand these relationships.

V.2 SENSITIVITY TESTING

In order to test the robustness of these results to variations in the parameters, we conduct several additional regressions. We use several different formulations of economic growth including GDP measured with PPP, GNI based on current US, and GNI based on PPP.[56] We also run these regressions only using Low and Lower Middle income countries as defined by the World Bank (given that these are the only countries to currently receive MCC scorecards) and countries with a GNI per capita below the World Bank's threshold for initiating IBRD graduation (as Congress has proposed raising the cutoff for countries that receive an MCC scorecard to the IBRD graduation line).[57]

Table 3 shows the summarized results of these regressions, which are largely in line with the main results. In all of these regressions, Control of Corruption and the number of indicators passed remain statistically significant at the 99% level, indicating a clear independent impact on extreme poverty independent of growth and population.

The effect size for incremental corruption improvements more than doubles when looking only at Low and Lower Middle Income countries or countries below the IBRD line. Whether a country passed the Civil Liberties indicator remains significant at the 99% level for all alternative formulations. Incremental improvements on Civil Liberties are statistically significant for all formulations, though this is at a lower level of significance for GNI using the Atlas method and using only countries below the IBRD line. Whether a country passes or fails the scorecard continues to have an impact at a 90% or 95% level of significance depending on the exact formulation.

As with the original results, Political Rights is only weakly associated with Poverty reduction independent of growth or Population at the incremental level (it appears to have a more significant effect when growth is measured using PPP). Passing or failing Political Rights has not statistically significant impact on poverty independent of growth.

56 World Bank 2024c; World Bank 2024d; World Bank 2024e

57 Collinson & Hurley, 2023; MCC 2023b; MCC 2023c; SFRC 2023;

Table 3 | Sensitivity Testing

	Civil Liberties	Political Rights	Control of Corruption	Indicators Passed	Scorecard Passed
Incremental Analysis					
GDP (PPP)	-52402 ***	-37840 **	1502429 ***	-370364 ***	
GNI (PPP)	-52468 ***	-37656 **	-1510516 ***	-366097 ***	
GNI (Atlas)	-32843 *	-5370	-1392653 ***	-314777 ***	
Current LIC/LMIC only	-97473 ***	-67306	-3618601 ***	-388429 ***	
Below IBRD Line	-69494 **	-43526	-3067584 ***	-386253 ***	
Binary Analysis					
GDP (PPP)	-1951680 ***	-93013	-3728849 ***	-3150269 ***	-1666464 *
GNI (PPP)	-1949395 ***	-90896	-3786136 ***	-3086095 ***	-1646666 *
GNI (Atlas)	-1644990 ***	350146	-3945789 ***	-3220655 ***	-2543264 **
Current LIC/LMIC only	-3072896 ***	774644	-4699159 ***	-3271060 ***	-2525085 **
Below IBRD Line	-2458378 ***	317518	-3753185 ***	-3506592 ***	-1958908 **

Values listed are regression coefficients
*, **, *** indicates significance at the 90%, 95%, and 99% level, respectively

VI ANALYSIS & CONCLUSIONS

VI.1 DATA ANALYSIS

There are several points that we can draw from this analysis. First, the current analysis confirms that governance has an impact on reducing poverty independent from its impact on GDP. This is true both for marginal improvements and for larger systemic changes. Small improvements on measures of Civil Liberties, Control of Corruption, and newly passing even a small number of indicators on MCC's scorecard are associated with bringing tens and even hundreds of thousands of people out of poverty, even without any change to population or GDP.

Moving from failing to passing MCC's Civil Liberties indicator, Control of Corruption indicator, or moving from passing fewer than 10 indicators overall to passing more than 10 indicators overall is associated with bringing over 1 million people out of extreme poverty, controlling for population and GDP. These numbers may seem impressive – and they are, but they also reflect something that MCC knows well: that making the policy reforms required to pass the scorecard is hard, but doing so can bear fruit for the country even before MCC invests any program dollars.

A second interesting conclusion from this analysis is that passing the Political Rights indicator on the scorecard does not have a statistically significant relationship with poverty reduction holding GDP and Population constant. Incremental improvements only have a weakly statistically significant relationship with poverty reduction. This is particularly interesting given the very high degree of correlation between the Political Rights and Civil Liberties indicators (r-squared 0.92). It seems to indicate that countries that have democratic elections, but fail to have strong institutions, respect for individual liberties, and checks on corruption, do not have an especially large impact on poverty reduction when controlling for GDP and population.[58]

58 This is consistent with the findings of Fails (2020) who argues that while electoral democracies are more likely to adopt social programs than closed autocracies, they often craft programs that do not in fact lead to increases in welfare.

It is also worthwhile to note that while GDP is highly correlated with poverty reduction, large increases in GDP, while holding population constant, are required to actually reduce poverty. For example, without controlling for governance, an increase in GDP of over $600 million is associated with bringing 1,000 people out of poverty. However, improving only one point on the Civil Liberties indicator is associated with bringing 55,000 people out of poverty, newly passing one indicator on MCC's scorecards is associated with bringing over 380,000 people out of poverty. The correlation between GDP and poverty reduction is clear, but the amount of GDP increases that are required to get a reduction in extreme poverty are very high, compared to the effect size of even small improvements in governance.

VI.2 CONCLUSIONS

These results have implications for policy makers and donors like MCC, as well as academics that are assessing the impacts of governance on poverty reduction. First, this analysis shows that good governance has a relationship with poverty reduction independent of its relationship with GDP, and that very large increases to GDP are required to match the impacts of good governance improvements on poverty reduction. One possible explanation for this relationship is that well governed countries are better at redistributing the resources of increased GDP to address extreme poverty than poorly governed countries where elites are more likely to capture the benefits of higher GDP either through corruption or regulatory capture. If this is the case, it makes sense for donors to work to improve governance and growth together as growth is more impactful in countries with strong policy environments.

Another important result to highlight here is that the relationship between good governance and poverty reduction is distinct from the relationship between good governance and GDP. It can be tempting for academics to use GDP (or GNI, or other similar measure) to be the desired outcome measure when running analyses given the wide data availability, the high correlation with poverty reduction, and the paucity of data on poverty. However, given the independent relationship between governance and poverty reduction, conclusions about the relationship between governance and poverty reduction which use GDP as a proxy for poverty are spurious because they fail to take into account the impact of the independent relationship of good governance on poverty reduction.

Finally, it should be noted that not all metrics of governance have the same impact on poverty reduction, holding GDP constant. Measures of Civil Liberties, Control of Corruption, and broad measures like the MCC scorecard (which includes many different components of good governance) all have an independent relationship with poverty reduction even when population and GDP are controlled for. Measures focused primarily on elections and political rights fail to have the same correlation. There are some possible explanations for this: electoral autocrats who do not have institutional checks on their power may be able to impose policies that appear beneficial to the population, focus primarily on majority communities, or benefit those that already have a degree of power in society, but have little impact on those marginalized groups which make up the extreme poor. Based on these results, donors that want to have an impact on reducing extreme poverty who incentivize and support governance reform would do well to go beyond support for clean elections and focus on pushing for greater civil freedoms, independent institutions, and controls on corrupt actors.

In summary, we find that governance has a substantial association with poverty reduction independent of its relationship to GDP. We find that this is most substantial for measures of civil liberties, corruption controls, and broad measures of governance like the MCC scorecard, instead of bare measures of electoral participation. More research is needed to expand the existing measures of extreme poverty so that more analyses confirming these results can be conducted, and academia may use poverty reduction as an outcome measure in more analyses instead of using proxies like GDP.

VII APPENDIX

SYSTEMATIC LITERATURE REVIEW

The journals examined in the systematic literature review include Sustainable Development, Long Range Planning, Habitat International, World Development, and Journal of Peasant Studies. For an article to "screen" in, it must contain original empirical research on the relationship between governance, growth, and poverty reduction. One article in Long Range Planning, twenty-six articles in Habitat International, and thirty-six articles in Journal of Peasant Studies, meet the search criteria, but none of these articles contain the necessary research. There are fifty articles found in Sustainable Development, five of which are screened in. Four of these articles were published in 2024, and one in 2023. One hundred and eighteen articles in World Development meet the search criteria, eight of which contain empirical research on the relevant relationship. Four of these articles were published in 2024 and four of them in 2025.

Five articles show a positive impact of institutional strength on curbing poverty and inequality.[59] Wang et al. (2024) demonstrate the role of institutional transparency in the nexus between energy transition and income inequality. Their data shows that when institutional transparency improves, consequently curbing corruption, the effect of energy transition on income inequality shifts in a positive direction. The data processed by Işık et al. (2024) identify the governing conditions for effective implementation of the SDGs for BRICs countries. The management of corruption, quality of regulation, adherence to the rule of law, government effectiveness, and political stability, exhibit a positive correlation with attainment of SDGs. While exploring SDG implementation on a global scale, Dima et al. (2024) also demonstrate that democracy and overall quality of public institutions contribute to promoting societal sustainable development as characterized by the SDGs. Results from Gomez-Gonzalez, et al. (2023) suggest that countries should increase their economic complexity and strengthen their institutions when fighting fiscal crises instead of focusing only on macroeconomic variables. Similarly, Ajide & Ojeyinka (2024) illustrate that anti-money laundering regulations, at a certain threshold, and fortified institutions enhance the ability to successfully implement the SDGs.

Three articles find a positive relationship between good governance and anti-corruption mechanisms and a reduction of the effects of the "natural resource curse" whereby developing countries with natural resources may experience extractivism rather than development.[60] In their research on the circumstances in which natural resources are either a blessing or a curse, Zhang, et al. (2024) find that effective anti-corruption measures are crucial for economic development in G-20 countries. Kinda & Mien (2024) also look at the impact of transparency and corruption related standards on the so-called resource curse, with results proving that committing to such standards help mitigate the problem. Bornschier & Vogt (2024) highlight the negative externalities of natural resource exploitation in their research on managing resource related protests and discontent. They find that where regional

59 Ajide & Ojeyinka, 2024; Dima et al., 2024; Gomez-Gonzalez et al. 2023; Işık et al., 2024; Wang et al., 2024.

60 Bornschier & Vogt, 2024; Kinda, & Mien, 2024; Zhang et al., 2024.

governments have institutional competences and electoral incentives to respond, they can mitigate growth, hindering social conflict.

Two papers look directly at the question of democratization's impact on growth and poverty reduction.[61] Dörffel & Freytag (2023) argue that though their regression data reveals mixed results of the impact of democratization on poverty, the treatments effects estimates suggest there likely is an effect of democracy on poverty reduction, which they see as a superior estimator because of its higher flexibility and allowing the estimation of causal effects. Taymaz et al. (2024) look at Turkey's transition to democracy, identifying what they call a "virtuous cycle," whereby the transition to democracy, especially after a long period of wage repression, provides conditions for exogenous wage increases. Their data shows that with the positive exogenous wage shock created by democratization, the virtuous cycle may improve income distribution, help to reduce poverty, and propel economic growth.

The remaining articles look at different aspects of good governance such as financial inclusion, policy incentives for social development, and the positive impact of representative politics.[62] In their examination of cadres in China, He, et al. (2023) validate the importance of policy incentives in poverty alleviation and social development, demonstrating that a singular focus on GDP fails to reduce poverty, Kumar & Jie (2023) probe the impact of financial inclusion practices on poverty reduction, finding that such attempts are successful mainly in countries with strong institutional quality. Data presented by Kukreja (2024) on India shows that more political representation increases citizens' trust in institutions and, notably, such trust in institutions is accompanied by an improvement in economic development as proxied by nighttime luminosity.

61 Dörffel & Freytag, 2023; Taymaz et al, 2024.

62 He et al., 2023; Kukreja, 2024; Kumar & Jie, 2023.

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Reducing Poverty Through Growth

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