

### Box 1.1 Setting national poverty lines around the world

Poverty lines are commonly used as cutoff points that delineate who in a country or region is considered poor at any given point in time, based on some predefined standard of living. The choice of poverty line—what type and how it should be set—depends on the local context and intended use. In high-income countries, where absolute deprivation is less common, poverty lines are often relative—that is, they are defined in relation to the overall distribution of income. For example, a poverty line could be set as a percentage of the overall population mean or median income. In developing countries, where large parts of the population cannot meet their basic needs, it often makes sense to define some absolute standard and thus set an absolute poverty line.

The challenge of defining an absolute poverty line at the country level can be summarized by two related questions. First, what is the adequate *minimum level of well-being* at which an individual is not considered poor in the specific local context (often called the referencing problem)? Second, how can the *minimum amount of money* that corresponds to that level of well-being be identified (the identification problem)? Commonly, these two problems are approached in what is called the *cost of basic needs method*. This approach first stipulates a consumption bundle that is deemed adequate for basic consumption needs in the local context and then estimates the cost of this specific bundle.

What is an adequate consumption bundle? One potential starting point is the average nutritional requirement for an individual to be in good health, often approximated to be 2,100 calories per person per day. Based on this food energy requirement, a local consumption basket is compiled for a diet that reflects the consumption habits of local households near the poverty line. The cost of this basket is estimated based on the prices of the various foodstuffs that are included. This is not a trivial task, since the

calorie requirement can be met with various food baskets and, depending on the cost composition of the basket and local price levels, the resulting poverty line can vary widely (Pradhan and others 2000; Haughton and Khandker 2009).

In addition to the food component (which gives the so-called food poverty line), the overall poverty line often also includes a nonfood component that is added to reflect costs for housing, clothing, electricity, and so on. There are various ways to estimate the nonfood component—and no consensus on best practice. One way is to stipulate a second consumption bundle that reflects an adequate level of nonfood items. Parallel to the approach for the food component, that bundle could then be priced accordingly. In the absence of an objective caloric requirement, however, it is difficult to define “adequate” nonfood consumption needs. An alternative approach to estimate the nonfood component is to divide the food component by the average share of food in total household expenditure (Orshansky 1963), although this approach raises the question of whether the food share of the average household, a poor household, or a nonpoor household should be used.

An alternative to the cost of basic needs approach is the *food energy intake method*, which does not require information on the prices of the goods that are included in the estimated consumption basket. Instead, this approach plots total household (food and nonfood) consumption expenditure or income against food consumption as measured in calories per person per day to find the level at which a household can meet its basic energy requirements. However, this requires analysts to assume a relationship between household expenditure and food energy, and this approach does not lend itself to comparisons across time or regions. Yet another potential approach to set absolute lines is based on asking people what minimum consumption or

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## Box 1.1 Continued

income level they need just to make ends meet. These *subjective poverty lines* remain relatively rare in practice, but they can be useful supplements to more objective measures.

Conceptually, the cost of basic needs approach provides the most reliable framework to set national absolute poverty lines and is widely used in practice. In a data set of national poverty lines compiled by the World Bank's Global Practice for Poverty, 38 of 45 national poverty lines set in low- and middle-income countries between 2001 and 2011 were based on the cost of basic needs method. The Russian Federation is one of the few countries that use the food energy method, while the remaining countries in Eastern Europe and Central Asia predominantly rely on relative poverty lines.

The common practice in high-income countries is to use relative lines. In the European Union, the main poverty measure identifies as “at risk of poverty” all households that have net incomes of less than 60 percent of the national median. Similarly, the Organisation for Economic Co-operation and Development uses national median household income as a yardstick and applies thresholds of 50 percent and 60 percent. A noteworthy exception is the United States, where the federal poverty measures are based on absolute thresholds. In 1963, U.S. government statistician Mollie Orshansky calculated the cost of a minimum food diet and multiplied it by three to account for nonfood expenditure. Since then, her results have been adjusted for inflation and today form the basis for a detailed matrix of poverty lines, varying by family size, number of children, and so on.

Empirically across countries, national absolute poverty lines tend to drift upward with average income, although for the very poorest countries the relationship is initially flat (Ravallion, Chen, and Sangraula 2009). The median poverty line across countries of Sub-Saharan Africa (using data from around 2000) was roughly equal to the World Bank's international poverty line of \$1.25 a day (at 2005 purchasing power parity [PPP]). Across countries in Latin America and the Caribbean around 2010, the median national poverty line was a little over \$4 per capita per day (at 2005 PPP). In contrast, in the United States in 2013, a household with two adults and two children under 18 years old was considered poor if its daily income was less than about \$16 (at current 2013 prices, around \$13.50 at 2005 prices).

Ultimately, the choice of a specific absolute or relative poverty line is a social and policy decision that depends on the local context. No matter how precisely a specific poverty line is estimated, it is important to keep in mind that living standards of those just above the poverty line are not very different from those just below. In other words, nothing happens to individuals in terms of their consumption, income, health, or any other indicator when their income crosses an absolute poverty line (Deaton 1997; Pritchett 2006). The key issue, then, in setting an absolute poverty line is not its precise location, but to ensure comparability and consistency across areas and over time.

*Source:* Based on Deaton (1997); Haughton and Khandker (2009); Ravallion (1988); and Ravallion, Chen, and Sangraula (2009).

### Global poverty counts

The World Bank employs a specific measure of poverty in its calculations. It reports the extent of global poverty by calculating the percentage of the world's population with a consumption or income level below the international poverty line. Producing global poverty counts in this way is intuitive