Growth and Poverty
The Great/False Debate

Address by Pradeep S Mehta, Secretary General, CUTS International
Australian National University, Canberra, August 11, 2011

Good Morning Ladies & Gentlemen,

At the outset, I thank the Australian National University for inviting me to deliver this address in front of this learned audience. A special thank is for Professor Raghabendra Jha. We know each other for a long time. The subject of today's address is one of many on which Professor Jha has made seminal contributions, and we all have benefitted and will be benefitting in future.

1. History of the Debate

On 2nd December 2010 Professor Jagdish Bhagwati of Columbia University delivered a Lecture to the Indian Parliament with the Prime Minister of India Manmohan Singh and many other Members of the Parliament and dignitaries in attendance. The Lecture was entitled *Indian Reforms: Yesterday and Today* and is available at the web site of the Indian Parliament.

The core point of his Lecture was that it is a myth that reforms are not helping the poor. He said that several analyses reveal that "the enhanced growth rates have been good for reducing poverty, while it has not increased inequality measured meaningfully".

Stating that high economic growth has led to greater revenues, and that India was finally able to spend more on health and education for the poor and underprivileged, Professor Bhagwati described conventional growth-enhancing reforms as stage one, and the spending on health and education of the poor as stage two reforms.

Both were 'inclusive', he said, adding that Stage 1 reforms have benefited, not immiserised, the poor and the underprivileged, while Stage 2 reforms, rendered possible by Stage 1 reforms, reinforced "the beneficial pro-poor effects of stage one reforms".

As an advocacy group committed to raising the living standards of people, and seeing that the issues raised by Professor Bhagwati are intrinsic to the policy discourse, CUTS International posted a news item of the Lecture on its web site and circulated it widely through its Internet-based Fora. The response was huge and unprecedented. The e-groups reach out to a large number of social scientists, intellectuals and policy-makers in India and indeed worldwide. Nearly all the contemporary important Indian economists joined the debate, which ran into thousands of pages, including some which were argumentative.

This lead Martin Wolf, the chief economics commentator of Financial Times to write: "Obviously higher incomes are a necessary condition for better state-funded welfare, better jobs and so forth. This is simply not debatable. Indeed, only in India do serious intellectuals dream of debating these issues."

2. The Discourse

Most commentators agreed that on the overarching importance of growth *albeit* to a varying degree – the forceful assertion by Professor Bhagwati. The contention that more attention to growth promotion policies is absolutely vital for developing countries like India with high initial levels of poverty mainly arise on account of three different perceptions, which tend to overlook certain positive aspects of growth.

First, a majority of those who underrate the role of growth believe that growth almost invariably leads to high income inequality because accrual of benefits thereof is biased in favour of the upper strata. Some commentators pointed out the glaring and growing disparities between the rich and the poor in the context of India's post-reform experience. This proposition (that growth typically caters to generating wealth for those who are already rich) is unfair considering that rising income inequality does not prevaricate poverty reduction as argued by Arvind Panagariya of Columbia University. Alok Ray of Indian Institute of Management, Calcutta provided examples of direct and indirect poverty reduction effects of growth in absolute terms.

On a related note, Shantayanan Devarajan, Chief Economist (Africa Region) of the World Bank argued that social spending could do little to reduce income inequality and may even raise it if not targeted properly by giving the example that 33 percent of public spending on health in India accrues to the richest 20 percent.

Secondly, the question whether growth leads to poverty reduction has been debated while mostly ignoring the fact that flow of causality between these two is not unidirectional and static but circular and continuous. Many participants in the debate resonated reports in the popular media that growth has failed to deliver for the poor, while some shared instances of social spending failing to deliver real economic empowerment of the underprivileged.

On the contrary, examples of reinforcement of the correlation between growth and poverty reduction were cited by G. S. Bhalla of the Centre for the Study of Regional Development. Another commentator drew attention to the fallacy of considering the mutual effects of growth and poverty reduction as static and stated the importance of giving growth policies a head start to be accompanied by poverty reduction programmes after reaching a certain threshold. This view also buttresses the idea of sequencing Stage 1 and Stage 2 reforms as mooted by Professor Bhagwati in his Lecture to the Indian Parliament.

Thirdly, some experts tend to harbour a belief that it is not feasible to target growth and poverty reduction through simultaneous policies which implies that governments are generally observed to be doing only one thing right at a time since there is always a trade-off. Abhijit Banerjee of Massachusetts Institute of Technology stated that government's capacity to do anything new is always limited especially when the state is weak.

Arvind Panagariya strongly countered this with the argument that governmental capacity to execute a mix of policies can vary considerably and improve significantly over time as has been observed in the Indian context. He further fortified his argument by proposing policy reforms on as many fronts as possible and through means that will impose a minimalistic burden on governments for their execution. Additional responses on this issue stressed that the past trend of focusing on a single policy objective must give way for setting multiple policy goals which is by no means impossible.

Given the underlying premise that growth must only be a means to an end: better quality of life for all, to which most experts adhere to, the debate provides an important synthesis by way of directions for future course of action. Several important insights emerged from this synthesis. Most of the commentators unanimously agreed that there is an urgent need to create favorable conditions for participation of unskilled labour in the growth process. Governmental support should be extended to improve the bargaining power and social security of employees in the unorganised sectors.

Arne Melchior of the Norwegian Institute of International Affairs argued that disguised unemployment in the agriculture sector has to be removed by generating new and productive non-agricultural jobs. At the same time, a solution must be sought for eradicating massive corruption running through public institutions and establishments. This, in turn, will help to substantially improve the exchequer's capacity for higher investment in health, education and other social sectors.

Indeed and this is happening in India as pointed out by one of the most respected economic journalists of India: Swaminathan S. A. Aiyar (*It's a Social Spend Boom, Stupid*, Times of India, 6th February, 2011): "Between 2004-05 and 2009-10, central plus state social spending more than doubled from Rs. 1.73 lakh crore to Rs. 4.46 lakh crore and from 5.33 percent of GDP to 7.23 percent. So, social spending has actually risen faster than GDP. Rapid GDP growth has financed, not hindered, rapid growth of social spending. The Economic Survey (2009-10) says gross central revenues more than doubled in 2004-05 and 2009-10, from Rs. 3.04 lakh crore to Rs. 6.41 lakh crore. This helped finance the social spending boom".

On the other hand, there were still critics who seemed to think that growth had not been 'inclusive' and growth was an obsession to be discarded. In particular, Professor Amartya Sen, who was on the CUTS Trade Forum but did not join the Forum debate while writing elsewhere, condemned the preoccupation with growth and suggested that growth had little to do with helping the poor and the underprivileged, and that obsession with growth comparisons of India and China was also misplaced.

In response, Professor Bhagwati and Professor Panagariya have noted that the post-reforms growth has indeed been good, not just for the elite or the upper middle class, but also for many underprivileged groups. The findings come from detailed empirical studies.

Given the richness of this debate, which was described by The Financial Express (a major business daily in India) as the one which overshadowed the Indian finance minister's pre-budget consultation with economists, we decided to publish it as an anthology on Growth and Poverty.

In his Foreword to the volume, Vijay Kelkar, Chairman of the Thirteenth Finance Commission of India wrote: "This collection of views on growth-poverty of a number of eminent scholars from India and abroad makes a rich contribution towards understanding these important issues. This debate seems to suggest that while our Stage I reforms had borne fruits, a time has come to push Stage II reforms in social sectors such as health and education and other crucial sectors such as agriculture and labour markets. Stage II reforms will be much more complex than Stage I reforms. We will need to confront a number of .social conflicts." He referred to his 2004 K R Narayanan Memorial Lecture (India: On the Growth Turnpike) delivered at the Australian National University.

3. The Panel Discussion

On 11th July, this volume was released by Montek Singh Ahluwalia, Deputy Chairman of the Planning Commission of India. A panel discussion of eminent experts was organised. The panel consisted of Shekhar Shah, Director General, National Council of Applied Economic Research; Nirmala Sitharaman, National Spokesperson of Bhartiya Janata Party (the main opposition party in India); Bibek Debroy, Professor, Centre for Policy Research; Ashok Chawla, Former Finance Secretary of India; and Jean-Pierre Lehmann, Professor, Institute for Management and Development, Lausanne.

Introducing the subject, I said that without the kind of economic growth over the last two decades the reduction in poverty would not have been achieved. However, in order to improve the efficacy of economic growth, more efforts are needed to improve 'access to opportunities' of disadvantaged communities so that they can overcome the poverty trap.

To buttress my argument, I quoted from the research done by Martin Ravallion and Shaohua Chen of the World Bank: "Estimates for India indicate a continuing decline in poverty. The revised estimates suggest that the percentage of people living below $1.25 a day in 2005 (which, based on India's PPP rate, works out to Rs 21.6 a day in urban areas and Rs 14.3 in rural areas in 2005) decreased from 60% in 1981 to 42% in 2005. Even at a dollar a day (Rs 17.2 in urban areas and Rs 11.4 in rural areas in 2005) poverty declined from 42% to 24% over the same period.

Both the dollar a day and $1.25 measures indicate that India has made steady progress against poverty since the 1980s, with the poverty rate declining at a little under one percentage point per year. This means that the number of very poor people who lived below a dollar a day in 2005 has come down from 296 million in 1981 to 267 million in 2005.

However, the number of poor people living under $1.25 a day has increased from 421 million in 1981 to 456 million in 2005. This indicates that there are a large number of people living just above this line of deprivation (a dollar a day) and their numbers are not falling.

To achieve a higher rate of poverty reduction, India will need to address the inequalities in opportunities that impede poor people from participating in the growth process."

According to Montek Ahluwalia: "Independent of the method of assessment, poverty in India has decreased in the last two decades. However, this has not translated into equality of access to opportunities. And therefore, 'inclusion' requires a multi-pronged response." He added that there is greater economic growth across all regions, however, within regions the inequality is worrisome. He underlined that four areas require concerted efforts, namely: energy, agriculture, urbanisation, water and land, to make growth inclusive.

On the issue of inequality across territories, Bibek Debroy raised a key question that why poverty and inequality are concentrated in a few districts of India and why have we not been able to address this? Ashok Chawla asserted that along with growth it is important to ensure that government's resources in terms of tax-GDP ratio from the existing 11 percent needs to be improved. This will generate more resources for direct intervention on the part of the government. Montek clarified that this ratio is only about income tax, but if we consider all taxes then the ratio is much higher.

Nirmala Sitharaman highlighted that there is lack of institutional readiness to take up the challenges of liberalisation. She added that we are giving out doles, rather than creating employment opportunities. In the current framework there are disincentives for entrepreneurs and micro-enterprises, which are bad for both growth as well as poverty reduction.

Jean Pierre Lehmann drew attention to the fact that given that many countries are disadvantaged in terms of demography, etc, India holds a great future.

Shekhar Shah reinforced the idea that growth provides the resources, which in turn, ensure the 'equality of access to opportunities'. He referred to the history of economic growth where one sees that a lot of countries, which gained a growth rate of seven per cent or so over twenty five years, have faded away later. He added that only those countries have survived which developed 'institutional endowments' to help them sustain the growth.

In response to the ensuing discussions, Ms Sitharaman said that the huge governance deficit will negate all efforts to reduce poverty. Quoting Martin Wolf, Montek Ahluwalia remarked that the title of this volume should have been more appropriately called as "false debate" and we need to move onto the future of Indian reforms.

I concluded the discussion by saying that the next debate on the CUTS e-fora will be conducted on the issues of governance and institutional reforms to address the poverty reduction agenda in India.

4. The Future

The political economy of India (for that matter in any developing society) is such that nothing is settled unless everything is settled. This was reflected in the debate that follows from the release of this volume. Even questions were raised on the importance of growth in poverty reduction.

Arvind Panagariya of Columbia University in one of his recent articles (*Growth and Redistribution*, Economic Times, New Delhi, 27th July, 2011) highlighted the following four fallacies on this subject:

- Growth is not necessary for poverty reduction – this is simply not true for a poor country like India.

- Growth by itself does not bring poverty down – there is no evidence to show that growth fails to help or actually hurts the poor in aggregate.
- Growth is not sufficient to eliminate poverty – no serious development economist argues that growth by itself is sufficient and that there is no need for redistributive policies in an economy with a large number of poor people.
- While growth barely trickles down, redistribution programmes are sure shot – when redistribution programmes themselves are subject to careful scrutiny as growth, one is forced to wonder if it is redistribution rather than growth that should be subject to the trickle-down critique.

He concluded by highlighting that "careful assessments of our (Indian) public distribution system show that just 10 percent of the food subsidy actually reaches the poor".

This resonates the concluding part of our panel discussion which underlined governance deficit in India and unless that is addressed carefully leakages will continue and with inequalities in opportunities our poor may not get much benefits out of growth.

In one of my recent articles (*Making food subsidies work better*, Business Standard, New Delhi, 31st July, 2011), I cited a contemporary study by the Asian Development Bank (*How Can Food Subsidies Work Better? Answers from India and the Philippines*, Shikha Jha and Bharat Ramaswami): "The deserving poor in India received only 10 per cent of the benefits from the system. Nearly twice accrues to the undeserving – the middle class. Around 43 per cent is siphoned off by the system illegally, and 28 per cent are excess costs incurred by the sarkari system – the Food Corporation of India, and so on."

The million dollar question is whether the public distribution system can be reformed at all. In my opinion, it is a Herculean task and well nigh impossible.

Given that the system functions with many vested interests, efforts to reform it will be countered with 'logical' arguments by the polity, because the system feeds on political patronage, and hence all political parties are unanimous in supporting it, like caste reservations in India.

In nearly all pro-poor schemes of the government, leakages are high and the poor do not get their rightful due. The much-touted National Rural Employment Guarantee Scheme too is infested with corruption. This is evident from various studies which have since emerged, though I have not yet come across any study pinning down the leakage figures exactly. One ballpark figure which is spoken about is that around 35-40 percent benefit does percolate to the poor, and the balance is pocketed by politicians, bureaucrats and touts.

As a civil society advocacy group espousing the cause of a questioning society, CUTS will up the ante on governance reforms (not just in food distribution but all welfare schemes) in general and prevention of leakages in particular. Factual/counter-factuals, thesis/anti-thesis will be debated to arrive at a better mechanism to make governance works better for the people, particularly the poor.

I thank you and looking forward to a stimulating discussion.