Growing out of Poverty

Economic expansion reduces poverty by creating employment opportunities and making anti-poverty programs fiscally feasible

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THERE can be little hope of making a major dent in poverty in low-income countries—many of them in South Asia and Africa—without sustained rapid growth. Rapid growth provides gainful employment to many while generating swiftly rising tax revenues to finance anti-poverty programs. Critics assert that growth barely trickles down to the poor, ignoring the reality that without it, low-income countries would lack fiscal resources for redistribution on a sustained basis.

Poverty alleviation has been a top priority for Indian leaders since the launch of the country's development program in 1950. Yet, for decades, India's anti-poverty programs were grossly underfunded because the country was poor and grew very slowly. That low income and slow growth denied the country's poor both the direct benefits of growth—increased employment opportunities—and the indirect benefits—well funded anti-poverty programs. In contrast, countries such as the Republic of Korea and Taiwan Province of China, which managed to launch their economies into high-growth orbits in the early 1960s, quickly pulled their entire populations out of poverty. More recently, China has moved in the same direction.

In India, it was the accumulation of slow growth for three decades followed by some acceleration that finally began to make a dent in poverty. But it was only after another two to three decades of approximately 6 percent annual growth that the country could afford to introduce large-scale social programs, such as the employment guarantee scheme for rural households and effective rights to education and food security. That these programs remain poorly conceived with possible adverse consequences for growth is, of course, another matter.

While growth is crucial to generating the resources needed to finance large-scale anti-poverty programs, its direct contribution to poverty alleviation should not be underestimated either. In the Republic of Korea and Taiwan Province of China in the 1960s and more recently in China and Vietnam, rapid growth of labor-intensive industry pulled large proportions of agricultural workers into well paid manufacturing jobs. For example, 9.4 percent of the Korean workforce was employed in industry in 1965, compared with 21.6 percent in 1980, while agricultural employment fell from 58.6 percent to 34 percent over the same period. Reflecting rising productivity, average real wages rose at an annual rate exceeding 10 percent during this period.

Symmetrically, the poor are helped less when policies hinder the growth of labor-intensive industry. For a long time, India limited the production of virtually all labor-intensive products, such as apparel, footwear, toys, and light consumer goods, to enterprises with an investment ceiling of approximately $100,000 (later revised to $250,000). This resulted in the proliferation of highly inefficient tiny enterprises with limited ability to exploit the vast world markets in labor-intensive products. Indian toys never made it into the world markets, and the country's share in the U.S. apparel market today is about the same as that of much smaller Bangladesh. Although this practice has been virtually eliminated, stringent labor laws in the formal sector still inhibit the entry of large-scale manufacturing firms in the labor-intensive industries. Growth in India has been led by capital- and skilled-labor-intensive sectors, such as automobiles, auto parts, petroleum refining, steel, information technology, and pharmaceuticals. The result has been an extremely slow shift of India's workforce from agriculture to industry and, therefore, a failure to exploit fully the potential direct impact of growth on poverty reduction. This

Laundry drying on satellite dish, Branquinha, Brazil.

has naturally placed a greater burden on anti-poverty programs. Unfortunately, these programs require the poor to stay where they are to receive benefits, which inhibits migration out of low-productivity employment such as agriculture.

Measuring inequality

When confronted with the evidence that no country has been able to cut poverty drastically without growth, critics shift the debate to inequality. They argue that even if growth helps reduce poverty, it should be moderated so that it does not increase inequality. It is harder to pin down the critics when it comes to inequality, because there are many alternative measures of it and they need not move in the same direction.

For example, we could look at the relationship of growth to the overall distribution of income across the national population as measured by the Gini coefficient (which ranges from 0 for total equality of income distribution to 1 for total inequality). Alternatively, we could worry about the average income of the top 5 percent of the population relative to the bottom 5 percent. It is possible—indeed, likely under plausible conditions—that even as the former measure shows declining inequality, the latter exhibits the opposite.

Inequality can also be measured in terms of the differences between average urban and rural incomes. We could also be concerned about regional inequality as measured by the differences in per capita incomes across states. Then there is wage inequality between skilled and unskilled workers, and between workers in the formal and informal sectors. The list goes on.

There are good reasons why inequality according to some of these measures would be rising with growth. For example, the ratio of the income of the top 5 percent to the bottom 5 percent of individuals is almost certain to increase in a rapidly growing economy. For sustained rapid growth to occur, a handful of entrepreneurs must create a lot of wealth through legitimate means. These entrepreneurs are bound to end up with a significant proportion of that wealth. After all, it is the prospect of keeping a significant share of the wealth they create that motivates individuals to create wealth in the first place. Similarly, in the early stages of growth, rapid growth often concentrates in a few urban enclaves, which may increase urban-rural as well as regional inequality.

Relative wealth

Therefore, the real question is not whether rapid growth increases inequality, but whether the form of inequality that citizens find offensive is rising and, if so, what to do about it. Inequality that results in abject poverty for a portion of the population is reprehensible, and the fight against it must take precedence. As long as abject poverty exists, the largest gains in fighting the most offensive forms of inequality are likely to accrue from poverty alleviation. For instance, because the poor are concentrated in rural areas, raising rural incomes through anti-poverty programs and also through worker migration to urban areas would automatically reduce urban-rural inequality. The poor also tend to be concentrated in particular regions, so concentrating anti-poverty programs in those regions will alleviate regional inequality.

Ironically, the measure of inequality on which economists most commonly focus—the Gini coefficient calculated for the entire nation or a specific region—has perhaps the least relevance to an individual citizen's perception of his or her welfare. Try asking a villager whether he knows the direction of movement of the Gini coefficient in his state or country in the previous 10 years, or whether the 10 percent increase in the national or provincial Gini in the past 10 years bothers him. You can be sure that he will not understand the question. On the other hand, as I learned on a recent visit to my ancestral village, the villager will be concerned about why the incomes in his village have not risen as rapidly as those in the city next door. When it comes to inequality, individuals evaluate themselves within their immediate context, often limited to their neighbors, friends, coworkers, and nearby municipalities.

There are two final points:

- First, inequality is certainly more tolerable in a growing economy. When everyone is moving up on an escalator, the fact that some manage to walk or run up on it is less bothersome than if the escalator is stuck, leaving some with no hope of reaching the top.
- Second, if wealth accumulation through legitimate means takes place in an open and competitive environment, inequality can have an inspirational effect. In 1997, when Bill Gates—who had become a multibillionaire within a matter of years—first visited India, he inspired awe among young Indians. But 10 years later, in 2007, when *Forbes* magazine reported as many as 54 billionaires within India, many among the young said to themselves: they are no different than me—if they can do it, I can do it!

Azim Premji—chairman of the information technology multinational Wipro and a self-made billionaire who maintains a modest lifestyle, flying economy class and driving a Toyota—put it this way to a British Broadcasting Corporation correspondent in 2007: "With the attention I got on my wealth, I thought I would have become a source of resentment, but it is just the other way around—it just generates that much more ambition in many people."

This same inspirational impact also works at the collective level. When Korea, China, and Taiwan Province of China grew rapidly, politicians in India would say, "We cannot do what they do; they are Chinese and we are Indians!" When the Indian regions of Haryana, Maharashtra, and Gujarat grew similarly rapidly, politicians in Bihar and Orissa could no longer make the same excuse. Instead, they were obliged to rethink policies in their states.

Less than five years ago, the Indian press was filled with warnings of impending revolution due to rising regional inequalities. Today, the same space is filled with the stories of how the chief ministers of Bihar and Orissa have turned their states around, delivering growth rates of 8 to 9 percent. ■

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