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Economic Growth and Poverty Reduction: Evidence from India

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Abstract: *Growth is regarded as key to poverty reduction. Poverty is a widely defined term, and most definitions take its multidimensional aspects into consideration. According to the World Bank (2000), "poverty is a lack of power to command resources". The poverty reduction has become a central goal for development. It can be achieved by economic growth and/or by the distribution of income. Issues related to the benefits of growth accrued to the poor have become a priority of development policy in the 1990s. An emerging consensus is that growth alone is a rather blunt tool for poverty reduction. In conjunction with an emphasis on poverty reduction, policies as to the redistribution of income and assets have become increasingly more important. A policy agenda that addresses both distributional concerns and poverty reduction could lead to enhancing both economic growth and equity. This study presents several analytical results on poverty elasticity, measuring the extent to which economic growth reduces poverty. It offers several propositions to demonstrate that the initial levels of economic development and income inequality can have significant impacts on poverty reduction. It also demonstrates that the poverty tradeoff between growth and inequality can be explained in terms of initial levels of development and inequality.*

Keywords: Economic Growth, Poverty Reduction, Inequality, Trade-Off

Research Area: Social Science

Paper Type: Research Paper

1. INTRODUCTION

Poverty reduction is considered one of the essential development goals for developing and developed countries both (United Nations, 2000). However, the poverty outcomes have varied extensively across countries depending on the particular success of their development strategies. Research that compares the experiences of a wide range of developing countries finds consistently strong evidence that rapid and sustained growth is the single most important way to reduce poverty. A typical estimate from these cross-country studies is that a 10 percent increase in a country's average income will reduce the poverty rate by between 20 and 30 percent (Adams, R, 2002) .

Initial levels of income inequality are important in determining how powerful effect of growth has in reducing poverty. For example, it has been estimated that a one percent increase in income levels could result in a 4.3 percent decline in poverty in countries with very low inequality or as little as 0.6 percent decline in poverty in highly disparate countries (Ravallion 2007).

Such calculations need to be interpreted with care, given the multitude of variables involved. Even if inequality increases alongside growth, it is not necessarily the case that poor people will fail to benefit – only that they will benefit less from growth than other households. But contrary to widespread belief, growth does not necessarily lead to increased inequality. While some theoretical research suggests a causal relationship between growth and inequality (and vice versa), the consensus of the latest empirical research is that there is no consistent relationship between inequality and changes in income.

The experiences of developing countries in the 1980s and 1990s suggest that there is a roughly equal chance of growth being accompanied by increasing or decreasing inequality (Ravallion 2001). In many developing countries, rates of inequality are similar to or lower than in developed countries. A series of studies using cross-country data all suggest that growth has neither a positive nor a negative effect on inequality (Chen and Ravallion 1997).

This is not to say that increased growth has not led to increasing inequality in some countries. Both China and India have seen widening inequality as their growth rates picked up over the 1990s. Both Bangladesh and Uganda would have seen higher rates of poverty reduction, had growth not widened the distribution of income between1992 and 2002. For example, one study suggests that the proportion of people living in poverty in Uganda at the end of this period would have been 30% instead of 38%, had the poor benefited proportionally from growth (Besley and Cord 2007).

2. ECONOMIC GROWTH AND POVERTY ERADICATION IN INDIA

Poverty is a significant issue in India, despite having one of the fastest-growing economies in the world, clocked at a growth rate of 7.6% in 2015, and a sizable economy. The World Bank reviewed and proposed revisions in May 2014, to its poverty calculation methodology and purchasing power parity basis for measuring poverty worldwide, including India. According to this revised methodology, the world had 872.3 million people below the new poverty line, of which 179.6 million people lived in India. In other words, India with 17.5% of the total world's population, had 20.6% share of world's poorest in 2011. Growth is considered pro-poor if the income share of the poor rises with growth (their incomes grow faster than that of the non-poor). We found evidence that inequality has declined slightly over the recent high growth period in India, and that it has also been accompanied by reduction in the poverty gap and severity. This evidence provides support for the view that the recent high growth period in India has been pro-poor.

Many economic studies have emphasized the role of higher economic growth to tackle the problem of poverty. This has been supported empirically by the work of Tendulkar (1998), Ravallion and Datt (1996) and Besley and Robins (2000). Using data from nearly 80 countries, Kray (2004) shows that in the medium-to-long-run, 66–90 percent of the variation in changes in poverty can be accounted for by growth in average incomes, and all of the remainders is due to changes in relative incomes. The role of economic growth in poverty reduction has also been supported by Deaton and Drèze (2001), Bhagwati (2001) and Datt and Ravallion (2002). Sen (1996) has strongly emphasized the need for higher government expenditure on social assistance to the poor, especially in the provision of education, as the most important determinants of poverty reduction. However, since government social expenditure that helps the poor is dependent on government revenue, which in turn grows with economic growth, the key role of economic growth is likely.

The change in poverty over a period can be broken into two components: the impact of income growth over the period and the impact of the change in income distribution over the period. Thus, if the income distribution does not change much (which is often the case with most countries), countries with higher growth rates tend to be associated with a more rapid reduction in poverty. We show with the help of national-level GDP growth data in comparison with poverty eradication in India. Economic growth also generates job opportunities and hence stronger demand for labour, the main and often the sole asset of the poor. In turn, increasing employment has been crucial in delivering higher growth. Strong growth in the global economy over the past10 years means that the majority of the world's working-age population is now in employment. Nevertheless, since the early 1990s, global employment has risen by over 400 million. While China and India account for most of this increase, almost all of the new jobs have been created in developing countries (Global Economic Prospects, 2007). While the relationship between growth and employment remains robustly positive, the strength of the link has weakened slightly since the turn of the millennium. This has raised concerns about 'jobless growth' in some countries.

Table: 1

		1993/94	2004/05	2009/10	2011/12	Annual Average Decline in Poverty 1993/94-2004/05	2004/05-2009/10	2004/05-2011/12
Poverty Headcount Ratio	Rural	50.1	41.8	33.8	25.7	0.8	1.6	2.3
In percent	Urban	31.8	25.7	20.9	13.7	0.6	1.0	1.7
	Total	**45.3**	**37.2**	**29.8**	**21.9**	**0.7**	**1.5**	**2.2**
Number of Poor	Rural	328.6	325.8	278.2	216.5	0.3	9.5	15.6
In millions	Urban	74.5	81.4	76.5	52.8	-0.6	1.0	4.1
	Total	**403.7**	**407.2**	**354.7**	**269.3**	**-0.3**	**10.5**	**19.7**

Sources: Planning Commission of India; IMF staff calculations.

1/ Data for 2011/12 based on the Planning Commission of India's Press Note on Poverty Estimates, 2011-12, July 2013.

From the above table, it is evident that poverty in India over the years has declined sharply, hence it can be argued that the growth has played its due part in eradication of poverty in India. The GDP growth rate over one decade can be easily compared with the decline in poverty shown in Table 2 below.

Table: 2

GDP Growth Rate at Base Year 2004-05 and Current

	GDP Growth	
Year	**2004-05**	**Current**
2013-14	4.74	11.54
2012-13	4.47	11.88
2011-12	6.69	15.77
2010-11	8.91	18.66
2009-10	8.59	15.18
2008-09	6.72	15.75
2007-08	9.32	15.91
2006-07	9.57	16.60
2005-06	9.48	14.10
2004-05	7.05	13.16

2003-04	7.97	12.03
2002-03	3.88	7.75
2001-02	5.39	8.72
2000-01	4.15	7.67
1999-00	8.00	11.35
1998-99	6.68	15.28
1997-98	4.30	11.20
1996-97	7.97	16.38
1995-96	7.29	17.08
1994-95	6.39	16.80
1993-94	5.68	16.23
1992-93	5.36	14.70
1991-92	1.43	15.37
1990-91	5.29	16.49

Source: Ministry of Statistics and Programme Implementation (2014)

3. THE RELATION BETWEEN POVERTY, GROWTH, AND INEQUALITY

This section presents a simple decomposition of the changes in the poverty rate in a country to show that the changes in per capita income and the income distribution are the main determinants of changes in the poverty rate.

The head count ratio of poverty (HCR) is defined as the percentage of the population whose income is below a given poverty line. Thus, HCR will generally depend on average income per capita (Y*) and the poverty line ($\underline{Y}$), both expressed in constant prices. It will also depend on the income inequality or distribution (D):

HCR = HCR (Y*,$\underline{Y}$, D)

Thus, the change in HCR stems from changes in either of the two determinants of Y*, given the constant poverty line.

a) If income growth is distribution-neutral, or the income of every individual grows by the same proportion, then the Lorenz curve (footnote it) will stay unchanged and change in HCR is due entirely to changes in the mean income.

b) When the mean income neither grows nor contracts, a change in poverty will occur if and only if the Lorenz curve shifts, i.e., there is income redistribution among some individuals.

4. POLICIES FOR MORE RAPID POVERTY REDUCTION

Although concerned efforts have been initiated by the Government of India through several plans and measures to alleviate poverty in rural India, there remains much more to be done to bring prosperity in the lives of the people in rural areas. India is a haven to 22% of the world's poor. Such a high incidence of poverty is a matter of apprehension, since poverty eradication has been one of the major objectives of the development process. Poverty eradication is considered integral to humanity's mission for sustainable development. Thus, the reduction of poverty in India is vital for the attainment of international goals. The philosophy underlying the poverty alleviation programs is to tackle the rural poverty by endowing the poor with productive assets and training for raising their skills so that they are assured of a regular stream of employment and income in raising themselves above the poverty line.

Economists, like Drèze and Sen (1995), have argued that effective government intervention in favor of the poor through social welfare policies is most important for poverty alleviation, and growth plays only a minor role (so that government focus should be on education and welfare promotion rather than growth promotion). The World Bank (1993 and 1997) suggests that poverty reduction depends not only on rapid economic growth but also on basic human development, that is, the level of social indicators such as literacy, life expectancy, health facilities, etc. could also be important.

5. CONCLUSION

Poverty is a national problem and it must be solved on a war footing. The government is taking several steps to mitigate poverty. Eradication of poverty would ensure a sustainable and inclusive growth of economy and society. We all should do everything possible and within our limits to help alleviate poverty from our country**.** Given the importance of growth, India needs to follow policies helpful in sustaining high rates of growth. These include the creation of a stable macroeconomic environment, good infrastructure, well-functioning education, and health services for the poor, well-functioning and inclusive financial system and good governance. We also need to pay special attention to the education sector and developing our human resources. Failure to sustain high growth will prove quite disastrous in terms of poverty reduction and development. But if we are able to sustain high growth, it will give India an excellent chance to reduce poverty significantly and meet various development goals, especially if the government takes steps to increase support for infrastructure development, education and health services, etc.

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