

Poverty, Inequality and Reforms

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- I. Reforms → Growth → Poverty Reduction**
- II. Poverty and Inequality → Opposition to Reforms**

I

The Reforms-Growth link seems quite vibrant in the corporate sector over the last two decades

In the non-corporate sector—which is most of the economy—it's less obvious

Two examples of why we need to be a little cautious before over-claiming the effects of reform on growth:

- Evidence is mixed and complicated by deflator problems, but growth in total factor productivity (TFP) in the industrial sector seems to be slowing in the period 1993-2004 compared to the previous decade**

- It seems that in the economy’s so-called service sector-led growth in the period 1993-2004 not all of the growth can be explained by finance, business services or telecommunication where reform may have made a difference.

A large part of the growth in the service sector, at a rate higher than that in manufacturing, was in the traditional or “unorganized sector” services, unlikely to have been directly affected substantially by the regulatory or foreign trade policy reforms

See Table, from Bosworth, Collins, and Virmani (2006):

Growth in Component Service-Producing Industries, 1980-2004 (percentages)

Period	Modern Services					Traditional Services				Services less Dwellings
	Total	Communi- cations	Finance	Business Services	Education & Medical	Total	Trade	Transportation	Other Services	
Share of Total Output in Services										
1960-61	19	2	6	1	10	81	40	14	27	100
1980-81	22	3	7	1	11	78	37	16	24	100
1993-94	31	3	14	2	12	69	34	14	21	100
1999-00	35	6	14	4	12	65	33	12	19	100
2004-05	40	11	12	5	11	60	33	11	16	100
Annual Percentage Rate of Change										
1960-80	5.7	6.9	5.9	3.4	5.5	4.6	4.5	5.6	4.3	4.9
1980-93	9.0	7.1	12.3	9.8	6.6	5.4	5.6	5.4	4.9	6.3
1993-99	12.6	20.3	9.3	28.0	10.6	8.9	9.8	7.5	8.6	10.1
1999-04	10.5	23.8	5.7	11.4	7.1	6.5	7.9	5.7	4.3	8.0
Percentage Contribution to Total Services Growth										
1960-80	1.1	0.1	0.3	0.0	0.5	3.8	1.8	0.8	1.2	4.9
1980-93	2.0	0.2	0.9	0.1	0.7	4.2	2.1	0.9	1.2	6.3
1993-99	3.9	0.7	1.3	0.5	1.2	6.2	3.3	1.1	1.8	10.1
1999-04	3.7	1.3	0.8	0.5	0.8	4.2	2.6	0.7	0.8	8.0

source: authors' calculations from CSO (2006) and prior years.

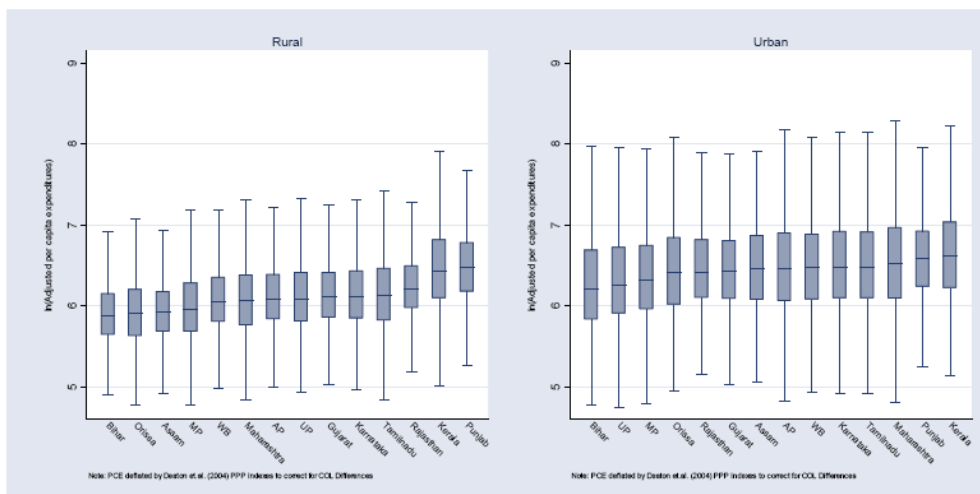
The Growth-Poverty Reduction Link is stronger

Yet some qualms:

- In the period 1977-2001 the growth-elasticity of poverty reduction was quite low in high-growth states like Maharashtra and Karnataka, and high in states like Kerala and West Bengal. See Purfield (2006). Datt and Ravallion (2002) point out that much depends on initial distribution of land and human capital. (Similarly, growth-elasticity of poverty reduction has been substantially lower in India than in China, again partly on account of the initial distribution of land and human capital being more egalitarian in China)
- The poorer sections of richer states are very nearly as poor as those in poor states

Table from World Bank Development Policy Review (2006):

Distribution of per capita expenditures, by state, 1999–2000



Note: The box plots show the 25th, median, and 75th percentiles and upper and lower adjacent values of the logarithm of per capita expenditures adjusted for cost-of-living differences across states.
Source: Authors' calculations using 1999–2000 Schedule 1.0 unadjusted 30-day consumption distribution and multilateral prices indexes for cost-of-living adjustments across states from Deaton and others 2005.

- **Non-income aspects of poverty: higher growth in India compared to Bangladesh and sub-Saharan Africa has been compatible with**
 - **Much higher infant mortality rates, maternal mortality rates and much lower child immunization rates than in Bangladesh**
 - **Percentage of underweight children (below age 3) is 47 in India, and about 30 on average in sub-Saharan Africa**
 - **Take the case of Gujarat, one of the richest and high-reform states: the percentage of underweight children, which was already high (higher than sub-Saharan Africa), went *up* between NFHS 2 (1998-99) and NFHS 3 (2005-6)**

The poverty reduction effect of a given growth rate, of course, depends on the income or wealth inequality

The link between reforms and economic inequality is, however, not clear.

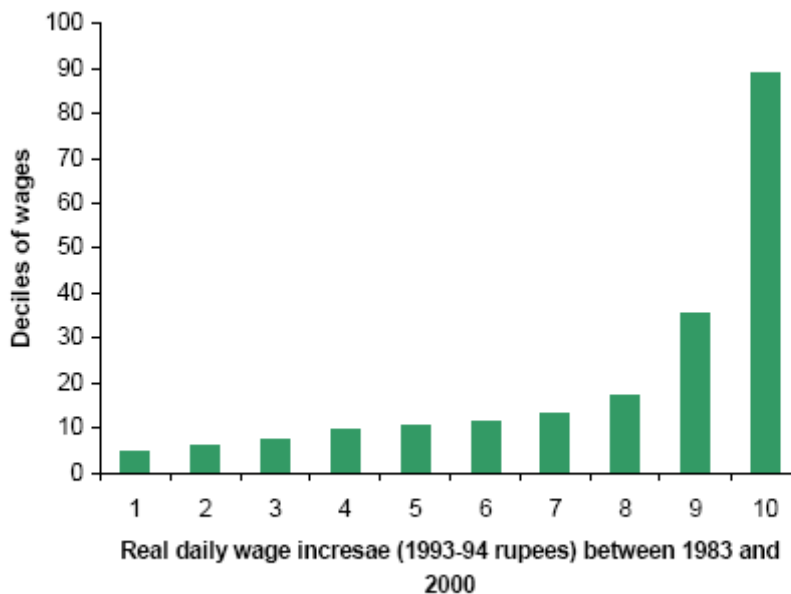
Some correlations, but causation, controlling for other factors, need to be analyzed

Divergence of per capita state domestic product was increasing in the 90's, but better reform implementation in a state may have gone hand-in-hand with better initial infrastructure (of course, with the removal of industrial licensing, which ostensibly used to give some weight to regional backwardness, private capital will move more to states where policies are business-friendly and infrastructure is better)

The following data, reported in the World Bank Development Policy Review, for wage inequality increase may be as much due to skill-biased technical progress (or the urban bias of infrastructural development) as to liberalization:

Wage growth has been disproportionate at the top end of the labor market.

Increase in real daily wages, by decile, 1983 to 2000



**A general result of second-best welfare economics:
product market liberalization with factor market
imperfections need not improve welfare**

**Much of the product market liberalization in India has
been carried out at the Central level. Doing something
about a large part of the factor market imperfections is
often in the hands of the states:**

Land

Labor

Credit (except some national-level financial reforms)

Electricity

**That's where reforms have been very slow and conflict-
ridden.**

II Poverty and Inequality → Opposition to Reforms

In a recent FT article I claimed that socially and economically India is one of the most unequal countries of the world

“Does it matter for economic reform? I believe it does particularly because heterogeneity and inequality make the social and political environment quite conflict-ridden, and it is difficult in this environment to build consensus and organize collective action towards long-term reform and cooperative problem-solving efforts. When groups don’t trust one another in the sharing of costs and benefits of long-run reform, there is the inevitable tendency to go for the “bird-in-hand” short-run subsidies and government handouts.”

Collective Action and Inequality: recent literature

I am referring particularly to the halting and hesitant reforms outside the corporate sector, reforms in the factor markets, which directly affect the lives and livelihoods of large numbers of people. In the CSDS National Election Survey data for 2004, two-thirds of the sample of about 23000 respondents who had any opinion on the subject say that the reforms “benefit only the rich” or none at all. A strong majority of respondents say they are opposed to privatization and a reduction in the size of government.

Partly, a failure of our reformers to explain the benefits of reforms to common people

But what financial columnists call anti-reform populism is also partly a product of the manifold inequalities and conflicts of Indian society.

The severe educational inequality (which is worse in India than in Brazil), for example, makes it harder for many to absorb shocks in the industrial labor market, since education and training could provide some means of flexibility in adapting to market changes.

In China the disruptions and hardships of restructuring under a more intense process of global integration were rendered somewhat tolerable in the 80's and 90's by the fact that China has had some kind of a minimum rural safety net, largely made possible by an egalitarian distribution of land cultivation rights that followed the de-collectivization of 1978. In most parts of India for the poor there is no similar rural safety net. So the resistance to the competitive process that market reform entails is that much stiffer in India.

Social safety nets and opposition to globalization

Canonical example of Nordic countries

- strong labor unions, egalitarian policies**
- yet unions are pro-globalization**
- these countries are at the top of the Global Competitiveness ranking of WEF, above US**

The discussion on economic reform is preoccupied with issues of fiscal and trade policy, financial markets and capital account convertibility. Reform would have been more popular if it were equally and simultaneously concerned with reform in the appalling governance structure in the delivery of basic social and infrastructural services for the poor in large parts of the country (in education, health, drinking water, irrigation, etc.).

Needed: a Social Contract that includes a package of market reforms, social safety net, and delivery of some basic services on a war footing, and political leaders (and movements) imaginative enough to push such a Package Deal

Gini Coefficients of Wealth Distribution

Rural

Urban

China		
1995	0.33	0.52
2002	0.39	0.47
India		
1991	0.62	0.68
2002	0.63	0.66

Source: For China, Li, Wei and Jing (2005).

For India, author's estimate from National Sample Survey data.

Educational Inequality: Gini coefficients of inequality in years of schooling in the adult population

China (2002)	0.37
India (1998/00)	0.56
Brazil (2001)	0.39
Argentina (2001)	0.22
Mexico (1999)	0.34
Ghana (1998/99)	0.46
Kenya (1999)	0.38
Indonesia (2002)	0.32

Source: World Development Report 2006