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The Mahbub Ul Haq Memorial Lecture

The Demands of Inclusive Growth: Lessons from South Asia

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This paper examines the concept of inclusive growth, compares and contrasts it with related concepts such as pro-poor growth and equitable growth, and analyses the recent experience of South Asia through the lens of this concept. A common experience of the region is that spells of rapid growth have been marked by accelerated poverty reduction on the one hand rising income inequality on the other. The contrasting movements in poverty and inequality render intriguing the question of whether South Asia has experienced inclusive growth or not. The reduction in poverty suggests inclusiveness, while the rise in inequality suggests otherwise. The implication is that the growth process has been inclusive in some dimensions but not in others. Closer examination shows that in each country of the region horizontal equity (between groups) has been served better than vertical equity (within groups). Thus, while the growth process has opened up plentiful opportunities for most groups of people to enjoy the benefits of growth, thereby making poverty reduction possible at an accelerated pace, in every group some individuals have failed to link up with the growth process, thereby exacerbating inequality. The problem was that within each group some individuals lacked the skills and endowments required to integrate with the growth process. Improving the 'integrability' of these people is an essential demand of inclusive growth.

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I. THE IDEA OF INCLUSIVE GROWTH

The concept of development has evolved a long way since the times when the demands of growth reigned supreme. In Amartya Sen's powerful new formulation, development has come to be seen as the expansion of human freedoms, encompassing all kinds of freedom—economic, social and political—and embracing all segments of the society, not just a privileged few [Sen (1999)]. In the course of this evolution, growth has not become redundant, however. Economic growth, in the sense of expansion of material production, is still essential to support the expansion of the freedoms that we all value. What has changed is a growing recognition that what matters for freedoms is not just the rate of growth but also the nature of the growth process. The same rate of growth may be achieved through different growth processes, each involving a distinct configuration of the structure of production, structure of employment, and distribution of income and assets among the population, leading to very different levels of achievement of freedoms. For widespread enjoyment of freedoms to be possible, the growth process must be inclusive in nature. In other words, the structures of production and employment that a growth process generates must be of a nature that offers opportunities to all segments of the society to benefit from economic expansion. Widespread expansion of opportunities is the demand of inclusive growth.

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This transformation in development thinking, shifting the emphasis from the demands of growth to the demands of inclusive growth, neatly parallels Mahbub Ul Haq's own intellectual journey during his illustrious career. Indeed, he was one of those visionary intellectuals who were at the very forefront of this transformation. From being one of the most articulate champions of 'growthmanship' in his early life, Mahbub Ul Haq became one of the most passionate advocates of inclusive growth in his mature life. The language he used may have been different, but the idea of human development with which Mahbub Ul Haq's name has become inextricably linked, is precisely what inspires the call for inclusive growth. When a growth process ensures widespread human development—defined broadly as the expansion of freedoms that human beings have reason to value—it is then that growth can be said to be inclusive. It is entirely appropriate that a lecture devoted to the memory of Mahbub Ul Haq should examine the conditions of inclusive growth, especially for South Asia, a region whose well-being was always close to his heart.

Before proceeding further, however, a bit of conceptual clarification may be in order. In particular, it is necessary to appreciate both the similarities and differences of the concept of inclusive growth *vis-à-vis* some closely related concepts. Sometimes the idea of inclusive growth is identified with pro-poor growth, sometimes with equitable growth, and sometimes with both by conflating the ideas of pro-poorness and equity into one and the same concept. Yet, neither the concept of pro-poorness, nor the concept of equity, nor a conflation of the two fully captures the idea of inclusive growth. One could argue, quite rightly, that being pro-poor in some sense is a necessary condition for growth to be inclusive, but it cannot be a sufficient condition. For, it is conceivable that while a growth process is biased in favour of the poor in general, there could exist some subset of the poor—defined by various attributes such as religion, ethnicity, location, etc.—who are being systematically excluded from enjoying the benefits of growth. Growth cannot be said to be inclusive in this case.

One could also argue, again quite rightly, that equity is an essential attribute of inclusive growth, and yet whether a particular growth process is inclusive or not may not always be obvious by looking solely at the equity outcome, especially in the short run. If inclusive growth is understood as widespread expansion of opportunities to enhance freedoms, it must also be recognised that spreading of opportunities is itself a process that occurs over a period of time. In the early stage of this process, the expansion of opportunities may not be as widespread as one would like, thus giving the appearance of non-inclusive growth in the short-term, and yet the process could contain attributes favouring convergence towards a more inclusive outcome over the longer term. The inclusiveness of growth must, therefore, be judged by longer term dynamic of the growth process rather than by its short-term distributional outcome.

Thus, while the idea of inclusive growth must contain the properties of both pro-poorness and equity of the growth process, it cannot be defined entirely in terms of the latter two concepts. Inclusive growth refers to the broader idea of a growth process that ensures widespread expansion of freedoms for all segments of the society over a period of time. All this is, admittedly, rather abstract so far. In this lecture, I shall try to add some concreteness to these abstract ideas by examining the recent experience of South Asia.[1] I shall begin by reviewing the recent record of growth, inequality and poverty in

[1]My discussion of South Asia is confined to four countries—viz., India, Pakistan, Bangladesh and Sri Lanka.

the region and then try to interpret this record in the light of the idea of inclusive growth. In the process, I shall try to offer some remarks as to where the focus of policies ought to lie if inclusive growth is to be ensured in the region.

II. THE RECENT RECORD OF GROWTH, INEQUALITY AND POVERTY IN SOUTH ASIA

All countries of South Asia have enjoyed respectable rates of growth during the last quarter century. Even though the region's growth performance during this period has been nowhere as spectacular as in East and South-East Asia, it has been far better than in most other parts of the developing world and, more importantly, much better than in its own past. As can be seen from Table 1, compared to the 1970s, every country of the region has enjoyed faster rate of growth since the 1980s. The ride has not been entirely smooth, though, as Pakistan faced a serious setback in the 1990s and Sri Lanka has done so in the present decade, but on the whole the quarter century since 1980 has witnessed a considerable acceleration of growth compared to the 1970s. In terms of per capita GDP growth, the acceleration has been from 0.6 percent per annum to 3.8 percent in India, from 1.5 percent to 2.7 percent in Pakistan, from 1.7 percent to 2.8 percent in Bangladesh, and from 2.4 percent to 3.2 percent in Sri Lanka. To a significant extent, this growth acceleration has happened as a consequence of a series of liberalising reforms that the countries of the region undertook at various times in the recent past, but other factors such as higher agricultural productivity, increased flow of workers' remittances from abroad, and favourable external circumstances have also played a role.[2]

Table 1

Growth of GDP in South Asia: 1971– 2005

	1971-1980	1981-1990	1991-2000	2001-2005	1981-2005
India					
GDP	2.93	5.89	5.56	5.94	5.77
Population	2.30	2.16	1.99	1.74	2.01
Per capita GDP	0.63	3.74	3.57	4.20	3.76
Pakistan					
GDP	4.66	6.12	4.41	5.25	5.26
Population	3.14	2.75	2.50	2.22	2.55
Per capita GDP	1.51	3.38	1.91	3.02	2.72
Bangladesh					
GDP	3.79	3.73	4.84	5.43	4.52
Population	2.40	2.08	1.67	1.35	1.77
Per capita GDP	1.65	1.67	3.17	4.08	2.75
Sri Lanka					
GDP	4.05	4.27	5.21	3.98	4.59
Population	1.66	1.48	1.28	1.27	1.35
Per capita GDP	2.39	2.79	3.93	2.71	3.23

Source: Calculated by the author from national and international sources.

[2]I have examined in some details the growth experience of South Asia since its independence from British rule in Osmani (forthcoming).

There has been much debate in the region as to how far the higher rate of growth has translated into a better life for the people at large, which is after all the essence of inclusive growth. Let us begin by examining the evolution of inequality (Table 2), which as I have noted earlier has to be an essential attribute of inclusive growth, even though the inclusiveness of growth cannot be judged fully by the short-run equity outcome of a growth process. In undertaking this examination, I shall pay special attention to the possible contrasts between what happened before and after the major economic reforms were launched.

Table 2

Trend of Inequality in South Asia (Gini coefficient)

Country/Year	National	Rural	Urban	Estate
India				
1983	38.6	30.79	34.06	n.a.
1993-94	38.0	28.55	34.31	n.a.
2004-05	38.5	30.45	37.51	n.a.
Pakistan				
1979	39.46	34.50	41.28	n.a.
1990-91	40.99	42.18	37.88	n.a.
2000-01	41.29	37.62	46.15	n.a.
2000-01	27.52	23.67	32.27	n.a.
2004-05	29.76	25.19	33.88	n.a.
Bangladesh				
1983/84	52.3	53.8	40.9	n.a.
1991/92	49.7	52.9	33.6	n.a.
1991/92	58.8	61.2	44.9	n.a.
2000	48.9	52.3	35.2	n.a.
2005	40	43.8	28.4	n.a.
Sri Lanka				
1985/86	46.0	48.0	43.0	31.0
1990/91	47.0	62.0	42.0	25.0
1995/96	46.0	47.0	46.0	34.0
1990/91	32.0	37.0	29.0	22.0
1995/96	35.0	38.0	33.0	20.0
2002	40.0	42.0	39.0	26.0

Notes and Sources: For India, Das (2008) for all-India and Dev and Ravi (2007, Table 3) for Rural and Urban (all based on consumption data); for Pakistan, Anwar (2005) for the upper panel (based on income data) and Anwar (2006) for the lower panel (based on consumption data); for Bangladesh, BBS (2005) for the upper panel and Khan (2008) for the lower panel (both based on income data); for Sri Lanka, Nicholas, *et al.* (2004) for the upper panel (based on income data) and World Bank (2007b) for the lower panel (based on consumption data).

In India, overall inequality appears to have remained static in the two decades since the mid-1980s, with the Gini coefficient of per capita consumption expenditure hovering around 0.38-0.39. This apparent stability in overall inequality has been accompanied, however, by rising inequality in both rural and urban areas in recent times. In the pre-reform decade between 1983 and 1993-94 the Gini coefficient had declined in rural areas and remained static in urban areas. But during the post-reform period (1993-94 to 2004-05), it has risen in both rural and urban areas. The fact that the overall Gini coefficient at the all-India level has hardly changed at all during this period suggests that the disparity between urban and rural areas has declined and that this decline has been sufficient to offset the rise in within-sector inequality.[3] If, however, one examines measures of inequality other than the Gini coefficient, there are some indications that overall inequality may have increased slightly during the post-reform period.[4]

The Pakistan scenario is somewhat similar to that of India. For the country as a whole, inequality was quite stable in the 1980s as well as in the 1990s, with the Gini coefficient of per capita income distribution staying close to 0.40. As in the case of India, both rural and urban inequality increased during these two decades but their effect on overall inequality appears to have been mitigated by the narrowing of urban-rural disparity. This pattern has changed, however, after the turn of the century. In the short space of four years (from 2000-01 to 2004-05), the Gini coefficient of per capita consumption distribution has gone up by two percentage points—from 0.28 to 0.30. Both rural and urban inequality have also increased but slightly less than overall inequality, suggesting a reversal of the past trend of narrowing urban-rural disparity.

The picture is very different in Sri Lanka, however. Overall inequality seems to have risen sharply since 1990 after remaining more or less stable in the second half of the 1980s. The Gini coefficient of per capita consumption distribution has increased steadily from 0.32 in 1990-91 to 0.35 in 1995-96 and further to 0.40 in 2002. In the urban areas the Gini coefficient has risen from 0.37 in 1990-91 to 0.42 in 2002, in rural areas it has risen from 0.29 to 0.39 during the same period and in the estate sector it has gone up from 0.22 to 0.26. Sri Lanka has thus witnessed sharp and pervasive increase in inequality during the post-1990 period.

Bangladesh, like Sri Lanka, has also experienced sharply rising inequality. Already in the 1980s inequality was on a rising trend but only mildly so, as the Gini coefficient increased by just three percentage points between 1983-84 and 1991-92. However, since then the Gini coefficient has gone up rapidly—from 0.30 in 1991-92 to 0.41 in 2000. What has happened since 2000 remains somewhat unclear. Official estimates of inequality show remarkable stability in inequality during 2000-2005, even suggesting, quite implausibly, that inequality has fallen in urban areas. On careful examination of the income data used by the official estimates, a recent study has cast doubt on their plausibility and after making suitable adjustments have come out with revised estimates which show that inequality has continued to rise after 2000—both nationally and within urban and rural areas separately [Khan (2008)].

[3]This contrast between 'within-sector' and 'between-sector' inequality will be discussed more fully in the next section.

[4]One such alternative measure—viz. logarithmic mean deviation—shows that reduced disparity between urban and rural sectors has not fully offset the rise in inequality within rural and urban areas; as a result overall inequality has risen but the rise has not been particularly sharp [Das (2008)].

The pattern for the region as a whole thus seems to contain two distinct strands. In India and Pakistan, inequality had remained more or less stable in the 1980s and the 1990s but has risen mildly since then. In Sri Lanka and Bangladesh, by contrast, inequality increased sharply in the 1990s and has remained on the rising trend afterwards. The overall trend for the region as a whole is one of rising inequality in the present decade.

We thus find that in the region as a whole faster rate of growth achieved in the recent past has been accompanied by rising inequality. What has been the consequence of this 'higher growth higher inequality' scenario for the pace of poverty reduction? Table 3 provides the answer.

Table 3

Trend of Poverty in South Asia (Headcount Ratio; %)

Country/Year	National	Rural	Urban	Estate
India				
1983	44.93	45.76	42.27	n.a.
1993-94	36.02	37.26	32.56	n.a.
2004-05	28.27	29.18	26.02	n.a.
Pakistan				
1979	30.68	32.51	25.94	n.a.
1990-91	22.11	23.59	18.64	n.a.
2000-01	33.30	37.90	22.00	n.a.
2004-05	28.30	32.90	18.40	n.a.
Bangladesh				
1983-84	52.3	53.8	40.9	n.a.
1991-92	49.7	52.9	33.6	n.a.
1991-92	58.8	61.2	44.9	n.a.
2000	48.9	52.3	35.2	n.a.
2005	40.0	43.8	28.4	n.a.
Sri Lanka				
1985-86	41.0	46.5	25.7	30.0
1990-91	29.5	32.3	22.0	23.3
1995-96	36.0	38.0	22.4	41.1
1990-91	26.1	29.4	16.3	20.5
1995-96	28.8	30.9	14.0	38.4
2002	22.7	24.7	7.9	30.0

Sources: For India, Dev and Ravi (2007), Table 1; For Pakistan, Amjad and Kemal (1997) for data on 1979 and 1990-91, and World Bank (2006) for 2000-01 and 2004-05; for Bangladesh, Osmani, *et al.* (2006), Table II.1 for the upper panel and World Bank (2007a) for the lower panel; for Sri Lanka, Gunewardene (2000) [as quoted in Nicholas, *et al.* (2004)] for the upper panel and World Bank (2007b) for the lower panel.

After remaining recalcitrant for nearly two decades since independence, poverty began to decline in India in the 1970s, thanks mainly to rising productivity in agriculture brought about by the Green Revolution. As the initial impetus of the Green Revolution has gradually weakened, the pace of poverty reduction has been sustained by more broad-based progress in the economy as a whole. In the early 1980s, when economic reforms had just begun in India, nearly half of the population still lived in poverty; in the next two decades and a half the proportion has come down to less than one-third. Thus, the rate of poverty fell from 45 percent in 1983 to 28 percent in 2004-05. Contrary to popular misconception, both rural and urban areas have shared in this reduction of poverty. Rural poverty, which has traditionally been higher than urban poverty, has come down from 46 percent in 1983 to 29 percent in 2004-05. Urban poverty at the same time has fallen from 42 percent to 26 percent.

There has been a lively debate in India on whether the pace of poverty reduction gathered momentum or slowed down after a set of wide-ranging economic reforms was adopted in the early 1990s to launch the Indian economy onto a higher growth path. A consensus has gradually emerged that the pace had actually slowed down in the 1990s compared with the preceding decade but has picked up strongly after the turn of the century.[5] The question still remains, however, whether the pace of poverty reduction has been commensurate with the historically unprecedented high rates of growth achieved by India in the recent years. This question lies at the heart of the theme of inclusive growth that this paper is concerned with and we shall return to it after taking a brief look at the evolution of poverty in some of the other South Asian countries.

The Sri Lankan experience has some similarity with that of India insofar as a healthy rate of poverty reduction in the 1980s gave way to a much slower pace after 1990, followed by a late revival. The difference, however, is that the recent revival has not been nearly as strong as that of India. In the second half of the 1980s, poverty had declined by as much as 10 percentage points in the country as a whole, but in the 12 years since 1990 it fell by just three percentage points. In fact, there was a reversal in the first half of the 1990s, when poverty actually went up unlike in India where poverty continued to decline albeit slowly. It was only a healthy decline since 1995-96 that allowed the poverty situation at the turn of the century to remain somewhat better than a decade earlier.

In yet another contrast with India, the process of poverty reduction has not been widespread in Sri Lanka. It is the urban areas that have benefited most, with the rate of urban poverty almost halving from an already low level of 16 percent in 1990-91 to 8 percent in 2002. By contrast, rural poverty fell only slowly from 29 percent to 25 percent during the same period, while poverty in the Estates actually increased quite sharply—from 21 percent to 30 percent.

The Pakistan experience has been somewhat similar to Sri Lanka's, except that the setback that occurred after 1990 lingered much longer. The decade of the 1980s had witnessed substantial and widespread reduction of poverty, with national poverty falling from 31 percent in 1979 to 22 percent in 1990-91. Then came the lost decade of the 1990s, and poverty jumped to 33 percent by 2000-01, exceeding the rate that had

[5]For a sample of the literature, see, for example, Deaton and Dreze (2002), Sundaram and Tendulkar (2003), Sen and Himanshu (2004a, 2004b), Himanshu (2008) and Dev and Ravi (2008).

prevailed a couple of decades ago. It seemed at the turn of the century that the clock had turned back in Pakistan, perhaps irretrievably. Fortunately, things turned around soon afterwards as poverty declined by 5 percentage points by 2004-05.[6]

Considering the two decades and a half since 1979, the overall poverty situation has slightly improved in Pakistan, thanks to the late push that came at the turn of the century. But there has been hardly any change in rural poverty—nearly a third of the rural population lived in poverty in 1979 and almost the same proportion of them continued to do so in 2004-05. Only the urban population have enjoyed the benefit of reduced poverty, as urban poverty has fallen from 26 percent in 1979 to 18 percent in 2004-05—a phenomenon that Pakistan shares with Sri Lanka but not with India.

Bangladesh has been somewhat of an exception in the region in terms of the evolution of poverty. Unlike the other three countries, Bangladesh has experienced accelerating pace of poverty reduction since 1990, embracing both rural and urban areas. In the 1980s, poverty had declined very slowly, falling only by a couple of percentage points during 1983-84-1991-92, and that too was confined mostly in urban areas. This is in sharp contrast with the rest of the region where poverty declined at quite a healthy pace in the 1980s. Since 1990, however, the pace of poverty reduction has gathered momentum in Bangladesh, in contrast to the slowdowns or reversals in the rest of the region. According to official estimates, poverty in the country as a whole came down from 59 percent in 1991-92 to 49 percent in 2000 and it fell further to 40 percent by 2005. As in India, both rural and urban areas have enjoyed substantial reductions in poverty, with rural poverty coming down from 61 percent in 1991-92 to 44 percent in 2005 and urban poverty coming down from 45 percent to 28 percent during the same period.

In summary, a large part of the region, comprising India, Pakistan and Sri Lanka, experienced a setback in the fight against poverty in some parts of the 1990s—in the form of slowdown of progress in India and increased poverty in Sri Lanka and Pakistan. Fortunately, recent years have witnessed a revival in each of these countries, with India leading the way. Bangladesh has been an exception in this regard, by maintaining an accelerated pace of poverty reduction all throughout the period since 1990. Taking all four countries together, the region as a whole can be said to have witnessed quickening pace of poverty reduction in the present decade as compared with the early 1990s.

So far, we have looked at the record of growth, inequality and poverty in isolation of each other. We now bring them together in order to make an initial assessment of the inclusiveness of growth (Table 4).

As we have noted earlier, India has had a faster rate of growth in the post-reform period, with per capita GDP growing at the rate of 4.2 percent during 1993-94-2004-05 as compared with 3.3 percent in the preceding decade. And yet, poverty declined almost exactly at the same rate in both periods—at about 2.2 percent per annum. Since faster growth in the post-reform period did not translate into faster reduction of poverty, the natural inference would be that distribution must have worsened. As it happens, however, the Gini coefficient does not reveal any such worsening. This may be because Gini is a summary measure of the overall distribution and it is entirely plausible that any

[6]These figures are taken from World Bank (2006); other independent estimates arrive at similar figures [e.g., Anwar (2007)].

Table 4

Rates of Change in GDP per Capita, Inequality and Poverty in South Asia (Percentage)

	GDP Per Capita	Gini Coefficient	Poverty Ratio
India			
1983 to 1993-94	3.32	0	–2.19
1993-94 to 2004-05	4.23	0	–2.18
Pakistan			
1979 to 1990-91	3.34	0.35	–2.93
1990-91 to 2000-01	1.53	0.07	4.18
2000-01 to 2004-05	3.97	1.98	–3.99
Bangladesh			
1983-84 to 1991-92	1.75	1.01	–0.64
1991-92 to 2000	3.50	3.47	–2.15
2000 to 2005	4.30	3.50	–3.94
1991/92 to 2005	*3.64*	*2.77*	*–2.81*
Sri Lanka			
1985-86 to 1990-91	2.69	0.43	–6.36
1990-91 to 1995-96	3.98	1.81	1.99
1995-96 to 2002	2.88	2.08	–3.60
1990-91 to 2002	*3.21*	*1.96*	*–1.21*

Source: GDP figures were compiled from national statistics; Gini coefficients and poverty rates are taken from Tables 2 and 3 above.

worsening of distribution at the lower tail (which is what matters for poverty) was offset by improvement in the middle of the distribution. Besides, as mentioned earlier, measures other than the Gini coefficient do indicate some deterioration in distribution in the post-reform period. Looking at more recent years one finds that in the five-year period 2000-2005 growth has accelerated even further and so has the pace of poverty reduction, even though inequality has increased mildly. India's overall experience in the post-reform period is thus one of faster growth being accompanied by faster rate of poverty reduction in the more recent period along with mild increase in inequality.

In Pakistan, the relationship between growth, poverty and inequality has gone through three distinct phases since 1980. In the decade of the 1980s, healthy decline in poverty was accompanied by an equally healthy growth of per capita income and only a mild increase in inequality. But poverty increased in the 1990s, primarily because of a drastic fall in the rate of growth, with inequality playing only a minor role. Happily, the decline of poverty resumed after 2000, but the pattern was very different from the earlier episode of declining poverty (in the 1980s). This time very sharp increase in inequality went hand in hand with rapid decline in poverty. It was only a very rapid growth of income that made possible a rapid rate of poverty reduction despite very sharp increase in inequality. Thus, as in the case of India, in Pakistan too faster growth has translated into more rapid poverty reduction in recent years, despite the fact that the rise in inequality has been much sharper in Pakistan than in India.

The Bangladesh scenario is essentially similar, except that what has been happening in India and Pakistan since about 2000 has been happening there for somewhat longer—since about 1990. In the 1980s, growth was slow and so was the rate of poverty reduction. When growth accelerated in the 1990s, so did the rate of poverty reduction but accompanied by a very considerable increase in inequality.

Sri Lanka on the other hand has had a completely contrasting experience. Despite faster growth since 1990, poverty declined at a much slower rate compared with the second half of the 1980s. This disjunction between growth and poverty reduction is accounted for by the fact that the rate of increase in inequality has accelerated from 0.43 percent to 2.0 percent per annum during the same period. In other words, faster increase in inequality has prevented faster growth from translating itself into faster reduction of poverty.

A common phenomenon in the region is that as growth accelerated in recent years not only has inequality increased but has done so at a faster rate than before. Also common is the fact that rising inequality has nowhere been strong enough to actually aggravate poverty by neutralising the effect of growth. The difference, however, lies in the pace of poverty reduction. The most adverse effect was observed in Sri Lanka where the pace of poverty reduction slowed down despite faster growth. By contrast, in Bangladesh and Pakistan, and to a lesser extent in India, faster growth has been accompanied by faster reduction of poverty despite rising inequality.

What does all this say about the nature of the growth process in the region? There is one indisputable fact on which everyone can agree—namely, that growth has been unequalising in nature all over the region. Has this tendency towards rising inequality had an adverse effect on poverty? This is a much trickier question to answer. On the basis of the kind of data presented above, one could claim that there was ostensibly an adverse effect in Sri Lanka but not in Bangladesh, Pakistan and India where poverty declined at a faster rate in the milieu of high growth and high inequality. But even for the latter three countries, it can be argued, and has been argued quite often, that rising inequality has had an adverse effect on poverty in the sense that but for higher inequality the pace of poverty reduction would have been faster still. The literature is rife with numerical demonstrations of how much lower poverty would have been if inequality had remained unchanged during the period of rapid growth.

These numerical exercises are not particularly meaningful, however. The problem lies not in the arithmetic, though. To say that poverty would have declined by certain percentage points more had inequality remained the same would be arithmetically true, provided one gets one's sums right. But the relevant issue is how useful such statements are in throwing light on the options available to a society. These exercises compare the actual situation with a counterfactual in which the actual growth rate is allowed to prevail but actual inequality is replaced by some base level inequality. In other words, while the counterfactual allows the growth rate to evolve in the way it actually did during the period in question, it does not allow inequality to evolve at all. The question is: can such a counterfactual be claimed to be a feasible option available to the society? If the answer is yes, then the numerical exercises are meaningful; otherwise they are not.

To claim, however, on purely *a priori* grounds, that the designed counterfactual is feasible is to imply that the level of inequality can be fixed independently of the rate of growth. But in practice this may not be possible. Both the rate of growth and the level of inequality are determined endogenously through the growth process. By influencing the growth process, different policy regimes may lead to different outcomes in terms of growth and inequality. Thus, for every society there will exist a set of feasible combinations of growth and inequality it can in principle achieve. But there is *no priori* reason to believe that this feasible set will necessarily contain the particular combination that the counterfactual assumes—namely, the achieved rate of growth combined with the unchanged level of inequality. Therefore, the numerical exercises purporting to show the effect of rising inequality on poverty, despite being arithmetically valid, are practically irrelevant.

The really important task is to try and understand the growth process so as to come to a judgement on whether an alternative growth process could have been induced by policy interventions so that the resulting combination of growth and inequality would have yielded a better outcome in terms of poverty. Such an enquiry could conceivably lead to the conclusion that there was no feasible growth process that would have bettered the outcome that has actually been achieved. In that case, an actual increase in inequality should not be a cause for concern as far as the objective of poverty reduction is concerned. Of course, equality is a valued goal in itself and from this perspective one may still be concerned with rising inequality and search for an alternative growth process that leads to lower inequality even if the resulting combination of growth and inequality makes for slower reduction of poverty. In this case, however, one would be confronted with a trade-off between the objectives of equality and poverty reduction, but so long as the society is aware of this trade-off and deals with it in accordance of the value judgements of the society at large this does not pose any problem in principle.

Alternatively, it's also possible that the enquiry could successfully identify feasible alternatives in which the poverty outcome could indeed be bettered either by raising the growth rate, or by reducing inequality or by a combination of the two. Identification of such alternatives and the policy measures that might help achieve those alternatives ought to be the primary focus of any analysis of inclusive growth. We cannot hope to attempt, let alone accomplish, this task within the confines of the present lecture, but we offer some reflections based on some fragmentary evidence in the following section.

III. REFLECTIONS ON THE NATURE OF THE GROWTH PROCESS IN SOUTH ASIA

There is widespread agreement that the growth process that has recently launched India on to a higher growth path has been unequalising in nature. In order to gain a clearer understanding of the precise nature of the growth process, it will be instructive to examine the sources of rising inequality. An important insight in this respect is provided by a decomposition exercise carried out by Das (2008), in which aggregate inequality was broken up into two components—one component measuring inequality between groups and the other component measuring inequality within groups. For this purpose, various kinds of groupings were considered—for example, urban and rural sectors, different occupational groups, a number of socio-religious groups, and the states of India. Inequality was measured by the mean logarithmic deviation of per adult equivalent household expenditure. The results are reported in Table 5.

Table 5

Within-group and Between-group Inequality in India

Sample Partition/Year	Aggregate Inequality	Within-group Inequality (%)	Between-group Inequality (%)
Urban/Rural Sector			
1983	216	96	4
1993-94	179	87	13
2004-05	185	90	10
Occupational Groups			
1983	NA	NA	NA
1993-94	179	77	23
2004-05	185	82	18
Socio-religious Groups			
1983	216	96	4
1993-94	179	90	10
2004-05	185	91	9
States			
1983	216	95	5
1993-94	179	90	10
2004-05	185	89	11
Forward/Backward States			
1983	216	99	1
1993-94	179	96	4
2004-05	185	95	5
Refined Groups			
1983	216	91	9
1993-94	179	78	22
2004-05	185	80	20

Source: Das (2008), Table 5.2.

Notes: (1) Inequality is measured by Mean Logarithmic Deviation of per adult equivalent household expenditure.

(2) 'Refined groups' refer to disaggregated groups: socio-religious groups × sector (urban/rural) × forward/backward states.

The first point to note is that, whatever grouping is considered, within-group inequality accounts for an overwhelming proportion of aggregate inequality, the contribution of between-group inequality being relatively minor. Second, according to the measure used by Das, aggregate inequality declined considerably between 1983 and 1993-94 but has gone up somewhat since then. This is the statistical basis of our earlier observation that the post-reform growth process has been unequalising in nature. The question we now ask is which of the two components had contributed more to the falling inequality in the 1980s and which component contributed more to rising inequality in the post-reform era.

The answer in both cases is within-group inequality. Thus, considering the urban-rural division, the share of within-group inequality had fallen from 96 percent in 1983 to 87 percent in 1993-94 but rose to 90 percent in 2004-05. Similarly, looking at the socio-religious groups, the share of within-group inequality had fallen from 96 percent to 90 percent during the pre-reform era but crawled back to 91 percent in the post-reform era. For the occupational groups too, it is the rising share of within-group inequality that accounts for the overall rise in inequality after 1993-94. The only exception to this pattern is found with respect to the states, especially to the binary division between forward and backward states, for which the share of within-group inequality has fallen in the post-reform era and that of between-group inequality has risen. However, if one disaggregates further and considers finer groupings such as socio-religious groups living in either urban or rural areas in either forward or backward states, then once again the share of within-group inequality appears to have risen after 1993-94.

Thus it is fair to conclude that it is the widening of within-group inequality rather than between-group inequality that accounts for recent widening of inequality in India. In other words, what has suffered more in the post-reform period is vertical equity rather than horizontal equity. Thus the post-reform growth process seems to have benefited most groups of people more or less equally, but within each group some have benefited less than others. This is what has made the growth process more unequal in recent years.

Something very similar seems to have happened in Pakistan. A recent study of earnings inequality among different occupation groups shows that while within-group inequality has widened sharply since the early 1990s, between-group inequality may have been narrowing in recent years [Sadiq and Akhtar (2006)]. As can be seen from Table 6, the Gini coefficient of earnings within each of the occupation groups jumped sharply in the 1990s and the upward trend has continued afterwards. Thus, while in 1992-93 the Gini coefficients ranged between 0.18 and 0.27, by 2005 all of them were found between 0.41 and 0.46. This amounts to a spectacular rise in inequality indeed. However, comparison across occupation groups shows that disparity in their mean incomes may have narrowed somewhat in the first half of this decade.[7] Thus, as in the case of India, the recent growth process in Pakistan seems to have given broadly similar opportunities to all occupation groups but very unequal opportunities to individuals within each group.

Table 6

Earnings Inequality within Occupation Groups in Pakistan

Occupation	1992-93	2000-01	2004-05
Senior Executives and Legislators	27.3	40.6	44.3
Professionals	13.6	39.4	44.2
White Collar Workers	26.5	38.1	42.1
Technicians	21.7	40.0	46.0
Other Skilled Workers	29.9	43.7	44.7
Elementary Occupations	18.0	35.8	41.1
Overall	–	43.4	45.7

Source: Sadiq and Akhtar (2006), Table 1.

[7]Thus, the coefficient of variation in the earnings of employees in the occupation groups came down from 0.90 in 2000-01 to 0.72 in 2004-05, while the coefficient of variation for the self-employed workers remained stable at around 0.60 (calculated from the information provided in Appendix B of Sadiq and Akhtar, 2006). We do not have corresponding information for 1992-93 with which to assess how between-group inequality changed in the 1990s.

For Sri Lanka we also draw upon a decomposition exercise but of a different kind from the one we used for India. Here aggregate inequality is broken up not among groups of people or households but among the determinants of household income, especially the ones that can be treated as policy variables such as education and infrastructure [Gunatilaka and Chotikapanich (2005)]. For this purpose, the authors first estimate an income-generating function by regressing income on a set of determinants and then apply the Shapely value decomposition technique to apportion total inequality to each of the determinants of income.

The results of this decomposition exercise show that income flows associated with access to infrastructure, education and with the nature of occupation were the principal determinants of inequality and the main drivers of the change in income distribution in Sri Lanka. Moreover, the contribution of income flows from education and infrastructure to the change in inequality appears to have increased over the years (Table 7). In other words, growing inequality is explained mainly by growing disparity in households' access to education and infrastructure.

Table 7

Factor Contribution to Inequality in Sri Lanka

Determinants of Income	1980–85	1995–2002
Adult Male	1.82	–11.83
Adult Female	10.58	–15.33
Ethnicity	9.71	–3.52
Education	17.19	37.74
Occupation	9.05	–7.88
Infrastructure	42.56	112.38
Spatial Dummy	–28.06	7.20
Residual	6.50	–47.62
Change in Gini	3.74	5.39

Gunatilaka and Chotikapanich (2005), Table 5.

Interestingly, in a related exercise the same two variables were also found to be the main drivers behind the rightward shift of the entire income distribution [Gunatilaka, *et al.* (2006)]. This means that the same policy variables that were primarily responsible for widespread income growth were also responsible for widening inequality. While the government policy of improving education and infrastructure has paid rich dividends in the form of higher growth of household income, the same policy has also led to wider inequality as the lower middle classes and middle classes benefited disproportionately more from state provision of education and infrastructure.

We now examine the Bangladesh case through the lens of yet another type of decomposition exercise. Here inequality is broken up into contributions that can be attributed to various components of household income—such as income from self-employment in agriculture, wage employment, non-farm income, remittances, etc. A number of recent studies have carried out such decomposition exercises with the help of a common methodology [Khan and Sen (2001); Khan (2006, 2008); Osmani, *et al.* (2006); Bhattacharya and Khan (2008)]. The technique is to estimate concentration ratio (also known as pseudo-Gini) for each component of income, which allows total inequality to be broken up into inequality in each of the components. The results then enable one to see which components of income have been mainly responsible for observed changes in overall inequality.

A couple of findings stand out prominently from these studies (Table 8). First, three components of income have exerted the most unequalising influence on household income distribution in both rural and urban areas—namely, self-employment in non-farm enterprises, salaried wage employment (as distinct from casual employment), and remittance income, especially foreign remittance coming from Bangladeshi migrants working abroad. Second, the share of these components in total income has gone up in the post-1990 period and so has the degree of inequality with which they are distributed. As a result, the contribution of each of these three components to overall inequality has increased during the 1990s and beyond, i.e., the unequalising components have become even more unequalising over time. It is the latter fact that accounts for rising inequality in Bangladesh.

The important point to note here is that these three components of income are also the very ones that played a critical role in accelerating the pace of both economic growth and poverty reduction in Bangladesh in the post-1990 period. Of the three, the role of remittance in Bangladesh economy has been particularly well documented. By the middle of the present decade nearly one percent of the country's labour force was working abroad sending remittances worth about 8 percent of GDP. During 2000-07, remittances have provided two and a half times as much resources as foreign aid and more than a quarter of all foreign exchange earnings, and have amounted to about a quarter of national savings and investment. In addition to augmenting resources on the supply side, remittances have also boosted aggregate demand, thereby stimulating production, especially of non-tradables. Clearly, the growth acceleration that Bangladesh has experienced since 1990 owes a great deal to the flow of remittances. At the same time, from tiny beginnings remittances have now come to account for nearly 8 percent of average household income. As most of the migrant workers belong to the bottom half of the population, the contribution of remittance to poorer households would be even higher. This has no doubt played an important part in accelerating the pace of poverty reduction in recent years.

As for the significance of the other two components—viz., non-farm income and salaried employment—for growth and poverty reduction in Bangladesh, we may draw upon the analysis of Osmani, *et al.* (2006). They have demonstrated that the growth acceleration of the 1990s owed itself primarily to the rapid growth of the non-tradable non-farm sector, which in turn owed itself to enhanced domestic demand.[8] Faster growth enabled the non-farm enterprises to increase their scale of operation, thus tilting the structure of the non-farm sector more towards relatively large enterprises. This structural change in turn brought about a change in the nature of labour absorption in this sector, as salaried wage employment became more plentiful with the emergence of larger enterprises. Whereas in the 1980s most of the surplus labour that got absorbed in the non-farm sector found their way into low-productivity self-employment type of activities, in

[8]The stimulus to domestic demand emanated initially from the crop sector and but increasingly from foreign remittances and the earnings of workers engaged in the readymade garments sector.

Table 8

Decomposition of Inequality: Rural Bangladesh

	Share in Total Income (%)			Concentration Ratio			Contribution to Inequality (%)		
	1991-92	2000	2005	1991-92	2000	2005	1991-92	2000	2005
									29.98
Farm Income	41.48	20.92	30.5	0.33	0.35	0.45	49.9	20.45	21.39
Wage Income	21.42	31.17	28.1	0.1	0.21	0.28	7.9	18.28	–0.02
Casual Agricultural Labour	10.86	10.29	14.88	–0.11	–0.15	–0.001	–4.38	–4.31	
Casual Non-agri. Labour	4.23	7.33		0.14	0.07		2.17	1.43	17.09
Salaried Non-agri. Labour	6.32	13.55	13.22	0.45	0.55	0.6	10.42	20.82	23.28
Non-farm Enterprise	15.53	20.24	17.05	0.22	0.48	0.66	12.4	27.14	15.83
Remittance		10.86	11.26		0.61	0.65		18.51	2.43
Internal		3.33	3.05		0.39	0.37		3.63	13.4
Foreign		7.33	8.21		0.71	0.75		14.93	2005

Sources: Khan and Sen (2001) for 1991-92; Osmani, *et al*. (2006) for (2000) and Bhattacharya and Khan (2008) for 2005.

the 1990s the absorption occurred more into salaried employment in the relatively larger and more productive enterprises. As it happens, salaried employment in larger scale enterprises is far more rewarding for the poor than self-employment in non-farm activities.[9] As a result, the structural change that was engendered by the growth process of the 1990s was especially conducive to poverty reduction.

The upshot of the preceding argument is that faster growth, faster reduction of poverty and rising inequality that Bangladesh experienced in the post-1990 period are all organically linked through the growth process. The same forces that contributed to the acceleration of both growth and poverty reduction were also responsible for the widening of inequality. In essence, this is pretty much the same story that we have told for Sri Lanka—the forces that promoted growth and helped reduce poverty also induced higher inequality.

To summarise, in India and Pakistan the growth process seems to have been inclusive enough to give most groups of people adequate opportunities for benefiting from growth, but within each group only some individuals have seized those opportunities while others have not. This has aggravated within-group inequality and thereby rendered the whole growth process unequalising in nature. In Bangladesh and Sri Lanka, the very same forces that bestowed dynamism to the growth process also induced greater inequality because people had differential access to the endowments that would enable them to integrate with the most dynamic sectors. The result is that neither in India and Pakistan nor in Bangladesh and Sri Lanka growth was inclusive enough, as evidenced by the fact that even as poverty declined inequality increased.

IV. CONCLUDING OBSERVATIONS

Since the growth process in South Asia has systematically pushed poverty and inequality in opposite directions, one is entitled to wonder whether there exists an inherent trade-off between poverty and inequality in this region. This is a sobering thought, because if indeed such a trade-off were to exist the achievement of truly inclusive growth would become infeasible, since as noted earlier both pro-poorness and equity are essential features of inclusive growth.

But before we allow pessimism to engulf us, let us pause for a while and ask why did poverty and inequality move in opposite directions? What exactly was the policy failure, if there was any? This question cannot be fully answered here, but our analysis suggests a clue. In a sense, the fundamental problem in all four countries was essentially the same. In each case, even though the growth process opened up plentiful opportunities for most groups of people to enjoy the benefits of growth, thereby making poverty reduction possible at an accelerated pace, in every group some individuals failed to link up with the growth process, thereby exacerbating inequality. In Bangladesh, inequality increased because only a subset of the poor people were able to take advantage of non-farm enterprise, salaried employment, and remittances—all factors that were directly involved with the dynamism of the growth process. Similarly, inequality increased in Sri Lanka because poor people had differential access to endowments such as education and

[9]For instance, in 2000, the return to labour of very poor households was Taka 56 per day (per worker) in salaried employment in the non-farm sector as against Taka 38 in non-farm self-employment [Osmani, *et al.* (2006), Table IV.2].

infrastructure that helped propel growth. In India and Pakistan, we don't know exactly what the poor people had lack of access to, but we do know that belonging to a particular social or occupational group was not the problem because the growth process did satisfy reasonable degree of horizontal equity among groups. The problem was that within each group some individuals failed to integrate with the growth process even though other members of the group managed to do so. This is essentially the same problem that we described for Bangladesh and Sri Lanka—i.e., some of the poor people were unable to link up with the growth process.

In an earlier analysis, I have described this inability to link up with the growth process as the 'integrability' problem [Osmani (2006)]. This is one of several problems that can cause a disjunction between growth and poverty reduction. Other problems that can cause similar disjunction are structures of production and employment that may promote growth but do not create adequate opportunities for poor workers to earn a higher return for their labour. Our analysis suggests that these other problems did not perhaps act as the binding constraint in South Asia because after all accelerated growth did lead to accelerated rate of poverty reduction. It is the integrability problem, facing a subset of the poor, which ensured that even as poverty declined inequality would rise. The solution lies in policy interventions that would enhance the endowments and skills that are needed for the poor people to integrate with the growth process better. Success of such interventions would ensure that as opportunities for advancement were opened up by a growth process the majority of poor people would be able to take advantage of them. When that happens, inequality will fall at the same time that poverty is reduced, which suggests that a trade-off between poverty and inequality may not exist in South Asia after all. Achievement of truly inclusive growth may thus yet be possible.

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Comments

Madame Chairperson,

Please allow me to thank the organisers of this session for inviting me to be a discussant on Dr Osmani's paper at the last minute, at my own request. It was mainly for the sentimental reason that the author was among the first three batch of students at the Islamabad University (now QAU), which consisted almost exclusively of students from then East Pakistan, whom it was my good fortune to teach, but also because of the thematic content of his paper, which has been close to my heart ever since I got seriously interested in economics more than half a century ago. My purpose here is not take any credit for Professor Osmani's academic achievement, for even at Islamabad University he probably benefited more from the instruction of others, especially Prof. Md. Anisur Rehman, who established the Economics Department.

Like Siddiqur Rehman, I also first went to LSE for my graduate studies. But LSE at that time had become a citadel of conservatism where development economics was taught as Economics of Tropical Countries, with a distinct colonial flavour. Osmani, however, was, like all succeeding generations (and late developing countries), much luckier and learnt his development economics from the Nobel laureate Amartya Sen, who stimulated his interest in the economics of inequality, in which he became a leading authority in his own right very soon. He has sustained his interest in the subject over the years by working as a researcher at the Bangladesh Institute of Development Studies, the surgically-separated Siamese twin of PIDE, the UN World Institute of Development Economic Research (WIDER) and now as an academic in the UK. His paper reflects the maturity of his research ideas and perceptions and the pioneering and abiding influence of Professor Sen.

Professor Akmal Hussain and Dr Rehana Siddiqui, who are several decades younger and wiser than me, have (will) do(ne) much more justice to the paper than I can—and (I am sure) they (will leave) have left little unsaid that (is) was worth saying, but I will nevertheless use this opportunity to reflect on the South Asian odyssey that Dr Osmani's paper discusses in terms of growth rates, Gini coefficients and poverty headcount ratios. While the narrative brings out interesting contrasts between different pairs of countries and a certain pattern of uniformity among the four South Asian majors, India, Pakistan, Bangladesh and Sri Lanka, in terms of these variables, it would have been far more illuminating had he broadened the canvas to include a historical and cultural perspective, which South Asian countries share with each other. As the author candidly admits, "These numerical exercises are not particularly meaningful, however. The problem lies not in the arithmetic, though. And further on he says: But the relevant issue is how useful such statements are in throwing light on the options available to a society".

However, within the confines of his self-imposed analytical boundaries, Professor Osmani has presented a masterful survey of the major trends in South Asia which have made the achievement of the goal of inclusive growth, in the sense of "the no child left behind" paradigm in education, difficult to achieve, despite progress in achieving substantially higher growth rates and reduction in headcount poverty ratios than in the 1960s and 1970s. Dr Osmani attributes the improvement in growth performance of South Asia, largely to the "liberalising reforms" in the 1980s and 1990s, although he acknowledges that other factors, such as higher agricultural productivity and remittances played a contributing role. The latter two factors were probably more responsible for reduction in poverty.

The paper's main contribution is to bring inequality in income distribution to the centre of the debate, replacing poverty, alleviating which has been the major concern in South Asia and to a considerable extent that has been assuaged by generally high growth rates since the 1980s. Osmani comes to the startling surmise "that the growth process in South Asia has systematically pushed poverty and inequality in opposite directions" and that "there exists an inherent trade-off between poverty and inequality in this region". Although he tries to dispel the disquietude raised by his conjecture through what he inadequately explains as an "integrability" problem which could be solved through "policy interventions that would enhance the endowments and skills that are needed for the poor people to integrate with the growth process better". He fails to elaborate how this problem can be overcome in South Asia, where rent-seeking and well-entrenched economic and social groups pre-empt the opportunities created by the growth process and frustrate the realisation of "inclusive growth". There is a need for addressing such structural issues as land reforms and access to human development capabilities more aggressively in South Asia. Countries and states within a country, which have paid greater attention to them such as Bangladesh, Sri Lanka, West Bengal and Kerala, seem to have reached the inclusive growth goal more closely than much of Northern India and Pakistan, which have considerably lagged behind in these efforts. Restructuring the industrial base and establishing linkages with the informal sector which provides the bulk of employment to the urban poor could also work towards that goal. Bangladesh's inspiring example in improving its human development indicators and in moving rapidly from primary production to manufactures should be a beacon to its larger South Asian neighbours.

However, the problem seems to be more fundamental than this and is embedded in the pattern of elitist growth common to most South Asian countries, which have been exacerbated by the liberalisation policies promoted by the IMF and World Bank and which have resulted in the almost complete withdrawal of the state from social sectors. While the developed world, in the wake of the current global economic crisis, is leaning heavily towards the state to save its failing banks and industrial enterprises and to strengthen the social safety networks by running trillion dollar deficits to finance fiscal stimulus packages, the developing countries are being asked to weather the storm without increasing their fiscal deficits. The optimism raised by high rates of growth and poverty reduction in South Asia since 1990, documented in Dr Osmani's paper is likely to disappear in the coming decades as the impact of the prolonged world recession makes itself felt. There is, therefore, a need for more autonomous policymaking to protect the poor while reviving the modern sector, which usually receives the brunt of government attention during periods of recession.

While making these somewhat critical comments, I fully appreciate the value of Professor Osmani's paper in raising some important policy dilemmas facing South Asia.

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