

### Pro-Poor to Inclusive Growth: Asian Prescriptions

Inclusive growth is now at the heart of mainstream development economics. Ifzal Ali explains why developing Asia needs to move its development focus from poverty reduction to inclusive growth. This policy brief examines the implications of such a shift for public policy.

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Asian Development Bank  
6 ADB Avenue, Mandaluyong City  
1550 Metro Manila, Philippines  
[www.adb.org/economics](http://www.adb.org/economics)  
ISSN: 1655-5260  
Publication Stock No.

Printed in the Philippines

# ERD Policy Brief

ECONOMICS AND RESEARCH DEPARTMENT

SERIES  
No. 48

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Ifzal Ali

May 2007

Asian Development Bank

Asian Development Bank  
6 ADB Avenue, Mandaluyong City  
1550 Metro Manila, Philippines

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May 2007  
ISSN 1655-5260

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ERD POLICY BRIEF NO. 48

# **Pro-Poor to Inclusive Growth: Asian Prescriptions**

Ifzal Ali

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Ifzal Ali is Chief Economist of the Asian Development Bank. The author is grateful to Rana Hasan for incisive insights and comments throughout the preparation of this policy brief. The comments and suggestions of Juzhong Zhuang, Christopher Maccormac, and Hyun Son were extremely useful. Rhoda Magsombol provided yeoman technical assistance. The author is solely responsible for opinions expressed and for remaining errors of omission and commission.



## I. Introduction

The release of two highly publicized reports in 2006 will have a major impact on the development debate in Asia over the next two decades. India, which has had poverty reduction as the central goal of policy over the last 50 years, has recently switched to a new development strategy focusing on two basic goals: raising economic growth and making growth more inclusive (Planning Commission of India 2006). The central focus of the *2006 World Development Report* (World Bank 2006b) is the pursuit of equality of opportunity while avoiding extreme deprivation. Both reports emphasize the paramount importance of inclusive growth, i.e., creating economic opportunities through sustainable growth and making the opportunities available to all including the poor.

This policy brief explains why developing Asia needs to move its development agenda from poverty reduction to inclusive growth in light of new and emerging challenges and examines its implications. Three key messages emerge from the discussions. First, while not preordained, the attainment of high per capita growth and lower inequality would almost ensure the accomplishment of the mission to eradicate extreme poverty in developing Asia by 2020. Second, rising income inequalities and the persistence of unacceptably high non-income inequalities pose a clear and present danger to sustaining Asia's growth. Third, inclusive growth that focuses on opportunities for all while eliminating extreme deprivation will need to address economic, social, and political inequality, making Asia's development agenda more complex and ambitious.

## II. Poverty Reduction: Achievements, Prospects, and Challenges

The pace of poverty reduction depends not only on the rate of economic growth but also how the benefits of this growth are shared, i.e., how the distribution of households' per capita income or consumption expenditure evolves. The \$1-a-day poverty line established by the World Bank in 1990 represents the median poverty lines of the 10 countries with the lowest poverty lines at that time. It focuses on extreme deprivation and represents a very conservative measure of poverty. Table 1 indicates that the incidence of extreme poverty declined appreciably between 1990 and 2005 in East Asia

and South East Asia.<sup>1</sup> As income inequality has increased over time (see Section III below), Asia's impressive achievement in poverty reduction has been driven by rapid growth. Every 1% of growth has been associated with an almost 2% decline in poverty incidence on average (ADB 2004).

Across regions, the income poverty target of the Millennium Development Goals had been met by 2005 for most Asian countries but not in South Asia. The decline in the number of the poor from

**Table 1. \$1-a-Day Poverty Incidence and Magnitude of Poor in Selected Developing Countries, 1990 and Projected 2005**

Country	Headcount Ratio (%)		Magnitude ('000,000)	
	1990	2005	1990	2005
PRC	32.5	7.1	374.0	92.7
Mongolia	27.3	10.5	0.6	0.3
<b>East Asia</b>	<b>32.5</b>	<b>7.1</b>	<b>374.6</b>	<b>93.0</b>
Bangladesh	34.4	36.0	38.9	55.2
India	43.5	35.0	374.0	397.6
Nepal	45.7	26.0	8.7	7.0
Pakistan	47.8	10.2	54.0	16.2
Sri Lanka	3.8	2.0	0.7	0.4
<b>South Asia</b>	<b>42.4</b>	<b>31.9</b>	<b>476.3</b>	<b>476.4</b>
Cambodia	32.5	12.7	3.2	1.8
Indonesia	20.5	7.4	37.5	16.8
Lao PDR	52.7	21.4	2.1	1.2
Malaysia	0.1	0.0	0.0	0.0
Philippines	20.2	10.9	12.4	9.2
Thailand	10.2	0.0	5.5	0.0
Viet Nam	50.7	6.5	33.5	5.5
<b>South East Asia</b>	<b>23.8</b>	<b>7.2</b>	<b>94.2</b>	<b>34.5</b>
<b>Total Regions</b>	<b>34.6</b>	<b>18.0</b>	<b>945.1</b>	<b>603.9</b>

<sup>1</sup> The economies in Table 1, and Hong Kong, China; Republic of Korea; Singapore; and Taipei, China had 98% of Asia's gross national income in 2005 and comprised 96% of the population.

945 million in 1990 to 604 million in 2005 is largely attributable to rapid growth in the People's Republic of China (PRC) and Viet Nam. In South Asia, with the exception of Pakistan and Sri Lanka, the incidence of poverty and its magnitude in 2005 are still very high.<sup>2</sup>

**\$2-a-Day Poverty Incidence and Magnitude of Poor in Selected Developing Countries, 1990 and Projected 2005**

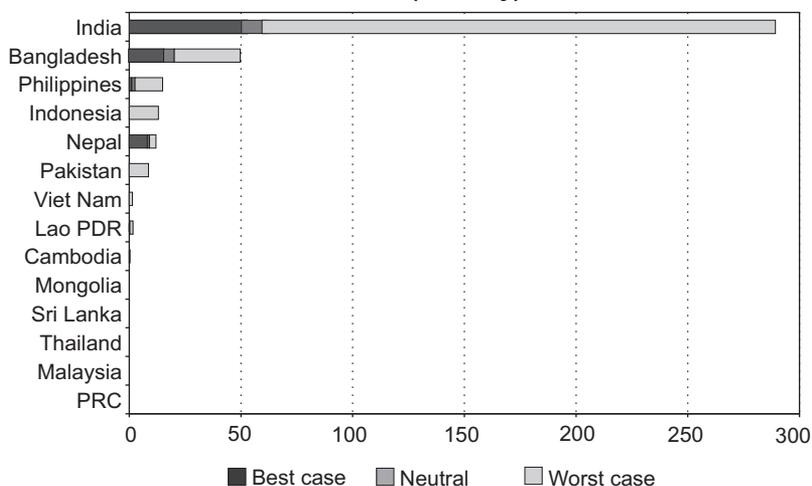
Country	Headcount Ratio (%)		Magnitude ('000,000)	
	1990	2005	1990	2005
PRC	71.5	<b>29.4</b>	821.5	385.6
Mongolia	69.9	42.4	1.5	1.1
<b>East Asia</b>	<b>71.5</b>	<b>29.4</b>	<b>823.1</b>	<b>386.7</b>
Bangladesh	85.7	81.7	96.9	125.2
India	86.5	<b>79.8</b>	744.3	904.8
Nepal	84.3	65.5	16.1	17.7
Pakistan	87.9	59.4	99.3	93.9
Sri Lanka	40.6	32.9	6.9	6.3
<b>South Asia</b>	<b>85.8</b>	<b>76.9</b>	<b>963.5</b>	<b>1148.0</b>
Cambodia	76.3	54.5	7.4	7.6
Indonesia	70.9	50.3	129.7	113.7
Lao PDR	89.6	67.7	3.7	3.8
Malaysia	23.4	9.8	4.2	2.5
Philippines	55.5	40.3	34.0	34.1
Thailand	43.1	16.2	23.4	10.2
Viet Nam	87.0	39.7	57.6	33.8
<b>South East Asia</b>	<b>65.6</b>	<b>43.2</b>	<b>259.9</b>	<b>205.7</b>
Total Regions	<b>75.0</b>	<b>51.9</b>	<b>2046.5</b>	<b>1740.4</b>

Sources: *World Population Prospects: The 2006 Revision*, medium variant projections (United Nations 2007).  
World Bank (2007) and PovcalNet Database for 1990 poverty estimates.  
ADB staff estimates for 2005 poverty estimates.

<sup>2</sup> The table shows a large reduction in poverty rates in Pakistan. There is reason to believe, however, that the available estimates in 1990 may be unrealistically high. See ADB (2004).

What are the prospects for poverty reduction in the years ahead? Scenario analysis suggests that both the pace and pattern of growth are critical for poverty reduction (Figure 1).<sup>3</sup> With a benchmark growth rate (the average of annual growth rates of GDP per capita between 2002 through 2006) coupled with pro-poor distribution (the bottom 40% of the distribution experiencing consumption growth 5 percentage points higher than mean growth), poverty incidence for developing Asia would fall from 18.0% in 2005 to 2.0% in 2020, with the total number of extreme poor falling from 604 to 78 million. In contrast, with a lower growth rate (40% lower than the benchmark rate) and pro-rich distribution (the top 40% of the distribution seeing its consumption grow 5 percentage points higher than mean growth),

Figure 1. Magnitude (m) of Poverty under Alternative Scenarios (2020) (\$1 a day)



poverty incidence would only fall to 9.9% in 2020, with the total number of extreme poor at 391 million, the bulk of which will be in South Asia. These results indicate that the elimination of extreme poverty by 2020 is not preordained. Countries must stay on a high growth trajectory and ensure that pro-poor distribution is attained. In the best scenario, poverty reduction is attained through both growth and a reduction in inequality, implying that people at the lower end of the distribution benefit more from growth.

<sup>3</sup> The scenarios are termed best (benchmark growth and pro-poor distribution), neutral (benchmark growth and neutral distribution), and worst (low growth and pro-rich distribution).

### III. Inequalities

From 1990 to 2005, the Asian development experience has been characterized by rising income and expenditure inequalities and stubbornly high levels of non-income inequalities. Using the Gini coefficient, a commonly used measure of inequality, except for those severely hit by the Asian financial crisis (Indonesia, Malaysia, Thailand) and Mongolia, inequality has increased in all countries, with the largest increases occurring in Bangladesh (5.8%), Cambodia (6.3%), PRC (6.5%), Nepal (9.7%) and Sri Lanka (5.8%).

Household expenditure surveys indicate that most Asian countries' growth in per capita expenditure of the top quintile far exceeded that of the bottom quintile. The ratio of expenditure growth of the top to the bottom quintile is 2.5 for PRC, 3 for India, 7 for Sri Lanka, and 25 for Bangladesh. Considering that the base year per capita mean expenditure of the bottom quintile was low to begin with compared to the top quintiles, it is clear that absolute differences in mean expenditures across quintile groups are increasing rapidly in most Asian countries.

Persistent and growing inequalities in education and health attainments within countries are also a significant concern for developing Asia, and they exacerbate income inequalities (ADB 2006). In many Asian countries, primary-school-age children from households of the poorest quintile are almost three times more likely to be out of school than those from the richest quintile. Inequalities are most prominent in health, with child mortality rates for the poorest quintile being two to three times higher than those for the richest quintiles. In the Philippines, the situation with primary enrolment and measles immunization, which significantly impact on child mortality, is worse today than in 1990. Even in the PRC with its spectacular economic growth, rising disparities in health outcomes between urban and rural populations have triggered a slowdown of improvements in health in the last two decades (Tandon and Zhuang 2007).

Rising income and non-income inequalities are primarily associated with inequalities in access to opportunities, as witnessed in labor market outcomes in Asia. Four features are noteworthy (Felipe and Hasan 2006). First, corresponding to rapid output growth, employment growth has been far lower in recent years. Second, in both relative and absolute terms, the differences in real wages between the bottom and top quintiles of the labor force in urban areas increased significantly over the last two decades. At the same time, rural–urban differentials in real wages have also widened.

Third, employment in the informal sector where productivity levels and wages are low is either on the rise or persistently high. Last, the nature of employment in the formal sector, which has been historically associated with regular contracts and job security, is changing toward that of the informal sector.

These features of labor market outcomes is only one contributing factor, albeit a very important factor, of inequality in opportunities in Asia. Determinants of the access to opportunities could be viewed as consisting of an individual's circumstances, efforts, and a society's policy (Roemer 2006). Circumstances or initial endowments reflect a person's starting point in life in terms of parental education, geographical location, caste (in India), religion, etc. Efforts represent actions that are under the control of the person. The opportunity that a person faces also depends on the policy that the country of residence adopts. Market, institutional, and policy failures could restrict access to opportunities. Presumably, one purpose of enlightened policy is to equalize the access to opportunity so that the only difference in opportunity results from differences in efforts and not from circumstances.

The persistence of income and non-income inequalities and their upward movement over time have led to the recognition of the importance of distinguishing between good inequalities and bad inequalities (Chaudhuri and Ravallion 2007). Good inequalities are associated with efforts that increase as a result of market incentives that foster innovation, entrepreneurship, and hard work. Bad inequalities that are linked to circumstances (e.g., geography, social exclusion, inadequate levels of human capital, and lack of access to credit) prevent people from moving to high-productivity activities. Bad inequalities that perpetuate the lack of access to opportunities and thereby leave people behind are detrimental to growth as well. They also stymie the evolution of a constituency for reform.

Further, the persistence of bad inequalities reinforces the capture of institutions and political power by an elite that determines who benefits from public policy, public investment, and delivery of public goods and services, which could water down the good inequalities. This leads to the emergence of inequality traps, i.e., chronic disparities in power, wealth, and status among different socioeconomic groups that are perpetuated by economic, political, and sociocultural mechanisms and institutions (Bourguignon, Ferreira, and Walton 2006; Rajan and Zingales 2007). The capture of political power by an elite that leads to political inequality aggravates the initial inequality in endowments and opportunities.

The persistence of inequality traps could lead to three outcomes. First, reforms could stall, resulting in lower growth and higher inequality, a la Latin America. Second, rising absolute gaps in income and consumption between the poorest and richest quintiles could trigger social and political tensions. Third, in its extreme form, these tensions could lead to armed conflict as is currently happening in parts of South Asia (Murshed and Gates 2005). Clearly, rising inequalities in Asia pose a clear and present danger to social and political stability, and therefore the sustainability of the growth process itself.

#### **IV. Poverty Reduction, Pro-poor Growth, and Inclusive Growth**

The discussions in Section II and III point to the importance of generating high and sustainable growth for poverty reduction and of addressing increasing inequalities that, if not addressed, generate significant social and political risks that may undermine the very sustainability of growth in Asia. From a political economy perspective, the circumstances, effort, and policy model as applied to an individual in determining his or her opportunity space provides a useful approach to appreciating the interlinkages between the three elements. The linkage of good inequalities to efforts and bad inequalities to circumstances and policy failures sets the stage for policy reform to preserve good inequalities and drive out bad inequalities. The dangers of the persistence of bad inequalities driving out good inequalities resulting in the evolution of the twin traps of low growth and high inequality are recognized.

While Asia's impressive poverty reduction has largely been due to rapid growth, growth alone does not guarantee that everyone will benefit equally. Pro-poor growth benefits the poor more than the non-poor, i.e., growth is accompanied by reduced income inequality for poverty reduction (Kakwani and Pernia 2000). Pro-poor growth is thus associated with attacking poverty through growth and reduced income inequality. As a result, people at the lower end of the distribution are better able to meet their basic needs.

Equalizing opportunities means that the benefits generated by economic growth are shared across the population including by those who are less well-off. Equalizing opportunities is multidimensional. Key elements in equalizing opportunities will include the creation of productive and decent jobs through efficient, sustainable, and environmentally friendly growth; reduction and/or elimination of

bad inequalities that impede the access to opportunities for the less well-off; and strengthened human capabilities to enable individuals to qualify for productive and decent employment. A reduction in economic and political inequality would be central in improving access to all in product and factor markets.

There is increased recognition that even if opportunities were equalized, there will be some chronically poor who for a variety of reasons will not be able to participate in and benefit from the opportunities provided by the growth process. Social protection through the provision of social safety nets will be required for the chronically poor to enable them to survive with a modicum of dignity. The pursuit of equality of opportunity and the avoidance of extreme deprivation of the chronically poor have been defined as equity (World Bank 2006b).

The multidimensionality of equity requires the reduction in inequality in the access to opportunities, access to public goods and services and access to social safety nets (World Bank 2006a). Equity encompasses pro-poor growth with its unidimensional focus on income inequality. On the other hand, pro-poor growth encompasses poverty reduction, which focuses solely on the impact of growth on poverty reduction regardless of income inequality.

While equity emphasizes the equality of opportunity, it is conditional on opportunities themselves expanding rapidly. Expansion of opportunities can occur only through sustainable growth that is efficient and environmentally sustainable. In order to avoid the danger of equating equity with redistributive policies that in the past have neither generated growth nor equity, equity as defined in this section is termed inclusive growth.

## **V. The Challenge of Inclusive Growth**

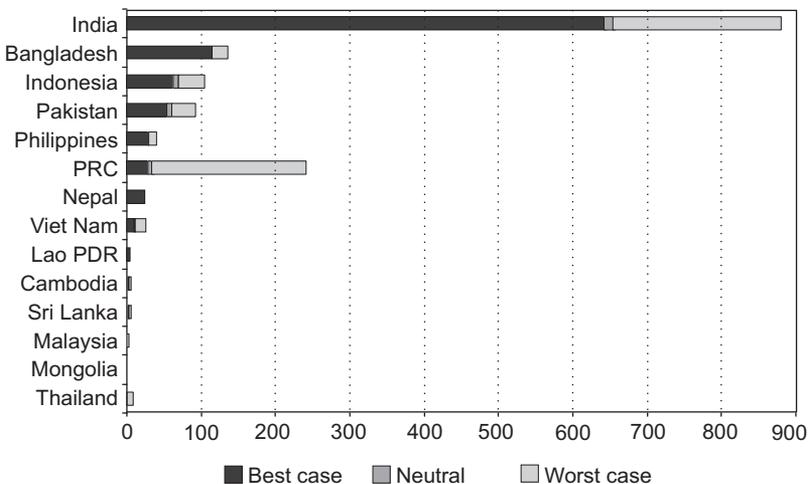
Inclusive growth focuses on expanding opportunities for all while targeting social protection interventions at the chronically poor. Viewed from this perspective, two issues need to be addressed at the outset to grasp the magnitude of the challenge facing developing Asia. First, while opportunities have to be expanded for all, inclusive growth focuses on expanding opportunities for the less well-off, through the elimination of distortions created by market, policy, and institutional failures. Second, the chronically poor need to be identified in order to establish social safety nets that could meet their legitimate needs.

The less well-off could be defined as the bottom half of the expenditure distribution of households. Alternatively, the \$2-a-day poverty line, which is closer than the \$1-a-day to the poverty line adopted by low middle-income countries, could be used (Chen and Ravallion 2001). In this policy brief, \$2-a-day is used to identify the less well-off. In 2005, 51.9% of developing Asia lived below the \$2-a-day poverty line.

The threshold for the chronically poor could be defined in terms of meeting the minimum consumption needs. Given that about 60% of expenditure of the poor is allocated to food, the threshold could be defined at \$1.20 a day. For simplicity, the threshold is set at \$1 a day. Table 1 indicates that in 2005, 18% of developing Asia was chronically poor. Figure 1 indicates the magnitude of the chronically poor in 2020 under alternative scenarios.

Figure 2 is used to illustrate the various implications of the discussion on inequality considered in Section IV. The best scenario of benchmark growth and pro-poor distribution has a less well-off incidence of 24.7%, with 974 million people in 2020. The worst scenario of low growth and pro-rich distribution has a less well-off incidence of 39.8%, with 1567 million people in 2020. With the exception of Sri Lanka and Pakistan, the problems are most acute in South Asia, which accounts for 86% and 72% of Asia's poor in the best and worst scenarios. Within South Asia, India has nearly 77% of the poor. The outcome of combining the benchmark growth with

Figure 2. Magnitude (m) of Poverty under Alternative Scenarios (2020) (\$2-a-day)



pro-poor distribution, underpinned by preserving good inequalities while reducing bad inequalities, indicates the potential effectiveness of policy, institutional, and governance reforms in dramatically reducing the incidence and number of the poor.

## **VI. Conclusion**

Asia's success in addressing extreme poverty in the last two decades is laudable. With prudent policies for growth and distribution, extreme poverty will be largely eradicated by 2020. However, rising income and non-income inequalities are making it very important that the focus shift to increasing opportunities for all. In particular, in addition to about 500 million workers who are underemployed, the Asian demographics suggest that over 300 million new entrants will join the job market by 2020 (Felipe and Hasan 2006). In order to find decent and productive jobs for the underemployed and to reap the benefits of the demographic dividend, opportunities from economic growth will need to be generated on a massive scale, and these opportunities will need to be equitably shared, i.e., inclusive growth will need to be ensured.

Inclusive growth ensures equality of opportunity for all to enjoy the fruits of growth while avoiding extreme deprivation for those people whose circumstances prevent them from benefiting from the opportunities created by growth. It requires a three-track approach. First, efficient, sustainable, and environmentally friendly growth must be ensured to generate new productive opportunities. Second, the economic and political playing fields must be leveled so that everyone can participate in, contribute to, and benefit from the new opportunities. Third, effective and efficient social protection systems must be strengthened to ensure that extreme deprivation is eliminated.

The second and third tracks constitute the core of inclusiveness. Inclusiveness requires leveling the playing field, with the burrows to be filled by social policy to counterbalance the disadvantages that some face as the result of circumstances beyond their control. Social policy for filling the burrows would include health, education, sanitation, water, and housing services. Fundamental institutional and governance reforms aimed at addressing market, policy, and institutional failures would be required to improve access to these social services. In turn, capability enhancement must be accompanied by the creation of productive and decent employment opportunities for the less well-off and to ensure that they do get access to these

opportunities. Opportunities for all would thus be translated into outcomes. The third track would require fiscal transfer to those who face extreme deprivation. Higher growth rates are conducive to fiscal resource mobilization to finance the fiscal transfers.

While creation of employment opportunities is a firm- and farm-level issue, the investment and business climate in which firms and farms operate are influenced by public policy and investment. Institutional and governance reforms in the formulation and implementation of public policy and public investment would be needed to ensure that the disadvantages of circumstances are indeed addressed to create an even playing field for all segments of society and for all regions in a country.

In developing Asia, the sustainability of stellar growth rates will hinge on broadening inclusiveness. While the adoption of an inclusive growth strategy is a natural evolution in Asia's development process, the reform agenda required is complex and ambitious as reforms relating to policies, institutions, and governance that reduce both economic and political inequality will need to be addressed simultaneously. Thus, in Asia's tryst with the 21<sup>st</sup> century, it has miles to go before it can sleep.

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