

RISING POVERTY TRENDS: CAUSES AND REMEDIES

By

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Distinguished members of the panel, Dr. Isher Ahluwalia, Sartaj Aziz Sahib, Dr. Salman Shah, Dr. Ait-Kadi, distinguished ladies and gentlemen, friends, colleagues, my students who are also my teachers.

It is a great pleasure to be here.

After a decade of slow growth, we appear to have turned the corner in the last four years, and now I think the challenge, is to sustain high GDP growth and at the same time restructure it for faster poverty reduction.

I remember 20 years ago when we started researching on this issue, poverty used to be a sort of add on to the main policy document. It was a marginal issue, which you mentioned at the end of a policy paper on growth. Now poverty has become central to the economic strategy and is indeed central to the crisis of both society and state in Pakistan. As President Musharraf correctly pointed out a few weeks ago, the principal threat to Pakistan is not external but internal. Endemic to the internal threat in a medium term sense is the simple fact that every third household in Pakistan is hungry; seventy-five percent of our people are sick; the majority does not have access to clean drinking water! I think this is the breeding ground of the violence, which is threatening both the fabric of the society and indeed the state itself.

I thought I would start with a few opening remarks on where we are right now in terms of our overall growth rate and then follow that up with a brief description of what happened in the decade of the 1990s in terms of poverty, inequality, and employment. We would then look at the last four years when at the end of a decade of slow growth, the GDP growth rate begins to accelerate steadily. However, simultaneously with the steady increase in overall GDP growth, you have an extremely unstable growth rate in agriculture, precisely in the last four years, and if you look at the figures for the last 40 years, a similar picture of increasing instability emerges. I think this fact then becomes the leading edge for examining the structural features of the problem of rural poverty. I then hope to very quickly bring together some of the possible policy interventions that can be made in the short and medium term.

I will not go into the details of the policy strategy for poverty reduction because I think I have done my bit as far as that is concerned. I spent about three years doing this book on poverty, growth and governance for the UNDP; so those of you who are interested could perhaps have a look at the Pakistan National Human Development Report, UNDP, 2003. However, I will quickly conclude the presentation with what appeared to me to be obvious policy measures, once we have examined the structure of the problem of growth and poverty.

I think it is clear that during the decade of the 1990s the GDP growth rate was substantially below the historical trend rate in Pakistan; the historical trend rate in Pakistan was about 6 percent and the growth rate during the 1990s was less than 4 percent. Not only was the GDP growth rate slow, it was accompanied by three features which we did not have before, or at least did not have these occurring simultaneously before together with slow growth. These three features are, (i) a sharp increase in poverty; (ii) a substantial decline in the employment generation capability of the economy, that is declining employment elasticities with respect to GDP growth; and (iii) there was also a historically unprecedented increase in inter personal income inequalities. So you had high poverty, growing inequality, and declining employment elasticities of growth occurring simultaneously.

The poverty trends during the 1990s are well known: Poverty measured in terms of the calorific norm increased from about 17 percent of the population below the poverty line in 1986–87 to about 32.6 percent at the end of the decade of 1990s. Similarly, employment elasticities declined pretty sharply, and inequality, measured in terms of both the Gini coefficients as well as the ratio between the top 20 percent of the income scale and the bottom 20 percent of the income scale, increased sharply from about 5 in the 1980s to 8 at the end of the decade of the 1990s. So overall, I think the picture in the 1990s was pretty grim. The fact that the employment generation capability was declining and inequality was increasing simultaneously with slow growth would be expected to substantially increase poverty, and that is indeed what happened. The percentage of the population below the poverty line doubled over the decade of the 1990s. So what happened in the first four years, between 2000 and 2004? GDP growth increased from 1.8 percent in the year 2000–01 to 3.1 percent, in the following year; and in the year 2004, the GDP growth rate was 6 percent. So what we have is a steady acceleration in the GDP growth. However, when we look at agriculture, we find a very different picture with agricultural growth being minus 2.2 percent in the year 2000–01 and minus 0.1 percent in the following year, and then jumped to 4.1 percent in the year 2003, and fell sharply again to 2.6 percent in the year 2004.

Now when we look at the overall growth performance, two obvious questions arise: (i) Is this growth rate sustainable? (ii) What would be the likely impact with respect to poverty reduction? On the issue of sustainability, the cause of concern is that the GDP growth rate in the last year has been primarily predicated on the growth of the large-scale manufacturing sector, because agricultural growth was just about 2 percent. So the overall 6.4 percent growth rate is fueled essentially by the large-scale manufacturing sector. And within the large-scale manufacturing sector, there are essentially three industries, which underlie the high-growth performance of that sector i.e., textiles, construction, and automobiles. Since, the majority of the poor live in the rural sector, if the agriculture sector is growing around 2.6 percent, which in any case is highly unstable, there is not likely to be a significant reduction in poverty. As far as the large-scale manufacturing sector is concerned, the worry is that growth in the three industries (textiles, automobiles and consumer electronics) which underlie the overall growth of the large scale manufacturing sector are not likely to significantly impact poverty. This is

because they neither generate employment nor produce output for the poor.

The construction sector which has also grown rapidly, will of course generate employment, and growth and put income into the hands of the poor. I would say, having looked at the data, that in the last four years, there is nothing that leads me to believe that there has been a significant reduction in poverty, despite the fact that we had fairly high growth rates. This is something to think about, because if you look at the Indian case, there is now, of course, a lively debate in India. One strong view in India, supported by people like Professor Abhijit Sen, is that in spite of having 8 to 9 percent GDP growth over the last few years, there has been no significant reduction in poverty in India.

So the issue that arises is twofold. (i) What is the target growth rate that Pakistan needs to achieve to enable a significant dent into poverty? (ii) What should be the structure of growth such that we are able to enhance the capacity of growth for poverty reduction? These are two distinct issues. First, the overall growth rate to target; and second, the composition of that growth so as to enhance what we call the elasticity of growth with respect to poverty reduction. It appears that there is a relationship between growth, poverty reduction and inequality: The higher the level of inequality, the higher the growth rate you need to make a dent into poverty. It is like sharing a cake. If you have a small cake and you give only 10 percent of the cake to the poor, they are likely to remain hungry. So the cake has to become very large rather quickly in order for 1/10th of it to affect the welfare of those who are poor today. You need at least a 7.5 percent GDP growth sustained over a period of time to make a significant impact on poverty reduction.

The second challenge is in respect of the growth itself. There is a view prevailing amongst some economists in India as well as policy makers in Pakistan that all that is required is to have high growth with an open economy framework and poverty reduction will be the outcome. In other words, there will be a trickle-down effect. Now, without going into the debate of whether there is a trickle-down effect of GDP growth or not, let us assume that there is. My point is that what we are concerned with is not just trickle down or poverty reduction per se, but the *pace* of poverty reduction. The faster you want to reduce poverty, the more important it becomes to restructure the growth process itself so as to enhance its poverty-reducing capability. You have to intervene in the composition of growth if you want to reduce poverty quickly. The structural aspects of growth, therefore, acquire some importance, and I think that is a challenge faced by both India and Pakistan.

Coming back to this problem of instability, it gives you an interesting clue into the relationship between agriculture growth and poverty. If you look at the last 20 years, the number of bad harvests is much more than the number of bad harvests in the two decades before that. In the last two decades, there were seven, but in the two decades preceding this, there were only five bad harvests. In the last four years, the amplitude of fluctuations in agriculture output, on an annual basis have increased sharply. Why is this happening? If you actually talk to farmers, they will tell you that they have to leach the soil before they start ploughing and planting. One ton of salt per acre per year is being deposited on agriculture land due to the salinity problem. Farmers have to flood the soil to get rid of

that salt. The second problem, of course, is that over the years, improper agricultural practices and loss of organic material within the soil itself have resulted in a situation where the responsiveness of yield to input application, has been declining. So in other words, you need more water precisely at a time when there is less water available. Remember, the decade of the 1990s was a decade of fiscal constraint, and the single most important consequence was that the minimum budget required to maintain the canal irrigation system was not made available. Only 45 percent of the finance required to maintain the irrigation system was actually made available.

So the irrigation system in the last decade has deteriorated, and that is why our irrigation efficiencies have now become rather low: Something like 63 percent of the water is lost during transportation from the river to the root zone of the crops. The irrigation efficiency, in other words, remains only 37 percent. So precisely at the time when less water is available, more water is required by the farmers. Consequently, farmers, even in the irrigated areas, are now more dependent on rainfall at the right time and in the right amount. It is, therefore, not surprising, given the vagaries of the weather, that we have such high instability in terms of agricultural output.

What does this instability do to the poor? Remember, the amplitude of fluctuations have increased. It is the smallest farmer who gets constricted. The small or marginal farmers, operating less than 7.5 acres basically go into debt. They have to borrow money for consumption purposes. That is what we discovered when we did the survey for this report. The small farmer is actually borrowing large sums of money for consumption purposes. Once they borrow for consumption purposes, the next year they are unable to reconstitute the production cycle. They do not have the investable surplus to buy the seed, water, and fertilizer, and when that happens, the small farmer gets locked into a debt trap. The average total debt of the poor farmer is three times his annual income because of this vicious cycle. I would suggest that the instability of agricultural growth, *ceteris paribus* would be expected to increase poverty. Therefore, when we talk about poverty reduction through growth, what we have to think about is not just the average but the fluctuations in it, particularly in the agriculture sector. Controlling these fluctuations to achieve stability in agriculture growth thus becomes a key policy challenge in the context of poverty reduction. GDP growth in the last four years has been induced by increased public sector expenditure, reduced interest rate and a sharp increase in private sector credit especially consumer credit. By contrast in order to reduce fluctuations in agricultural output, we need to build new institutions through which, (i) farmers, particularly small farmers can be enabled to increase the humus in the top soil, (ii) new heat resistant varieties of seeds can be developed and (iii) application efficiency of irrigation can be increased through building brick lined water channels and improved on farm water management.

We have come full circle. In the 1960s, we had an elite farmer strategy. We thought we could solve the problems by adopting the high-yielding varieties of foodgrain and focusing on the rich, who had the money to buy the inputs, to generate high growth rates. Now, both growth and poverty reduction in agriculture depend on a poor farmer strategy rather than an elite farmer strategy. As far as growth is concerned, more than half the farm area is under farms below 25 acres. Of this area, about half, or slightly less than

half, is operated by tenants. When you look at the yield potential, you see the large farms have grown rapidly and have nearly achieved the yield potential in many cases. The greatest potential for yield increases is, in fact, in the small farm sector. So, if we could increase yield in this sector, we could simultaneously accelerate growth and at the same time improve the distribution of income to achieve faster poverty reduction.

Now, let me try to identify some of the structural constraints to both growth and poverty reduction, at least in the agriculture sector. Unless we address the structural constraints in an organized and serious fashion, we are not likely to either sustain high growth nor are we likely to be able to significantly impact poverty.

The first, as I have already pointed out, is the problem of the topsoil. We need an effective institutional framework for improved extension services to the farmers. In the Indian Punjab, a large number of soil testing stations are noticeable. They look at the chemistry of the soil, and then they advise the farmer on the exact composition of fertilizer to use.

The second structural constraint to growth, and I think this is something that we have not worried enough about, is the age of the seed we use. As you know, when we keep reusing the same seed from year to year, its potency depletes. The average age of seed in Pakistan is 11 years, compared to the developing country average of 7 years. So, institutions for developing new seeds particularly, heat-resistant seeds, now that global warming is occurring, will have to become an essential element in your growth strategy.

The third issue is the extremely unequal distribution of land ownership. Fifty percent of rural households are landless. Of the households that are cultivating land, just over 25 percent are tenants. The problem with tenancy is that they have neither the capacity to increase yield, nor do they have the incentives to increase yield because they know that half the increase in output will go to the landowner. Therefore, I think the issue of providing ownership rights to tenants will be the single most effective way of reducing poverty and indeed of accelerating agricultural growth.

The fourth structural constraint to poverty reduction, and growth is our asymmetric market structure.

Ladies and gentlemen,

Poverty reduction is not just about resources. Equally important, it is about power and the structure of power. The survey for the UNDP, NHDR showed that the poor lose something like 37 percent of their income to asymmetric markets. When the small farmer goes to buy the inputs, he pays a higher price than when the large farmer goes to buy it. When the small farmer goes to sell milk or rice or whatever else he wants to sell, he gets a much lower price than the larger farmer. So in other words, this market mechanism, which is being postulated as the basis of resource allocation, is in terms of its present asymmetry, loaded against the poor. One of the important features of making the market mechanism efficacious is to bring in institutions that bring about equity with respect to

access. We need to provide the small farmer and the poor farmer fair access, not just over markets but over all the institutions which provide some product or some service and this includes all the public sector institutions, be these for justice or security or health or education, and at the local level.

That brings us to the issue of local governance. We will have to start looking at the local government more seriously. Let us get out of the old hype that the local government reforms are a great success, and will empower the poor. The poor at the moment are unable to participate in decisions regarding local resource allocation or provision of services. What we need is an institutionalized relationship between organizations of the poor on the one hand and local governments on the other, so that the poor begin to systematically participate in decisions that affect their existence at the local level. Unless we do that, markets will continue to remain asymmetric, and poverty will continue to get reproduced, regardless of the level of growth generated at the aggregate level.

Finally, ladies and gentlemen, is the question of health. We have historically been locked into our own epistemology of development by regarding health and education as sectoral issues. They have been considered to be marginal to the mainstream of the growth process. When Dr. Mahbub ul Haq came up with the human development indices, he helped change the focus from sectoral to human development. But health and education still remain, and have remained, marginal to our thinking about growth. I would propose that we start thinking of health and education as central to the process of growth itself. In the UNDP, NHDR survey, the questions posed were “How much money are the poor losing when they access health facilities?” and “What percentage of the poor are sick?” It turned out that 65 percent of the poor who were interviewed in 10 districts were sick at the time of the interview, and they reported that, on average, they had been sick for three months of the year. Obviously it impacts productivity and the ability to earn income, even if the poor have access to employment, which in many cases they don’t. The point is that the cost of medical care is too high. So when a person falls sick, that becomes probably the single most important determinant of his falling into poverty. If you are on the margins, you get pushed into poverty. If you are poor, you get into deeper poverty. I have recently visited the peri-urban areas of Multan. Sewerage was flowing down the main street. The residents reported that every person in that neighborhood is sick, and they knew why because the sewerage is going right into the canal from where the ladies go and bring the drinking water. When a person falls sick, just a single visit to the doctor throws them into hunger. Just one visit to the doctor brings hunger to the whole family, and therefore, they said that when somebody falls sick, they pray to Allah that either he gets cured or be taken away.

So, ladies and gentlemen, health is an issue that is central to productivity, growth, and poverty reduction. It cannot be treated as a social sector issue. It is a growth issue. Therefore, when one is planning for growth and poverty reduction, the paradigm that we have right now is not adequate, because it does not address the structural constraints to growth and poverty reduction. I think issues of empowering the poor at the local level so that they can get access over markets, providing health, sanitation, drinking water and education must become central to our poverty reduction strategy.

Ultimately, the distribution of income depends on the distribution of productive assets. We have to do something to improve the distribution of land ownership. And finally, the one-step that the government has taken, and it was a good step, is to initiate the water sector program. I think that the government has undertaken a number of commendable initiatives for accelerating economic growth. But before we get carried away by the figures of growth, please remember to ask yourself three questions. First, can we sustain it? Second, is this growth rate high enough to make a dent into poverty? Given the level of income inequality, if the growth rate is not high enough then poverty will not go down. Third, you have to start thinking of changing the composition of growth itself, and changing the composition of growth involves issues of building new institutions, of changing the asymmetry of power, of making markets more accessible to the poor, and of providing them with health and education. These are all issues that must become the central concern of those who claim to be engaged in poverty reduction. Thank you very much.