

Report No. 11

**ECONOMIC REFORMS AND THE POOR:
UNEARTHING NEW LINKAGES**

Centre for Policy Dialogue

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The Centre for Policy Dialogue (CPD), established in 1993, is an innovative initiative to promote an ongoing process of dialogue between the principal partners in the decision making and implementing process. The dialogues are designed to address important policy issues and to seek constructive solutions to these problems. The Centre has already organised a series of such major dialogues at local, regional and national levels. These dialogues have brought together ministers, opposition front benchers, MPs, business leaders, NGOs, donors, professionals and other functional groups in civil society within a non-confrontational environment to promote focused discussions. The expectation of the CPD is to create a national policy consciousness where members of civil society will be made aware of critical policy issues affecting their lives and will come together in support of particular policy agendas which they feel are conducive to the well being of the country. The CPD has also organised a number of South Asian bilateral and regional dialogues as well as some international dialogues.

*In support of the dialogue process the Centre is engaged in research programmes which are both serviced by and are intended to serve as inputs for particular dialogues organised by the Centre throughout the year. Some of the major research programmes of CPD include **The Independent Review of Bangladesh's Development (IRBD), Governance and Development, Population and Sustainable Development, Trade Policy Analysis and Multilateral Trading System and Leadership Programme for the Youth.** The CPD also carries out periodic public perception surveys on policy issues and developmental concerns.*

*As part of CPD's publication activities, a CPD Dialogue Report series is brought out in order to widely disseminate the summary of the discussions organised by the Centre. The present report contains the highlights of the dialogue held on April 8, 1999 on the theme of **Economic Reforms and the Poor: Unearthing New Linkages.***

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Dialogue on **Economic Reforms and the Poor: Unearthing New Linkages**

I. The Dialogue

An in-house dialogue was held on April 8, 1999 on *Economic Reforms and the Poor: Unearthing New Linkages* organised by the Centre for Policy Dialogue. CPD Chairman Professor Rehman Sobhan presided over the dialogue.

II. Keynote presentation

Dr. Ric Shand, Executive Director, Australia South Asia Research Centre, Australian National University, presented his paper on *Economic Reforms and the Poor: Unearthing New Linkages*. His aim in this paper was to explore some new ideas and also to look at the causes why poverty has been declining in India at such a slow rate. He hypothesised that this has been due to the weaknesses in sectoral linkages. Dr. Shand argued that there has been considerable progress in the incidence of poverty in terms of declining the percent of population below poverty line. But he found that the absolute number of poor has hardly changed at all. Dr. Shand was of the view that what was important for the rapid rate of reduction of poverty was nothing but sectoral high growth and interaction among these sectors.

Dr. Shand thought that the debate on growth in India was focused on the question of sectoral priorities for “engines” of development. The *Lewis* model of development saw traditional subsistence agriculture as the source of cheap labour for industrial growth. The possible constraints to growth in the model is the form of inadequate demand from an impoverished agriculture that led to the balanced growth strategy of *Kaldor*. The agriculture-first strategy, arising from the experience of the Green Revolution (GR) in the 1960s and 1970s, was espoused by *Mellor* who argued that linkages between agriculture and industry were strong enough to adopt a strategy where agriculture would be the engine of growth. *Adelman* argued for an intermediate strategies.

Dr. Shand observed that for the period 1950-51 to 1995-96, India’s real GDP growth averaged 4.3 per cent per annum. The annual average growth rate for manufacturing was 5.9 per cent over the period from 1950-51 to 1995-96. The annual growth rate for GDP from agriculture and allied activities was only 2.9 per cent during the same period. Thus the long term growth rate of agriculture has remained well below that of manufacturing and dampened the overall performance of the economy from the 1950s.

According to Dr. Shand the manufacturing sector comprises of registered and unregistered production units. He cited from 1991 decennial Census of India which

indicated that of a total of 28.7 million employed in the manufacturing sector, 28 per cent were in registered or factory establishment, 48 per cent were in small scale establishments and 24 per cent were in (tiny) household units. Some 6 per cent of those employed in registered establishments were in small scale units, so 54 per cent were in the small scale industry category or 78 per cent if the household units were included and the remaining 22 per cent were employed in large scale factory units.

Dr. Shand applied tests for causality between growth rates in agriculture, manufacturing and its registered and unregistered sub-sectors. The hypothesis was that significant interrelationships exist between these sectors, and that they might be bi-directional.

Dr. Shand argued that causality in growth from agriculture-to-industry could occur through both production and consumption linkages. On the production side, growth in agricultural output increased supplies of raw materials for processing, stimulated the demand for industrial inputs such as fertilisers and pesticides, pump sets, tractors and agricultural equipment, and raised investment. On the consumption side, higher agricultural incomes raised demand for consumer goods produced by the manufacturing sector. Thus output, employment, wage levels, incomes and investment were raised in the manufacturing sector.

He also argued that causality in growth from manufacturing-to-agriculture operates through higher employment, wages, and incomes in manufacturing. These led to increased demand for agricultural products. Thus growth in manufacturing output led to higher output, employment, wage levels and incomes in agriculture and might stimulate increased investment in agriculture. These relationships would be stronger if the location of manufacturing was rural based and if it was supported by public investment, particularly in physical infrastructure linking manufacturing locations with rural markets. In this process, expanding availability and variety of consumer goods in rural areas might also act as a stimulus to the aspirations of rural producers and thus indirectly lead to further expansion of agricultural production provided profitable opportunities exist. This again was all the more likely if transaction costs of marketing were lowered in rural areas with improvements in infrastructure, and if manufacturers of consumer goods target growing rural markets.

With the background of such theoretical exercises he then used Granger's methodology and test procedures in testing for causality. His findings were as follows:

1. Causality in growth from agriculture-to-manufacturing at sector level for the period between 1950-51 to 1990-91 was not significant, i.e., growth in agricultural output did not stimulate growth in manufacturing during this period. Causality in

growth within the manufacturing sector from agriculture-to-registered-manufacturing sub-sector was significant but from agriculture-to-unregistered-manufacturing was not. The lack of significance of this relationship suggests that rural demand for consumer goods was weak and very likely reflects the slow rate of growth of agricultural income over the period. When the period was extended to 1995-96 to include post-1991 reform years, even the causality from agriculture-to-registered-manufacturing became non-significant, indicating a weakening of the growth stimulus for manufacturing emanating from the agricultural sector's growth.

2. For the pre-1991 reform period from 1975-76 to 1990-91, there was significant causality in growth from agriculture-to-manufacturing at sectoral level. This was due to the significance of causality from the agriculture-registered manufacturing. It appears likely that the widespread and expanding use of purchased inputs and the increased crop output for processing with the Green Revolution substantially strengthened agriculture's linkages with this sub-sector. The addition of the post-1991 reform years did not weaken this relationship.
3. Causality in growth was again not significant from agriculture-to-unregistered manufacturing sub-sector. Thus, the relatively faster growth rate in agricultural output and incomes during this period was not enough to induce a significant expansion of consumer goods output in this sub-sector. The relatively slow growth in this sub-sector adds support to this conclusion. Extending the period to 1995-96 did not change any of these three relationships.
4. Causality in growth from manufacturing-to-agriculture was significant at sectoral level over the first periods from 1950-51 to 1990-91 and from 1950-51 to 1995-96. This demonstrates that, in terms of directional influence in growth, manufacturing was the "leading sector" or "engine of growth" and not agriculture. Within the manufacturing sector, the registered sub-sector was the significant causal influence on agricultural growth. The stimulus to agricultural growth was manifest through enhanced demand effects on agricultural output from expanding manufacturing output, higher wage levels and from rising industrial demand for agricultural raw materials. This view was supported by the relatively rapid growth rate of registered manufacturing output over this period.
5. The influence of growth from unregistered manufacturing-to-agriculture was not significant, which is consistent with the relatively slow growth rate of the non-registered sub-sector over the period.
6. Over the more recent period 1975-76 to 1990-91, there was significant causality from registered manufacturing-to-agriculture which was maintained with the

inclusion of the reform years to 1995-96, indicating that the causal relationship was not weakened by the inclusion of the post-1991 reform years. It was again non-significant from unregistered manufacturing-to-agriculture in this more recent period. The net result at sectoral level was that the overall manufacturing-to-agriculture linkages were not significant.

Dr. Ric Shand finally argued that absolute poverty could be reduced more speedily in the future provided direct reforms are implemented which would encourage faster growth rates of agriculture and of labour intensive manufacturing. More rapid growth in each sector would not only increase employment and wage levels within the sectors but would strengthen unidirectional growth relationships between the sectors. To the extent the incidence of bi-directional relationships could be increased, synergistic growth of both sectors was possible, further enhancing the growth contributions of each sector. The addition of the contribution of strong sectoral interrelationships could significantly raise the overall growth rate of the economy.

III. Discussion

Taking part in the discussion CPD Chairman Professor Rehman Sobhan argued that two independent issues needed to be addressed properly. (a) the factors responsible for both low and high agricultural growth needed to be identified, and (b) the whole problem of causality between agriculture and manufacturing and vice versa needed to be examined. He argued that some peculiar structural features in Indian economy rather than weak linkages between agriculture and manufacturing sectors were responsible for slow progress in poverty alleviation.

In a response to Professor Sobhan's point on structural factors Dr. Ric Shand agreed that there were structural constraints on growth and these were responsible for weak sectoral linkages. He argued that there were certain policies which also acted as constraints on growth rates. He was of the view that without a substantial high growth rate, poverty level would not be declined. At this point Professor Sobhan expressed his doubts whether there was any threshold growth rate for poverty reduction. In response Dr. Shand admitted the limitation of *Granger-causality test* and argued that it was not possible to reach a conclusion about the threshold growth rate from the *Granger-causality test* exercises.

Dr. Rushidan Rahman, Senior Research fellow, BIDS, questioned whether we need high growth rates in both sectors to establish causality links. She was much more interested in looking at the structural factors responsible for weak linkages. She argued for time series data on both poverty and growth rates.

Dr. Binayak Sen, Senior Research fellow, BIDS, rejected the idea of weak linkages between agriculture and industry and argued that causality remained for agriculture to industry. He thought Green revolution was the prime example in support of his argument. Mentioning that since 1991 Indian government has been undertaking the programmes of structural adjustment and economic reforms, he was interested to know about the outcome of such reform programmes in promoting economic growth as well as agricultural and industrial growth. He also mentioned that dynamics of employment in both agriculture and manufacturing sector needed to be addressed properly. There was surplus labour in the agricultural sector and the productivity of this surplus labour was very low. He was much more interested in looking at the employment dynamics of this surplus labour. In this connection rural non-farm sub-sector was very important, he opined. He thought that the paper has not referred to the rural non-farm sub-sector. He argued that transformation of labour force into modern sector was very important for poverty alleviation.

Dr. Sen also criticised the paper for not covering the issue of distribution of income and also the issue of sharing the prosperity out of economic growth. He found that in spite of the increase in the growth rate of the economy the income inequality was rising. Especially, urban inequality was rising sharply. He argued that only the richer people have demand and they demand mainly the products of registered manufacturing not the products of unregistered manufacturing. Therefore, the growth of unregistered manufacturing has been sluggish. Dr. Sen stated that China would be a very good example of both high growth rate and high sectoral linkages. He argued that rural non-farm sub-sector especially the TVEs (township and village enterprises) accounted for high economic growth in China.

Dr. Rushidan Rahman, also argued that there should be emphasis on rural non-farm sector. She also noticed that the tertiary sector, the service sector, is absorbing the largest part of labour force.

Mr. Selim Raihan, Research Fellow, CPD, observed that the paper talked only about economic growth in the belief that economic growth would automatically lead to the alleviation of poverty. The paper was silent about the need for active role of the state in this regard, he opined. He also argued that the paper did not duly address the consequences of economic reform especially the consequences of the structural adjustment programmes on poverty.

Dr. Ric Shand elaborated that his intention was to focus solely on growth paradigm and he was of the view that economic growth was a must for the alleviation of poverty. He considered Taiwan and Japan as two good examples where causality links between agricultural and manufacturing growth were high. That resulted high economic growth and significant achievements in poverty alleviation. Dr. Shand also

mentioned that Japan with saturated domestic market went into export phase, and on the other hand Taiwan did agricultural land reform.

Citing from Martin Ravellion, Dr. Binayak Sen differentiated between the growth in rural economy and the growth in urban economy and drew implications for poverty alleviation from that. He argued that rural growth can contribute to urban poverty reduction, but urban growth did not contribute to rural poverty reduction. Because, urban growth mainly benefited the rural elite.

Citing the findings of a BIDS study, Mr. Syeduzzaman, former Finance Minister and Chairman, BOC, observed that in rural Bangladesh, benefits from growth was unequally distributed. Only the income of the richer portion of the rural population was increasing leaving the majority in absolute poverty.

Professor Sobhan asked to know whether we have any contemporary evidence of what the rural farmers were buying with their additional income. Were they buying any imported items? He also thought that in an open economy there was high demand for cheap imported commodities. Citing an example of a small part of Bogra, Mr. Salahuddin stated that agricultural growth induced the demand for imports.

Professor Sobhan mentioned that though the paper presented some interesting findings but there were certain limitations with the methodology it applies. He argued that there are some critical structural factors that hinder linking agricultural growth to industrial growth and vice versa. To have linkages high growth was not a must, even with a low growth rate one could find linkages. He also argued that high sectoral growth and high linkages did not readily ensure poverty to be alleviated. He was of the view that land reform and more egalitarian distribution of income would facilitate poverty alleviation.

Professor Sobhan also observed that open economy was causing closing down of the small industries. He gave example of GEC, where due to the cheap import of diesel engine from China, the demand for locally produced diesel engine was going down. He cited the case of Chinese TVEs, which enjoyed local sub-regional protection, and argued for some effective protection for the domestic industries.

He was of the opinion that as subsidy in fertiliser was being reduced there would be a drastic fall in the absorption of TSP and subsequently there would be a rise in the use of imported urea fertiliser. This would result in reduction in the fertility of the soil. He thought that agricultural output was more or less stagnant but the use of chemical fertiliser was increasing indicating the declining marginal productivity of the soil and also the declining factor productivity of fertiliser and irrigation.

List of Participants
(in alphabetical order)

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Prof. Rehman Sobhan	Chairman, CPD
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