Poverty Reduction and Economic Growth:

The Asian Experience

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I. Introduction

If policies are to be designed so as to reduce absolute poverty most effectively, much remains to be understood about the causes of poverty and the conditions that lead to its reduction. For example, it is now well-established that the rate of economic growth is a significant determinant of the rate at which poverty declines over time. However, it seems likely that the effectiveness of overall growth as an engine of poverty reduction varies from one country to another, and may also vary from time to time. We wish to know not only whether economic growth is associated with poverty reduction, but also the degree to which the nature of the economic growth also matters. Assuming it does, we then wish to know which kinds of growth are most conducive to reducing poverty.

The present paper looks at three regions of Asia with these issues in mind. It studies the relationship between changes in the headcount measure of absolute poverty incidence and the rate of economic growth in South Asia (India); East Asia (Taipei,China); and four countries of Southeast Asia (Indonesia, Malaysia, Philippines, Thailand). The data cover the period from the 1960s to the 1990s. The above six economies were chosen for their wide geographical coverage and for the availability of data on aggregate poverty incidence covering a significant number of years in each case.

Average rates of poverty reduction differed substantially in these three regions. In India the incidence of absolute poverty declined from 60 percent of the total population in 1957 to 41 percent in 1992 (Table 1), an average annual rate of reduction of 0.67 percent. The comparable rate of reduction for Taipei,China was 1.57 percent per year, and for Southeast Asia the average rate was 1.45 percent (Indonesia 1.41, Malaysia 1.59, Philippines 0.94 percent, and Thailand 1.86). The growth of real gross domestic product (GDP) per person followed a pattern roughly similar to these data on poverty incidence. The growth rates of real GDP per person, covering the same periods as the poverty data above, were: India 1.91; Taipei,China 6.88; and Southeast Asia 3.46 percent (Indonesia 4.25, Malaysia 4.32, Philippines 1.09 percent, Thailand 4.19). Nevertheless, crude correlations between average GDP growth rates and average rates of poverty reduction, extending over long periods of time, do not necessarily indicate that the differences in GDP growth rates *caused* the differences in rates of poverty reduction.

The limited availability of data that may support statistical analysis has been an impediment to the systematic study of poverty incidence. Some recent studies have attempted to explore the relationships involved by analyzing cross-sectional data sets involving average rates of poverty reduction and growth across many countries, or across regions or households for individual countries, while others have attempted to assemble long-term time series data sets on poverty incidence for individual countries. This paper begins with the time series approach, but then pools data for different economies to increase the number of observations available for analysis. The exercise amounts to testing whether year-to-year fluctuations in GDP growth rates are associated with similar year-to-year fluctuations in rates of reduction in poverty incidence. Section II reviews the data to be studied and section III summarizes the analytical approach to be used. Section IV describes the results and Section V concludes.

II. Poverty and Growth: India; Taipei,China; and Southeast Asia

We begin with the time series data for each economy. Figures 1 to 6 summarize the available data on poverty incidence in the six Asian economies listed above. The data are presented as aggregate poverty incidence and its rural and urban components. Significant poverty reduction has been achieved in all six economies but the rate of reduction in Taipei,China and in each of the four countries of Southeast Asia was larger than that in India (Figures 1 to 6 and Table 1).

First, we discuss the decomposition of the data on poverty incidence themselves. Table 1 shows the results of this decomposition. All results shown in this table are evaluated at the mean values of the data set. For example, the mean annual change in the aggregate level of poverty incidence for Thailand was -1.86 percentage points per year (i.e., an annual reduction, on average, from numbers like 20 percent to numbers like 18.14 percent). Equation (2) above is an identity and must apply at all points in the data set. It must therefore apply at the means of the data. The equation shows that this mean aggregate change in poverty incidence can be decomposed into three components: average poverty reduction in urban areas, average poverty reduction in rural areas, and the average movement of population between these two areas.

The second half of the table normalizes the decomposition by dividing all values by this mean change in aggregate poverty (-1.86 for Thailand, for example) and multiplying by 100. For Thailand, reductions in rural poverty accounted for 56 percent of the overall reduction in poverty; in urban

poverty, 10 percent; and in migration, 34 percent. Migration effects were even more important for Indonesia, but for all six economies reductions in rural poverty account for more than 40 percent of the total reduction in poverty incidence.

The above calculations are, of course, merely descriptions of the data. We wish to know what caused these observed changes in poverty incidence to occur and, in particular, what caused the differences across countries? Poverty incidence and its changes over time obviously depend on many factors, of which economic variables are only part of the story, and among the economic variables many issues aside from simply the overall rate of growth will be relevant. Changes in commodity prices will play a role, along with tax policies. The sectoral composition of growth and the degree to which it is directed toward export markets or domestic markets may also be important. Nevertheless, the data suggest superficially that the overall rate of growth may be an important part of the story. The data on real GDP growth per person are summarized in Table 2, covering the same time periods as the poverty data reviewed above.

India's rate of GDP growth was the lowest, as was its rate of poverty reduction. Taipei,China's rate of economic growth was the highest and its rate of poverty reduction was the third highest, after Thailand and Malaysia, and higher than the average for Southeast Asia. Among the Southeast Asian countries, reductions in poverty have been achieved in each of the four countries but the rate of reduction was lowest in the Philippines, where the average rate of growth was also lowest. At the level of individual economies, a relationship between the rate of poverty reduction over time and the rate of growth over time also seems possible. For example, in Thailand poverty incidence fell throughout the period indicated except for the recession period of the early 1980s when measured poverty incidence increased, and again in the Asian crisis period of the late 1990s when it increased again. We shall explore this statistical relationship in more detail below.

III. Analytical Framework

We shall review first the relationship between aggregate, rural, and urban poverty incidence and then turn to the manner in which each of these measures is affected by economic growth. Changes in aggregate poverty incidence may be decomposed into rural and urban components, as follows. We shall write N, N^R and N^U for the total, rural and urban populations, respectively, where $N = N^R + N^U$. We write $a^R = N^R / N$ and $a^U = N^U / N$ for the rural and urban shares of the

total population, respectively, where $a^R + a^U = 1$. The total number of people in poverty is given by $N_P = N_P^R + N_P^U$, where N_P^R and N_P^U denote the number in poverty in rural and urban areas, respectively. Aggregate poverty incidence is given by

$$P = N_P / N = (N_P^R + N_P^U) / N = a^R P^R + a^U P^U, \quad (1)$$

where $P^R = N_P^R / N^R$ denotes the proportion of the rural population that is in poverty and $P^U = N_P^U / N^U$ the corresponding incidence of poverty in urban areas.

Now, differentiating (1) totally, we obtain a key relationship,

$$dP = a^R dP^R + a^U dP^U + (P^R - P^U) da^R. \quad (2)$$

From (2), the change in poverty incidence may be decomposed into three parts: (i) the change in rural poverty incidence, weighted by the rural population share; (ii) the change in urban poverty incidence weighted by the urban population share; and (iii) the movement of populations from rural to urban areas weighted by the difference in poverty incidence between these two areas.

The last of these terms is described by Anand and Kanbur (1985) and by Ravallion and Datt (1996) as the "Kuznets effect". As the population moves from rural to urban areas, a change in aggregate poverty incidence will occur even at constant levels of rural and urban poverty incidence, provided that the levels of poverty incidence in these two sectors is different. In growing economies, we expect to find that the rural population share is falling ($da^R < 0$) and that the incidence of poverty in rural areas typically exceeds that in urban areas ($(P^R - P^U) > 0$). Thus, the expected sign of $(P^R - P^U) da^R$ is negative. How important the Kuznets effect is as a determinant of overall poverty reduction is, of course, an empirical matter.

We now turn to the manner in which poverty incidence is affected by economic growth and, for simplicity, we hypothesize initially that the total number of households in poverty, N_P, depends on the aggregate level of real income, *Y*, and the size of the population, *N.* Thus

$$N_P = j(Y, N). \quad (3)$$

The incidence of poverty is defined as

$$P = N_P / N = j(Y, N) / N. \quad (4)$$

Totally differentiating this equation,

$$dP = (j_Y Y / N) y + (j_N - j / N) n, \quad (5)$$

where lower case Roman letters represent the proportional changes of variables represented in

levels by upper case Roman letters. Thus $y = dY / Y$ and $n = dN / N$ are the growth rates of aggregate real income and of population, respectively. In the special case where the function $j(.)$ is homogeneous of degree one in *Y* and *N*, (3) may be written $N_P = j_Y Y + j_N N$ and (5) reduces to

$$dP = (j_Y Y / N)(y - n). \quad (6)$$

In this case the change in poverty incidence depends on the growth of per capita income. We shall impose this assumption and will therefore be estimating expressions of the form

$$dP = a^1 + b^1(y - n). \quad (7)$$

The constant term a^1 captures the impact of factors other than growth, which also influence changes in poverty incidence. We wish to test whether the coefficient b^1 is significantly greater than zero and whether there are systematic differences between countries or regions in this coefficient.

We wish to study the way economic growth affects each of the components of the change in aggregate poverty incidence, as given by (2). Ravallion and Datt apply an ingenious method for estimating decomposed equations systems of this kind. We have a four-equation system, consisting of (7) and:

$$a^R dP^R = a^2 + b^2(y - n) \quad (8)$$

$$a^U dP^U = a^3 + b^3(y - n) \quad (9)$$

$$(P^R - P^U) da^R = a^4 + b^4(y - n). \quad (10)$$

But from the identity given by (2), these equations are linearly dependent. Equation (7) is identically the sum of equations (8), (9), and (10). Of these four equations, only three need to be estimated. The parameters of the fourth can be computed from (2). It is therefore possible to estimate equations (7), (8), and (9) and then to infer the parameters of (10) from the identities $a^4 = a^1 - a^2 - a^3$ and $b^4 = b^1 - b^2 - b^3$.

IV. Statistical Method

Data were assembled for the dependent variables dP, $a^R dP^R$ and $a^U dP^U$. For India and Taipei,China the data are approximately annual, but for the countries of Southeast Asia, they are not. Allowance must be made for this fact. Each interval between the data points indicated in Figures 3 to 6 is used to construct the change in the value of the dependent variable for each of the economies concerned, with the calculated value divided by the number of years corresponding to that time interval, giving an annual rate of change for that variable. These annualized rates of change then

become the dependent variables used in the regression analysis. There was a single independent variable, rate of growth of GDP per person, and it was constructed on a comparable basis. In the regression analysis, observations were then weighted by the number of years in the interval concerned.

Since the meaning of the poverty lines is different in each of the six economies studied, and since the structure of the economies is also different, we should not expect that the same relationship between poverty incidence and aggregate growth per person would exist in all these economies. Intercept and slope dummy variables were used to determine the relationship most consistent with the data. Initially, intercept and slope dummy variables were used for five of the six economies (all but the Philippines). Slope dummies for each of the four Southeast Asian countries proved to be highly insignificant and were dropped. Thus all four of the Southeast Asian countries have the same slope term. Intercept dummies were also insignificant for these countries, though not to the same extent as the slope dummies, and they were retained for all four countries but one (Philippines) The intercept dummies for the other three Southeast Asian countries are therefore to be interpreted as differences from the Philippines intercept term, which is the constant term for the overall regression. Slope and intercept dummies were retained for India and Taipei,China but only intercept dummies were retained for Southeast Asia. The meaning of the slope dummies for India and Taipei,China is therefore that they are differences from the slope coefficient for Southeast Asia. The estimated slope coefficient for each of those economies (India and Taipei,China) is obtained by adding its slope dummy variable to the overall slope coefficient for the data set (the coefficient for Southeast Asia). We wish to determine whether these slope dummies for India and Taipei,China are significant and if so, their signs.

V. Results

A. Statistical Results

The regression results are summarized in Table 3. The surprising feature of the results is that while the overall slope coefficient for the combined regression was highly significant (significant at the 1 percent level), slope dummies for individual economies were all insignificant, including both India and Taipei,China. What this indicates is that the relationship between the change in absolute poverty incidence and economic growth per person is significant and approximately the same for all

six economies. That is, the results imply that the power of economic growth to reduce poverty did not differ significantly among these six economies. To the extent that the differences in the poverty outcomes can be attributed to economic growth, it is primarily not differences in the *quality* of growth that explains their different performance in terms of absolute poverty reduction, but differences in the *rate* of economic growth per person. Similar results were obtained in this respect for aggregate poverty incidence, rural poverty and urban poverty.

It is notable that the response of poverty incidence to growth was approximately the same in all six economies in spite of the fact that the composition of their growth was quite different. Table 2 shows that the sectoral composition of growth differed considerably among the six economies. For example, agriculture's contribution to overall growth was quite high in Indonesia and Thailand and low in India; Philippines; and especially Taipei,China. These results suggest that the sectoral composition of growth may be a secondary issue. The overall *rate* of growth is apparently the overwhelmingly important determinant of the rate of poverty reduction—regardless which sector of the economy actually generates the growth. Further research will nevertheless be required before any generality could be attributed to this result.

B. The Quality of Growth

That the effect of growth on absolute change in poverty incidence is approximately the same across countries does not imply that the proportional change is the same. The estimated response of absolute poverty incidence to economic growth (incorporating the slope dummy variable estimates shown in Table 3) can be used to estimate the elasticity of poverty incidence with respect to the rate of growth of real GDP per capita. These estimates, evaluated at sample means, are as follows:

Growth Elasticity of Aggregate Poverty:

India	-0.92	Indonesia	-1.38
Taipei,China	-3.82	Malaysia	-2.06
Thailand	-2.04	Philippines	-0.73

These elasticities should be understood as the proportional change in absolute poverty incidence relative to the proportional change (growth rate) of real GDP per person. The result that

the change in poverty incidence per unit of economic growth is similar across countries implies that the elasticity of poverty with respect to growth is highest in economies where average levels of poverty incidence is lowest and lowest where average levels of poverty incidence is highest.

It is notable that the more open economies—Taipei,China, followed by Malaysia and Thailand—exhibit the highest growth elasticities. The least open economies—India and the Philippines—exhibit the lowest growth elasticities. The issue raised by these results is whether the "quality of growth", interpreted here as its capacity to reduce poverty incidence, is causally related to trade policy in particular and to development strategy in general. The evidence produced by the small sample of countries considered here is consistent with the hypothesis that a more open trade policy leads to pattern of development that entails (i) a higher rate of growth and (ii) a pattern of growth that is more poverty-reducing. The sample is too small to support strong conclusions in that regard, however, and much more evidence would be required before a relationship of this kind could be asserted. There are nevertheless analytical reasons to suggest that a relationship of this kind may exist.

Consider the pattern of industrialization that has occurred in Taipei,China, on one hand, and in India on the other. Taipei,China's pattern was not supported by protection of manufacturing but by exploitation of Taipei,China's comparative advantage. This produced a labor-intensive pattern of industrial growth, involving a high proportion of small- and medium-scale enterprises and included extensive rural-based industrial development. India's pattern was based on high levels of industrial protection. This led to industrial development that was capital-intensive, involving predominantly large-scale enterprises that were urban-based and isolated from rural areas. It would hardly be surprising if Taipei,China's export-oriented strategy was not merely more growth-promoting, but also led to a pattern of growth that reduced poverty incidence more effectively *per unit of growth* than India's import substitution-based strategy. Of course, the issue is ultimately empirical. It remains to be seen whether systematic exploration of the evidence on this point supports these theoretical conjectures.

The analytical issue that seems central is the demand for unskilled and semi-skilled labor. Unskilled and semi-skilled labor are the principal resources owned by poor people. This line of reasoning suggests that patterns of development that increase the demand for unskilled labor—

involving more labor-intensive modes of production and high rates of productivity advance—will produce more rapid poverty reduction.

C. Determinants of Poverty Reduction

The results confirm that the rate of growth of real GDP per person has a significant influence on the rate of poverty reduction. Naturally, it is not the only determinant. The R-squared statistics indicate that only around 40 percent of the annual variation in the rate of poverty reduction is explained by variation in the rate of growth. Moreover, the presence of a constant term means that on average some change in poverty incidence occurs regardless of the rate of growth. That is, the effect that all the nongrowth factors have on poverty incidence does not have a mean of zero. The importance of the constant term is further explored in Tables 4 to 9. These tables decompose the changes in poverty incidence at the means of the data set. We know that at the mean of the data, the value of the error term is zero. But the constant term is nonzero. The mean change in poverty incidence can be decomposed into two parts: the estimated effect of growth and the estimated net effect of all other influences. What Tables 4 to 9 show is that for all six economies the growth effect (the slope component) outweighs the net effect of all other variables (the constant term component).

VI. Conclusion

This paper has analyzed the statistical evidence on the relationship between poverty incidence and economic growth in six economies: India; Indonesia; Malaysia; Philippines; Taipei,China; and Thailand. The economies were chosen because they each provide estimates of aggregate poverty incidence over a large number of years. Data on these six economies were pooled to determine whether the relationship between the rate of growth and the rate at which absolute poverty incidence declined was different among the six. The somewhat surprising result was that the effect that a unit of growth of real GDP per person has on the decline of total poverty incidence was very similar across the six economies. The surprise arises from the fact that the sectoral composition of growth was very different for the six economies. For example, the contribution of agriculture to overall growth differed widely.

The above results suggest that the sectoral composition of growth may be a less important issue in determining its poverty-reducing capacity than was previously thought. Further research would be needed before any generality could be attributed to results of this kind. But if these results

are confirmed, their implications could be considerable. They would imply that policies intended to influence the sectoral composition of growth—on the grounds that, say, growth of agriculture is more poverty-reducing than growth in other sectors—could actually *reduce* the rate at which poverty declines if these policies have the effect of reducing the rate of overall growth.

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Table 1. **Data Decomposition: Annual Rate of Change of Poverty Incidence**[a]

	India	**Taipei,China**	**Thailand**	**Indonesia**	**Malaysia**	**Philippines**
	(1957-1992)	**(1964-1995)**	**(1969-1999)**	**(1976-1999)**	**(1976-1995)**	**(1965-1997)**
			Actual			
Aggregate[b]	-0.665	-1.573	-1.862	-1.414	-1.589	-0.941
Rural[c]	-0.320	-1.12	-1.043	-0.582	-1.094	-0.484
Urban[d]	-0.369	-0.454	-0.187	-0.262	-0.298	-0.369
Migration[e]	-0.033	-0.001	-0.632	-0.57	-0.197	-0.088
			Normalized (aggregate=100)			
Aggregate[b]	100.0	100	100	100	100	100
Rural[c]	48.1	71.2	56.0	41.2	68.8	51.4
Urban[d]	46.9	28.9	10.0	18.5	18.8	39.2
Migration[e]	5.0	-0.1	33.9	40.3	12.4	9.4

Notes:

[a] The decomposition relates to the terms of equation (2). Aggregate = urban + rural + migration.

[b] Mean annual value of dP, the year-on-year change in aggregate poverty incidence.

[c] Mean annual value of $a^R dP^R$, the year-on-year population share-weighted change in rural poverty incidence.

[d] Mean annual value of $a^U dP^U$, the year-on-year population share-weighted change in urban poverty incidence.

[e] Mean annual value of $(P^R - P^U)da^R$, the year-on-year migration-induced change in poverty incidence

Table 2. **Annual Average Rates of Growth of Real GDP Per Person and its Components**

	India	**Taipei,China**	**Thailand**	**Indonesia**	**Malaysia**	**Philippines**
	(1957-1992)	**(1964-1995)**	**(1969-1999)**	**(1976-1999)**	**(1976-1995)**	**(1965-1997)**
Total	1.91	6.88	4.19	4.25	4.32	1.09
Agriculture	0.39	0.10	2.01	1.84	1.29	0.29
Industry	4.41	7.61	8.04	6.56	6.37	1.94
Services	4.26	7.5	5.33	5.17	4.96	1.64

Table 3. **Poverty Incidence and Aggregate Growth: Weighted Regression Results**

	Percentage Change in Total Poverty		**Percentage Change in Rural Poverty**		**Percentage Change in Urban Poverty**	
Variable	Coefficient	t-Statistic	Coefficient	t-Statistic	Coefficient	t-Statistic
Constant	-0.495	-1.501	-0.109	-0.463	-0.291	-2.5***
GDP growth per capita	-0.405	-4.84***	-0.341	-5.68***	-0.072	-2.44**
Slope dummy, Taipei,China	0.107	0.64	0.134	1.12	-0.019	-0.33
Slope dummy, India	-0.043	0.265	0.074	0.621	-0.044	-0.768
Intercept dummy, Thailand	0.333	0.647	0.496	1.35	0.405	1.554
Intercept dummy, Indonesia	0.804	1.469	0.976	2.49***	0.334	1.2
Intercept dummy, Malaysia	0.661	1.17	0.492	1.22	0.303	1.07
Intercept dummy, Taipei,China	0.973	0.86	0.410	0.51	0.467	1.18
Intercept dummy, India	0.329	0.58	0.060	0.15	0.143	0.73
R-squared	0.429		0.41		0.133	
Adjusted R-squared	0.402		0.38		0.09	
F-statistic	15.54***		14.1***		3.17***	15.54***
No. of observations						

Notes:
* significant at 10 percent level
** significant at 5 percent level
*** significant at 1 percent level

Table 4. **Decomposition of Changes in Poverty Incidence: India**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-0.665	-0.166	-0.499
Rural	-0.32	-0.049	-0.271
Urban	-0.312	-0.148	-0.164
Migration	-0.033	0.031	-0.064
		Normalized (aggregate=100)	
Aggregate	100	25	75
Rural	48	7	41
Urban	47	22	25
Migration	5	-5	10

Table 5. **Decomposition of Changes in Poverty Incidence: Taipei,China**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-1.573	0.478	-2.051
Rural	-1.12	0.301	-1.421
Urban	-0.454	0.176	-0.63
Migration	0.001	0.001	0
		Normalized (aggregate=100)	
Aggregate	100	-30	130
Rural	71	-19	90
Urban	29	-11	40
Migration	-0.1	-0.1	0.0

Table 6. **Decomposition of Changes in Poverty Incidence: Thailand**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-1.862	-0.162	-1.7
Rural	-1.043	0.387	-1.43
Urban	-0.187	0.114	-0.301
Migration	-0.632	-0.663	0.031
		Normalized (aggregate=100)	
Aggregate	100	9	91
Rural	56	-21	77
Urban	10	-6	16
Migration	34	36	-2

Table 7. **Decomposition of Changes in Poverty Incidence: Indonesia**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-1.414	0.309	-1.723
Rural	-0.582	0.867	-1.449
Urban	-0.262	0.043	-0.305
Migration	-0.57	-0.601	0.031
		Normalized (aggregate=100)	
Aggregate	100	-22	122
Rural	41	-61	102
Urban	19	-3	22
Migration	40	43	-2

Table 8. **Decomposition of Changes in Poverty Incidence: Malaysia**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-1.589	0.166	-1.755
Rural	-1.094	0.383	-1.477
Urban	-0.298	0.012	-0.31
Migration	-0.197	-0.229	0.032
		Normalized (aggregate=100)	
Aggregate	100	-10	110
Rural	69	-24	93
Urban	19	-1	20
Migration	12	14	-2

Table 9. **Decomposition of Changes in Poverty Incidence: Philippines**

		Estimated (% points change per year)	
		Constant	**Aggregate Growth per Capita**
Aggregate	-0.941	-0.405	-0.536
Rural	-0.484	-0.109	-0.375
Urban	-0.369	-0.291	-0.078
Migration	-0.088	-0.005	-0.083
		Normalized (aggregate=100)	
Aggregate	100	43	57
Rural	51	12	40
Urban	39	31	8
Migration	9	1	9

Figure 1. **Poverty Incidence: India, 1957 to 1997**

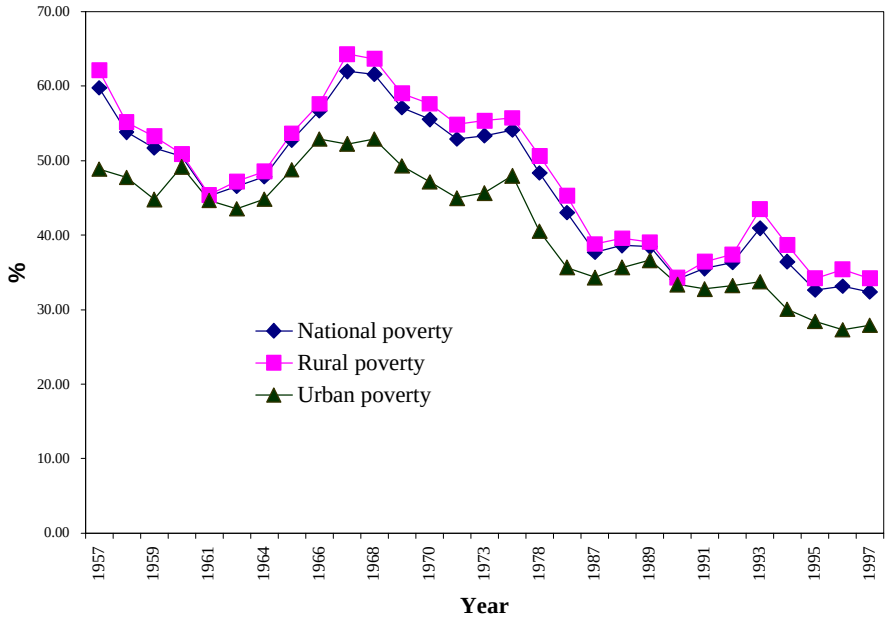

Figure 2. **Poverty Incidence: Taipei,China, 1964 to 1995**

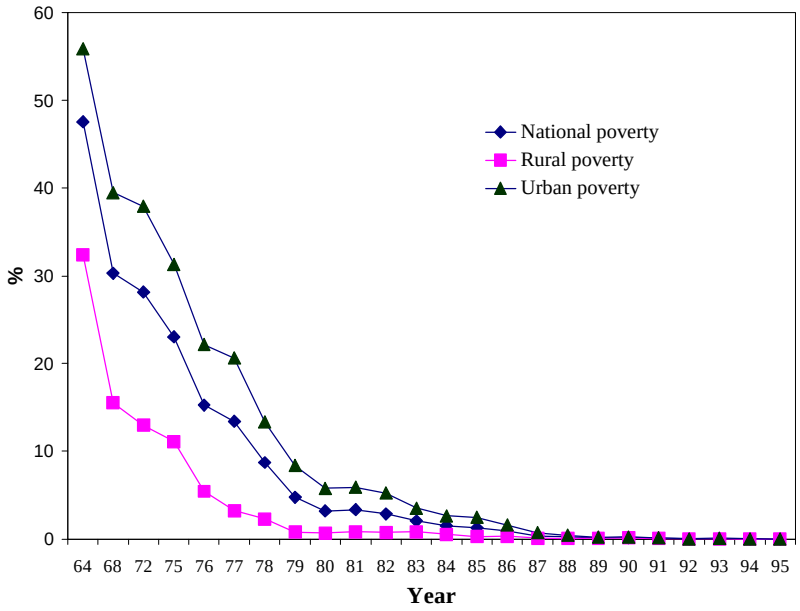

Figure 3. **Poverty Incidence: Thailand, 1969 to 1999**

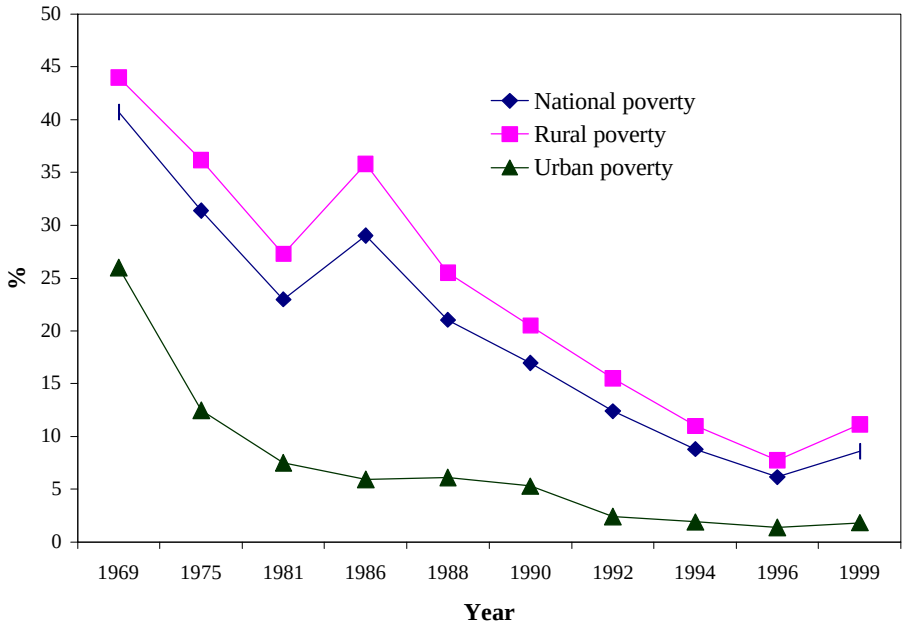

Figure 4. **Poverty Incidence: Indonesia, 1976 to 1999**

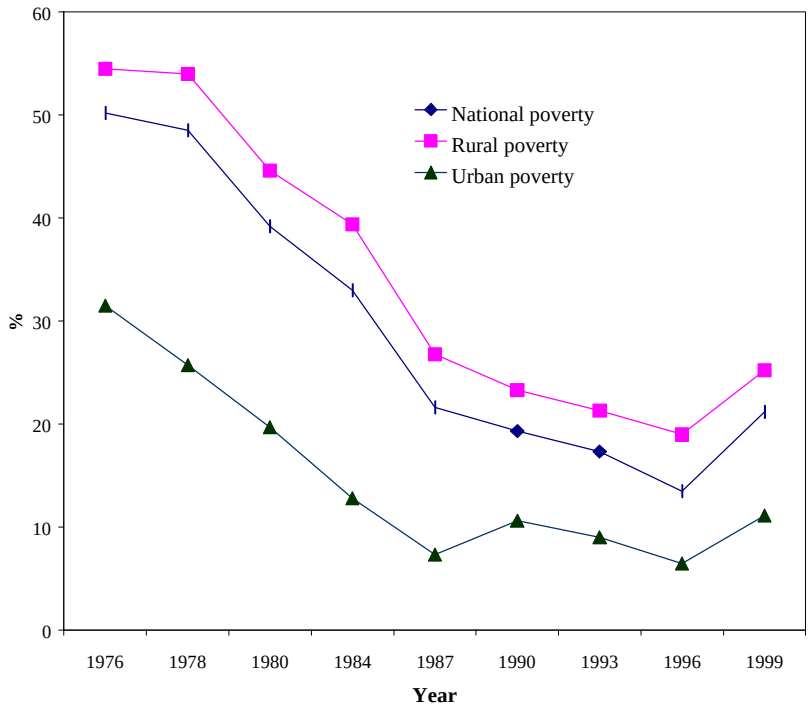

Figure 5. **Poverty Incidence: Malaysia, 1976 to 1995**

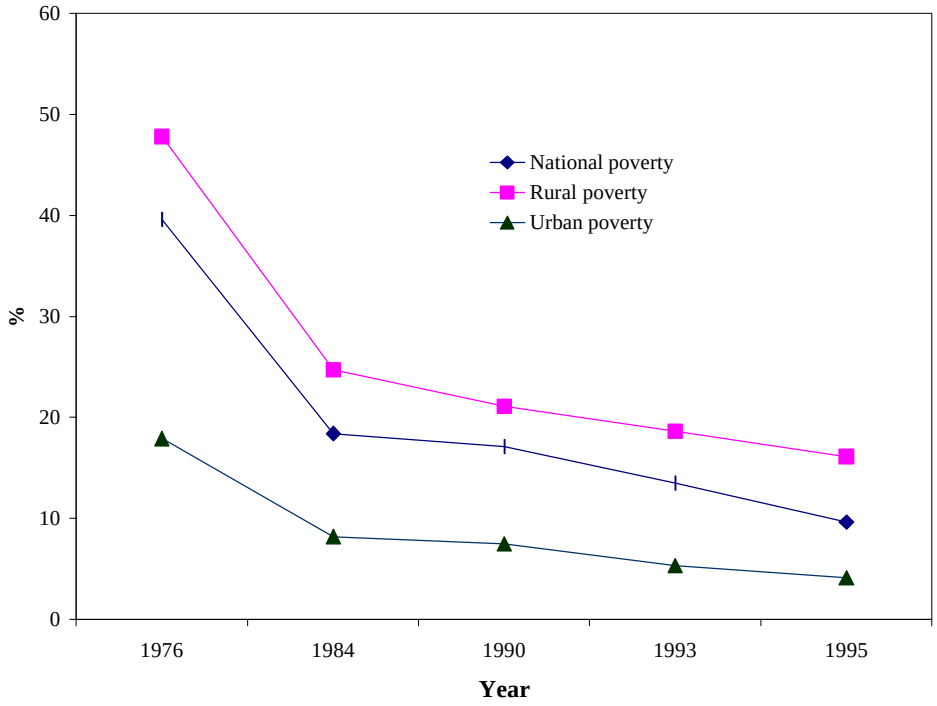

Figure 6. **Poverty Incidence: Philippines, 1976 to 1999**