

## **A Theoretical Model for Inclusive Economic Growth in Indian Context**

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### **Abstract**

*The failure of Washington Consensus in the early 1990s forced International Monetary Fund (IMF) and World Bank to address the problems of inequality and poverty through Pro-Poor Growth (PPG). This shift in the global policy debate is evident from the international commitment to the Millennium Development Goals (UN, 2000). The paradigm shift to inclusive growth is evident from the Approach Papers of 11<sup>th</sup> Five Year Plan of Government of India (2007-12) which focused on faster and more inclusive growth and 12<sup>th</sup> Five Year Plan (2012-17) which focused on faster, sustainable and more inclusive growth. Inclusive growth is broad based high growth in which the poor not only benefits there from but also participate in the growth process. It not only creates new economic opportunities but also ensures the equal access to them by all, particularly the poor the maximum possible extent. This paper explores the shift in development economics in the last two decades from Pro Poor Growth (PPG) to Inclusive Growth (IG) with special reference to Indian economy. Finally this paper also offers a theoretical framework for inclusive growth model which can support future research in measurement of inclusive growth for diagnosis of economic progress of a country.*

**Keywords:** Pro Poor Growth, Inclusive Growth, Productive Employment, Poverty, Inequality

**JEL Classification:** F43, D63, O11, O12, O40, O47 and O53

The pace of economic growth and economic development attracted the attention of global researchers in doing complex interpretations to arrive at prudent policy framework which guided development agenda for many underdeveloped and developing economies including India. If the economic growth causes inequitable distribution of opportunities then it results in imbalanced and lop sided development. Therefore different development strategies and models were evolved over a period of time. During the cold war the ideological rivalry between capitalism and communalism produced the two competing perspectives which were represented by western development economics and the central planning respectively. The policy debate on the economic relationship between growth, inequality and poverty can be traced to the Kuznet's (1955) and Solow's (1956) models. This is followed by disputes between Keynesian state intervention and the free market policies advocated by the monetarists. The rise of monetarists and the neo-classical economists in the mid 1970s and in the late 1980s shifted development theory towards the trickle down proposition, which emanated from the application of policy debate and deliberations culminated with Washington Consensus (WC).

The failure of Washington Consensus in the early 1990s and the pressure of institutional economies forced the International Monetary Fund (IMF) and World Bank to address the problem of inequality and poverty through Pro-Poor Growth (PPG). This shift in the global policy debate is evident from the international commitment to the Millennium Development Goals (UN, 2000) and the subsequent shift to inclusive economic growth. There is no universal definition of inclusive growth. However the scanning of existing literature reveal that there are relatively few but well founded studies, reports and publications on inclusive growth which are the knowledge products of World Bank, IMF, International Policy Centre for Inclusive Growth–IPC-IG, an initiative by UNDP, Asian Development Bank (ADB) etc. This paper is organized as follows: Section-II explores the evolution of inclusive growth from pro poor growth over a period of time. Section III scans the existing literature, Section IV offers an Inclusive Growth Theoretical Model and finally section V concludes.

## **Section – II Evolution of Inclusive Growth**

Development economics is witnessing a paradigm shift from Pro Poor Growth to inclusive growth. Growth means increase in real per capita income. For decades many countries focused on accelerating the economic growth. Then suddenly the global discourse in development economics moved to prop-poor growth. If the growth increases inequality then it will by-pass the poor. High inequality can foster macro-economic instability and will impede the growth itself. Pro Poor Growth (PPG) is identified as that which reduces the income poverty.

For Kakwani (2000) pro-poor growth (PPG) is defined by the *increase in the income share of the poor* (alternatively, in PPG, the incomes of the poor grow faster than those of the non-poor, in which case poverty falls faster than it would if all incomes had grown at the same rate. In contrast, Ravallion (2004) focused on the *absolute improvement of the living standards of the poor*, regardless of changes in inequality. Typically, Ravallion (2004) stressed the pro-poor implications of growth in China because it reduced absolute poverty, regardless of worsening inequality in the country (McKinley,2010). While Kakwani’s rejection of Ravallion’s definition of PPG is debatable. It is too elastic and can potentially include most growth processes in history, Ravallion (2004) criticized Kakwani (2000) for the alleged inconsistency of his definition of PPG- “growth-enhancing policies and institutions end to benefit the poor—and everyone else in society—equip- proportionately.

In other words, while the impact of targeted interventions is both uncertain and weak, growth can *certainly improve* the welfare of the poor. Consequently, attempts to shift the income distribution are largely a diversion, and conventional policies (Kruegar, 1974). The search for a general relationship between growth and equity has highlighted the implications of the two competing definitions of PPG commonly found in the literature. If PPG is defined as *growth that promotes equity*, equity becomes the key principle for the selection of economic policies, and only those policies which directly promote equity are “pro-poor”. Conversely, if PPG is defined as *growth that improves the absolute condition of the poor*, PPG includes all non-perverse types of growth, and any poverty-alleviating policy is “pro-poor”. In this case, equity has only instrumental value: it is a tool which *may* be deployed *if* it increases the poverty-alleviating impact of a given set of economic policies (McKinley, 2009).

The logical consequence of shifting the terms of the debate away from the *principle of equity* and towards the *goal of poverty reduction* is the resolution of the PPG debate in terms that are unfavorable for promotion of equity (ADB, 2007) If everyone agrees that elimination of poverty is the ultimate goal, and admits that growth helps to achieve it, they can disagree only about the combination of policies which maximizes the poverty-reducing impact of growth (and which may or may not include certain modalities of equity). Much of the debates in 1990s focused on links between growth and poverty reduction measured in terms of per capita income and number of people living below poverty line. Accordingly growth is pro poor if it reduces poverty, reduces inequality and enhances the income share of the poor (Han and Throat, 2013).

However if the poor gets benefits but do not participate in the growth process it will widen the inequality. Therefore the policy maker should focus on reducing the inequality. We need to quantify the trade-offs between alternative policies and growth strategies. This necessitated the need for broad based inclusive growth. The paradigm shift to inclusive growth is evident from the Approach Papers of 11<sup>th</sup> Five Year Plan of Government of India (2007-12) which focused on faster and more inclusive growth and 12<sup>th</sup> Five Year Plan (2012-17) which focused on faster, sustainable and more inclusive growth. Inclusive growth is broad based high growth in which the poor not only benefits there from but also participate in the growth process. It not only creates new economic opportunities but also ensures the equal access to them by all, particularly the poor the maximum possible extent.

UNDP's International Policy Centre for Inclusive Growth (IPC-IG) now focused the development perspective on inclusive growth. Its preamble reads the global shift in development debates – "Inclusive Growth is both an outcome and a process. On one hand it ensures that everyone can participate in the growth process, both in terms of decision making for organizing the growth progression as well as in participating in the growth itself. On the other hand it makes sure that everyone shares equitably the benefits of growth".

### ***Section-III: Literature Review***

The usage of the term "inclusive" in the characterization of growth episodes can be traced back at least to the turn of the century when Kakwani and Pernia (2000) employed it to highlight the contents of pro-poor growth as that one enables the poor to actively participate in it and benefit from the growth process. Inclusive growth involved both poverty and inequality reduction. Ali and Son (2007) defines inclusive growth as the growth process that increases the social opportunity function which depends upon the average opportunities available to the population and how these opportunities are shared among the population.

According to Ali (2007) the key elements in inclusive growth are employment and productivity, development in human capabilities and social safety nets and the targeted intervention. Habitat (2009) defines inclusiveness of economic growth as gross domestic product growth that leads to significant poverty reduction. Elena and Susana (2010) of World Bank focused on both the pace and pattern of growth and have identified the employability of the poor and the cost of capital, geography and infrastructure as building blocks of inclusive growth analytical framework.

Elena and Susana (2010) defined inclusive growth as that growth which can reduce poverty and allow people to contribute to economic growth and benefit from the growth process. They pointed out that rapid pace of growth is unquestionable necessary for substantial poverty reduction but for growth to be sustainable in the long run should be broad based across the sectors and inclusive of the large part of the country's labor force. This definition of inclusive growth has a direct link between the micro and macro determinants of growth. Inclusive growth is disadvantage reducing growth (Klasen, 2010). Growth Report (2010) notes that inclusiveness is a concept that encompass equity, equality of opportunity and protection in market and employment transitions. World Bank (2009) stated that inclusive growth can be achieved by focusing on expanding the regional scope of economic growth, expanding access to assets and thriving markets and expanding equity in the opportunities for next generation.

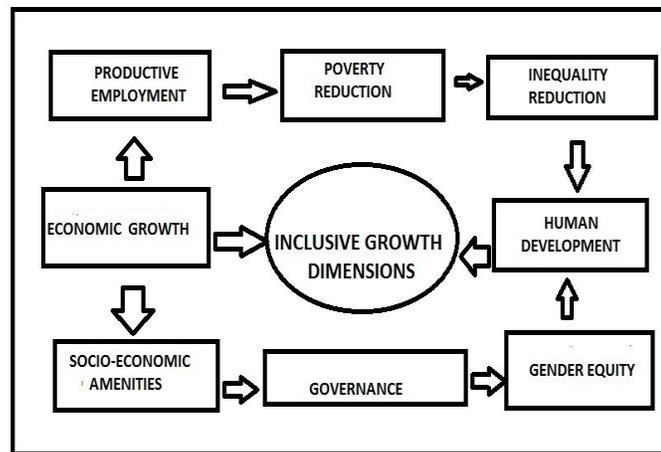
McKinley (2010) identifies that inclusive growth entails achieving sustainable growth that will create and expand economic opportunities and ensuring broader access to these opportunities so that members of society can participate in and benefit from growth. In reviewing the ADB literature Raumiyyar and Kanbur (2010) point out that while there is no agreed and common definition of inclusive growth or inclusive development, the term is understood to refer to "growth coupled with equal opportunities and consisting of economic, social and institutional dimensions. They further pointed out that inclusive growth is accompanied by lower income inequality so that the increment of income accrues disproportionately to those with lower incomes.

Asian Development Bank (ADB, 2013) defines inclusive growth economic growth that results in a wider access to sustainable socio economic opportunities for a broader number of people, regions or countries while protecting the vulnerable, all being done in an environment of fairness, equal justice and political plurality. Ramos et al (2013) follow the concept of benefit sharing and participation to measure inclusiveness. Exchange rate coordination, improved international tax capacity, coordinated fiscal stimulus, global resource system, issue of macro-economic imbalances are some of the key policy actions that will stimulate inclusive growth in developing countries (Maritns and Lucy, 2013). Inclusiveness of growth is the growth elasticity of poverty in the sense that poverty reduction is the overall objective of any policy debate over a period of time (Han and Thorat, 2013). It depends upon two factors (a) income growth and (b) income distribution (Anand et al, 2013).

Research studies so far focused how to identify whether growth is pro poor or not. Growth process is called distribution neutral if the growth incidence curve is perfectly flat in such a way that all percentiles grow at the same rate, leaving inequality unchanged. The distributional change is pro poor if the redistribution reduces poverty sharply. Therefore the rate of pro poor growth is equal to the distributional correction multiplied by ordinary growth rate (Ravallion and Chen, 1997). The criteria and indicators for inclusive growth framework must be developed for monitoring country progress on inclusive growth (McKinley,2010).

### Section-IV-Theoretical Model for Inclusive Economic Growth

The typical model of inclusive growth for Indian Economy can be constructed as follows.



The theoretical model exhibits the key drivers of inclusive growth in a country. First and foremost, faster and sustainable economic growth is pre requisite of inclusive growth. Perhaps this best explains why the emerging Economies like Brazil, China, India etc. focus more on the accelerated economic growth in the last couple of decades. Economic Growth should provide basic socio economic amenities in the form of food for all, health for all, education for all, electricity for all, access to all weather-good roads and safe drinking water. Government should achieve administrative efficiency and should guarantee gender equity so that the trickle-down effect of the growth will actually materialise. Good governance and gender equity will enhance the human capabilities. Followed by economic growth productive employment is the key driver of inclusive economic growth since jobless growth is as dangerous as stagnation. Productive employment can increase the labour productivity. Employment outcome is an important outcome of inclusiveness. Naturally employment should be capable of poverty reduction. Inclusive growth assumes significant since it alone can uproot the absolute poverty. Inclusive growth can substantially reduce the income inequality both vertical and horizontal. All these will enhance the quality of human capabilities.

The drivers to inclusive growth exhibited in the conceptual framework can be explained as follows.

**1. Economic Growth:** Sustainable and faster economic growth is pre requisite for achieving the goal of inclusive growth. While the Approach Paper to 11<sup>th</sup> Five Year Plan, Government of India (2007-12) focused on faster and more inclusive growth, the Approach Paper to 12<sup>th</sup> Five Year Plan (2012-17) focused on faster, sustainable and more inclusive growth. However researchers normally face the problem of selecting the right indicator and therefore the choice of indicator of economic growth is very important. One needs to choose between the Per Capita Income and Per Capita Consumption Expenditure. One concern with per capita income at the state level is that it may not adequately measure what reaches the people. Resource rich states may have high levels of average income, which is likely to be appropriated by resource-extracting corporations that may or may not be owned in the state. As a result, average consumption at the household level may still be low. Conversely, states with many emigrants may see inflows from remittances that tend to raise average consumption, even if average state incomes are low. (GOI, 2013). Therefore MPCE can better capture the dynamics of inclusive growth than the PCI. Asian Development Bank's long term strategic framework 2008-2020(Strategy,2020) identifies inclusive growth as its first development agenda with the second and third being environmentally sustainable growth and regional integration. It details two key determinants of inclusive growth: (i) achieving sustainable growth that will create and expand economic opportunities, and (ii) ensuring broader access to these opportunities so that members of society can participate in and benefit from growth. The second determinant for inclusive growth is identified as "expanding human capacities such as investing in education, health and basic social services". Social safety nets are also emphasized to protect the most vulnerable and deprived who have been excluded in the growth process.

**2. Productive Employment:** Growth to be inclusive needs to be pro employment. The concept of productive employment as a fundamental element of inclusive growth was stressed by Bhalla (2007). The concern with the growth and distribution of employment growth was expressed by Elena and Susana (2010). While many low- and middle-income countries have weathered the economic crisis since 2008 well, and economic growth rates have remained high or have recovered, many of the imbalances that caused the crisis and remain responsible for persistent deprivation continue to exist. At the core of this global challenge is a need to enhance populations', and particularly poor and marginalized groups', access to productive opportunities, to find decent jobs, or to maintain and promote their small businesses. The nature of these challenges is different in each country and region. However, across these contexts it is important for research to move beyond the growth-redistribution dichotomy, and advance conceptual and empirical knowledge that identifies the conditions for inclusive growth (Haan and Throat, 2013). The inclusive growth approach takes a long term perspective as the focus is on productive employment rather than on direct income distribution (Growth Report, 2010). While paying attention to marginally excluded groups, we need to focus on descriptions of income earning activities of self or wage employed distinguished by sector, size of firm, by geographical area, type and other features (Elena and Susana, 2010)

**3. Poverty Reduction:** Growth to be inclusive needs to be pro poor. The Tendulkar Committee has moved over from a calorie determined poverty line to a food expenditure determined poverty line. The Report (GOI, 2009) has a concept of inclusive growth wherein the state does not take on itself such pro poor responsibilities but provides for a concept of income supplements for private expenditures for them. (Alag, 2010).

**4. Inequality Reduction:** Growth to be inclusive needs to ensure income equality. Inclusive growth is that which is accompanied by declining income inequality (Raunier and Kanbur, 2010). Measures are needed to track the adverse distributional changes that affect not only the extremely and moderately poor, but also the disadvantaged non-poor (McKinley, 2010). Countries that have successfully reduced poverty but have witnessed increasing income inequality will need to design policies to expand job opportunities and access to social services and infrastructure for regions and populations that are left behind to achieve the goal of inclusive growth (ADB, 2013).

**5. Human Development:** Growth to be inclusive needs to enhance human capabilities. The supply side of the inclusive growth dynamics needs to be addressed i.e. whether the working population possesses the human capabilities necessary to be productively employed to take advantage of available economic opportunities (McKinley, 2010). Access to health and education and other vital infrastructure such as safe drinking water and adequate sanitation decides the quality of human capital. Within the analytical framework of inclusive growth, health and education can also be utilized as an indicator of the degree of equality of opportunity that a country's population enjoys. This implies that all members of a society should be provided with the means to form the basic human capabilities that are an essential foundation for social inclusion. Macro-Economic stability, human capital and structural changes are found to be the key determinants of inclusive growth in emerging world (Anand et al, 2013).

**6. Gender Equity:** Growth to be inclusive needs to ensure gender equity. Achieving greater gender equity is an important aspect of fostering greater inclusiveness of growth including enhancing human capabilities. (McKinley, 2010). Regardless of gender, ethnicity and religion people from all social sectors should be able to contribute to and benefit from economic development (Huang and Quibria, 2013). Both Economic growth and equity are importance to advance the inclusive growth in an economy (Anand et al, 2013)

**7. Basic Socio-Economic Infrastructure:** Growth to be inclusive needs to develop economic infrastructure so that all sections of the society will have *access to safe drinking water, electricity, housing, toilet, transport and financial inclusion*. Inclusive growth results in a wider access to sustainable socio economic opportunities for a broader number of people, regions or countries while protecting the vulnerable, all being done in an environment of fairness, equal justice and political plurality. (ADB, 2013). Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit (Rangarajan, 2008). Financial development creates enabling conditions for growth when access to safe, easy and affordable credits is recognized as pre condition for growth.

The Report of the Committee on Financial Inclusion (2008) advocated the effective improvement within the existing formal credit delivery mechanism, leveraging on technology based solutions, financial literacy and credit counseling, extensive support of micro finance institutions for enhancing the outreach of micro finance to micro, small and medium enterprises and recommended to set up the National Rural Financial Inclusion Plan. Considering the importance of financial inclusion, the proposed research strongly advocate the financial inclusion as an important dimension of inclusive growth.

**8. Governance:** Governance deficit is considered as a crucial hindrance towards achieving inclusive growth (McKinley, 2010). Many developmental programmes were only outlay based, not outcome based. Therefore to be inclusive governance standards have to be lifted and huge elements of accountability and transparency in governance are indispensable. To implement inclusive policies successfully government effectiveness will have to be strengthened (ADB, 2013). Inclusive growth focuses on expanding the opportunities for all while targeting social protection and interventions at chronically poor (Ali, 2007). Therefore social protection through social safety nets should be incorporated as an additional dimension of inclusive growth strategic framework (McKinley, 2010). Recently in India the Mahatma Gandhi National Rural Employment Guarantee Act, 2006 (GoI,2006) fostered inclusive growth by providing employment involving the poor people in the development process and in creating durable community assets which is now paying rich dividends.

### **Section – V - Conclusion**

In brief the inclusive growth theoretical model encompass the whole macro-economic management which attempt to reduce the inequality, urban-rural divides, expansion of human development, investment in human capital and all these need to be addressed through proper policy mix. Therefore it is important to enhance the capacity building of the people which is indeed the main objective of inclusive economic growth unlike the pro poor growth which ensured only the transfer of benefits to the poor through subsidies and other ways. The policy makers have to understand the undercurrent of different dimensions of inclusive growth before framing an appropriate policy mix for achieving the objective of inclusive growth. This paper has thrown open some of the pillars of inclusive growth which a country like India needs to incorporate to get rid of the current policy logjam. Now the billion dollar question is how to measure the extent of inclusive growth which has already generated attention of likeminded researchers across the world. Therefore we need to focus on measurement of inclusive growth or else the endless debate and discourse over inclusive growth will go on without any assessment or diagnosis of inclusive growth in any country.

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Explorative theoretical lenses for inclusive growth. Inclusive innovation can be explored through established management theories, but the richness and variability of the phenomena involved highlight questions that remain unanswered by current organizational and management theory. The boundary conditions in which extant theories operate need to be modified not only to account for these phenomena – the characteristics of context and the initial conditions for innovation – but also to account for fundamental issues in the organization, distribution, and allocation of benefits. Thus the economic reforms have been able to stabilise the fundamentals of the economy and could shift the gear of the economy from crisis-driven economic reforms to development-driven one. Keeping this trend in mind, the then Finance Minister in his budget (2000-01) speech observed, “I propose to put India on a sustained, equitable and job-creating growth path of 7 to 8 per cent per year in order to banish the scourge of poverty from our land within a decade. The next 10 years will be India’s decade of development.” The pace of economic growth and economic development attracted the attention of global researchers in doing complex interpretations to arrive at prudent policy framework which guided development agenda for many underdeveloped and developing economies including India. If the economic growth causes inequitable distribution of opportunities then it results in imbalanced and lop sided development. The theoretical model exhibits the key drivers of inclusive growth in a country. First and foremost, faster and sustainable economic growth is pre requisite of inclusive growth. Perhaps this best explains why the emerging Economies like Brazil, China, India etc. focus more on the accelerated economic growth in the last couple of decades.