How Does Poverty Decline?

Suggestive Evidence from India, 1983-1999

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Abstract

A convincing empirical case has been made in the literature that higher growth translates into lower poverty. However, the empirical correlations do not throw light on the process by which different growth strategies impinge on the incomes of the poor. This paper evaluates the relative impacts of productivity growth in agriculture and non-agriculture on India's poverty decline. Such a sectoral decomposition of growth and its impact on poverty is valuable because the sector amenable to faster growth may not be the one whose growth has a greater impact on poverty. This issue is also integral to understanding the process by which economic growth impacts poverty.

The paper sets up a theoretical model to contrast the effects of productivity increase in the farm and non-farm sector, and we find that these effects depend on whether the region under consideration is a closed economy or an open one. Drawing on the theoretical model, the paper undertakes a counterfactual exericse to estimate the relative contribution of the non-farm sector to the increase in the agricultural wage earnings during the period 1983-1999. The contribution is found to be no more than a quarter of the observed wage earnings. The extension of this methodology to individual states requires the assumption that agricultural productivity growth leads to a net increase in nonfarm employement. The paper presents econometric evidence in support of this assumption.