China Policy Series

DEVELOPMENT AND POVERTY REDUCTION

A GLOBAL COMPARATIVE PERSPECTIVE

Edited by
Yongnian Zheng and Jiwei Qian

Development and Poverty Reduction

Although the absolute number of poor people in the world has declined significantly in recent decades, poverty reduction continues to be a very important issue. There still are very large numbers of poor people, relative poverty is an increasingly concerning problem, and progress on poverty reduction varies enormously from one part of the world to another. Factors contributing to poverty reduction include economic growth, economic integration, and specific poverty-reduction programs, which are often initiated by Western countries. This book considers poverty reduction from a global perspective. *Development and Poverty Reduction* looks at a wide range of specific subjects, across all continents. It highlights in particular how the issues are perceived from a non-Western perspective and especially how the rise of China is both having a profound impact on poverty reduction globally and also changing the overall way in which development and poverty reduction are approached.

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Development and Poverty Reduction

A Global Comparative Perspective

**Edited by Yongnian Zheng and
Jiwei Qian**

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Abbreviations

AAA	Accra Agenda for Action
ADB	Asian Development Bank
AfDB	African Development Bank
ASEAN	Association of Southeast Asian Nations
BHI	Basic Health Insurance
BPEDC	Busan Partnership for Effective Development Cooperation
BRI	Belt and Road Initiative
CAADP	Comprehensive Africa Development Programme
CATTF	Forum for China Africa Cooperation
CCT	conditional cash transfer
CEQ	Commitment to Equity
CGSS	Chinese General Social Survey
CIDCA	China International Development Cooperation Agency
CIIC	China Internet Information Center
CLDS	China Labor-force Dynamics Survey
CPC	Communist Party of China
CPI	consumer price index
CPIA	Country Policy and Institutional Assessment
CPI-U	Consumer Price Index for all Urban Consumers
CSO	civil society organization
CSSF	Conflict, Stability and Security Fund
DAC	Development Assistance Committee
DFID	Department For International Development
EAI	East Asian Institute
EITI	Extractives Industries Transparency Initiative
FAO	Food and Agriculture Organization
FCO	Foreign and Commonwealth Office
FDI	foreign direct investment
FOCAC	China Africa Think Tanks Forum
FOD	first-order dominance
GDP	gross domestic product
GNP	gross national product
GPEDC	Global Partnership for Effective Development Co-operation

HDI	Human Development Index
HIC	higher-income country
HIPC	heavily indebted poor countries
HLF	High-Level Fora
ICAI	Independent Commission for Aid Impact
IDA	International Development Association
IHDI	Inequality-adjusted Human Development Index
ILO	International Labour Office
IMF	International Monetary Fund
IPCC	Intergovernmental Panel on Climate Change
IPP	Institute of Public Policy of the South China University of Technology
IPRCC	International Poverty Reduction Center in China
L2C	Learning to Compete
LDCs	less developed countries
LECS	Laos Expenditure and Consumption Survey
MDGs	Millennium Development Goals
MIC	middle-income country
MNCs	multinational corporations
MPI	Multidimensional Poverty Index
NAEP	National Assessment of Educational Progress
NEPAD	New Partnership for Africa's Development
NGO	non-governmental organization
NSC	National Security Council
NSE	New Structuralist Economy
NSGRP	National Strategy for Growth and Reduction of Poverty
NSO	National Statistical Office
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OPHI	Oxford Poverty and Human Development Initiative
PATT	Poverty Analysis and Tabulation Tool
PBA	performance-based aid
PCC	Peasant Conciliation Committee
PCD	policy coherence for development
PCL	Peasant Conciliation Law
PEM	protein-energy malnutrition
PIDA	Programme for Infrastructure Development in Africa
PPP	Purchase Power Parity
PRC	People's Republic of China
PRSP	Poverty Reduction Strategy Paper
QE	quantitative easing
SALDRU	Southern Africa Labour and Development Research Unit
SAP	Structural Adjustment Programme
SDG	Sustainable Development Goal
SES	socio-economic survey

SEZ	special economic zone
SME	small and medium-sized enterprise
SNAP	Supplemental Nutrition Assistance Program
SOE	state-owned enterprise
SPM	Supplemental Poverty Measure
SSA	Sub-Saharan Africa
SSC	South-South Cooperation
SSDI	Social Security Disability Insurance
SSI	Supplemental Security Income
STEM	science, technology, engineering, and mathematics
TANF	Temporary Assistance for Needy Families
TFL	Tenant Farmer Law
TPA	Tripartite Project Agreement
UI	unemployment insurance
UNDP	United Nations Development Programme
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific
UNHCR	United Nations High Commissioner for Refugees
UNU-WIDER	UN University's World Institute for Development Economics Research
VAT	value added tax
VFM	value for money
WDI	World Development Indicators
WHES	World Hunger Education Service
WIS	Workfare Income Supplement
WP-EFF	Working Party on Aid Effectiveness
WTS	Workfare Training Support scheme

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Part I

Background discussions

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1 Introduction

Poverty reduction in comparative perspective

Yongnian Zheng and Jiwei Qian

Development and poverty governance remain key issues around the world today. Since the mid-twentieth century, economic development has been intimately linked to poverty reduction. The general belief is that the benefits from economic development will automatically trickle down to the poor and will lead to poverty reduction. Internationally, in 2000, the UN Millennium Declaration aimed to halve global poverty by 2015. The target was met five years ahead of the 2015 deadline. Indeed, in the past decades, the numbers of the absolute poor in the world have been significantly reduced. The number of people living below US\$1.9 a day in Purchase Power Parity (PPP) terms was reduced from 1.87 billion in 1990 to 783 million in 2013 (World Bank 2018). This is reflected in the world's two most populous countries, namely, India and China. In India, the rural poverty headcount ratio had decreased from over 60 percent in the mid-1960s to below 15 percent in 2012 (Datt *et al.* 2016). In China, the total number of rural population living below the official poverty line was reduced from 220 million in 1980 to about 56 million in 2015 (Qian 2016).

However, since the 2008 global financial crisis, global economic recovery has been slowing down, while the wealth gap resulting from economic development has widened in both developing and developed nations. The widening income inequality is already posing a major challenge to social justice worldwide. Global governance now will have to transcend the traditional growth strategy based on the neoliberal ideology, enhance governments' abilities to implement social policies and deliver public services, develop effective poverty alleviation strategies, and effectively promote social welfare and freedom.

Developed and developing countries alike face the challenges resulting from development and poverty reduction. According to US Statistics, there are still more than 836 million people living in poverty, or on less than US\$1.5 a day. The majority of these individuals live in developing countries, especially in Sub-Saharan Africa (SSA) and Southeast Asia. Such situations have led to social and political instability in developing countries. For developed countries, economic transformation, free movements of capital and globalization have exacerbated social inequality, forcing governments to rely on social welfare to minimize the effects of poverty on society; nevertheless, such government-sponsored welfare

has led to significant government debts. When governments can ill afford such expensive welfare programs, street riots become prevalent.

Poverty reduction remains an extremely important policy issue for several reasons. First, the number of people in absolute poverty is still huge. In 2010, about 41 percent of the population in the developing world were living on less than US\$2 per day (Alvaredo and Gasparini 2015). Second, relative poverty, which refers to poverty that is “contingent on the average standard of living” (Ravallion 2015: 2004), is becoming an important issue, suggesting that poverty is also a significant issue, even for the developed world. For example, in Italy, about 19.7 percent of its population was living below 60 percent of the median income in 2008, which was set as the poverty line for the EU (Marx, Nolan, and Olivera 2015). Third, poverty is persistent in many countries because there are critical constraints preventing access to health care and education (Rodrik and Rosenzweig 2010). While absolute poverty is defined by the income level, some dimensions of poverty measurement other than income are considered to be very relevant for poverty reduction. The dimensions of poverty measurement could be multiple, including income, education, health, and others. The United Nations Development Programme (UNDP) has constructed a Multidimensional Poverty Index that includes health, education, standard of living, and so on.¹

China as an example of effective poverty reduction

Since the reform and opening up, China has made remarkable progress in economic development, along with poverty reduction. Indeed, China has been regarded as the paramount example of effective poverty reduction. The role of the government in promoting economic development and poverty reduction cannot be underestimated. Poverty reduction, in particular, rural poverty alleviation, has been a very important policy area in China since the 1980s, and particularly so in the Xi Jinping era (since 2012). Since the 1980s, China has initiated development programs to reduce poverty, in particular, in rural areas. Between 1990 and 2011, the number of people living on an income of less than US\$1.25 a day (at 2005 prices) in China dropped from 689 million to 250 million (UNDP 2015). The Millennium Development Goals to reduce poverty were achieved 10 years ahead of the stipulated deadline (*ibid.*).

Economic growth and poverty alleviation have been closely linked in the development process of China. Between the 1980s and the 2000s, poverty reduction policies were largely regional and development-oriented. In the 1980s, 331 key national poverty counties were nominated and resources for poverty reduction were channeled to economic development and revenue-generating activities in these counties. National-level poverty-stricken counties were first designated in 1986. Since 1994, 592 counties have been designated as national-level poverty-stricken counties (*guojiaji pinkunxian*) (Qian 2016).

The gap between the nation as a whole and key national-level poverty-stricken counties in terms of poverty headcount ratio (*i.e.*, the share of the poor in total population) had narrowed from 15 percent in 2002 (*i.e.*, nation: 24.3 percent and

key counties 9.2 percent) to 5.5 percent in 2010 (i.e., nation: 8.3 percent and key counties 2.8 percent) (ibid.).

One important concern from this period is that poverty alleviation policies should take into consideration the reasons for poverty and the accuracy in targeting the rural poor. The effects of many poverty reduction programs are heterogeneous and context-dependent. For example, migration policies are effective in some national-level poverty-stricken counties with a poor natural environment.

Many beneficiaries of the poverty reduction programs are, however, not the rural poor. While income level has been the major criterion for targeting the poor, in accordance with much research in other developing countries, poverty is multidimensional and could include income, education, health, and others. The UNDP has thus constructed a multidimensional poverty index to include criteria, such as health, education, standard of living, among others.

Also, the effects of the programs may not be enduring. Some rural poor (over 62 percent of 35 million in 2009) (Ye, Zhao, and Sun 2013), who had been lifted out of poverty were soon found to have fallen back into poverty (Chen, Mu, and Ravallion 2009; Meng 2013).

Further, income inequality has become increasingly serious, given the achievements of poverty reduction. It has been observed that the trend of the Gini coefficient of household income per capita has been increasing. Between 1984 and 2017, the Gini coefficient increased from 0.277 to 0.467. In 2008, the Gini coefficient of China peaked at 0.491, among the highest in the world.² Households with low income may have difficulty accessing public services. Since the 1990s, the provision of public services has been marketized after the government retreated from providing and funding public services. People have to pay user fees to access public services (Wong and Bird 2008). For example, for junior secondary school education, students in the rural areas were charged over RMB102 on average for miscellaneous fees in 1999 (Lv *et al.* 2004), which accounted for about one-sixth of the rural poverty line in that year.

The 13th Five-Year Outline Plan approved by the National People's Congress in March 2016 has set establishing a *Xiaokang* or an all-round moderately prosperous society by 2020 as the major target between 2016 and 2020.³ In this context, lifting rural residents out of poverty is an indispensable task when building a moderately prosperous society.

The 13th Five-Year Outline Plan stipulates that China should reduce the number of national-level poverty-stricken counties and the number of the rural poor to zero by 2020. In November 2018, it was announced by the State Council Leading Group Office of Poverty Alleviation and Development that the number of poverty-stricken counties reduced by 153 in 2016 and 2017.⁴ The 2017 target was to lift over 10 million rural residents out of poverty, and this was backed by a substantial increase of more than 30 percent in 2017 government expenditure in the central government's fund earmarked for poverty alleviation above that in 2016.⁵

To achieve these goals, social safety nets have been initiated and expanded in the rural areas to protect the poor, through the implementation of the rural social

assistance and rural social security programs in 2007 and 2009, respectively. By February 2018, rural social assistance programs covered about 39.4 million rural residents.⁶ In addition, over 144 million enrollees claimed pension benefit from the social security scheme in 2017 and most of them are residents of rural areas.⁷

Therefore, it is important for both scholarly research and policy research if China's experience is examined in the global context of economic development and poverty reduction. With this aim in mind, in August 2017, the Institute of Public Policy, an independent research institute affiliated with the South China University of Technology in Guangzhou, invited scholars from Europe, the USA, East Asia, South Asia, Africa, Latin America, and Mainland China to discuss the experiences and challenges faced by countries in their global development and poverty reduction initiatives. The conference aimed to deepen the understanding of the issues of poverty reduction through analyses of poverty governance experience in China and around the world.

The chapters in this volume are those originally presented at that conference even though some of the papers were also presented elsewhere. All the papers have been revised to fit our general theme of economic development and poverty reduction. All the contributors hope that this volume can aid in our understanding of worldwide poverty today.

Poverty, inequality, and economic growth

In earlier research, it was questioned whether economic growth is useful for poverty alleviation. For example, Dollar and Kraay (2002: 195) comment, "The world economy grew while during the 1990s, there is intense debate over the extent which the poor benefit from the growth." Recent research in the literature shows that economic growth is highly relevant to poverty reduction (e.g., Bourguignon 2004; Aghion and de Aghion 2006). In particular, the rapid economic growth in the past decades in China and India was associated with large-scale poverty reduction. Rapid economic growth is likely to facilitate the structural transformation from the agricultural sector to the manufacturing and service sectors, thus raising the income/wage level and alleviating poverty (Eswaran and Kotwal 2006).

While economic growth can lift people out of poverty, economic inequality may also be positively associated with poverty. From the recent dataset of 38 countries, including both developed and developing countries (i.e., the Luxembourg Income Study),⁸ a 10-point increase in the Gini coefficient is associated with a 6 percentage point increase in relative poverty (Morelli, Smeeding, and Thompson 2015: 618). Inequality may also be linked to institutions with limited access to economic opportunities (Engerman and Sokoloff 2006; North, Wallis, and Weingast 2009; Acemoglu and Robinson 2012) as there is a lack of investment in public goods and human capital.

In the literature, poverty, economic inequality, and economic development are interconnected (e.g., Bourguignon 2004; Ferreira 2010). In this context, policies, including structural transformation, institutions, development policy, foreign aid, and human capital accumulation, are very important.

However, the way economic growth or inequality can affect poverty reduction could be highly country-specific and related to policies and economic, political, and social conditions there. Poverty affects developing countries in a heterogeneous way at different stages of their economic development. The income differences among developing countries could be more than a factor of 20. Further, the inequality in the political and economic orders can also be related to the quality of the institutions (e.g., the capability of the bureaucracy) in the process of economic development and reducing inequality (e.g., North *et al.* 2013). For example, in the past few decades, East Asia's economic growth policies have been highlighted, in which an export-oriented growth strategy, industrial policy, and an investment driven economy are major features. Many of these policies were connected to the capability of the bureaucracy (e.g., Johnson 1982; Hayami and Godo 2005: 275). Nevertheless, in the Southeast Asian countries or Sub-Saharan Africa, policy implementation could differ greatly, given different initial conditions.

The impact of social policies on poverty reduction could also be country-specific. For example, it has been well observed that conditional cash transfer (CCT) programs in developing countries have great heterogeneity (Lleras-Muney 2018). These outcomes may depend on contextual or compositional factors, such as the labor market conditions and household composition (e.g., marriage/divorce and childbirth) (Marx, Nolan, and Olivera 2015). How these social programs have been implemented can be very important determinants of the outcomes. An example is the set of behaviors that should be emphasized as the conditions for those transfer programs (e.g., children's school attendance and parental work). It was also observed that CCT programs could be useful in improving school attendance and health care use in the short run but may not be very useful in human capital accumulation (Lleras-Muney 2018).

Poverty issues in the globalized world

Another major change in the recent decades is the unprecedented degree of connectivity among economies across the world. World imports and exports of goods and services as a percentage of gross domestic product (GDP) increased from 38.9 percent in 1990 to 60.1 percent in 2013 (World Bank 2018). Poor countries are generally less open to capital flow than rich countries. However, in recent years, the pace of foreign direct investment (FDI) growth for the rest of world has picked up speed (annual growth rate 8.7 percent between 1990 and 2017), surpassing that of Organisation for Economic Co-operation and Development (OECD) countries (annual growth rate 7.4 percent between 1990 and 2017).⁹ In particular, the share of China in world merchandise exports increased drastically from 1 percent in 1973 to 14.2 percent in 2015 while the US share decreased from 12.2 percent in 1993 to 9.4 percent in 2015 (Helpman 2018).

Economic integration on a global scale has a significant impact on economic growth, inequality, and poverty reduction. First, globalization can promote

economic growth by facilitating the allocation of factors such as capital, commodities, and human resources (Bhagwati 2004). Second, globalization could also have an adverse effect on poverty reduction and inequality (Autor *et al.* 2013; Helpman 2018). Globalization can be defined as a process of businesses “competing with everyone from everywhere for everything” (Sirkin, Hemerling, and Bhattacharya 2008). In other words, the globalization process is related to the distribution of resources among people in different countries. Third, the rise of China is a major change which has had a significant impact on the labor market in other countries. China’s share of world manufacturing exports increased from 2.3 percent in 1991 to 18.8 percent in 2013 (Autor *et al.* 2016). However, recent research showed that the rise of China can have an effect on increasing unemployment rate and lowering the wage rate in the local market in the United States (*ibid.*), raising the poverty rates of some regions in the United States.

The contributions of this volume

As mentioned above, policies and institutions have a country-specific and heterogeneous effect on economic growth, poverty alleviation, and economic inequality. Studies on national experiences of economic growth and poverty reduction are important for both scholarly understanding and policy purposes. As globalization and international economic integration are increasing in importance, some new phenomena in poverty reduction and economic growth have been registered. For example, the role of foreign investment and international trade in the local labor market could be critical to both economic development and poverty reduction. Of particular note is the saliency of poverty issues even in developed countries in the context of the dramatic scale of globalization. For example, the child poverty rate in the United States is about 20 percent (Lleras-Muney 2018). How this process of economic integration interacts with economic development and poverty growth could also be country- or region-specific.

The contribution of this edited volume is twofold. First, this book details a wide range of country- or region-specific experiences in economic development, income redistribution, and poverty reduction. Chapters in the book attempt to discuss the triangular relations between poverty, inequality, and economic development from the policy perspective. Industry policies, poverty reduction initiatives, and income redistribution programs are some examples of these policies to promote economic growth, reduce poverty, and address income inequality. National policies in both the developing and the developed countries are covered, including America, Africa, Southeast Asia, and East Asia.

Second, chapters in the book also provide an account of the new trend of global economic integration and the changing global economic order, particularly both foreign aid and foreign investment. How foreign aid and investment can make an impact on the local economy and the role of China as a rising power in global economic order are discussed. China may provide more foreign aid,

contribute to infrastructure building in developing countries and perhaps facilitate knowledge transfer based on its own experiences in poverty reduction and economic growth (e.g., Lin and Monga 2017).

The organization of the book

The book consists of 14 chapters, which are divided into five Parts. In this first Part, a background of poverty reduction in China is covered in the Introduction. Also, the relation between economic development, poverty reduction, and inequality in China has briefly been discussed. In Chapter 2, Yongnian Zheng provides a conceptual framework to discuss how the state interacts with the market in the process of economic development. In this chapter, Yongnian Zheng traces the intellectual origins of the role of the state in China and Europe respectively, to see how the two civilizations have generated two different concepts of relations between politics and economy. He suggests that, in the European tradition, politics is supposed to be separate from economic development, while based on the political culture in China, promoting economic development is an “indispensable means” for the state to achieve its goals.

Part II focuses on the United States. In Chapter 3, Douglas Besharov and Douglas Call discuss the major challenges of poverty alleviation in the United States. Means-tested social programs, such as Unemployment Insurance, Supplemental Nutrition Assistance Program, Medicaid, and Social Security Disability Insurance, have been employed to address the poverty issue. Although these social programs are useful in reducing poverty, Besharov and Call underline the disincentives for work and marriage in line with these programs. For them, the active labor policy implemented in other developed countries, mainly the European countries, could be one solution to address the disincentive problems.

Part III discusses the conditions in the African countries. Chapter 4, co-authored by Tony Addison, Ville Pikkarainen, Risto Rönkkö, and Finn Tarp, is a comprehensive review of the growth, poverty, and development in Sub-Saharan Africa. It covers economic structural transformation, macroeconomic governance, foreign aid, and other issues in the Sub-Saharan Africa economies as well as challenges, including demographics. This chapter also explores the relationship between economic growth, development, and inequality in the Sub-Saharan African countries. They argue that the objectives of development are more general than economic growth. Health, education, and other non-monetary indexes can also be considered part of development. They highlight the relevance of structural transformation, the urban informal sector, and foreign aid in these countries to reduce poverty. Some key challenges for the future development of the Sub-Saharan African countries, including infrastructure, agriculture development, and public sector capacity, are discussed.

In Chapter 5, Mark McQuinn gives an overview of the paradigm of aid under the Overseas Development Assistance program provided by the OECD countries to Africa, compared to that from China. McQuinn argues that the current

paradigm of foreign aid is experiencing serious challenges and China provides a possibility for the paradigm change. However, evidence-based evaluation is necessary to understand to what extent China's foreign aid is effective.

Humphrey P. B. Moshi's Chapter 6 discusses the challenges of poverty alleviation in African countries. He highlights the importance of the agricultural sector in the process of poverty alleviation. Moshi also argues that Africa can learn from China's experiences and should deepen Africa-China cooperation, which could be useful in capacity building and infrastructure development.

In Chapter 7, Michael Mitchell Omoruyi Ehizuelen also highlights the relevance of China's experiences in poverty alleviation to African countries. In this chapter, strong state capacity in mobilizing resources to reduce poverty and development-oriented poverty have been considered to be among the major reasons for China's poverty reduction experiences. As in Humphrey Moshi's chapter, Africa-China cooperation is one of the points highlighted. Knowledge sharing and increased training and capacity-building activities between African countries and China have been suggested.

Part IV, on Southeast Asia, starts with Chapter 8 by Peter Warr. Warr turns to the situation in Southeast Asia and suggests that agricultural development is very important for poverty alleviation. He analyzes the determinants of poverty in Southeast Asia in recent years. By using data from seven Southeast Asian countries, he argues that the relative price of food and the sectoral composition of economic growth are major determinants of poverty reduction, subject to the economic growth rate.

In Chapter 9, Yap Kioe Sheng discusses the urbanization of poverty in Southeast Asian countries in the context of globalization. The urban informal sector is growing due to migration and economic integration. For the informal sector, employment is precarious and social safety nets are lacking. Human development in the informal sector, including the attainment of education and health, is an important issue. Yap Kioe Sheng also argues that globalization has worsened unemployment.

Part V is about East Asian countries. Justin Yifu Lin starts the discussion, in Chapter 10, by studying the economic growth strategy in China. Lin highlights the importance of comparative advantage in economic development. The timing and strategy in the process of economic transition could be what other countries could learn from China's experiences. Besides policy-making implications, Justin Yifu Lin suggests that the experiences of China's economic growth in recent decades can even shed light on theoretical economic development in the future.

In Chapter 11, the late John Wong highlights the poverty reduction experiences of East Asian countries in the process of economic development. He underlines the relevance of economic development, which is fundamental to poverty reduction. He cites examples from different countries in Asia, such as Japan and Korea, to illustrate the point. Singapore is also highlighted as an example of successful poverty reduction by focusing on human development, such as education and training. Social policy in Singapore, such as housing

policy and a compulsory pension scheme, is also very useful in addressing the poverty issue.

Echoing Chapter 8 by Peter Warr, Yoshihisa Godo suggests, in Chapter 12, that agricultural development is important in reducing inequality in Japan, especially since the 1950s. According to Godo, the income gap between urban and rural residents in the pre-war period had widened in Japan. However, Godo argues that through the political participation of farmers, institutions for income redistribution have been established in post-war Japan and the income gap between urban and rural residents has since narrowed.

Chapter 13, by Jiwei Qian, reviews the condition of the urban informal sector in China. Based on some recent research, he argues that the urban informal workers in China have lower incomes and less social protection, compared to their counterparts in the formal sector. For these workers, the intergovernmental fiscal system, the performance evaluation system for officials, and the household registration system (*hukou*) are major institutional constraints to participation in the labor market and coverage of social insurance. Interestingly, responses from urban informal workers to these institutions may offset some of the welfare losses.

Discussion and conclusion

There are a number of overlapping themes upon which chapters have a dialogue:

- 1 *Government strategies for economic development* are very useful. There have been debates on whether institutions or policies are pivotal to economic development. For institutionalists, economic development mainly depends on institutions, which reflect long-lasting historical, cultural, or geographical factors (e.g., Easterly 2005: 1054; Fisman and Miguel 2007). In contrast, the policy view is that changes in knowledge about development policies or in political incentives can result in rapid changes in economic development (Easterly 2005: 1054). This point is clearly illustrated by China's experiences in the past four decades, discussed in Chapters 2 and 10, by Yongnian Zheng and Justin Lin. Similarly, in the context of Sub-Saharan Africa, Tony Addison, Ville Pikkarainen, Risto Rönkkö, and Finn Tarp highlight the importance of policies in promoting human capital in the area of health, education, and so on. Policy also matters for the poverty reduction area. In the context of the East Asian countries, John Wong argues that economic development can be considered a strategy employed by the government to reduce the poverty headcount.
- 2 The structural transformations from agriculture to industry and from rural to urban areas are important in the process of economic development. Tony Addison, Ville Pikkarainen, Risto Rönkkö, and Finn Tarp discuss the structural transformation in the Sub-Saharan African countries, which is still very relevant for economic growth today. In a different context, Peter Warr highlights the important role of the agricultural sector in the process of economic development in Southeast Asia. In the policy area of poverty reduction, Yap

Kioe Sheng discusses the urban informal sector in Southeast Asia and how this sector can be linked to urban poverty. Jiwei Qian argues that the urban informal sector in China could be associated with lower economic productivity and urban poverty. While the speed of structural transformation in post-war Japan has been very rapid, income inequality between urban and rural Japan has been reduced because of the political participation of farmers

- 3 *The role of social programs, such as a social safety net*, could also be very important when poverty is a result of adverse shocks from unemployment or diseases (e.g., see Darity, Lopez, Ajilore, and Wallace 2012). However, how to target the correct groups of people is critical (e.g., Currie and Gahvari 2008). Besharov and Call analyze how means-tested programs in the United States provide disincentives to beneficiaries to work. The chapter by Besharov and Call is consistent with the recent empirical findings that means-tested programs in the United States are less useful for poverty alleviation than social insurance programs (Ben-Shalom, Moffitt, and Scholz 2011). Similarly, the findings in Chapter 13 by Jiwei Qian show that social insurance in China is not very effective as some workers opt out of the social insurance programs because of the shallow coverage of these programs.
- 4 *Globalization and foreign aid* have a very heterogeneous impact on both developed and developing countries. The role of China in international development and foreign aid has been discussed in the various chapters by Moshi, Ehizuelen, and McQuinn. McQuinn also examines the positive impact of foreign aid and globalization in Africa. Yap Kioe Sheng, however, shows that globalization, in particular, the penetration of multinational companies, can increase the size of the informal sector and urban poverty in Southeast Asia. In Yongnian Zheng's Chapter 2, interestingly, globalization can induce fundamental changes in the governance modes in both the Western world and China. In some countries in the West, where politics have recently become dysfunctional (e.g., the United States and the United Kingdom), politics and the economy could be linked closely again to address the various challenges, including that from globalization. In China, globalization could introduce structural reforms and offer a new balance between the public sector and the private sector.
- 5 *Knowledge and experiences in one country may shed some light on policy design and implementation in another country*. Developing countries may face similar issues in the process of economic development and a careful policy evaluation of one country could provide some insights for other countries. In their chapters, McQuinn and Ehizuelen suggest that China's experiences in poverty reduction could be very useful in African countries. McQuinn suggests that China's foreign aid policy may be useful in the emerging paradigm of the OECD's Official Development Assistance. John Wong underlines the experiences of East Asian countries and, in particular, Singapore, in poverty reduction which could be very useful for other countries.

The discussions in these chapters, however, have brought to light one important remaining issue, namely, national policies, including industry policies, poverty reduction initiatives, and income redistribution programs, are implemented to promote economic growth, reduce poverty, and address income inequality. However, international economic integration may undermine these national policies for a few reasons. First, production factors, such as capital and skilled labor, can move across borders. In this case, enhancing income redistribution programs may encourage the outflow of capital and skilled labor as the income redistribution programs are likely to raise production costs and reduce the profitability of capital. Second, industry policy/trade policy may not be compatible with international trade agreements, as illustrated by the recent US-China trade war.¹⁰

Notes

- 1 See <http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi> (accessed January 31, 2019).
- 2 See CEIC, available at: <http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi> (accessed January 31, 2019).
- 3 Xinhua News Agency, March 5, 2016, available at: http://news.xinhuanet.com/politics/2016lh/2016.03/05/c_1118243429.htm (accessed January 31, 2019).
- 4 www.xinhuanet.com/politics/2018-11/06/c_1123670288.htm (accessed January 31, 2018).
- 5 http://bjrb.bjd.com.cn/html/2018-01/26/content_218149.htm and www.gov.cn/shuju/2017-05/29/content_5197900.htm (accessed September 29, 2018).
- 6 www.bjnews.com.cn/news/2018/04/25/484618.html (accessed September 22, 2018).
- 7 <http://industry.people.com.cn/n1/2018/0330/c413883-29898174.html> and www.xinhuanet.com/2018-03/30/c_1122612430.htm (accessed September 22, 2018).
- 8 Available at: www.lisdatacenter.org/
- 9 Calculated from the World Bank data, available at <https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>.
- 10 See a recent report in the *New York Times*, available at: www.nytimes.com/2018/08/26/technology/pentagon-artificial-intelligence.html (accessed September 16, 2018).

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2 The state and development

The two political economy models of China and the West¹

Yongnian Zheng

Introduction

In his book, *Jealousy of Trade: International Competition and the Nation-State in Historical Perspective*, Hungarian-born British historian Istvan Hont explores eighteenth-century theories of international market competition that remain relevant to the twenty-first century.² “Jealousy of trade” refers to a particular nexus between politics and economics that emerged when success in international trade became a matter of the military and political survival of nations. The book thus connects the commercial politics of nationalism and globalization in the eighteenth century to theories of commercial society and Enlightenment ideas of the economic limits of politics.

Hont begins with an analysis of how the notion of “commerce” was added to Hobbes’ “state of nature” by Samuel Pufendorf.³ He then considers British neo-Machiavellian political economy after the Glorious Revolution. From there he moves to a novel interpretation of the political economy of the Scottish Enlightenment, particularly of David Hume and Adam Smith, and concludes with a conceptual history of the nation-state and nationalism in the French Revolution.

Although Hont endorses Hobbes’ achievement in inaugurating a new and pure political science, he considers Hobbes to be not the first modern political theorist, but the last political theorist in the post-Renaissance period. The reason for this is that Hobbes declined to regard the economy and commercial sociability as significant elements determining how politics emerged. Hont regards Hobbes’ theory on political science to be anti-commerce.

According to Hont, Hobbes’ perception of politics was pre-economics and thereby pre-modern. Considering that trade and politics are closely associated, modern scholarship on politics should be regarded as a form of political economy rather than what today’s political science stands for. In this regard, David Hume is the pathfinder of modern political theory, while Adam Smith systematically explained Hume’s thoughts and laid the foundation for the modern political economy. In other words, what fundamentally divides classical and modern scholarship on politics is whether they see the economy and commerce as major components of the political agenda or the state agenda of nations.

What I am interested in this chapter is neither Hont's book *per se*, nor the literature he reviewed, but the relationship between politics and economics. More specifically, I am interested in exploring what kind of role the government should play in economic development and poverty reduction. In fact, in his explanation of the politics-economy nexus using the Western literature, Hont revealed the real evolution of that nexus in the West. In the pre-modern history of human society, a similar connection between politics and economics existed in various civilizations. Economics had never been an isolated part of society; instead, it was well connected and coexisted with other fields of society. But in modern times, the rise and development of modern capitalism in the West have led to the gradual detachment of economics from other fields of society, which evolved into what is identified as neoliberal economics today.

Such a development in the West is, however, not universal. In contrast, economics in the Chinese civilization has never evolved into a domain that is independent of society, and the government has always regarded it as its main responsibility in governance.

To sum up, two different models of political economy are derived from distinct processes of evolution between the Western and Chinese civilizations, and the two models continue to shape how states in each civilization perform activities, such as economic development and poverty reduction. In the contemporary era, the two models each have their own advantages and disadvantages, and they can improve their functioning by learning from each other.

Western political economy: the separation between politics and the economy

In both the West and the East, the kernel of political economy is to regard economic activities as a necessary component and political responsibility of the state. According to economic historian Karl Polanyi, in the long history before modern times, a similar economy-politics nexus had appeared in various civilizations, demonstrated by the coexistence and interplay of the economy with other fields of human society.⁴

In modern times, however, with the rapid rise of capitalism, economics began to find its place outside the general studies of society, and eventually evolved into what is termed neoliberal economics today. Basically, the evolving process of Western political economy is characterized as a continuous separation of economics from politics, and such a separation has affected every aspect of Western society. While this separation has served as a fountainhead of industrialization and economic development in the West, it is also the origin of its social problems. By contrast, in the East and especially in China, economic activities are considered to be the ability to generate sources of political legitimacy and have never been excluded from the responsibilities of government. Even though the government-market nexus takes various forms in different economies and at different times, there has been no fundamental transformation of government responsibilities into economic activities. Until today, most people in East Asian

societies continue to have high expectations and belief in the economic responsibility of their government.

Tracing Western political economy back to the era of Ancient Greece, one finds that the Greeks were astonishingly similar to the Chinese in their perceptions of what economics was. In Ancient Greece, a household was regarded as the fundamental unit of a state, and economics mainly referred to the management of household affairs. This matched the standpoints held by ancient Chinese philosophers, particularly Confucian and Legalist scholars. In the West, such a perception of economics did not encounter radical changes during the Roman Empire.⁵ It was only in modern times that politics and economics began to split. It is not the focus of this chapter to go into a detailed examination of this long process, but a brief discussion is necessary.⁶ To put it simply, two major forms of practices have fostered this split in the West: (1) the collapse of the Roman Empire and the rise of merchants; and (2) the rebuilding of political order.

In fact, the Roman Empire had a mixture of politics, economics, and religion. The Empire was expanded and maintained using political power, including military power, and the economy within the borders of the Empire was almost “globalized.” In other words, vibrant trade activities existed among various sub-regions within the Empire. The expansion of the Empire and its religion were driven by each other. Unsurprisingly, the fall of the Roman Empire exerted a significant impact on its economy and religion. Without a unified central government, the Empire broke up into many localized regimes and small kingdoms, and so did the economies. Eventually, religion became the predominant authority throughout the land, and religious-related economies emerged.

In the late Dark Ages of Europe, there was an upsurge in the number of cities. Because there was no centralized regime or authority, cities were autonomous, while merchants became the main body in the political activities of cities.⁷ Merchants played an extremely critical role in Europe’s economic rise, without whom there might be no modern Europe. Max Weber offered a very in-depth discussion of cities and their roles in economic development.⁸ The responsibility of merchants was mainly economic and what they wanted was the smooth circulation of commodities. Since there would be no smooth circulation of commodities without political intervention, their economic roles eventually led to their political functions. To seek profits, merchants preferred markets on a larger scale. The larger the market, the more profits there would be. Hence they had a strong incentive to break out of the boundaries of cities and to expand their market. Before and after the collapse of the Roman Empire, the merchants and kings had similar incentives to enlarge and expand their spheres of influence. In other words, they had identical interests in building an integrated national market and a unified national state. Their common interests became an enormous driving force of the centralization in Europe, and political centralization initiated the long process of modernization in Europe.⁹

The exchange between political power and economic power resulted in the featured institutional setting in Europe. As discussed above, merchants preferred a unified national market and kings desired a unified national state, so their

interests were in line with each other. In fact, most kings seeking to conquer new land suffered from a shortage of financial resources. Therefore, merchants were extremely important because they were probably the only ones who could finance the kings' expansionist activities, including wars. However, as the kings requested financial reports from the merchants, the merchants were uncertain about the extent to which they could trust kings and their promises of expanding the governing borders. To tackle this problem, the merchants dealt with the kings by signing "contracts" incorporating clauses to protect the private property rights of the merchants, without which the kings would face no risks when they defaulted. However, the contracts alone were not enough to guarantee that the kings would keep their promises, especially when their political power was increasingly overwhelming during military expansions.

As the merchants pondered over how they could seize the source of political legitimacy from the kings, this gave birth to the earliest concept of "popular sovereignty." Clearly, the concept of "popular sovereignty" at that time did not include the rights of the entire population as we understand them today; the sovereignty was limited only to wealthy merchants. The approach which the merchants took to achieve "sovereignty" was to take over the parliament, through which government could be established and authorized. Understandably, for a long period of time in modern Europe, the government was built upon the will and interests of the merchants when the parliament was under their control. In Karl Marx's terms, democracy in the West was the democracy of capitalists, while the government was just an agent of capital.¹⁰ In this regard, in Europe, merchants had tamed political power and became the first group of people to share political power with kings.

However, it would be simplistic to characterize the centralizing process of political power as described above. After all, the deal or "contract" was not only signed between political and economic powers, but also between religious groups, localized regimes, and social organizations or civil society. Particularly in the early period, the formation of national states in Europe was extremely violent. In fact, how to accomplish state unification was always a central question for scholars, ranging from Niccolò Machiavelli¹¹ to Thomas Hobbes,¹² and the focus of their thinking formed the early scholarship on politics. According to Machiavelli and Hobbes, politics was the primary resort to solve all problems, and in order to achieve unification, the state should adopt whatever means would guarantee success, according to their doctrine of the end justifies the means. Only when European countries succeeded in state unification did they begin to discuss the roles of governments in developing the economy.

Therefore, Hont's comments were unfair to a large degree, because Hobbes did not live in the same era as political economists David Hume and Adam Smith, and each era is unique, with its own set of conditions and social problems. Only when the problem of state unification had been tackled, did the issue of economic development, which Hume and Smith were concerned with, emerge.

If Machiavelli and Hobbes inaugurated the pure political science and Hume and Smith established the field of political economy, then the discipline of pure

economics, buttressed by the rise of capitalism, has emerged from the political economy of Hume and Smith and become an independent field of research. Hume and Smith were classical political economists whose studies included politics and moral sentiments, beyond simply economic issues. However, things changed radically after them. As hinted at above, while the development of capitalism hinges on the power of the state, capital always attempts to escape from the constraints of politics to gain autonomy, especially when it attains a certain degree of growth. In practice, this autonomy-seeking process resulted in a radical change in economic, political and social relations. In the West, where the destiny of society is highly dependent on economic autonomy, the historic waves of radical change between politics and economics constituted the origins of the modern social sciences.

The merchants and capitalists relied on the power of the state to maintain a unified market, and in turn, they became the foundation of politics by taking control of the government. As such, there was a *de facto* integration of politics and capital, and hence the inexorable rise of ruthless primitive capitalism. At this stage, the capitalists were bent on profits and sacrificing the society. Victor Hugo,¹³ Charles Dickens,¹⁴ and Karl Marx had all described the shocking impact that the rise of capitalism had on society. When society reached breaking point, there were waves of anti-capitalism campaigns. This partially explains why socialist movements originated in Western Europe. However, regardless of the venues and motivations of the socialist movements, they ended when a balance was struck between capitalism and society. Socialist movements actuated the building of welfare states in Europe.

The transformation from primitive capitalism to welfare capitalism was not a natural product of capitalism, but a political process. In other words, it was the interaction of forces from politics, economics, and society that engineered the transformation. At the societal level, the transition was quite straightforward—it was to pursue a decent living standard, higher salaries, higher job satisfaction, and greater educational opportunities, etc. In the very beginning of the socialist movements, these basic demands had demonstrated several essential values of “human rights,” as later defined in the West. However, Marx believed that these demands could only be achieved if the capitalist private ownership system was overturned, and so he advocated social revolution. Although Marx’s ideal was accepted to some degree by the intellectuals of that period, the revolution did not take place as he had predicted, at least in Europe, apart from some less developed countries, such as Russia. Marx overestimated the power of social movements, and underestimated the varieties of political and economic powers. In fact, when socialist movements are launched, capital and politics face a brand-new environment and subsequently undergo self-modification.

There are at least two major motivations for the self-modification of both capital and politics. First, capitalism naturally prefers and requires social stability. To be specific, capitalism has a tendency to achieve growth in the continuous process of investment, and this demands a predictable business environment. Capitalism may even absorb some costs and thereby makes a deal for the

purpose of maintaining stability. In a highly differentiated society, the rule of law alone is insufficient to ensure social stability. Therefore, with regards to its anchoring functions, capitalism does not entirely oppose safeguarding society. Not surprisingly, the first social insurance program in the world was set up in Germany during the Bismarck era, and the aim of the program was to stabilize society.¹⁵ The second motivation for the modification derived from the inherent contradictions of capitalism, in which it not only seeks to exploit the working class but also needs consumers. Given that capital controls production, the products can only generate profits after they have been consumed. The consumer market is divided into domestic and international segments. As demonstrated in history, once the market has been saturated internally, Western capitalism expands outside the domestic market. This is usually carried out through force, through which it obtains raw materials and dumps goods in the non-Western world. Notably, the increase in the number of consumers was not driven by the goodwill of the capitalists, but purely as part of the profit-seeking mechanism. Nevertheless, this process has enabled the working class to partially meet their demands.

As for political transformation, this has been driven by the varying foundations of political legitimacy. In modern times, the foundation of the early system of monarchy was the aristocrats or traditional aristocratic families. As discussed above, after their rise, merchants began to share power with the aristocrats. The merchants were therefore the first social group to participate in the political process that gave impetus to the modern democratization in the West. Although the early electorates were confined to certain groups of people such as men of property and tax payers – and excluded workers, women, and ethnic minorities – elections had their own logic of expansion because candidates inherently prefer winning as many votes as possible. As the right to vote expanded to more groups of people, the foundation of political power also changed. In the early stages, the foundation of political power was the aristocrats and the merchants, and thereafter it was extended to the working class. The extension was precisely a process of converting the working class into the middle class. When the foundation of political power was not limited to the capitalists, the government started to lean toward society. This provided the stimulus to develop the welfare state in the West. In the long period after World War II, it was the political and social powers that fostered the unparalleled progress of welfare states.

The progress of the welfare system strengthened the power of society, while it also revealed the imbalance among capitalism, politics, and society. It was not until the 1980s that capitalism began to seek a new approach to transform the imbalance, and this was the background to the neoliberalist movement, focusing on privatization, launched by Ronald Reagan and Margaret Thatcher. The movement was a reaction against the welfarism since World War II. From the viewpoint of capitalism, welfarism had led to shrinking capital and the emergence of big government as well as a strong society. The movement's effect on privatization on the domestic front was minimal, because privatization was severely restricted in the political environment of "one man, one vote" democracy.

Nevertheless, the “privatization” movement achieved great success externally, which resulted in the globalization of capitalism, which has lasted for decades. The globalization of capitalism enabled it to avoid regulations and constraints by the governments and society in their home countries, and to succeed in profit-making abroad. As a result, the imbalance among capitalism, politics, and society gave rise to extremely unfair income distribution and a highly divided society.

In his (2014) book, *Capital in the Twenty-First Century*, French economist Thomas Piketty discusses the serious income inequality in the contemporary world, and finds that capital has far-outweighed labor in the rate of return.¹⁶ Although there had already been consensus on how capital return outweighed labor, the book had a significant social impact. The real problem was how to resolve the severe income inequality and allow society to maintain its integration. Piketty highlighted the importance of government, and even appealed to all governments in the world to unify. Piketty’s book could be regarded as a political explanation of Western capitalism. However, in the present wave of globalization, capital’s regaining dominance in the West showed that Piketty’s appeal is apparently too idealistic. In reality, it is much easier for global capitals to be unified than for governments. The wave of globalization is a result of the coordination of global capitals, while inefficient governance on the part of governments leads to severe income inequality.

From a historical point of view, the linchpin of the above-mentioned problems is the overwhelming lack of connection between society, politics, and economics in the West. In retrospect, western democracy has completed the transition from an elite democracy to popular democracy. The earliest democracy was elitist, which was the “republic” of the minority. However, with the spread of the “one man, one vote” system since the 1970s, the legitimacy of politics has been underpinned by votes. The transition has brought about several changes.

First, politics was separated from economic development. Although economic issues have always been a subject in election debates in the West, economic development is at best indirectly connected with government. Politicians are more concerned about votes, which is the source of their political power. However, the ways for politicians to retain votes are certainly not confined to improving economic performance.

Second, even if politicians wish to take initiatives in improving economic performance, they lack the effective means to achieve the goal of development. In the West, fiscal and monetary policies constitute two major ways for government to intervene in markets. However, monetary policies will not function well when the interest rate is close to zero, while fiscal policies do not work when government debt is overburdened. Today, western governments are inclined to adopt quantitative easing (QE), namely, increasing the money supply. Nevertheless, the QE may only defer rather than fundamentally solve the economic problems.

Third, the increasingly widening income inequality has resulted in a highly divided society, which in turn has created an equally divided political system.

As a result, politics in many Western countries has lost its capability to centralize. Therefore, it is increasingly difficult to form an efficient government, let alone a government that is capable of advancing and promoting economic development. In the era of the elites' "republic," the Western multi-party system was able to forge consensus among different political parties because all the politicians came from the same elite class. Similarly, political parties can achieve consensus in a society where the middle class constitutes the majority of the population. In such a society, any political party, be it rightist or leftist, will have to take into consideration the benefits and interests of the middle class. However, in the era of popular democracy, especially in a highly divided society, political parties will veto each other as they represent the policy preferences of a divided population.

Given this backdrop, it is not difficult to understand why anti-globalization, trade protectionism, economic nationalism, and populism are found to be increasing in many Western societies today. In essence, these developments are the results of the imbalance among politics, economics, and society. For the West, there is no clear and direct way of regaining the balance through reforms and development. Nevertheless, if the Western governments continue to leave the responsibility of economic development to capitalism and the market, the imbalance will not easily be rectified even if the governments take an active role as the middleman through taxation and fiscal policies.

The Chinese political economy: development as the state's responsibility

In the East, the Chinese civilization has constructed another type of relationship between politics and economics. In the Chinese civilization, the economy has never been treated as an independent area of knowledge, nor has it been independent from the empirical perspective. More specifically, economics has been an indispensable means to achieve state governance. The most important piece of work on economics in ancient Chinese history, *Guanzi*, in its first chapter entitled, "On Shepherding the People," explained how critical the economy was to state governance.¹⁷ During the period of Spring and Autumn and the Warring States, despite the various views held by 100 schools of thought and the disagreements on how robust should the government-economy nexus be, scholars had no disagreements on government's role in the economy. Since *The Discourses on Salt and Iron* in the Han dynasty, consensus on the economic responsibility of the government as well as the way to carry out this responsibility has been formulated in China.¹⁸ As opposed to a modern Western system where economics and politics are separated, the natural nexus between politics and economics intrigued many Western scholars, leading them to see China as a hydraulic society and thereby regarding the hydraulic feature as a source of "oriental despotism" in Chinese civilization.¹⁹ However, from the Chinese perspective, the "hydraulic society" is only a natural reflection of the government's economic responsibility.

For years, many scholars in the West have considered China as purely state capitalism. However, that is not correct since state capitalism is only a part of the truth. The Chinese economy from the Han dynasty to the contemporary era has been consistent for thousands of years, and maintained a complex and sometimes efficient system of political economy. Whether it was named capitalism or the market economy, there have always been at least three layers of the market in the Chinese economic structure. State capitalism always exists at the top, and private capital, such as today's small and medium-sized enterprises (SMEs) in the free market economy, is at the bottom. Between the top and the bottom, there is a middle layer where the state and private capital interact with each other. In this economic structure, the state has to maintain control of the most critical pillars of the national economy, while private capital takes responsibility for the areas unrelated to the pillars. For the middle layer, the government and private capital interact through both cooperation and competition.²⁰ With this triple-layered market system, the government maintains the balance while shouldering the responsibility of economic governance.

In the long history of China, there have been only four brief periods when the political economy structure was in turmoil and that economy was nationalized. The state took charge entirely and markets were distorted or even eliminated. The first is the period during the Wang Mang Reform between the Western Han (206 BCE–9 CE) and the Eastern Han (25–220 CE); the second is the period during the New Policies reform (1069–1076 CE), initiated by Wang Anshi in the Song Dynasty; and the third is the period during Zhu Yuanzhang's Land Reform (1368–1398 CE) in the early Ming Dynasty; and the fourth is the period right before the reform and opening up of contemporary China (the 1950s–1979).

In these four periods, the state-market nexus lost equilibrium and the government dominated demand and supply. Other than these four periods, the state-market nexus has been relatively balanced. Nevertheless, even during these four periods, the fundamental motivation of the government's policy was to achieve more efficient economic governance or better development. The triple-layered market system determines that the Chinese market has to be subject to the state's supervision and regulation.²¹ In other words, the market has been functioning well in Chinese history, even though it did not always belong to the category of the free market system seen in the early stage of Western capitalism. Even after Keynesianism, although Western governments have adopted regulations to tame market forces, the market continues to be dominated by capital rather than the government. In the West, even the government has to comply with the law of the market.

Compared to Western economic theories, *Guanzi* has an overwhelming explanatory power when applied to the thousands of years of Chinese economic history. In this regard, it can be considered the best work on economics in China. For instance, the supply-demand nexus in Western economics is largely adjusted by the market. Even in Keynesianism, which highlights that the government could intervene in economic affairs when necessary, the market still takes a

leading role. This is fundamentally different from the economic philosophy of *Guanzi*. In *Guanzi*, there are 16 chapters on “Weighing and Balancing Economic Factors” (*Qing Zhong*). The agent of “weighing and balancing” is the government rather than the market, and it is about the extent and degree of the government’s regulation over the market, not the other way round.

In responding to the challenges posed by the West in modern times, China has experienced a rapid transition in almost every aspect. For quite a long period until the establishment of the People’s Republic of China (PRC) in 1949, the problem which China attempted to tackle was centered on the state and revolution,²² rather than on the state and development. The latter problem only emerged after the Cultural Revolution. The process was violent but understandable, since the economic development agenda can only be raised after the establishment of political order. What happened to modern China is in fact similar to Machiavelli’s and Hobbes’s proposal mentioned earlier, namely, political order should outweigh other issues, including economic and commercial development.

To tackle the problem of the state and revolution, various political parties in China had come up with different theories and strategies, but the Communist Party of China (CPC) proved to be the most successful. The linchpin of the success was the CPC’s embrace of Marxism-Leninism. In *The State and Revolution*, Vladimir Lenin resolved the puzzle of how to establish a new political order in a less developed country.²³ Mao Zedong and his revolutionary comrades took Lenin’s thought and applied a localized version of Marxism to the Chinese revolution. After which, they overcame all the other political forces and managed to set up a new political order.

After the establishment of the PRC, Mao went on to resolve economic development problems through what he called “continuous revolution,” which he applied when building the state. However, he did not succeed in the way he expected. In fact, his “continuous revolution” failed badly. After the reform and opening up policy was initiated by Deng Xiaoping in the late 1970s, China became one of the few countries in the world that have successfully solved the problem of the state and development. In hindsight, the success of Deng’s reform lies in the return of the old Chinese triple-layered market system, which somehow unconsciously inherited the Chinese reformers’ tradition of learning from their own historical experience. Deng’s approach differentiated itself from the Western trajectory by retaining the state-owned enterprises (SOEs) as the means of driving economic development more efficiently. Although China has learned a lot from the West on operating a market economy, it was not the goal of China’s reform to become a political economy system that is similar to the West. In other words, unlike a totally Westernized economy, the Chinese government has refrained from losing the authority to efficiently intervene in economic activities. In the same vein, China did not replicate the approach of economic transition adopted by the Former Soviet Union and other East European countries. China has rejected radical political liberalization and economic privatization. In this regard, China has also differentiated itself from most developing countries.

At present, the West does not recognize China's market economy status. But the fact is, China may never fully become the market economy as defined by the West. China's economic structure of a triple-layered capital is too entrenched to be fundamentally altered, particularly because this structure has both advantages and disadvantages. Being backed by the government, certain sectors of the Chinese economy, especially SOEs, are less efficient. But this is also true in the West where the public sector tends to be less efficient than the private sector. On the other hand, the middle and bottom layers of the economic structure in China are as efficient and innovation-driven as their counterparts in the West. Furthermore, the triple-layered structure is beneficial to developing countries like China because it can dodge major economic crises, build an infrastructure with high efficiency, and reduce poverty massively and effectively. In contrast, recurrent economic crises inexorably plague Western capitalism, as analyzed by Karl Marx, such as the Great Depression in the 1930s, the Asian financial crisis in 1997, and the global financial crisis in 2008.

In the past four decades, China has not experienced a major economic crisis related to its systemic self-adjustment ability. Since the reform and opening up, China has achieved tremendous economic modernization in a short period, and it has transformed itself into the second largest economy in the world from an impoverished socialist economy. Notably, apart from the number of people who accumulated wealth, what is more important is that China has contributed to the world through poverty alleviation. In the past 40 years, China has lifted over 700 million people out of absolute poverty. This social miracle of poverty reduction is more meaningful than the economic miracle, and the key to this spectacular achievement is the unique system of political economy derived from the economic thoughts and practices of the Chinese civilization.

In a wider sense, the East Asian economic model, including the development patterns of Japan, South Korea, Singapore, Taiwan, and Hong Kong, is a derivative of the Chinese civilization. After World War II, there were no more than 20 economies that had escaped the "Middle Income Trap."²⁴ Among them, five are from East Asia, which belongs to the Confucian cultural circle. In this circle, both the state and society have a consensus that regards economic development as the responsibility of the government, even though there might be some disagreement on how the government should facilitate economic development. Recognizing development as an absolute principle, the five economies have not only accomplished economic development, but also cultivated a middle class. To date, some of these economies, such as Taiwan, are struggling with weakened economic vigor, mainly because their government has failed to efficiently generate economic development. In other words, when the government and economy are separated from each other, East Asian economies could encounter problems similar to the West.

The future of the two models of political economy

Currently, both the Western and Eastern models of political economy are facing serious challenges. In the West, the primary agenda is to discover ways to reconnect politics and the economy, which means politics needs to empower the economy again so that the latter could cooperate with the demand of the former. By doing so, politics, economics, and society would return to a balance. The recent rise of populism and economic nationalism are producing the internal economic problems in many Western societies. The 2008 global financial crisis was the result of the structural imbalance in the West,²⁵ which has yet to improve since then. The main sticking point is, given that politics rarely takes effect, the structural reform that is highly dependent on economic factors alone is difficult to be realized.

As recently demonstrated in the United States, the government has adopted relatively more active roles in economic governance, including re-industrialization, technological innovation, and protecting domestic industries, etc. However, the Trump administration has paid too much attention to trade battles against China, which has few benefits when it comes to improving the US domestic economic structure. Trade protectionism may instead cause more problems in the long term. In some European countries, governments floated the trial balloon of a universal wage policy, namely, the “one person, one salary” policy, which in essence is just another extended welfare state policy rather than an entirely new idea. Above all, it remains to be seen whether the West can accomplish the rebalance between politics, economics, and society through adjustments and reforms as they did when they built the welfare state in the last century.

In the Chinese model, economic development has consistently been part of the government’s responsibility, and China will not only continue with but has also strengthened this practice. However, China needs to proceed with institutional reform to further optimize and balance the triple-layered market structure. If dominated by either statism or market fundamentalism, the structure will be imbalanced. But how to achieve a balance? China can learn from the West in areas such as protection of property rights, the rule of law, and efficient policy implementation. In terms of property rights, it is far from enough to simply highlight the clarification or protection of private properties. Property rights of all sectors should be well defined and protected, including those of SOEs, joint ventures between SOEs and private firms, as well as those entirely owned by private entities. It is worthwhile highlighting that laws should be applied equally and should replace politics and policies in shielding the three layers of capital. With regards to policy implementation, there is a need to actively adjust the imbalance emerging in the triple-layered structure. This would require the government to support and assist different forms of capital, in order to maintain a balance among them.

To draw clearer boundaries among the different sectors, more research is needed to accurately identify the areas that require SOEs to be the dominant player, the areas to be assigned to private companies, and the areas for collaborations between the government and private firms. Additionally, the government

should improve SOEs' efficiency and competitiveness, especially their capability to independently develop instead of relying on monopoly or rent-seeking. In order to enable society to supplement the government's power in balancing against capital, the government should empower society by encouraging its autonomy.

Notes

- 1 The initial ideas expressed in this chapter were presented at the conference organized by the Institute of Public Policy of the South China University of Technology in 2017. The paper was expanded and presented at the International Forum on China's reform and poverty reduction held in Beijing in November 2018. The author would like to thank Bojian Liu for his translation of the speech from the Chinese into English and Chen Juan for her research assistance.
- 2 See Hont (2010).
- 3 Samuel von Pufendorf (1632–1694) was a German jurist, political philosopher, economist, and historian. Among his achievements are his commentaries and revisions of the natural law theories of Thomas Hobbes and Hugo Grotius.
- 4 Polanyi (1944) contends that the modern market economy and the modern nation-state should be understood not as discrete elements but as the single human invention he calls the "Market Society." Prior to the great transformation to the "Market Society," people based their economies on reciprocity and redistribution across personal and communal relationships. As a consequence of industrialization and increasing state influence, competitive markets were created that undermined these previous social tendencies, replacing them with formal institutions that aimed to promote a self-regulating market economy. The expansion of capitalist institutions with an economically liberal mindset not only changed laws but also fundamentally altered humankind's economic relations; prior to this great transformation, markets played a very minor role in human affairs and were not even capable of setting prices because of their diminutive size. It was only after industrialization and the onset of greater state control over newly created market institutions that the myth of human nature's propensity toward rational free trade became widespread.
- 5 For a general discussion, see Zheng and Huang (2018), Chapter 1.
- 6 There is a large body of the literature on this subject. Major works include Karl Polanyi's (1944) book, and Fernand Braudel, *Civilization and Capitalism, 15th–18th Century*, vols. 1–3 (1981, 1982, 1985).
- 7 See Heilbroner (1983, 1994).
- 8 See Weber (1986). The work was published in 1921 after Weber passed away, and incorporated into his masterpiece, *Economy and Society* in 1924. One theme that Weber focused on is how cities took effect in Western economic development. Likewise, in his books such as *The Religion of China: Confucianism and Taoism* and *The Religion of India: The Sociology of Hinduism and Buddhism*, he also explained why cities did not play as important roles in China and India as in the West when it comes to fostering economic development.
- 9 See, for example, Charles Tilly (1975). Tilly's major concern is to understand why the nation-state emerged as a major political form in modern Europe.

The hard questions are: (1) what structural alternatives were possible; and (2) why this alternative rather than the others? I have identified the empire, the theocratic federation, the trading network and the feudal system as possible alternatives. I have then gone on to propose that the pre-existing political fragmentation, the weakness of corporate structures, the effectiveness of specialized organization, the openness of the European periphery and the growth of cities, trade, merchants,

manufactures, and early capitalism weighted the outcome towards the national state. Such a statement implies that a number of other factors like the particular geography of Europe, its cultural homogeneity, and its largely peasant population did not affect the choices among outcomes so much. The way to check out such assertions is through a detailed comparative examination of the correlates of state-making and the alternative processes both in Europe and elsewhere. But this book can be no more than a preface to that noble enterprise.

(Ibid.: 31)

The chapters on different aspects of state formation constitute the core of the entire book.

- 10 In *The German Ideology* (Marx and Engels 1939 [1846]), Marx viewed the state as a creature of the bourgeois economic interest. Two years later that idea was expounded in *The Communist Manifesto*, “The executive of the modern state is nothing but a committee for managing the common affairs of the whole bourgeoisie” (Marx 2015 [1848]).
- 11 Niccolò di Bernardo dei Machiavelli (1469–1527) was an Italian diplomat, politician, historian, philosopher, humanist, writer, playwright, and poet of the Renaissance period. He has often been called the father of modern political science. He wrote his best-known work *The Prince* [Il Principe] in 1513. Machiavellianism is widely used as a negative term to characterize unscrupulous politicians of the sort Machiavelli described most famously in this book. Machiavelli described immoral behaviour, such as dishonesty and the killing of innocents, as being normal and effective in politics. He even seemed to encourage it in some situations.
- 12 Thomas Hobbes (1588–1679) was an English philosopher, considered to be one of the founders of modern political philosophy. Hobbes is best known for his 1651 book, *Leviathan*, which expounded an influential formulation of social contract theory. In the book, Hobbes set out his doctrine of the foundation of states and legitimate governments and creating an objective science of morality. Much of the book is occupied with demonstrating the necessity of a strong central authority to avoid the evil of discord and civil war.
- 13 Victor Marie Hugo (1802–1885) was a French poet, novelist, and dramatist of the Romantic movement. He is considered to be one of the greatest and best-known French writers. Outside France, his most famous works are the novels *Les Misérables*, 1862, and *The Hunchback of Notre-Dame*, 1831. In France, Hugo is known primarily for his poetry collections, such as *The Contemplations* and *The Legend of the Ages*.
- 14 Charles John Huffam Dickens (1812–1870) was an English writer and social critic. He was regarded as the literary colossus of his age. His major works include *A Christmas Carol*, *Oliver Twist*, *Great Expectations*, and *A Tale of Two Cities*. Until today, the term Dickensian is used to describe something that is reminiscent of Dickens and his writings, such as poor social conditions or comically repulsive characters.
- 15 Germany became the first nation in the world to adopt an old-age social insurance program in 1889, designed by Germany’s Chancellor, Otto von Bismarck. The idea was first put forward, at Bismarck’s behest, in 1881 by Germany’s Emperor, William the First, in a ground-breaking letter to the German Parliament. Bismarck was motivated to introduce social insurance in Germany both in order to promote the well-being of workers in order to keep the German economy operating at maximum efficiency, and to stave off calls for more radical socialist alternatives.
- 16 Piketty (2014).
- 17 The *Guanzi* is an ancient Chinese political and philosophical text that is named for and traditionally attributed to the seventh-century BCE statesman Guan Zhong, who served as Prime Minister to Duke Huan of Qi. At over 135,000 characters long, the *Guanzi* is one of the longest early Chinese philosophical texts. For the English versions, see W. Allyn Rickett (1985), pp. 51–58, and “Economic Dialogues in

- Ancient China,” selections from *The Kuan-Tzu*, a book written probably three centuries before Christ, (1954), pp. 31–35.
- 18 See Gale (1967).
 - 19 Wittfogel (1981).
 - 20 Zheng and Huang (2018), Chapter 2.
 - 21 Zheng and Huang conceptualized this political economy system as “Market in State,” which means that the market functions in the regulatory framework upheld by the political entity.
 - 22 Specifically, it means state building through revolution, while “state and development” means developing the economy and making the state greater.
 - 23 See Lenin (2017). Lenin described the role of the state in society, the need for proletarian revolution, and the theoretic inadequacies of social democracy in achieving revolution to establish the dictatorship of the proletariat.
 - 24 The middle income trap is a theoretical economic development situation, in which a country that attains a certain income (due to given advantages) gets stuck at that level. According to the theory, a country in the middle income trap has lost its competitive edge in the export of manufactured goods because of rising wages. However, it is unable to keep up with more developed economies in the high-value-added market. As a result, newly industrialized economies, such as South Africa and Brazil, have not, for decades, left what the World Bank defines as the “middle-income range” since their per capita gross national product has remained between US\$1,000–US\$12,000 at constant (2011) prices. They suffer from low investment, slow growth in the secondary industry, limited industrial diversification, and poor labor market conditions. See *The Economist* (2017) “The Middle-Income Trap: Mixed-Income Myths,” October 17, 2017, pp. 6–8.
 - 25 See, for example, Caballero and Krishnamurthy (2009): 584–588.

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3 Poverty in the US and its causes

Douglas J. Besharov and Douglas M. Call

In the past six decades, the United States has made much more progress in fighting poverty than is suggested by the official poverty measure or the administration's new Supplemental Poverty Measure (SPM). In fact, both measures substantially understate the progress—thus distorting academic as well as political debates. Despite much progress, however, much more needs to be done.

By our calculations, using reasonable corrections to the official US poverty measure, the reported poverty rate would have been about 7.2 percent, rather than the 15.0 percent reported by the US Census Bureau.¹ This does not mean that we have eradicated poverty. Besides the material hardship faced by many low-income Americans—whether or not officially “poor”—the psychological and social conditions under which they live can sap energy and ambition, worsening cycles of intergenerational poverty.

Nevertheless, real progress has been made in combatting many forms of material hardship and this should be celebrated, even if some of it was purchased at the price of government transfer programs that have exacerbated many socially counterproductive behaviors. Further progress will require an honest assessment of this progress—followed by a clear-eyed view of the challenges that remain.

As described below, those challenges include:

- 1 the greater productivity of workers worldwide (especially through automation), and the consequent global competition over wages and outsourcing creating downward pressure on American wages;
- 2 rising health care expenditures, apparently exacerbated by the Affordable Care Act (Obamacare), that increase the cost of American labor and threaten to make it less globally competitive;
- 3 an aging population that is making greater demands on underfunded public and private retirement systems, including Medicare and Medicaid, and that threatens to trigger sharply higher taxes on all American workers;
- 4 millions of low-skilled immigrants, often starting at the bottom of the economic ladder, who have increased the US low-income population and the burdens placed on the social safety net;

- 5 a rising percentage of single-parent families, many of whom face great financial hardships and emotional stresses, with often severely negative consequences for both the parents and the children;
- 6 racial discrimination, especially against black men, coupled with poor education and disproportionate criminality, that reduces job opportunities;
- 7 the continuing inability of public schools to give their graduates the skills needed in the global economy;
- 8 the work and marriage disincentives embedded in most means-tested benefit programs that send the wrong economic signals about the behaviors needed to succeed in a modern economy.

Many of these challenges require long-term solutions, often beyond the effective reach of government. Some, however, are caused by government and could be addressed right now. This includes an area that we have spent many years studying: the work and marriage disincentives embedded in means-tested benefit programs.

Hence, we close with a description of what many other developed countries are doing to reduce dependency on their social programs (primarily unemployment insurance, disability, and social assistance). They call it “labor activation,” and we call it “welfare-to-work” or, more generally, “work-first.” Their experience provides many lessons for the USA.

Measuring and mismeasuring poverty

In the past six decades, the USA has made more progress fighting poverty than is suggested by either the official poverty measure or the government’s new Supplemental Poverty Measure (SPM). Both substantially understate our progress.

The official poverty measure

The official poverty measure of the US federal government is the most commonly used indicator of the material well-being of low-income Americans. It compares an individual’s or a family’s income to the amount believed is necessary to meet a minimum standard of living. For almost four decades, it has been the primary statistic by which the extent of US poverty is measured and on which federal, state, and local governments allocate social welfare benefits.

The current poverty measure was famously constructed in the early 1960s by the economist Mollie Orshansky and her colleagues at the Social Security Administration. Initially, it was an estimate of the proportion of households whose annual income was less than three times the cost of the U.S. Department of Agriculture’s “Economy Food Plan” (now known as the “Thrifty Food Plan”) for a family of that size and composition. Since, at that time, American families on average spent about one-third of their after-tax income on food, the implicit idea was that this “poverty threshold” indicated the income level below which any given household might experience nutritional or material hardship.

In 1969, Orshansky's simple formula was adopted by the federal government as the official metric by which to determine poverty status. It has remained largely unchanged since then, with the major exceptions being adjustments to reflect inflation (1969) and the elimination of separate thresholds for farm vs. nonfarm families and male-headed vs. female-headed families (1981). When it was first established in 1963, the poverty threshold for a family of four was about \$3,100. In 2016, the poverty threshold, adjusted for inflation using the Consumer Price Index for all Urban Consumers (CPI-U), was \$24,339.² Both amounts are for a family with two adults and two children. (Unless otherwise indicated, all amounts are in 2017 US dollars.)

Each year, the Census Bureau issues its estimates of the “poverty rate,” both nationally and with various demographic and geographic breakdowns. Although this chapter focuses on the current measure's weaknesses, despite all its problems, it seems to capture the “big picture” and important trends—and has proven to be a useful and informative policy tool. For example, as Figure 3.1 illustrates, the current measure captures the decades-long decline in poverty among the elderly and simultaneous increase among children. But, as discussed below, and as Figure 3.1 also illustrates, it often obscures what is happening. For example, social security payments are countable and therefore reduce the poverty rate among the elderly, but benefits provided by the Supplemental Nutrition Assistance Program (SNAP; formerly known as “food stamps”) are not countable so they have no impact on the child poverty rate.

Unfortunately, the American official poverty measure fails to provide a full picture of family income, including government assistance and support from other household members. Since the 1980s, research from the left and the right has documented the extent to which the official poverty measure is badly skewed.³ The following is a well-known list, but worth repeating. The official poverty measure simply *ignores*:

- the failure to reflect underreporting of means-tested government benefits (and of income generally);

Figure 3.1 Poverty rate in the United States, by age, 1967–2017

- the failure to include noncash benefits;
- the failure to include the effects of taxes, and particularly refundable tax credits;
- the failure to include the income of other members of the household (including cohabitators);
- the failure to include the value of home equity;
- the failure to adopt more accurate measures of inflation.

If corrections had been made for all these measurement shortcomings, in 2011, the reported poverty rate would have been about 7.2 percent, rather than the 15.0 percent reported by the Census Bureau.⁴

The Obama administration's Supplemental Poverty Measure (SPM)

The Obama administration's Supplemental Poverty Measure (SPM) claimed to fix the problems of the official poverty measure by making some (but not all) of the changes listed above. But because of other changes it made—such as raising the poverty line (“threshold”) to negate the counting of more forms of income—the SPM actually *raises* the measured poverty rate. In 2016, by about 1.3 percentage points (from 12.7 percent to 14.0 percent).⁵ And, because of the way it treats government benefits, it changes the distribution of poverty, making the elderly and Latinos more poor, while making children and African Americans less poor.⁶

Perhaps the best way to demonstrate the importance of measuring income accurately is to see what more complete counting of income does to the much discussed growth in inequality. Between 1968 and 2005, the Census Bureau, using its definition of “money income,” reported that mean family income for families in the bottom quintile appeared to have changed little when adjusted for inflation, rising by a mere \$1,666 (from \$13,101 to \$14,767) or about 13 percent. In contrast, mean family income for the top quintile almost doubled, rising \$83,006 (from \$93,286 to \$176,292). These numbers, however, do not count several forms of income (such as employer-paid health insurance premiums, non-cash government benefits, taxes, and the imputed value of owner-occupied housing). When these forms of income are included, the income of the bottom quintile, instead of being relatively flat for 40 years, actually rose by about \$12,000 or by about 92 percent.⁷

The well-being of low-income Americans

The well-being of low-income Americans, of course, is the main reason why we are worried about poverty status. An outsider to the political debate would think that the evidence of progress is incontestable. Over the past six decades, a combination of higher earnings and sharply increased means-tested spending has improved the physical status of most low-income Americans.

Here is one example: Food program advocates typically cite data from “food insecurity” surveys to claim how much feeding and other nutrition programs

should be expanded. Perhaps. But it is worth noting that, since the 1970s, the physical manifestations of real malnutrition—including emaciation, kwashiorkor, marasmus, stunting, and wasting—have all but disappeared from the nation’s health data.

Between 1973 and 2011, the percent of US children who were underweight⁸ declined from 7.3 percent to 3.5 percent and the percent of children who were short in stature⁹ declined from 9 percent to 6.3 percent.¹⁰ (Many of these children suffered from other illnesses or diseases that caused their being underweight.) Over the past 30 years, there have been almost zero cases of children suffering from protein-energy malnutrition (PEM) and, where cases of PEM have been diagnosed in adults, the vast majority are the result of chronic diseases or drug addictions, and not hunger.¹¹

This is not to say that poverty has been eradicated in the USA. Besides the material hardship still faced by many low-income Americans—whether or not officially “poor”—the psychological and social conditions under which they live can sap energy and ambition, worsening cycles of intergenerational poverty.

Nevertheless, real progress has been made in fighting many forms of material hardship and this accomplishment should be celebrated, even if some of it was purchased at the price of government transfer programs that have exacerbated many socially counterproductive behaviors. Further progress will require an honest assessment of this progress—followed by a clear-eyed view of the challenges that remain. We turn to them next.

Economic challenges

Greater productivity (including automation) and globalization

These have been a mixed blessing for Americans. On the one hand, greater productivity and globalization have brought the gift of lower-priced consumer goods in area after area, in effect, increasing the purchasing power of the poor. In 2005, Jason Furman (then at New York University, and later the chairman of President Obama’s Council of Economic Advisers) summarized the economic literature on the effects of “supercenters,” such as Wal-Mart, on income and wages. Because supercenters have low prices, competing supermarkets also lower their prices, leading to about a 25 percent gain in consumer purchasing power. Households with incomes under \$10,000 enjoyed an increase of about 29 percent in purchasing power.¹²

On the other hand, both greater worker productivity (often through automation) and greater competition from abroad have surely cost millions of American jobs across many industries and regions.

In today’s political rhetoric, this tends to be called the loss of middle-class jobs, but when an entire industry moves abroad—almost all its jobs go with it, low-wage ones included. What remains are jobs in distribution, sales, and government lobbying. Between 2000 and 2017, for example, the number of manufacturing jobs in the United States declined by about 27 percent (from

about 17 million to about 12.4 million).¹³ As President Obama said in the 2012 presidential debates with Mitt Romney, “There are some jobs that are not going to come back because they are low wage, low skill jobs.”¹⁴

An open question is whether these lost jobs have been replaced by others and, if so, whether, on average, they pay more or less than the lost jobs. In the past, the vast majority of economists have believed that these “disruptive innovations”¹⁵ helped the economy to grow and generated new and better jobs. (This is the old “buggy-whip” example.)

Health care costs

Health care expenses have risen much faster than average wages over the last two decades (an average of 5.3 percent compared to 3.5 percent per year)¹⁶—with the result that take-home pay has not risen as much as increased productivity would have predicted—further pressuring those at the bottom. The USA spends more on health care per capita and more as a percentage of gross domestic product (GDP) than any other country.¹⁷ By ignoring how growing health care and retirement benefits have reduced take-home pay, it is all too easy to demagogue income inequality issues.

This is, of course, a much more complicated issue than we have made out. Surely, as a society becomes wealthier, we should expect more spending to keep people healthy and living longer. (That’s better than ever larger cars and houses—but, of course, only if health care spending is reasonably efficient.)

The growth in health care costs is reflected in the changing composition of workers’ total compensation packages, essentially health insurance and retirement benefits as well as wages. Between 1986 and 2016, median total hourly compensation rose from about \$22.33 to about \$25.55, an increase of about 14.4 percent. During this same 30-year period, median hourly wages increased by only \$1.34, or only about 41.6 percent of the total increase in median hourly compensation (wages plus benefits), meaning that the increase in benefits was about 58.4 percent of the total increase in compensation.¹⁸

On the left, many think that wise health care spending requires government supervision and subsidies. On the right, many think the answer is market competition. To the authors, market-based solutions are preferable whenever possible, but the underlying truth is that, since World War II, the USA has added so many subsidies (and cross-subsidies) and non-market provisions (accelerated by Obamacare) that it is extremely difficult to envision a pure market approach.

In any event, even with Obamacare’s unprecedented subsidies (and many think because of them), health care costs will continue to rise unless effective counter-measures are adopted, worsening the employment and earnings prospects of most Americans, especially low-income workers.

Demographic challenges

An aging population

An aging population means higher taxes on young workers to pay for the elderly's underfunded public and private retirement systems, including Medicare and Medicaid, that threaten sharply higher taxes on all American workers. Although those with modest incomes may not pay income tax, they all pay payroll taxes.

According to the Pew Research Center, in the last 25 years, the average wealth of American householders over the age of 65 has increased by 42 percent, compared to a decline of 68 percent for those under 35. The average wealth of elderly American households is now 47 times that of younger ones.¹⁹

As more Baby Boomers retire, the burden on younger workers will only grow. Barring unprecedented taxation of the "rich" (itself a tax on all workers from a macroeconomic perspective), all working Americans will have to pay for the retirement of the often relatively well-off—unless Social Security and Medicaid/Medicare are better targeted.

The author knows the substantive and political issues well, so we will only mention that, as the European experience demonstrates, sharply higher taxes on workers is a direct threat to their wage competitiveness in the global market. The authors explored this general issue in greater detail in a 2010 article, entitled "The Global Budget Race," that appeared in *The Wilson Quarterly*.²⁰

Immigration

Immigration is responsible for an additional 27 million workers in the workforce or about 16.9 percent of the total workforce.²¹ Although there is some disagreement, most researchers have concluded that—on balance—immigration has been good for the US economy. But that is "on balance." While about a quarter of all foreign-born (mainly from Asia) are better educated than the average native-born American, the other three-quarters are not. In 2016, for example, an estimated 24.7 percent of the foreign-born aged 25 and over had neither graduated from high school nor passed a high school equivalency exam (such as the General Educational Development test), compared to only about 7.4 percent of the native-born.²²

Low education means low wages. In 2011, the median income for full-time workers was \$50,056 for native-born men, \$47,547 for naturalized men, and \$28,507 for noncitizen men, compared to \$38,044 for native-born women, \$38,419 for naturalized women, and \$24,347 for noncitizen women.²³ Because so many immigrants start at the bottom of the economic ladder, these low-skilled/low-wage immigrants have had the effect of increasing the number of American poor. A rough indication is revealed by the following, pre-recession calculation that one of the authors made for the *New York Times*: "If the proportion of Hispanics in the population in 2006 had been the same as it was in 1975, then the overall American poverty rate in 2006 would have been 7 percent lower (11.4 percent rather than 12.3 percent)."²⁴

Lest we feel too bad for the economic plight of these immigrants, Robert Lerman of the Urban Institute and American University calculates that the foreign-born in the US workforce have earnings that are more than double that of their earnings in their native countries.²⁵

Recently, the Congressional Budget Office estimated that, over the next 20 years, legalizing the status of currently illegal or undocumented immigrants would lead to a 5.3 percent increase in GDP.²⁶ That is plausible, although it seems to leave out the costs associated with their underfunded Social Security and Medicare benefits in the third decade. It is also an average for all immigrants.²⁷ Those at the bottom will continue to be a burden on the social safety net.

Social challenges

Single-parent families

Single-parent families are a major cause of poverty and, according to many analysts, also a major consequence of poverty. In 2015, 40.3 percent of all US births were nonmarital, including about 29.2 percent of all White births, 53 percent of all Hispanic births, and 70.6 percent of all African-American births.²⁸ For each group, rates were far lower before the War on Poverty.

One of the primary reasons why the nonmarital birth rate has increased is because it is an arithmetic function of total births, including marital births, and there has been a steep decline in marriage and in the fertility rate of married women (although, between 2010 and 2015, the fertility rate for married women increased from 84.3 to 89.0 per 1,000 women).²⁹ According to the American Community Survey, about 34 percent of all nonmarital births are to women in households with incomes below \$25,000,³⁰ even though they make up only 15.7 percent of all households.³¹

Whether a cause or effect of poverty (and both are undoubtedly true), single-mother families have lower incomes than two-parent families and often have far greater needs for child care and other social supports. About 45 percent of families with incomes below the poverty line are headed by single mothers.

Many researchers have estimated the impact of family breakdown on poverty rates. According to Maria Cancian and Deborah Reed of the University of Wisconsin, using data from the Census and the American Community Survey to model the effects of increased divorce and increased out-of-wedlock births, these phenomena had an independent effect of increasing poverty by 2.6 percentage points (from 11.5 percent to 14.1 percent) between 1969 and 2006 (an increase which was partially offset by the increase in the number of women in the workforce during the same time period).³²

The financial hardships and emotional stresses faced by single-mother families can have severely negative consequences for both parents and children. Although here, too, there is disagreement about the magnitude, researchers have documented the negative effects of family breakdown on children.

Summarizing decades of research in 2014, Isabel Sawhill of the Brookings Institution writes:

Children raised by single mothers are more likely to fare worse on a number of dimensions, including their school achievement, their social and emotional development, their health and their success in the labor market. They are at greater risk of parental abuse and neglect (especially from live-in boyfriends who are not their biological fathers), more likely to become teen parents and less likely to graduate from high school or college. Not all children raised in single parent families suffer these adverse outcomes; it is simply that the risks are greater for them.³³

All across the developed world, and in most income groups, divorce and non-marital birth rates are rising to unprecedented levels—reflecting cultural and social roots as well as economic ones. What to do? Many suggestions have been made from the left as well as the right. Below, we will address only the role of government means-tested programs play in discouraging marriage.

Racial discrimination

Racial discrimination has long hurt the economic prospects of African Americans and other disadvantaged minorities. Most experts think that racism still plays a significant role, especially for black men. But even here, progress is real, if mixed.

According to Harry Holzer of Georgetown University, in 2004, there was little difference in the incomes of white and black women—when education was taken into account. Yet, there were still large differences between white and black men, about 28 percent between college-educated, for example.³⁴ Expert opinion is mixed, but the cause of earnings differences is undoubtedly a combination of poor schooling (even if black and white men have the same number of years in school), disproportionate levels of criminal activity and incarceration, as well as continuing discrimination.

Government programs

K-12 education

The poor quality of K-12 education leaves many American students ill-equipped to find well-paying employment. In consequence, the absence of a skilled workforce leads many firms to relocate abroad, contributing to the downward spiral in “good” jobs that the USA is experiencing.

Although the underlying impact of weak public schooling is difficult to disentangle from the demographic changes that have engulfed American schools (as well as those in other developed countries), the available data suggest that, despite billions of dollars of added spending,³⁵ the performance of American students has been essentially unchanged—for 40-plus years.

The most widely used measure of student learning is the National Assessment of Educational Progress (NAEP), a large, ongoing nationally representative assessment of US students' knowledge and ability in a variety of subject areas. Often called "The Nation's Report Card," the main NAEP assesses reading and math skills every two years, based on a random sample of all American 4th, 8th, and 12th grade students. According to the NAEP, US students evidence no statistically significant increases in either math or reading over the past 40-plus years.³⁶

It is difficult to see how there will be great progress in the fight against poverty without substantially improved schooling, particularly for disadvantaged minorities.

Means-tested benefit programs

Means-tested benefit programs undermine much of the good they do because their very structure creates substantial disincentives to work and marriage. As these programs have become more generous and as eligibility has crept to families with higher incomes, many more Americans have become subject to these disincentives. Economist and Nobel laureate Gary S. Becker and others have called this "European disease" of over-dependence on government programs, but, as described below, many European countries have adopted policies that attempt to remedy the problem while we seem unable to do so.³⁷

Even before the Global Financial Crisis and the continuing economic weakness, safety net programs were steadily increasing in size. Between 2000 and 2016:

- *Unemployment insurance (UI)* spending increased slightly from about \$30 billion to \$33 billion (almost 100 percent paid by states), and the number of recipients remained about the same at 2.1 million.³⁸
- *Supplemental Nutrition Assistance Program (SNAP)* expenditures almost tripled, growing from \$24.9 billion to \$73.8 billion, and the number of recipients more than doubled, going from about 17.2 million individuals to about 44.2 million individuals.³⁹
- *Medicaid* spending increased by about 50 percent, from about \$294 billion to about \$575 billion (about 37 percent was state spending and the remaining 63 percent was federal), and the number of recipients increased from 31.7 million to almost 75 million.⁴⁰
- *Social Security Disability Insurance (SSDI)* spending from the Trust Fund for benefit payments grew from about \$80.3 billion to \$148.5 billion. The number of recipients grew from 6 million to 10.2 million. For *Supplemental Security Income (SSI)*, spending increased from \$46.5 billion to \$55 billion. The number of recipients increased from 6.6 million to 8.3 million.⁴¹

Some would argue that these increases are merely the result of the safety net responding to the Great Recession and its aftermath. This certainly seems true for Unemployment Insurance which increased to \$118 billion and 9.8 million

recipients in 2011 but subsequently declined to pre-recession levels. However, Medicaid, SNAP, and SSDI expenditures and enrollment began to increase during the Bush Administration and did not decline to pre-Recession levels.

With so many more low-income and now moderate-income workers receiving benefits from these programs, the impact of high marginal tax rates for an increase in earnings has worsened and spread the disincentives to employment and marriage to many more Americans. Estimating these marginal tax rates at a national level is somewhat difficult because states have varying eligibility policies and benefit amounts for different programs. In 2015, Eugene Steuerle of the Urban Institute testified to Congress that, in that year, if a household's income increased from \$15,000 to \$55,000, the average marginal tax rate would be as high as 76 percent if the household received benefits from all the programs for which it was eligible. Although not all households may receive all benefits, Steuerle also adds:

Effective tax rates from work would be higher still if we included consumption taxes, transportation and additional clothing expenses, and, particularly, the out-of-pocket costs of child care. For many on unemployment insurance or disability insurance, benefits may be higher than the returns from a job, particularly if the new job pays less than the old one. Here also, taking a job for one month can result in the loss of months or years of benefits. Add these factors in, and the rate can exceed 100 percent.⁴²

These high marginal tax rates also create a disincentive to marry, assuming that the new spouse has an earned income. By getting married, the new spouse's earnings are applied to the total overall earnings of the family which can lead to a loss in benefits. In a 2015 study, Gregory Acs and Elaine Maag of the Urban Institute found that a cohabiting couple with children (where one member of the couple either is not the biological parent or does not report that they are a biological parent) could lose up to 34 percent of their income (depending on the state) if they were to marry.⁴³

Moreover, SNAP benefits undermine UI and Temporary Assistance for Needy Families (TANF) activation efforts—because benefits rise if UI or TANF are terminated. If the average UI recipient (in a three-person household) loses benefits, monthly SNAP benefits rise from about \$180 to about \$530. If the average TANF recipient (in a three-person household) loses benefits (about \$430 a month), then monthly SNAP benefits rise from about \$400 to about \$530 a month.⁴⁴

SSDI recipients lose their benefits if they have earnings above a specified earnings limit, but are able to keep 100 percent of their earnings below the specified limit and the entirety of their benefits.⁴⁵ No partial benefits are provided. Therefore, SSDI recipients do not have an incentive to take full-time employment unless it exceeds the amount they are already making by combining disability benefits and part-time work. And because benefits are not reduced for each additional dollar of earnings, the effect of exceeding the specified limit is magnified as it represents a 100 percent loss of benefits.

“Labor activation”

Starting in the 1980s and 1990s, many other developed countries experienced extended periods of high and persistent unemployment often coupled by low or declining rates of workforce participation and increases in the number of recipients of government benefits (essentially unemployment, disability, and social assistance). In response, starting in the 1990s, a number of countries introduced policy changes aimed at “activating” those recipients apparently able to work, by requiring them to actively seek employment or to engage in other specified, work or job training-related activities in order to remain eligible for support. With the possible exception of social assistance (welfare programs), other OECD countries have made more fundamental changes to their labor activation policies than has the USA.

Then, with the Global Financial Crisis (starting in 2007 in the United States and in 2008 in the rest of the world), a number of other developed countries further modified their safety-net assistance programs for unemployment, disability, and social assistance. These changes were both programmatic and administrative. The changes they made—and continue to make—can be summarized under four overarching themes:⁴⁶

- *Encouraging work* by embedding coordinated activation requirements, phase-outs, and time limits on benefits (followed by transfers to other programs), and targeted job training services in most various safety-net programs and, when possible, by reducing high marginal tax rates and other disincentives to work.

In unemployment benefit programs, this includes increasing the work-related activities they require of recipients (as in Australia, Denmark, France, Germany, Italy, the Netherlands, and the UK); requiring more intensive monitoring of unemployment benefit recipients after a period of unemployment with failure to comply resulting in sanctions (as in Australia, Austria, Denmark, the Netherlands, and the UK); and establishing one (or more) timed step-downs in benefits that would encourage job seeking (as in Austria and Denmark).

In disability programs, this includes lowering the payments to those found able to work but who do not, and by raising the benefits of those who work (as in the Netherlands); establishing a “partial disability” category of benefits—and parallel procedures to assess the extent of a disability and work capacity (as in the Netherlands and the UK); requiring recipients to participate in labor activation programs such as job search or job training (as in the UK); and establishing more frequent and more intensive monitoring of disability status (as in the Netherlands, Sweden, and the UK).

In welfare/social assistance programs, this includes reducing or suspending benefits for noncompliance in activation programs or for refusal to take “suitable” employment (as in Denmark and France); and establishing one (or more) timed step-downs in benefits that would encourage job seeking (as in Denmark and France).

- *Synchronizing benefits* across safety-net programs to facilitate seamless benefit receipt over time as well as activation and job training efforts, so that, as individuals are time-limited off unemployment and disability programs, they are transitioned to welfare/social assistance—with progressively heightened efforts to get recipients into jobs through targeted job training and benefit cuts. This includes imposing similar activation requirements in both UI and welfare/social assistance programs (as in Australia, Denmark, Germany, the Netherlands, and the UK); aligning phase-out rates of benefits across government programs to create a consistent marginal tax rate (as in the UK with its Universal Work Credit including tax credits, welfare/social assistance, disability benefits, and housing credits—although the implementation of the Universal Work Credit has been problematic); shortening the time limits of UI benefits, but then formally linking them to welfare/social assistance programs so that recipients who time out of the former are moved to the latter with a step-down in benefits (as in Denmark, Germany, and the Netherlands); and by combining the authority for administering both job training and welfare/social assistance in a single government agency (as in France).
- *Decentralizing authority* to local jurisdictions in order to facilitate programmatic innovation, experimentation, and accountability with the help of ongoing performance measurement and collaborative management systems. This includes providing local jurisdictions with funding for welfare/social assistance and allowing them to keep all or a substantial portion of any savings that result from reduced caseloads (as in the Netherlands); giving responsibility for the provision of activation and job training services to the long-term unemployed to sub-national jurisdictions (as in Austria, Germany, and Switzerland); consolidating the administration of services (such as activation and job training services) into one office (as in France, Norway, and the UK), even when it requires combining federal and local agencies (as in Germany); and establishing financial incentives for local jurisdictions with the highest employment placement rates for job training recipients (as in Austria and Switzerland).
- *Outsourcing activation and workforce development services* to increase technical and operational expertise, shift implementation risk, and reduce the programmatic inflexibility and staff rigidities of bureaucratic government agencies. This includes authorizing local jurisdictions to contract out job training, UI, and welfare/social assistance activation services; and encourage them to use results-based or performance-based contracting to improve results (as in Australia, Germany, the Netherlands, and the UK); and implementing a multi-tiered system of screening and services based on the needs of clients, with a process for moving from less intense streams to more intense streams, if they are not making sufficient progress (as in Australia).

Many Americans feel that the European experience is not applicable to the United States, either because of the deep economic crisis they face or because

the Europeans are “socialists.” We think that is wrong. In many ways, they have shown a greater willingness to accept the political costs of lessening the work disincentives embedded in many contemporary social welfare programs. In other words, they are seeking cures for the “European disease.”

Some of the problems that we have outlined in this chapter are uniquely American, of course. Many others, however, reflect conditions that are global in scope or, at least, widespread in the developed world. This suggests the importance of sharing data, experience, and ideas for programmatic improvement.

Notes

- 1 Calculations from the University of Maryland (UMD) Poverty Tabulation Tool using 2007 data from the Current Population Survey and applying it to the 2011 poverty rate.
- 2 US Census Bureau, “Poverty Thresholds for 2016 by Size of Family and Number of Related Children Under 18 Years.” Available at: www2.census.gov/programs-surveys/cps/tables/time-series/historical-poverty-thresholds/thresh16.xls (accessed January 10, 2018).
- 3 See, for example, Douglas J. Besharov and Peter Germanis, *Reconsidering the Federal Poverty Measure* (College Park, MD: Welfare Reform Academy, 2004). Available at: www.welfareacademy.org/pubs/poverty/povmeasure.description.pdf (accessed January 11, 2018); Constance F. Citro and Robert T. Michael (eds.), *Measuring Poverty: A New Approach* (Washington, DC: National Academy of Sciences, 1995); and Nicholas Eberstadt, *The Poverty of “The Poverty Rate”* (Washington, DC: AEI Press, 2008).
- 4 Calculations from the UMD Poverty Tabulation Tool using 2007 data from the Current Population Survey and applying it to the 2011 poverty rate.
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Part III

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4 Development and poverty in Sub-Saharan Africa

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Introduction

When it comes to reporting on Africa, the international news media has, over time, delivered very mixed messages. *The Economist*, in its issue of May 11, 2000, ran an article under the heading “Hopeless Africa” (*The Economist* 2000). But in its March 2, 2013 issue, *The Economist* characterized Africa as a “hopeful continent” (*The Economist* 2013), and the trend in media reports has become more upbeat over the last decade. Yet there are still many who characterize Sub-Saharan Africa (SSA) as a region of hunger, economic crisis, and political unrest. Over the years, generalizations about the region have included claims that: African economies cannot grow sustainably; no progress has been made in education and health; natural resource-rich countries will be forever cursed by their resource wealth; corruption is rampant and irreversible; conflict is inherent to the region; and, lastly, SSA is aid-dependent to the point that development is a lost cause.

It is certainly accurate to say that SSA has, since the decade of independence in the 1960s, experienced serious challenges—much too much has gone wrong, and the high hopes of the early post-colonial era have not been fulfilled. When *The Economist* cast its eye over SSA in 2000, the economic, social, and political fall-out from the intense crises of the 1980s and the 1990s was still evident—the region had seen genocide in Rwanda, wars in Angola, Liberia, and Sierra Leone, the disintegration of Somalia, and the collapse of Zaire (the Democratic Republic of the Congo). Today, there are ongoing humanitarian crises in the Central African Republic and South Sudan, as well as hunger in many areas of the Horn of Africa. Across SSA, infrastructure and education systems are generally underdeveloped and often of poor quality. The region’s health systems are too limited in coverage, especially in rural areas, and have been subject to severe stress, most recently in the Ebola epidemic. And too many Africans remain in deep poverty.

At the same time, when one takes a somewhat longer-term perspective, there is reason to be cautiously optimistic about the region’s development progress. While African societies have experienced deep shocks, many of them have remained remarkably resilient. South Africa peacefully moved on from

apartheid, helping to bring independence to Namibia and peace to Mozambique. Angola, Liberia, and Sierra Leone are at peace, and Rwanda has turned into a remarkable African growth story. Many economies have been turned around, and returned to growth, by the hard work of policy-makers with the support, in many cases, of international development partners. Flows of foreign direct investment (FDI) as well as portfolio flows have been substantial in recent years, and at levels that would never have been imagined in the crisis-era of the 1980s. There has also been some luck: the region has, over much of the time since 2000, successfully ridden the commodities “super-cycle,” driven by rapid and sustained growth in emerging economies, notably in China. The optimism of *The Economist* of 2013 reflected this brighter picture.

Still, SSA and the global economy move on, and the world of 2017 is not that of 2013; in the intervening period there has been a sharp correction in the prices of oil, gas, and metals, and the finance ministries of oil-rich nations which budgeted for oil at US\$100 a barrel are highly unlikely to see it return to those levels. This price correction exposed SSA’s continuing over-dependence on the export of unprocessed commodities, and the long-standing challenge of creating more diversified economies remains to be met. While some countries have moved up to lower middle-income status (Ghana and Kenya, for instance), their brighter economic futures are not yet secure. Growth has stalled in the two biggest economies, Nigeria and South Africa. SSA’s existing pattern of growth is not generating sufficiently good jobs for growing populations, the region’s food security remains vulnerable given that agriculture is still largely rain-fed rather than irrigated (and has low yields), and environmental shocks—such as droughts and floods—will become more frequent if climate change is uncontrolled.

This chapter discusses where SSA has come from, and where it might now be going. It is structured as follows. After this introduction, the second section sets the scene by presenting some of the trends in SSA’s economic growth, and reviews what has come to be known as the “poverty-growth-inequality triangle.” This is followed by an overview of a selected set of non-monetary welfare and human development indicators. Then the chapter turns to the structural weaknesses in the region’s development process to date, while the next section addresses the evolving governance, economic policy, and general societal framework of SSA. Consequently, we identify and discuss a set of core challenges for the future, while the final section concludes on an optimistic yet cautious note.

Aggregate economic growth, monetary poverty, and inequality

The 1980s saw severe crises across much of SSA, as terms-of-trade shocks hit economies and called into question the model of development that had been followed since independence. The 1979 oil-price crisis substantially increased the import bills of oil-importing countries, many of which also saw a fall in the prices of their commodity exports (mainly unprocessed agricultural products) as the global economy slowed in response to the oil-price shock. The resulting foreign exchange shortages undermined the nascent industrial sector, which was

highly dependent upon imports of intermediate inputs and capital equipment. The industrial strategy was largely import-substituting in nature and reliant on mostly small domestic markets (with the hope, subsequently dashed, that regional economic co-operation would eventually enlarge the market). SSA's manufacturing did not attain the large economies of scale and learning-by-doing that East Asia achieved, via its export success, in the 1970s and the 1980s. In hindsight, warning signals from the first global oil crisis of 1973 had been overlooked, partly because SSA performed as well as anyone from 1976 to 1979.

The global economy in the 1980s saw a move to strict monetary tightening, resulting in a sharp spike in interest rates which caught indebted countries, including those in Africa, unprepared.¹ Having borrowed on international financial markets at low (and even negative) real rates of interest, countries were unable to service their external debts, a problem compounded by the collapse in export earnings. Oil economies such as Nigeria borrowed heavily on the back of the rise in their oil earnings, only to see a slump in those earnings as the price fell back in the 1980s (following the rise in global interest rates and the resulting global economic slowdown).

Caught in a serious debt trap, much of SSA entered more than a decade of stabilization and structural adjustment, assisted by concessional (and conditional) lending from the International Monetary Fund (IMF) and the World Bank, as well as loans and grants from bilateral aid donors. The 1980s have been characterized as a disastrous experience and “a lost decade” in terms of development for Africa, and the clash between economic policy and development paradigms anchored in, respectively, orthodox and heterodox approaches, was fierce. While we do not pursue this topic in detail here,² it is pertinent to recall that it was only after the Heavily Indebted Poor Countries (HIPC) debt relief program got underway from 1996 onwards that SSA's development prospects started changing more decisively for the better.³

In sum, the shocks of the 1980s exposed the vulnerable nature of the African economies, with their low per capita incomes, generally small economic size, and a degree of openness to trade—with a large dependence on the export of primary commodities. The disastrous performance in terms of economic growth of SSA in the 1980s, which lasted well into the 1990s, is evident from Figure 4.1. Figure 4.1 also illustrates what happened both before and after the “lost decade” in SSA in comparison to other developing regions.

Three observations stand out. First, SSA certainly did experience a “growth turnaround” when one compares the 1980s and the 2000s. This is important for many reasons, and highlights that the 1997 financial crisis had only a relatively limited impact on SSA.

Second, while the “growth turnaround” is clear, actual per capita growth rates in SSA have remained far lower than those experienced in East Asia and the Pacific. With a very high population growth rate, SSA needs its economies to grow at a significantly greater rate than its population for per capita income to show substantial improvement. SSA's population growth is presently (2016) around 2.7 percent (World Bank 2017), far above that of the two other developing regions,

Figure 4.1 Real GDP per capita growth rate by region

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

The region aggregates exclude high-income countries defined as having higher than 12,235 GNI/capita (current US\$).

and it will cause the total number of Africans to increase very significantly in the coming decades due to the underlying population dynamics (see Figure 4.2).

Third, comparing the 2000s and the 2010s, the aggregate growth performance has dropped in SSA, as elsewhere. This reflects in part the impact of the global financial crisis of 2009 and the falling commodity prices, and it suggests that SSA was not as immune to the 2009 global shock as it was in 1997.

A fourth observation to consider when reviewing the African growth performance is that the aggregate growth rate for SSA hides very considerable variation both over time and among countries, as shown in Table 4.1. Ignoring countries for which data are not available for some of the sub-periods/decades under study, only four (Botswana, Burkina Faso, Lesotho, and the Seychelles) experienced positive average growth rates in all six decades. Turning to the 2000s and 2010s, there are only six countries (Ethiopia, Mauritius, Mozambique, Rwanda, Sudan, and Tanzania) with per capita annual growth above 3 percent in both decades, and growth was less than an average of 2 percent per year in either one or both periods in no less than 35 of the 48 countries included. This includes 11 cases where growth was outright negative in either one or both periods, with Zimbabwe and South Sudan as examples of outright economic collapse. Importantly, regional powerhouses, such as South Africa, and to some extent Nigeria, have been among the poorer growth performers since 2000 (with Kenya also experiencing periods of low growth during this time).⁴

Figure 4.2 Population projections by region, 1950–2049

Source: Authors' illustration of data from United Nations Population Division (2017).

Note

Data from 2016 are forecasts.

A key question facing policy-makers in Africa and beyond is whether the growth experienced in SSA has been translated into reduction in consumption-based monetary poverty. Figure 4.3 suggests this has been the case when focusing on the headcount ratio based on the widely used US\$1.90 a day poverty line. By this measure, poverty fell from 54 percent of the population in 1990 to just

Figure 4.3 Monetary poverty headcount ratio at US\$1.90/day (2011 purchasing-power parity), 1981–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Table 4.1 Real GDP per capita annual growth rate in SSA (period average growth rate in percent)

	<i>1960s</i>	<i>1970s</i>	<i>1980s</i>	<i>1990s</i>	<i>2000s</i>	<i>2010s</i>
Angola	N/A	N/A	N/A	-2.23	5.42	1.34
Benin	1.13	-0.19	-0.31	0.97	0.74	1.89
Botswana	4.28	10.07	6.94	2.46	1.75	2.55
Burkina Faso	1.52	1.48	1.24	2.55	2.30	2.31
Burundi	0.39	0.69	1.23	-3.50	-0.10	-0.71
Cabo Verde	N/A	N/A	3.52	7.43	4.54	0.62
Cameroon	-0.36	4.12	1.20	-1.55	0.62	2.59
Central African Republic	-0.08	-0.18	-1.08	-0.77	0.63	-8.14
Chad	-0.91	-3.46	3.10	-0.66	5.83	1.22
Comoros	N/A	N/A	-0.28	-1.55	-0.48	-0.02
Congo, Democratic Republic of	0.57	-2.26	-0.91	-7.65	1.04	4.32
Congo, Republic of	0.99	1.89	2.08	-1.69	1.31	1.38
Côte d'Ivoire	3.78	2.21	-2.66	-0.34	-0.85	3.89
Equatorial Guinea	N/A	N/A	-2.11	25.46	14.83	-2.77
Eritrea	N/A	N/A	N/A	N/A	-1.94	N/A
Ethiopia	N/A	N/A	N/A	-0.82	4.71	7.30
Gabon	4.43	5.37	-1.11	-0.49	-1.30	2.92
Gambia	N/A	1.49	-0.57	0.07	0.26	-0.95
Ghana	-0.32	-1.73	-0.95	1.57	2.58	5.10
Guinea	N/A	N/A	N/A	-0.01	0.42	-0.61
Guinea-Bissau	N/A	1.12	2.34	-1.87	0.11	0.61
Kenya	1.94	3.93	0.26	-0.77	1.09	2.71
Lesotho	3.06	5.44	1.44	2.38	2.53	2.87
Liberia	2.05	-0.31	-5.58	-2.38	-2.03	2.37
Madagascar	0.17	-1.65	-2.24	-1.53	-0.14	-0.20
Malawi	2.41	3.38	-2.22	1.79	1.52	0.94
Mali	N/A	2.83	1.16	1.65	2.29	0.47
Mauritania	4.18	-1.29	-0.68	0.11	1.73	N/A
Mauritius	N/A	N/A	4.40	3.34	3.29	3.43
Mozambique	N/A	N/A	-0.94	4.12	4.72	4.14
Namibia	N/A	N/A	-1.96	0.54	2.80	3.13
Niger	-0.08	-1.06	-2.47	-1.21	0.33	1.80
Nigeria	0.16	1.80	-4.38	-0.93	5.58	1.94
Rwanda	-0.14	1.60	-1.16	-0.85	4.75	4.49
São Tomé and Príncipe	N/A	N/A	N/A	N/A	2.52	2.27
Senegal	-1.45	-0.49	-0.07	0.25	1.17	0.90
Seychelles	1.55	6.27	1.47	2.58	0.69	4.62
Sierra Leone	2.09	-0.02	-1.72	-3.22	2.56	1.61
Somalia	N/A	N/A	N/A	N/A	N/A	N/A
South Africa	3.03	0.36	-0.59	-0.45	2.00	0.60
South Sudan	N/A	N/A	N/A	N/A	N/A	-14.43
Sudan	-1.46	0.46	0.31	2.11	3.73	4.92
Swaziland	N/A	2.17	3.78	0.79	2.39	1.35
Tanzania	N/A	N/A	N/A	-0.11	3.24	3.52
Togo	5.34	0.58	-1.94	-0.02	-0.69	2.21
Uganda	N/A	N/A	N/A	3.25	3.63	2.01
Zambia	0.34	-2.06	-1.80	-1.10	3.84	2.00
Zimbabwe	1.11	-1.25	0.29	0.39	-6.63	3.85

Source: Data from World Development Indicators, World Bank (2017).

below 41 percent in 2013. It is noted, however, that the rate of progress in monetary poverty reduction has been slower than in other regions, though the absolute improvement has been higher than that of Latin America.

Furthermore, while the monetary poverty headcount ratio decreased, population growth has, as already noted, been very fast. Table 4.2 shows that the population of SSA almost doubled from just above half a billion in 1990 to almost 1 billion people in 2013. The implication is that the absolute number of people living in monetary poverty in SSA as measured by the US\$1.90 a day poverty line increased from 278 million in 1990 to 390 million people in 2013.

There is reason to highlight, as well, that choosing the more stringent—yet still very modest—poverty line of US\$3.10 a day implies that the headcount ratio only fell from 74 percent in 1990 to 65 percent in 2013, while the total number of people in absolute monetary poverty by this measure increased from 377 million to 619 million. In other words, two out of every three Africans live on less than US\$3 per day, making it clear why poverty reduction must remain an important overarching aim for development policy and action in SSA.

Growth, monetary poverty, and income inequality tend to be related in what is sometimes referred to as the “poverty-growth-inequality triangle” (see Bourguignon 2004; Arndt *et al.* 2016: 38).⁵ To illustrate, with no growth, the only way in which poverty can be reduced in a closed economy is through lower inequality. Experience has shown that this is impossible to achieve in practice. Similarly, if inequality is high, the poor will tend to benefit less from a given growth performance. Figure 4.4 shows that inequality is very high in SSA in

Figure 4.4 Income inequality across geographical regions, by decade

Source: Authors' illustration of data from World Income Inequality Database (WIID) (UNU-WIDER 2017b) and own calculations.

Note

Figures are based on country-year observations of the net income Gini. If the net income Gini was not available, the consumption Gini was used. If there were multiple country-year observations for the net income or consumption Gini, data with household equivalence scale and largest possible age and area coverage were chosen.

Table 4.2 Population and poverty headcount (in millions of people), and poverty headcount ratio for Sub-Saharan Africa

	1990	1993	1996	1999	2002	2005	2008	2010	2011	2012	2013
Population	511.4	555.8	602.7	652.4	705.9	764.9	830.1	877.0	901.5	926.5	952.3
Poverty headcount ratio at US\$1.90 a day (2011 PPP)	54.3	58.4	57.7	57.1	55.6	50.0	47.0	45.7	44.1	42.6	41.0
Poverty headcount at US\$1.90 a day (2011 PPP)	277.6	324.8	347.7	372.6	392.4	382.7	390.4	400.6	397.2	394.7	390.3
Poverty headcount ratio at US\$3.10 a day (2011 PPP)	73.8	76.6	76.5	76.8	76.5	73.1	70.3	69.1	67.9	66.5	65.0
Poverty headcount at US\$3.10 a day (2011 PPP)	377.2	425.8	461.2	501.3	540.2	558.8	583.4	606.3	611.7	616.2	618.9

Source: Data from World Development Indicators, World Bank (2017).

Note

PPP = purchasing-power parity.

international comparative perspective, though substantial heterogeneity exists among countries. For example, inequality in South and southern Africa is particularly high, with an average Gini index in South Africa of more than 65 (see, for example, Hundenborn *et al.* 2016, or UNU-WIDER 2017b) weighing heavily in the aggregate picture.

Figure 4.5 takes a more granular look at the movement in inequality in SSA since the early 1980s. After the sizeable rise in inequality in the early 1980s, which was a “dismal decade” in this dimension also, there is no obvious trend to note. It is highlighted, though, that the level of inequality in SSA (and elsewhere) may well be underestimated due to what is referred to as the top-tail adjustment issue, i.e., the fact that top-income earners are not captured as well as other income groups in the underlying survey data. The extent to which this is a matter of concern is an active area of ongoing research on income inequality by UNU-WIDER.⁶

A key line of argument in development economics is that economic growth is not an end in itself. At the same time, economic growth is critical to delivering sustained poverty reduction and improved welfare in SSA. Higher inequality means less inclusiveness and that the poor benefit less from growth; similar observations can be made for discrimination by gender, ethnicity, and religion. Inequality and discrimination are key concerns in the Sustainable Development Agenda approved by the world community at the United Nations in September 2015, and the underlying rationale goes well beyond that of the moral imperative of aiming for more equal societies per se. This perspective has been expressed as follows:

Figure 4.5 Gini coefficient in SSA, 1981–2014

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

Gini, SSA countries' simple averages (line), number of countries observed (bars).

The observed level of inequality of opportunities in access to basic services—such as health and education—are ethically indefensible, undermine social cohesion, and fuel a spiral of policy capture by elites which further exacerbates inequality. High inequality tends to rob the poor of voice and so results in a weakening of democracy. The empowerment of women and of historically discriminated groups is a priority in its own right, but it also provides a sound basis for economic efficiency.

(Stockholm Statement 2016: Section 3)

Put differently, income inequality has been found to have a clear negative effect on economic growth in low- and middle-income economies (Castelló-Climent 2010), and gender inequality undermines the health, wealth, and livelihoods of girls and women.⁷ Gender inequality also reduces society's overall wealth by not using to the fullest possible extent the talents of *all* its members; it therefore harms the prosperity of men as well.

Non-monetary welfare indicators and human development

One drawback of the monetary-consumption-based measures of poverty and welfare is that they have proven to be relatively volatile. Arndt *et al.* (2016) and Arndt and Tarp (2017a) elaborate, pointing out that non-monetary measures are more stable. In addition, they provide essential insights into the multi-dimensional nature of poverty and the welfare conditions of the poor. We, therefore, now turn our focus to a set of non-monetary measures, including indicators such as life expectancy at birth, child mortality, health, and school enrollment, after which we discuss insights from existing multi-dimensional welfare indices. Overall, the core message is that while SSA is lagging in development in almost all non-monetary welfare indicators when compared with other continents, there are clear and positive aggregate trends over the past decades (while heterogeneity continues to be characteristic as one moves from one country to the next).

Figure 4.6 provides a telling insight into how life expectancy at birth has evolved in SSA from 1960 onwards. Steady progress from 1960 until 1980 was followed by a period of stagnation until the late 1990s, when renewed progress set in. From 1960 to 1980, life expectancy increased by 8.3 years from 41.5 to 49.8 years, while it only increased by 1.6 years to 51.4 years between 1980 and 1999. Due to renewed progress after 2000, 9 years were added by 2015, by which point, life expectancy in SSA had reached a level of above 60 years. While this remains well below that of the other two developing regions considered here, the gap has nevertheless remained at around 15–18 years, except for the years 1960–75, during which East Asia improved considerably as compared with SSA.

There is a striking similarity between the trends in the evolution of life expectancy in Figure 4.6 and the growth performance discussed in relation to Figure 4.1. This underlines that while poverty and welfare are indeed multi-dimensional concepts, economic performance is of critical importance in low-income environments, such as those of SSA. This is also evident from Figure 4.7, which shows that

Figure 4.6 Life expectancy at birth by major world region, 1960–2014

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

Region aggregates excluding high-income countries defined as having higher than 12,235 GNI/capita (current US\$).

Figure 4.7 Under-five mortality (per 1,000 live births) by major world regions, 1970–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

under-five mortality per 1000 live births fell from more than 240 in 1970 to 83 in 2015. Figure 4.7 reflects again a relative stagnation in progress in the two decades from 1980 to 2000, and there is reason to reiterate that while the overall trend in the progress achieved in this indicator is clear, the level of under-five child mortality remains well above that of other regions, with the partial exception of South Asia.

Non-monetary measures of health contain critical evidence as well. Good health is an important indicator of welfare in its own right, and it affects in turn the process of growth and development through the following four channels: labor productivity, education, investment, and demographics. First, healthier people have more energy and are more productive. Second, healthy children are able to attend school and can absorb more knowledge. Moreover, their parents have higher incentives to invest in their education as the returns on schooling only materialize over the long term. Third, healthy populations may also have higher incentives to save for future consumption, increasing capital for investment, combined with a greater ability to attract more FDI. Fourth, a healthier population triggers a demographic transition that leads to higher rates of growth for labor as well as physical capital and human capital (see Bloom and Fink 2013).

The progress in health has been accompanied by improvements in other types of living conditions. For example, the share of population with access to electricity increased from 20.8 percent to 35.6 percent from 1993 to 2013, and we have also seen a steady increase of 20.7 percent from 1990 to 2015 in the share of the population with access to drinking water from an improved source, as illustrated in Figure 4.8. Such improvements have clearly added positively to the living

Figure 4.8 Access to clean drinking water from improved water source, 1990–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

Region aggregates excluding high-income countries defined as having higher than 12,235 GNI/capita (current US\$).

standards and capabilities of the poor. Still, not all health-related indicators have improved this steadily. Access to sanitation is a case with much more room for improvement. This indicator only increased from 24.2 percent to 29.8 percent of the population in the 20 years from 1995 to 2015. Also within countries there are differences in services provided for different people. For example, access to and quality of basic services are lower in rural compared with urban areas (Brinkerhoff *et al.* 2017).

Progress in measures related to health have gone hand in hand with measures related to education, reflecting in large measure the priority given to social sectors in the 2015 Millennium Development Goals (MDGs). The MDGs guided global development efforts from 2000 to 2015, and influenced the sectoral allocation of both foreign aid and domestic resources (Addison, Singhal, and Tarp 2015). The priority associated with education reflected its role as an aim in itself and the understanding that education helps prepare the youth for more productive jobs, increases equal opportunities, and adds to their knowledge in areas that affect both health and welfare. In short, education adds to human capital, fueling in turn growth and development. The sizeable progress made in school enrollment in SSA from the mid-1990s to date is evident in Figure 4.9, including almost 100 percent enrollment in primary school. However, while increasing numbers of African children are attending school, the quality of their education leaves much to be desired, and policy-makers are now focusing more on improving the quality of the learning environment.

While the share of girls attending school remains lower than that of boys, enrollment rates of both boys and girls have increased significantly over the past 20 years. While the primary school-level enrollment rate increased from 58 percent to 80 percent for boys between 1994 and 2014, the corresponding

Figure 4.9 School enrollment in Sub-Saharan Africa, 1970–2014

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

increase for girls during this period was from 50 percent to 76 percent (World Bank 2017). Reflecting the quality issues referred to above, progress has been less impressive in terms of youth literacy. For young men (aged 15–24), it only increased from 75 percent to 77 percent, and for young women from 62 percent to 66 percent, during the 2000s (World Bank 2017). This reflects a whole gamut of factors ranging from issues, such as low teacher salaries, poor educational infrastructure, and the challenges for poorer households in supporting the educational progress of their children. To illustrate, in Kenya in 2013, teachers were absent from classrooms for 42.2 percent of the time on average and less than 40 percent of Grade 4 teachers had minimum knowledge in the basic reading, writing, and arithmetic skills needed to be effective in teaching (see Martin and Pimhidzai 2013). That said, and while much remains to be done to catch up with other regions, SSA has made major strides in the educational sector over the past 20 years.

We noted earlier that poverty and welfare are multi-dimensional concepts that cannot be fully captured by any single measure. At the same time, there are helpful indices that combine progress across several dimensions, the most widely used being the Human Development Index (HDI), introduced by United Nations Development Programme (UNDP), and the Multidimensional Poverty Index (MPI) put forward by the Oxford Poverty and Human Development Initiative (OPHI 2017). The HDI is a composite measure of average achievement in three important dimensions of human development—(1) a long and healthy life; (2) being knowledgeable; and (3) having a decent standard of living—and it is calculated as the geometric mean of normalized indices for each of these three dimensions.⁸ The MPI complements monetary measures of poverty by considering overlapping deprivations suffered by individuals at the same time. The index identifies deprivations across the same three dimensions as the HDI and shows the number of people who are multi-dimensionally poor (suffering deprivations in 33 percent or more of the weighted indicators) and the number of weighted deprivations with which poor households typically contend.⁹

The region's sound progress discussed earlier is also reflected in the HDI. Figure 4.10 shows the steady increase in the HDI from 2000 onwards. While sizeable gaps remain, compared with other regions, it appears that SSA is on a promising path as measured by the HDI. This evidence is supported by the Global MPI, which shows that while SSA suffers from more poverty than other regions, countries in SSA are indeed reducing both the headcount ratio and the intensity of poverty (Alkire *et al.* 2017). Thus, both monetary and multi-dimensional measures of poverty and welfare point to progress in SSA in recent decades. Arndt *et al.* (2016) and Arndt and Tarp (2017a) emphasize that improvements in non-monetary indicators are also prevalent in relatively weak growth performers.

While both the HDI and the Global MPI are widely recognized internationally and provide helpful overviews of development performance, they have also been subject to discussion, including questions such as: why should indicators be aggregated into a single index; which indicators should be chosen; and how

Figure 4.10 Human Development Index by region, 1990–2015

Source: Authors' illustration of data from UNDP (2016).

should weights for the different indicators included be established? It is beyond the scope of the present chapter to pursue these topics in detail,¹⁰ so we merely point out that the weighting underlying these indices is bound to be arbitrary in nature, implying that robustness checking is called for (Ravallion 2010; Giselquist 2014b). Similarly, the discussion has motivated UNU-WIDER to pursue in its present work program the development of other analytical approaches, including the first-order dominance (FOD) approach described in Arndt and Tarp (2017a). They stress that the FOD approach “allows multidimensional welfare comparisons across populations over time and space while requiring no more restrictive assumptions than a preference to be non-deprived as opposed to deprived in any dimension” (ibid.: 6). This advantage comes at the cost that the FOD criterion sometimes leads to indeterminate outcomes, and satisfaction of the FOD criterion also gives no sense of the extent of domination. It is, however, important that all the detailed country-specific case studies covered by Arndt *et al.* (2016) and by Arndt and Tarp (2017a) reinforce the general assessment outlined above.

Structural transformation, jobs, and the informal sector

The process of economic and social development is intimately linked to the rate of aggregate growth and its composition; and the inclusiveness of a specific growth trajectory is negatively associated with the level of inequality. High

inequality in access to productive assets generally results in high income inequality, requiring a faster rate of economic growth to achieve the same amount of poverty reduction over time as in societies with lower initial income inequality.

Successful development also depends on the extent to which large numbers of people move out of low-productivity agriculture for their livelihoods to higher-productivity activities throughout the economy, including the manufacturing sector, shifting sectoral balances in the process. Figure 4.11 shows that the share of the agriculture sector in the SSA economies has indeed decreased over the past 15 years. However, it remains very high. Large numbers of people, amounting to more than 60 percent of the population, continue to live and work in the rural sector in SSA. On the other hand, the share of manufacturing, as shown in Figure 4.12, has remained low and decreasing. Thus, aggregate growth in SSA has occurred together with de-industrialization. To compare, in East Asia the agriculture sector share decreased significantly. While the manufacturing share also decreased slightly in East Asia, it remained high after its initial growth.

What has been happening in SSA is that people have indeed been leaving the agriculture sector in search of a better living in urban areas, reflected in the fact that the share of the urban population in SSA, which was around 30 percent around 2000, reached about 40 percent 15 years later (World Bank 2017). The transformation and job challenge are that people have not found employment in a thriving, higher-productivity manufacturing sector. Instead they seek a living in the low-productivity services sector, which has increased its share of GDP as illustrated in Figure 4.13, and in the informal sector.

Figure 4.11 Agriculture value added, 1981–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

High-income countries defined as having higher than 12,235 GNI/capita (current US\$) excluded in the regional figures.

Figure 4.12 Manufacturing value added, 1981–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

High-income countries defined as having higher than 12,235 GNI/capita (current US\$) excluded in the regional figures.

Figure 4.13 Services value added, 1981–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

High-income countries defined as those countries having higher than 12,235 GNI/capita (current US\$) excluded in the regional figures.

Put differently, people have moved from low-productivity agriculture into low-productivity services and the informal sector. The services sector has also been increasing its share in East Asia, but to a lesser extent, and at a much higher level of productivity than in SSA. The Latin American pattern shown in Figures 4.11–4.13 reflects much higher income levels, and a manufacturing sector that is giving way to a higher-productivity services sector, in much the same way as agriculture previously gave way to a higher-productivity manufacturing sector: a process that is not currently on track in SSA.

The lack of successful structural transformation of SSA's economies is reflected in the region's jobs crisis. According to the World Development Report 2013 (World Bank 2012), there are 10 million entrants into the labor market each year in SSA, and few find gainful employment in the formal higher-wage sectors. Consequently, while there is limited open unemployment *per se*, about 75–80 percent of the jobs in SSA fit the International Labour Office (ILO) definition of vulnerable employment (Sparreboom and Albee 2011).

Vulnerable employment is described as the sum of own-account workers and contributing family workers. They are, according to the ILO:

less likely to have formal work arrangements, and are therefore more likely to lack decent working conditions, adequate social security and 'voice' through effective representation by trade unions and similar organizations. Vulnerable employment is often characterized by inadequate earnings, low productivity and difficult conditions of work that undermine workers' fundamental rights.¹¹

The share of the informal economy, while inherently difficult to measure, according to the IMF (2017b), accounts for between 20 and 65 percent of GDP in SSA countries, and includes in the IMF approach both non-registered household enterprises and any productive activity that is illegal or avoids compliance with regulations or the payment of taxes. The estimations of the IMF (2017b) highlight that the informal sector share of GDP varies significantly among countries. While the region's oil-exporting countries have an informal sector share of almost 50 percent on average, the low-income country average is 40 percent and that of middle-income countries 35 percent. The highest informal sector share is that of Nigeria (approximately 65 percent) and the smallest is in Mauritius (approximately 20 percent).

While SSA's population is growing and the formal sector is at this point unable to absorb all potential employees, it has been widely argued that the informal sector provides both flexibility and much-needed opportunities, at least in the short run. In this sense, the informal sector has significant potential to contribute to economic growth and development—economic policy and government regulations permitting. There is ongoing debate about the extent to which this holds true in the SSA context. Based on the World Bank firm surveys, Porta and Shleifer (2008) conclude that the informal sector is highly inefficient and is neither a threat to firms in the formal sector nor a significant contributor to

economic growth, as small informal firms seldom grow to become medium- or large-scale enterprises generating the additional jobs desired.¹² From this perspective, while the informal sector provides millions of people with a (poor) livelihood, economic growth is generated by the creation and growth of formal firms. An increase in the share of the formal sector increases productivity and tax revenue, underpinning efforts to mobilize domestic resources, which must evidently also include concerted efforts to minimize tax evasion and optimize tax compliance.

Foreign aid, macroeconomic policy, governance, and conflict

Exogenous shocks and decisions taken elsewhere have played a critical role in the development process on the African continent since independence. Reference has already been made to the impacts of the oil crises of the 1970s and the financial crises of 1997 and 2009. Turning to foreign aid, its impacts have been debated for decades, the main question being the so-called micro-macro paradox (introduced into the aid literature by Mosley 1986). It has generally been agreed (even by aid sceptics) that aid has often been associated with successful projects in the health and education sectors. In the longer term, this should lead to increased growth, which analysts have had difficulty in identifying in a convincing manner. The data have often suggested an insignificant impact of aid on growth. Speculation has therefore continued that aid undermines recipient institutions in SSA and has negative macroeconomic effects due to “Dutch disease.”¹³

More recently, it has become clear that the micro-macro paradox does not exist. It was embedded in inadequate data and methodological difficulties that led analysts to present insignificant statistical results, which were regularly taken as evidence of no impact. In contrast, when properly analyzed, and using up-to-date analytical methodologies, existing data tell a coherent story provided aid is analyzed over the appropriate longer-term horizon within which its impact should be assessed. Moreover, it is pertinent to stress that it has also been convincingly established in the literature over the past decade that aid contributes positively to all three cumulative processes that underpin growth processes: physical capital, human capital, and institutional capacity-building.¹⁴

The colonial inheritance has cast long political, economic, and social shadows over the African continent, which we shall not pursue here.¹⁵ Moreover, global shocks have been of critical importance throughout the post-independence period, most recently in the weakening of oil, gas, and metals prices (to the detriment of exporters, such as Nigeria and Zambia, but with importers of oil, e.g., Rwanda, benefiting from lower import bills). However, this does not imply in any way that domestic factors have been unimportant in shaping development outcomes over the past half-century or so. It is widely understood that unwise and irresponsible choices have been made by African governments and policy-makers—both for good and well-intentioned reasons and sometimes for unscrupulous reasons. Wrong choices were sometimes made based on bad advice (including from aid

donors) and sometimes they were made to further corrupt ends (with outsiders facilitating that corruption in, for example, the natural resources sector).

It is now fully recognized that the import-substituting industrial policies pursued in an attempt to accelerate economic growth and transformation in the early post-independence years turned out to be simply too costly and ineffective.¹⁶ While the underlying theoretical rationale seemed to make sense to many at the time (and the strategy was based on expanding the size of the market for infant industries through greater regional economic co-operation, which sadly disappointed), it led to inappropriate macroeconomic policy choices and furthered an unsustainable industrial policy that proved very costly. This increased the vulnerability of the SSA economies to external shocks and it has subsequently been a major policy challenge to reorient the path taken. It was not that the ambitions were necessarily wrong and ill-intentioned; the “medicine” was not the appropriate one.

The same can be said for the single-minded way in which economic liberalization and privatization were pursued as somewhat of a panacea in the context of the stabilization and the structural adjustment process that followed.¹⁷ “Getting prices right” became a rallying call for reformers, overlooking the fact that well-functioning markets require high-quality institutions to reduce transaction costs for all market participants. In any case, macroeconomic stability (as measured by the inflation rate) and policy management (as measured by the central bank policy rate, CBPR) have since then improved very considerably, as illustrated in Figures 4.14 and 4.15. Inflation has also come down markedly and the policy interest rates in SSA have converged to a significantly lower level with a smaller variation, as is the case elsewhere in the global economy.

There is some debate as to whether “good policy” caused the “growth” revival or whether causality goes the other way round.¹⁸ In practice, good policy will

Figure 4.14 Annual inflation by region, 1980–2014 (%)

Source: Authors’ illustration of data from World Development Indicators, World Bank (2017).

Note

Inflation as measured by the consumer price index (the annual percentage change).

Figure 4.15 Policy rates for SSA countries with floating exchange rates, 1999–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

SSA countries with floating exchange rates. No data available for Sierra Leone. The CBPR is the rate that is used by central bank to implement or signal its monetary policy stance.

reinforce growth, and growth reinforces good policy, and there is little doubt that both the growth turnaround and the improved policy management have been factors underlying the socioeconomic progress reported in previous sections. That there remains room for improvement in dimensions such as public management, the control of corruption, and the rule of the law is clear from Figures 4.16, 4.17, and 4.18. In all cases, SSA finds itself lower-ranked than the other regions considered, illustrating the continuation of corruption as well as fragility in public sector management and institutions. It is also notable that in all three cases there is substantial stability in the performance of SSA. This suggests, as just noted, that concerted policy efforts will continue to be required across the board. It also suggests that a degree of stability has been achieved—circumstances have not grown worse, as one might sometimes be led to believe.¹⁹

The political environment has also stabilized in SSA in general in the last quarter of a century (albeit with major crises and conflicts along the way, e.g., in DRC, Rwanda, and Somalia, to name just three). Many former autocracies have introduced multiparty elections since the beginning of the 1990s, and this is reflected in the democracy and autocracy scores of Polity IV (2017), as shown in Figure 4.19. Importantly, armed conflicts have become less common in the region, as is clear from Figure 4.20, which supports the assessment that “despite shouldering a larger share of the conflict burden, in absolute terms, Africa has become more *peaceful* as well.”²⁰

Figure 4.16 CPIA Public sector institutions and management score, 2005–2015

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

Note

The Country Policy and Institutional Assessment (CPIA) indicator takes values between 1 and 6, with the former reflecting the lowest level of institutions and management.

Figure 4.17 Control of corruption, 1996–2015

Source: Authors' illustration of data from Worldwide Governance Indicators, World Bank (2016).

Note

Region figures are averages of country estimates. Higher value indicates better control of corruption.

Figure 4.18 Rule of law, 1996–2015

Source: Authors' illustration of data from Worldwide Governance Indicators, World Bank (2016).

Note

Region figures are averages of country estimates. Higher value indicates better rule of law.

Figure 4.19 Democracy and autocracy in Sub-Saharan Africa, 1960–2014

Source: Authors' illustration of data from Polity IV (2017).

Note

Composite indicators of democracy and autocracy for Sub-Saharan Africa.

Figure 4.20 Conflicts in Sub-Saharan Africa: number of Sub-Saharan countries at war, 1952–2012

Source: Authors' illustration of data from UCDP/PRIO Armed Conflict Dataset (Gleditsch *et al.* 2002; Themnér and Wallensteen 2014).

Note

A conflict is defined as war when there are at least 1,000 battle-related deaths in a given year. Extra-systemic war occurs between a state and a non-state group outside its own territory. Interstate war occurs between two or more states. “Internationalized internal” refers to internal war with intervention from other states.

Critical issues for the future

At its most basic, economic development is a process of accumulating physical, human, institutional, and technological capacities. However, this process is far from simple or straightforward, since many actors and interlocking factors are at play—both domestically and internationally. Predicting the future is therefore hazardous, and we will not attempt it. Rather, this section highlights selected issues that are likely to occupy centerstage in SSA in the coming decades.

Demographics and gender equality

Reference has already been made to the region's high population growth rate of 2.7 percent per year. This means that large numbers of newborns are being added each year to those below the age of 15, and Africa's population is set to double to 2.5 billion between 2015 and 2050. By mid-century, the population in Africa will outnumber both China and India, and the population of Nigeria will be larger than that of the USA. As shown in Figure 4.21, the dependency ratio peaked at around 94 percent in 1985–1990 in SSA. This means that there were almost as many persons in the category of younger and older people as in the working-age group of 15–65-year-olds.

Figure 4.21 Dependency ratio for major regions, 1950–2050

Source: Authors' illustration of data from United Nations Population Division (2017).

Note

Forecasts since the year 2016. Dependency ratio defined as the share of 0–14-year-olds and 65-year-olds or older to 15–64-year-old population.

The dependency ratio provides telling insights into the kinds of development challenges the African people and their governments have had to deal with over the past decades. This is so especially when it is recalled that the population includes large numbers of female-headed (or single-parent-headed) households, mostly in the low-productivity agriculture sector. Under such circumstances it is difficult to generate sizeable economic surpluses, especially when exogenous shocks hit communities and nations.

It is also clear from existing data summarized in Figure 4.21 that the share of the working-age population in the total population has been on the increase since the mid-1990s, and will continue increasing over the coming decades until around 2050 due to the in-built demographic dynamics. In fact, it is generally expected that some 10 million people will be added to the working-age population each year until 2050, by which time the dependency ratio is likely to be around 60 percent. This is roughly on a par with that of the other two regions considered here, which have already moved through the demographic transition. To illustrate further, the number of people in the 15–24 age group is projected to increase from 190 million in 2015 to 410 million in 2050 (United Nations Population Division 2017). This corresponds to 6–7 million added each year and implies that significant expenditures will be required to address the health and education requirements of all this youth.²¹

It should be highlighted, though, that the decreasing dependency ratio does represent a significant potential demographic dividend in terms of growth and

increased income, provided that decent jobs and livelihoods are created. Put differently, it is critically important in the coming years that enough jobs emerge for the new entrants to the labor market. Their expectations are high, seen against a period of relative progress and the greater interconnectedness of local, national, and global communities. Accordingly, it will be essential that growth is maintained and that the pattern of growth is modified in a much more job-intensive direction than so far experienced.

It is therefore encouraging that development efforts over the past two decades have indeed managed to achieve significant advances in both health and education. New entrants into the workforce are not only young, they are also healthier and better educated than their parents. This includes progress on gender issues, though significant further steps are clearly needed in this area.²² Gender inequality hurts the well-being of girls as they are more adversely affected by income and price shocks (Björkman-Nyqvist 2013). In addition, gender empowerment leads in turn to more development, as it is well established that women tend to make decisions that favor overall household and child welfare as compared with men (Duflo 2003; Qian 2008; Afridi *et al.* 2012). In short, a focus on improving gender equality would raise household incomes and positively affect the prospects and well-being of children who will join the labor market in the coming years. Another challenge in this regard is that while women's workforce participation rate has slowly increased from the 1990s, it remains lower than that of men. In 2016, the workforce participation rate in SSA was estimated at 62.8 percent for women and 76.0 percent for men (World Bank 2017).

Commodity dependence and economic transformation

One of the thorniest issues is the region's continued dependence on the export of primary commodities, much of which is unprocessed or only lightly processed for shipment (implying that much of the value in the next stage of processing the commodities, and then their use in manufacturing processes, are captured elsewhere in the global economy). Africa's commodities are in turn derived from the region's immense (and often still untapped) wealth of non-renewable resources (oil, natural gas, coal, and minerals) and renewable resources (soils, water, fisheries, sunlight, and wind).

While the region's overall dependence on commodities is high, there is some substantial variation in that dependence across countries, as shown in Figure 4.22. At the top in terms of commodity dependence (as a percentage of GDP) are the long-standing and big oil and gas exporters (Angola, Gabon, and Nigeria), the major and long-standing mineral exporters (DRC, Mauritania, and Zambia), and the big agricultural exporters (notably Côte d'Ivoire, the world's largest cocoa producer), some of which are also big mineral (and now oil) exporters (notably Ghana's cocoa, gold, and oil).

In sum, SSA needs to add increased value to its commodities, be they minerals or agricultural produce, to move itself up global value chains. It must also create new sectors of activity in manufacturing through, for example, more

Figure 4.22 Commodity exports, imports, and net exports from SSA countries

Source: Authors' illustration of data from World Development Indicators, World Bank (2017) and own calculations.

Note

Commodity exports (bars with horizontal stripes), imports (bars with vertical stripes), and net exports (dots) per GDP by Sub-Saharan African countries. Country averages since the year 1990. Commodity exports include agricultural raw materials, food, fuel, and ores and metals exports.

agro-processing.²³ In the extractives sector, it needs to maximize the benefits from the large revenues for inclusive development, while keeping a close eye on international price trends. More broadly, it needs to conserve its renewable resources, including its unique wildlife, both for the planet's biodiversity and as the basis of the region's tourism sector.

Until the price downturn commenced in 2014, the commodity "super-cycle" which began around 2000 constituted a positive economic shock for SSA, especially for those with oil and gas (e.g., Angola, Ghana, Nigeria) or mineral resources (e.g., Guinea, Liberia, and Sierra Leone) (Andersen *et al.* 2014). This commodity boom had been one of the most powerful since 1945 (see, for example, Radetzki 2006; Humphreys 2013). The FDI inflows associated with the boom have become a major component of Africa's overall capital flows over the last decade, and mark a welcome turnaround for the region, which has traditionally been dependent on official flows. This FDI has also brought in much-needed technical expertise which is vital to the effective discovery, extraction, and management of oil and mineral wealth. New oil and gas producers, or countries

which are expected to be major producers, have received welcome attention from foreign investors, thereby reducing their aid dependence (e.g., Mozambique, Tanzania, and Uganda).

China was one of the main drivers of the commodities price boom until 2014 (Erten and Ocampo 2013). China is a net importer of most metals, as well as most of the oil and gas that it uses. China accounted for more than 50 percent of the increased global demand for metals over 2001–2006 (Francis 2007: 20). Africa's bauxite, copper, iron ore, nickel, uranium, and other minerals all saw strong growth in production, prices, and earnings (Pigato and Tang 2015). China is Africa's largest bilateral trading partner: trade totaled US\$211 billion in 2013, with commodities, especially oil, dominating Africa's exports to China. The US was a significant importer of African oil a decade ago (the region supplying roughly 10 percent of total US oil imports around 2005) but the US largely ceased to be a buyer of oil and gas from Africa as its own supplies of shale oil and gas came on stream (this is one reason why total US trade with Africa is, at US\$83 billion in 2013, less than half that of China). In sum, Africa has seen a major shift in its trading patterns over the last decade or so, and has benefited greatly, as a commodities supplier, from China's robust growth.

Economies that ride booming commodity prices must also ride them on the way down. Oil illustrates the risks. The oil price fell from US\$115 a barrel (for Brent, the international benchmark) in June 2014 to a range of US\$43–50 by mid-2015; there have been some small price recoveries since then, but the price currently languishes at under US\$50, with little prospect of rising from there. While this has been good news for net oil importers (e.g., Kenya and Rwanda) and has helped boost their growth, it is very bad news for the budgets (and the currencies) of oil producers, many of which were predicated on oil staying above US\$100 for the indefinite future. Moreover, many of the large oil producers failed to create sufficient fiscal buffers to ride out the adjustment to the oil-price fall; Nigeria's fiscal reserves are small in relation to its total public budget. Currencies came under pressure: Angola devalued, thereby leading to a jump in inflation, while Nigeria tried to defend a fixed exchange rate, burning through a considerable sum from its foreign exchange reserves.

Just before the price collapse, oil accounted for some 57 percent of Africa's total export earnings in 2013 (AfDB *et al.* 2013: 66). The market for oil, but especially for coal, faces strong headwinds, not least from the accelerating move to renewable energy, in which China itself is a major innovator and producer (China now accounts for over half the world's production of lithium-ion batteries, for example). For the metals used in such technologies we can expect strong future demand in, for example, cobalt and lithium, to the benefit of producers such as the DRC and Zimbabwe, while copper will be required, whatever the source of energy supply (to the benefit of producers such as Zambia). Hence, the sharp downturn in some metals prices in recent years should prove temporary. It is likely that gas exporters will face growing demand as Asia and other regions switch from coal-fired power plants to natural gas, the use of which in electricity generation emits roughly half the amount of carbon dioxide per megawatt-hour

of electricity that coal does. However, the global gas market is well supplied (perhaps over-supplied) and countries with exports coming on stream over the next decade (e.g., Tanzania) may be disappointed in their earnings expectations.

Aside from the price volatility, as well as the potentially adverse long-term trends for some commodities, the management of resource wealth is problematic for other reasons. Research shows that natural resource-dependent economies tend to grow at a slower pace when other determinants of growth are controlled for (Sachs and Warner 1995, 2001). While this view has been challenged (Maloney 2002; Alexeev and Conrad 2009), it remains widely agreed that resource wealth poses serious difficulties for economic policy, irrespective of the level of development.

Resource-rich countries in Africa have been prone to “Dutch disease”: large inflows of foreign exchange cause a rise in aggregate demand (when not “sterilized” by central bank sales of treasury bonds). With low supply elasticities (reflecting structural constraints on the ability of producers to expand output), the rise in demand causes an increase in prices. For imported goods, supply increases via extra imports (which are also encouraged by the tendency of the currency to appreciate) which are financed from oil earnings. The currency appreciation tends to depress the incentive to produce agricultural exports and domestic food crops (which are now subject to increased competition from food imports). Non-tradeable sectors see the largest price rises of all as their supply elasticities are very low. Typically this manifests itself in an urban property boom.²⁴ The net result, as exemplified by Nigeria in the 1970s and the 1980s, is a contraction of previously competitive sectors such as agriculture and manufacturing, accelerated urbanization (as farmers give up and head for the city), and an economy ever more dependent on imports (leading to a great reluctance to devalue when the oil price slumps). Commodity price booms also typically lead to over-borrowing, as illustrated by the cases of Nigeria and Ghana (a new player in the African oil economy).²⁵

Most seriously, resource wealth is associated with an increased propensity to corruption and violent conflict. This may be particularly prone to happening in ethnically diverse contexts where group-motivated policies tend to be characteristic (Berman *et al.* 2017). States and rebel groups battle for control over natural resources (both renewable and non-renewable) and the revenues they generate. Such conflicts may be localized, taking the form of either continued but low-level fighting and theft (e.g., Nigeria’s Delta region) or outright attempts to secede by well-organized rebel armies (e.g., the DRC). It is important, however, not to reduce war in Africa to simple economic determinants: the wars in Angola, DRC, and Mozambique were as much (or more) the product of the Cold War and regional politics as of the existence of resource wealth (e.g., apartheid South Africa’s military interventions and financing of rebel groups in Angola and Mozambique, and the interaction of Zaire/DRC’s breakdown with the genocide in Rwanda) (Addison 2003). But for sure, “blood diamonds” and other resource wealth can finance conflicts for long periods after they have broken out. The region’s governments and organizations as well as the international

community must do more, given the terrible economic and human impact of violent conflict in Africa.

In sum, commodities constitute a strength of Africa's economy—in generating livelihoods, economic growth, and export earnings—but also a source of vulnerability, as they expose the region to price instability (and adverse longer-term price trends in the case of fossil fuels) and the associated macroeconomic difficulties in managing booms and slumps. SSA has done better in managing recent price shocks than was the case in the 1970s and the 1980s; macroeconomic policy responses, especially exchange-rate adjustments, have been activated at an earlier stage as commodity prices weakened (one exception is Nigeria, as noted above) and fiscal policy has been more prudent, though fiscal buffers are still not high enough (AfDB *et al.* 2013). The fundamental problem, however, remains: how best to invest resource wealth into infrastructure, education, and health in ways that really transform the supply side of economies, and which secure the move up to lower middle-income country (MIC) status, and eventually upper MIC (and higher-income country, HIC) status, in the coming decades.

Agriculture and industrialization

Both the agriculture and manufacturing sectors have performed below their potential in SSA over the past decades. By the 1980s, SSA's agriculture was in crisis, with deepening rural poverty, and famine in the Sahel and Horn of Africa. The widespread confidence of the 1960s that Africa could feed itself, and become a major player in global agricultural markets, had eroded away, with many donor-financed agricultural projects in serious trouble. Weak project selection, project mismanagement, and the impact of deepening foreign exchange shortages on imported inputs to the sector combined, in some cases, with exchange-rate misalignment that reduced farmers' incentives (particularly the case in oil economies subject to Dutch disease, notably Nigeria).

In the stabilization and structural adjustment programs of the 1980s it was assumed that price liberalization ("getting prices right"), and the privatization of agricultural marketing boards, would lead smoothly to a strong revival in agricultural production and exports.²⁶ By the late 1980s, the World Bank was committed to the view that it could pull back on its project and sector support to African agriculture, and the share of agriculture in its SSA portfolio fell from the 1980s to the 1990s.

This was a naïve view. At the time, critiques of "getting prices right" focused on the distinction between supply elasticities for individual crops and the aggregate elasticity of agricultural production; the latter is smaller than the former, since farmers have some ability to shift between crops (as their relative prices change) but the sector's ability to expand total output—of both food crops and non-food crops—is limited by the multiple constraints on SSA's farmers, especially its women farmers (who account for much of the region's smallholder food production). These constraints include:

- lack of irrigation and water storage that make agriculture and pastoralism dependent on rainfall;
- the inability of many poor farmers to afford key inputs (and often erratic supplies of inputs, especially in areas deficient in transport infrastructure);
- poor-quality extension services resulting from under-funding (and hindered by the low education levels of many farmers);
- time constraints on women farmers, resulting from the time that they must also commit to childcare, household tasks, and family health care;
- under-investment in agricultural research that is appropriate to the conditions faced by Africa's smallholders, leading to a lack of new seed varieties and of new solutions to plant and animal diseases (and environmental stress).

These challenges were well known by the 1980s, and indeed the World Bank's own research had contributed to the stock of knowledge available by that time. Today, we must also add climate change; there are many tasks necessary to increase the resilience of agriculture and food security to weather shocks, which will accelerate if the world community fails to curb greenhouse gas emissions.

In sum, there is a compelling case for more agricultural investment, both public and private, to achieve job-creating economic growth, export diversification (especially into crops with higher value in world markets), and poverty reduction (given the numbers of rural people still in poverty, which is often of the deepest kind). Agriculture continues to be neglected both in the allocation of public expenditure by SSA governments and in foreign aid. The Maputo Declaration on agriculture and food security—agreed by the New Partnership for Africa's Development (NEPAD) in 2003²⁷—calls for agriculture to be allocated 10 percent of public expenditure; not even half of that target is being achieved.

The 2008 World Development Report entitled *Agriculture for Development* (World Bank 2007) provides a comprehensive overview. In a succinct summary of lessons from the report, de Janvry and Sadoulet (2008) list seven reasons behind agriculture's neglect. They remain relevant and are therefore reproduced here in summary form:²⁸

- 1 Low profitability of investment in agriculture under conditions of low and continuously falling commodity prices.
- 2 Policy priorities geared toward stabilization and adjustment.
- 3 Focus on rapid poverty reduction via transfers and social assistance programs; with pressures for quick success being enhanced by the urgency of meeting the 2015 MDGs, resulting in strategies that frequently disregarded the role of agriculture and focused instead on the role of the macro-fundamentals and of social safety nets.
- 4 Concerns by donors and environmentalists regarding the negative environmental effects of agriculture, creating a reticence to invest in a sector with large negative externalities, particularly water and climate change.
- 5 Development theories that looked at agriculture as a backward and declining industry.

- 6 Ill-defined roles for the state, the private sector (market), and civil society (producers' organizations) that place barriers to private sector investment to replace descaled public roles—severely reducing the quality of the investment climate for private investment, and limiting the possibility of public–private partnerships in opening new areas of economic activity.
- 7 A low rate of success in investment projects involving agriculture due to poor design and weak implementation.

The agricultural development and policy reform menu is a large one, and “business as usual” will not be sufficient to address the present state of affairs. A complete overhaul of agricultural policy and investment is called for, and to be effective will require action at the highest policy-making levels both in the African countries and the international community. An instructive perspective on this is available in the policy responses to the 2007 international food-price crisis, in which prices spiked upward (studied in detail by Pinststrup-Andersen, 2014, and his colleagues). The 16 SSA country cases studied by Arndt *et al.* (2016) demonstrate that those that achieved agricultural progress experienced aggregate growth and poverty reduction as well.

Turning to the manufacturing sector, there is reason for concern here as well, and repeated calls for reform have been made in recent years. While agricultural progress has been essential for development throughout history and across all regions of the world, industry has been a driving force behind structural transformation. SSA’s low level of manufacturing is a problem because it denies SSA countries an essential source of economic growth (Rodrik 2016). Rodrik (2013) shows that whereas poorer countries only partially reach the income levels of richer countries, productivity in poorer countries’ manufacturing tends to reach richer-country productivity levels. This is explained by the international competition faced by manufacturing; accordingly, poor countries which are able to industrialize tend to grow faster than those which do not. The rapid economic growth experienced by Southeast Asia’s “Tiger” economies in the 1970s and the 1980s is a classic example.

Why, then, is there so little industry in Africa? Newman *et al.* (2016a, 2016b) set out the reasons why industry matters for Africa, and why the region has not performed well. They subsequently study the realities and opportunities, summarizing the results of a major UNU-WIDER research program into Learning to Compete (L2C),²⁹ and identify a strategy for future industrial development. They recognize that industry is a high-productivity sector potentially capable of absorbing large numbers of workers, and argue that it is essential to remove traditional barriers, such as poor infrastructure, low skills, and intrusive regulation. However, the agenda does not end here. To compete, African governments will have to formulate new policies to promote exports, build the capabilities of domestic firms, and foster industrial clusters. FDI also underpins productivity growth, as it facilitates the transfer of knowledge and capabilities to the host country.

For SSA to succeed in manufacturing development, donors will need to move on from their single-minded focus on deregulation, which has prevailed since

around the 2000s, paradoxically replacing the equally single-minded focus on “getting prices right.” Donors need to put their energies and finance into helping countries scale up and create competitive economies, aimed at taking advantage of a fast-moving global economy; this entails creating sectors which sell goods and services with more value added (thereby helping the diversification from unprocessed commodities). Deregulation has been prominent in the support to investment climate reforms practiced throughout Africa. Newman *et al.* (2016a: 206) note:

As originally conceived, the investment climate reform agenda was intended to balance reducing the physical constraints to industrialization, mainly infrastructure and skills, to the regulatory and institutional environment. As implemented by the donors, however, the focus has been on a narrow set of regulatory reforms defined in Washington.

In sum, “getting the investment climate right” is more than simply deregulation (which is not always desirable in any case, when there is a public interest to be protected, e.g., in curbing private sector monopoly power or curtailing the imposition of bad environmental externalities on society via air and water pollution). This implies overcoming an interacting set of constraints which hold back enterprises from the small- and medium-scale to the very large. One hopes that these lessons have by now been learnt by African governments and their partners in the international community.

Infrastructure³⁰

One major constraint on Africa’s households and enterprises is infrastructure. Now much attention is being paid to Africa’s infrastructure challenge, and for good reasons. To begin with, Africa faces a power crisis, with an estimated 600 million people having no electricity connection; and some 30 African countries face regular power shortages (with households and enterprises paying high prices for emergency supplies). Low-income SSA lags behind the low-income country averages, by all key infrastructure measures, and by significant margins, as can be seen from Table 4.3, and the gaps are growing. Africa is presently expanding its paved roads, telephone main lines, and power generation much more slowly than other developing regions; this is illustrated by three key observations: (1) investment in power has not matched population growth; (2) over 80 percent of the road network remains unpaved; and (3) the road stock is actually contracting.

There are many reasons to focus on infrastructure in the SSA context. High transaction costs are a widely recognized reason for lower productivity at the farm, household, and firm levels (see Escribano *et al.* 2010) and they result in lower economy-wide multipliers and lower impacts from economic policy measures.³¹ Infrastructure development has positive impacts on long-run growth, and is critical for reaping the benefits of improved agricultural technology (see Arndt

Table 4.3 Infrastructure measures for Sub-Saharan African low-income countries and other low-income countries

	<i>Sub-Saharan African low-income countries</i>	<i>Other low-income countries</i>
<i>Roads</i>		
Paved-road density	31	134
Total road density	137	211
<i>Telecommunications</i>		
Main-line density	10	78
Mobile density	55	76
Internet density	2	3
<i>Electricity</i>		
Generation capacity	37	326
Electricity coverage	16	41
<i>Water and sanitation</i>		
Improved water	60	72
Improved sanitation	34	51

Source: Data from Pierce *et al.* (2008).

Note

Paved-road density and total road density are measured in km/1,000km²; main-line density and mobile density in subscribers per 1,000 people; internet density in subscribers per 100 people; generation capacity in MW per 1 million people; electricity coverage, improved water source, and sanitation coverage in % of households with access to services.

et al. 2000). One estimate referred to by Page in his UNU-WIDER keynote is that the current infrastructure deficits contribute to a loss of about 2 percentage points per year,³² so appropriate investments have high economic and social returns.

Various measures of the infrastructure financing gap exist. Foster and Briceño-Garmendia (2010) estimate that US\$93 billion is required annually to meet existing needs, whereas actual spending is US\$51 billion (IMF 2014), leaving a shortfall of US\$42 billion (see Sy and Copley 2016). Page makes the point that this is probably an underestimate and needs obviously vary considerably among individual countries—for example, depending on whether they are fragile or not. The IMF (2014) has estimated that national budget spending was about 73 percent of total funding for infrastructure in 2012, or 63 percent excluding financing by international financial institutions.

It is therefore evident that African countries will need to increase their fiscal effort to close the infrastructure gap, but the challenge goes further than this. Increased efficiency and improving the quality of public services will also be critical. While it is beyond the scope of the present chapter to address the details, the challenge is evident, and it is one that aid donors have not addressed head-on, via either their old “getting the prices right” approach or the present focus on the “investment climate” (with its *de facto* emphasis on deregulation).

Public sector, development finance, and private sector development

Domestic resource mobilization will constitute a more significant component of the region's development finance envelope in the years to come. SSA has made reasonably good progress in raising the tax/GDP ratio over the last decade (though not in conflict-affected countries), as tax administrations have been reformed and compliance improved. This was motivated by the need to shift revenues from a dependence on trade taxes (initiated under the trade liberalizations from the 1980s onwards), to introduce value added tax (VAT) to make up for the reduced reliance on trade taxes, and to reduce the burden of cumbersome tax procedures on enterprise development. As the commodity super-cycle led to large inflows of FDI into Africa's extractives sector, the region has also had to revisit its taxation of the sector, balancing revenue generation relative to the incentives of companies to invest in what are very large and complex projects of often long duration. Over-taxing the extractives sector leads to a loss of total revenue in the long term as it discourages investment, and countries need the advanced technology that oil and mining companies bring if they are to maximize output and earnings from the sector. But countries understandably want to get reasonable deals in the many contracts that are underway in natural resource extraction, and they are concerned that foreign companies can shift taxable earnings and profits out of the country to affiliates in jurisdictions with lower tax rates. There are a number of ongoing tax disputes in the extractives sector with many millions, sometimes billions, of revenues at stake.

In summary, progress has been made in domestic revenue mobilization, but there is still quite a way to go. One major question is how to judge progress in improving tax administration (i.e., whether it is near or far from being "optimal") to reduce the compliance gap (the difference between what tax is legally due and what is collected).³³ Reducing the compliance gap to zero is not feasible: it is too costly in terms of administrative costs or behavioral responses to insist on perfect compliance. But how far should it be reduced? Whereas economists have over the years created a framework for assessing whether tax rates are optimal, there has until recently been no analytical framework to guide institution-building in the reform of tax administrations. This is starting to change through, for example, the work of the IMF on optimal tax administration (Keen and Slemrod 2017). Practical and informed assessments are called for in concrete country and case contexts.³⁴

Taxes and non-tax revenues are only one dimension of fiscal policy: the others are public expenditure management and public debt management. On the expenditure side, SSA went through considerable pain, starting in the era of structural adjustment, as it put in place better systems to control and monitor public expenditures: "cash budgeting" was used for many years to rein in expenditures in line with revenues, the numbers of civil servants were reduced, hiring was frozen, and wholesale civil service reform implemented. Better systems to ensure parliamentary oversight of spending (as well as taxation and debt management) were put in place. Turning around public expenditure management systems took longer than anyone expected, not least the IMF.

Better expenditure management is vital: achieving the ambitious goals of the MDGs (and now the Sustainable Development Goals, SDGs) requires large-scale expenditures (in the social sectors, for example). Aid donors will not supplement domestic revenues in financing these expenditures if they are not reassured that the money is being wisely spent. And domestic tax payers will be reluctant to comply with their obligation to pay taxes if they believe public money is being misspent (hence expenditure management reform is a key element of the “good governance” agenda).

Good expenditure management is especially important in countries deriving ample and growing revenues from natural resource wealth. Many countries have histories in which revenues have been used for personal gain rather than the public good. Transparency in the management of oil, gas, and mining revenues is especially important, and has been assisted in recent years by the Extractives Industries Transparency Initiative (EITI). The task for countries rich in non-renewable resources is to transform those resources into physical and human capital that supports a development process associated with higher per capita incomes over time—and one that sustains itself after the natural resources are mined out. This can only be done with a well-functioning fiscal system that collects the revenue, accounts for it transparently, and then allocates it to areas of spending with high social rates of return. Education is a good example: funding the creation of a high-quality school system results in human capital formation that can drive inclusive development for many decades.

The resource-rich countries also illustrate the importance of the third pillar of fiscal management: debt policy and management. Hydrocarbon-rich countries have a tendency to over-borrow on international capital markets. This was the case with Nigeria in the 1970s and the 1980s, and Ghana and Mozambique have also recently experienced an over-accumulation of foreign debt. Typically, much of this debt is contracted in dollars at floating interest rates, making the debtor vulnerable to any shift upward in global interest rates (which have been unusually low as central banks cut rates to cope with the 2008–2009 financial crisis) as well as any depreciation of the domestic currency (which raises the domestic currency cost of servicing foreign currency debt). Debt crises have undesirable fiscal consequences, as they claim revenues that otherwise fund development and social spending. Given the experience of the HIPC countries in the 1980s and the 1990s, this is a danger that SSA needs to guard against.

Turning now to development finance from external sources, net official development assistance (ODA) to SSA has grown sizeably in absolute terms over recent years. This absolute increase goes together with a falling trend, since the early 1990s, as a share of GDP in aid recipient countries, as shown in Figure 4.23, reflecting in large measure the growth turnaround in SSA. In fact, this falling trend, together with the marked relative increase in the ODA/GDP ratio from the mid-1970s to its all-time high in 1992, is striking; it confirms that ODA has become a much smaller player in relative terms. In fact, from 2010 to 2016, ODA accounted for about one-third of the net financial inflows, as indicated in Table 4.4.

Figure 4.23 Net financial flows to Sub-Saharan African countries, 1960–2016

Source: Authors' illustration of data from Balance of Payments Statistics, IMF (2017a), World Development Indicators, World Bank (2017), and authors' own calculations.

Table 4.4 Average financial inflows and outflows to Sub-Saharan Africa as a share of GDP (%)

		1980s	1990s	2000s	2010–2016
Inflows	FDI	0.60	1.33	2.84	4.16
	Net ODA received	5.26	5.89	4.08	2.58
	Personal remittances	0.63	1.02	2.27	2.11
	Portfolio investment	–0.33	2.23	1.06	2.19
Outflows	FDI	0.11	0.63	0.13	2.23
	Portfolio investment	–0.03	0.85	1.09	0.75

Source: Authors' illustration of data from Balance of Payments Statistics, IMF (2017a), World Development Indicators, World Bank (2017), and own calculations.

Among the major changes, one also notes that official financing from China to SSA has in recent years picked up very considerably to US\$5 billion per year. This exceeds any other bilateral or multilateral source.³⁵

While the share of ODA has decreased from a high of about 10 percent in 1992, significant increases have taken place in the role of FDI, personal remittances, and portfolio investment flows. Portfolio flows, and to a somewhat lesser extent FDI, have experienced sizeable fluctuations, whereas remittances have tended to be more stable (noting the increase around 2004 and a more recent dip in 2016).

It is also clear in Table 4.4 that FDI outflows from SSA became important in the 2010s; and the overall increase in the relative importance of non-aid-related

sources of external development finance since 1992 is striking for the region as one. Moreover, Table 4.4 illustrates financial inflows to SSA and outflows from SSA separately, and even though SSA countries are not as closely connected to global financial markets as some other regions, the connection is getting closer, as reflected in increasing gross inflows and outflows over time. It must, however, be highlighted that this aggregate picture hides very significant differences among the most robustly performing economies in SSA and those that continue to struggle to break out of fragile circumstances.

The above changes have a series of implications for the assessment of future financing prospects, where private sources have obviously assumed much more importance than previously. Individual countries have also started issuing foreign currency-denominated sovereign bonds. While this is a logical extension of a more normalized relationship with international capital markets, the need for care and proper management of the consequent debt to avoid a repetition of the failures of the early 1980s should be kept in mind throughout (as noted earlier in relation to the fiscal dimension). Similarly, the whole ODA architecture is undergoing review and discussion,³⁶ both in general and because of the policy signals about drastic cuts in foreign aid issued by the Trump administration in the USA.

It can confidently be stated that an international co-operation system exists that has contributed to the achievement of shared development goals over the past decades.³⁷ There is, nevertheless, ample reason to think hard about this system in the changing global context.³⁸ In 1970, most absolutely-poor people resided in low-income countries. Partly due to successful aid efforts, today there are far fewer such countries (and they have relatively small populations). As a result, about three out of four of the approximately 800 million absolutely-poor people in the world now reside in middle-income countries.

In nearly all developing countries, human and institutional capabilities are manifestly superior to three or four decades ago, and alternative sources of finance are—as alluded to above—more readily available. The value of aid flows relative to economic size is typically small, particularly for middle-income countries, though traditional aid flows are, and should remain, important in the dwindling number of low-income countries. Finally, environmental issues, to which we shall turn below, are far more salient. Middle-income countries will be key players in determining future global concentrations of greenhouse gases and hence the fate of the environment of the planet.

The evidence for aid effectiveness also indicates that aid has rarely been decisive on its own. Looking forward, development assistance will be, almost always, a complement to nationally determined policies and programs. The main route to success for development institutions, whether bilateral or multilateral, runs through the formation of genuine, long-term, and sustained partnerships that help to facilitate better decision-making and effective action at country, regional, and global levels. Within this twenty-first-century context, development institutions should place increasing emphasis on fostering the human and institutional capabilities for good decision-making. How to put such a system in place

remains a major challenge, as does continued attention to how the private sector can best be supported in mobilizing its dynamic potential to promote inclusive growth.

As alluded to, in externally generated strategies for development in Africa, there has been a tendency to assume that “getting prices right” or “getting the regulatory framework right” would suffice to provide a supportive environment for private sector development. It is now generally understood that a much broader set of interventions are needed, ranging from the provision of public goods to actively supporting public–private partnerships. It is beyond the scope of this chapter to address this topic in detail; however, see Newman *et al.* (2016a, 2016b), Arndt *et al.* (2016), Gisselquist (2014a, 2015b), and Resnick and Gisselquist (2014) for further background and inspiration.

Finally, whatever the source of development finance—be it domestic or external—its use in achieving development must rest on a sound analytical framework. There is never enough finance for every conceivable project: the task is therefore to select the projects with the best returns to society as whole, to maximize the overall gain within the existing and expected resource constraints. Since the benefits of any project can never be known with certainty, and the costs are subject to variance as well (between the expectation and the outcome), countries need to develop the analytical capacity to manage risk and uncertainty.³⁹ This is of vital importance when they finance their projects via the issuance of domestic or foreign debt: for the repayment of that debt, and the servicing of its interest cost, depend on achieving a reasonable rate of return from the project. Unfortunately, Africa has had a history of projects that failed to meet expectations due to bad design, cost-overruns in their construction, or sheer bad luck (as well as exogenous shocks, including political instability). One of the biggest sources of future risk and uncertainty is climate change, to which we now turn.

*Climate change*⁴⁰

Climate change is one of the defining challenges of the twenty-first century: how to pursue appropriate mitigation and adaptation policies and strategies is a vital and urgent set of questions. We note that CO₂ emissions per capita from SSA are extremely low in international comparative perspective, as illustrated in Figure 4.24. Africans are rightly concerned that their development prospects and chances for a better standard of living are being harmed by a global threat which is not of their making. Adaptation is especially crucial for the African continent, and large volumes of finance, both public and private, must be mobilized. With many Africans still reliant on rain-fed smallholder agriculture and pastoralism, an infrastructure that is vulnerable to flooding (and a number of large coastal cities), and a unique biodiversity and wildlife which are globally important, the region is highly vulnerable to climate change.

Inevitably, climate change will impact countries in different ways. For the region as a whole, and while estimates vary for Africa, the Working Group II contribution

Figure 4.24 CO₂ emissions per capita, 1960–2012

Source: Authors' illustration of data from World Development Indicators, World Bank (2017).

to the Intergovernmental Panel on Climate Change (IPCC) Fourth Assessment (AR4) states that: “projected reductions in yield in some countries could be as much as 50 percent by 2020, and crop net revenues could fall by as much as 90 percent by 2100, with small farmers being the most affected” (Parry *et al.* 2007).

Lobell *et al.* (2011), using experiment station data on maize field trials in Africa, find that: “roughly 65 percent of present maize-growing areas in Africa would experience yield losses for 1 degree centigrade of warming (very likely to occur prior to 2050) under optimal rain-fed management.” These are significant impacts, even if they do appear to be an upper-bound in academic work.

More recent assessments that consider growth and development implications up to 2050 conclude that: “while expected climate change is likely to negatively affect overall growth/development with strong negative effects for some sectors and regions, climate change is unlikely to derail development prospects at least over the next three decades or so.”⁴¹

However, independently of precise estimates, there is a huge difference between development impacts if the global temperature rise can be restricted to a maximum of 2 degrees and those at, say, 4 degrees or more; and Africa is one of the most vulnerable regions to climate change. Food security is going to be an issue as agricultural production is affected by rising temperature and more limited water availability. Exposure to infectious diseases, such as malaria, is going to change as average temperatures increase and rainfall patterns change (Boko *et al.* 2007).

It follows from the above observations that what will happen in SSA depends critically on what happens to global mitigation efforts as well as on government

policies to adapt to climate change in SSA. Regarding the latter, one of the five lessons identified by Arndt and Tarp (2015) relates to the inseparability of the development and climate agendas; and UNU-WIDER ReCom work concludes that the existing window of opportunity must now be used in planning for long-term investments, such as infrastructure and energy. The Stern Report argued that early action on climate change is essential and will save money in the long run.⁴² If this opportunity is not taken, the efforts of countries to meet their development challenges will become progressively more difficult—and then more assistance will have to be allocated to disaster relief, putting further pressure on quite limited aid. If climate change becomes acute, then the welcome recent progress of countries from low-income to middle-income status will be halted or reversed, and they will slide back into increased aid dependence.

It is therefore evident that very substantial amounts of finance will have to be mobilized and allocated to climate change-related investments. This is so for infrastructure, training, and capacity-building, and in support of technology development and innovation (including agricultural technology). One of the specific recommendations of the UNU-WIDER ReCom program is the distinct need to support mechanisms to mobilize, catalyze, and leverage private and domestic public investment (Arndt and Tarp 2017b). Given the high investment costs of private investment in this area, it is critical to think creatively about ways to encourage more private investment, recognizing that SSA possesses vast amounts of so-far untapped and high-potential renewable energy sources. If they are properly developed, SSA will be able to produce and use more energy, which is indispensable as an integral and sustainable element of the countries' development strategies. It is, however, clear that they cannot be expected to do so unless action against "dirty" energy sources is taken and supported worldwide. At present, global fossil fuel subsidies vastly exceed the amount of foreign aid annually, and cheapen fossil fuels relative to renewables. For Africa to sustain the recent improvement in its living standards, and to achieve the SDGs, global climate action combined with Africa-specific assistance and investment are vital.

Conclusion

We started this chapter by noting that it is easy to find gloomy assessments of the future development prospects of Sub-Saharan Africa. Such views are understandable: the region has been through many crises since independence, not least in the 1980s (the era of structural adjustment and debt crises) and in the early 1990s (the Rwandan genocide), while today the DRC, Somalia, and South Sudan remain unstable or in conflict. Nevertheless, compared with the situation some 30 years ago, real progress has been made.

SSA experienced much-needed growth recovery from around the mid-1990s. Between 1993 and 2015, average household consumption (in purchasing-power parity terms) increased by more than one-third from US\$1,580 to \$2,080, according to the World Bank's World Development Indicators (WDI). This achievement rests on:

- an overall decline in the incidence of conflict in the region (with the exceptions noted above);
- the successful transition from apartheid in South Africa (which benefited the whole of southern Africa);
- some progress in improving governance (e.g., in the management of public expenditures and revenues);
- improved macroeconomic management, driven by an increasing number of well-qualified African economists in government and universities;
- assistance from the international community via peace-keeping as well as bilateral and multilateral aid.

Looking forward, SSA has immense potential, including:

- untapped natural resources, both non-renewable and renewable (such as solar and wind energy);
- a young population and a decreasing dependency ratio;
- a better-educated and healthier population than ever before;
- an accelerating uptake of information technology.

It is often argued that none of the growth experienced in SSA has benefited poor people; or even worse, that growth has led to a deterioration in the conditions of the poorest. This does not seem to be the case based on the available empirical evidence. A reduction of 13 percentage points in the poverty rate was experienced between 1990 and 2013, and non-monetary indicators improved, in some cases quite substantially (across a range of indicators), in ways summarized in this chapter.

This, and the region's other achievements, are no small accomplishments given the complex historical heritage—including slavery and colonialism—and the global, regional, and national-level shocks and disturbances experienced (and to which reference was made throughout this chapter). These events have largely been beyond the immediate control of African policy-makers, who have had many extraordinarily difficult issues to deal with—and with their task not made any easier when leaderships sometimes engage in abuse of power and corruption. Still, the nations and peoples of SSA have demonstrated a high degree of resilience to adverse circumstances and shocks. This resilience should make SSA an attractive candidate for continued and increasing FDI; perceptions of investor risk have fallen, and can fall further if the region continues to progress.

Nevertheless, the pattern of SSA's growth needs to change. This chapter has emphasized the structural characteristics of SSA's economies, including their lack of infrastructure and poor integration, which limit economic "multiplier effects" from investments. These structural factors also impede the growth of self-employment and wage-employment opportunities. This is especially so for remoter regions with poor-quality transport and communications infrastructure. Sectors such as oil, gas, and mining are highly capital-intensive; investments in the sector have low multiplier effects on the rest of the economy—in the absence

of policy action and complementary investments to increase the backward and forward linkages from the extractives sector. To produce more goods and services at higher levels of skill and value added—thereby yielding more jobs and more income—SSA will need an industrial policy to overcome the constraints, and realize the opportunities, of each economy (with its own special and unique characteristics and problems). The present momentum for greater integration into the global economy on terms more favorable to SSA is achievable—if the region builds on its gains over the last two decades. This should certainly be possible provided that supportive policy decisions and investments are made, combined with adequate inflows of foreign financing.

For these reasons, public investments in the social sectors are not enough. Better education and health care have been real achievements, and ones facilitated by the MDGs; however, the implementation of the MDGs gave, in practice, more priority to the social sectors than to livelihood creation via agriculture and manufacturing. This was reinforced by the allocation of donor aid, which favored the social sectors. Investments in education and health improve non-monetary welfare indicators, which is a key objective with widely agreed importance. They also have relatively long gestation times, meaning that the material (monetary) returns take a relatively long time to emerge (e.g., once a young person enters the workforce after their primary, secondary, and tertiary education). While investments in the social sectors are vital to reducing inequality in health status and educational outcomes, they are insufficient to reduce Africa's high income and wealth inequality, which is the result of insufficient employment opportunities (itself reflecting insufficient structural transformation). Scaling up job creation stands out as a central task for economic policy in SSA in the coming years with wide-ranging implications for getting both growth and sector policies in tune with existing realities and for investments in social sectors and family planning.

High income and wealth inequality implies that while growth has helped to reduce the incidence of poverty over the period 1990–2013, that reduction is less than it would have been if (initial) inequality had been lower (i.e., SSA must raise its growth–poverty elasticity). More than 40 percent of the African population remains poor, as measured by the US\$1.90 a day criterion; and the total number of poor increased from 278 million in 1990 to 390 million people in 2013, as the population grew. Two out of every three Africans are presently living on less than US\$3 per day; and inequality has remained stubbornly high in SSA. Moreover, high inequality has probably reduced the growth rate itself, as lower inequality implies a larger and more prosperous set of consumers for local products and services. Therefore, reducing Africa's high inequality can help economies achieve more growth via a bigger domestic market—an important dimension of structural transformation.

The inequality–growth relationship reinforces an important point of strategy: “hands-off” or “trickle-down” approaches to economic policy and strategy will be insufficient in coming years. African policy-makers and their international development partners need to act on this, to ensure that progress continues—and

accelerates. The Stockholm Statement, prepared by a group of leading international economists, provides a critique of the “trickle-down” approach and presents consensus-seeking policy guidance of value to the region in the years ahead (Stockholm Statement 2016).

The potential pitfalls are many. In the short term, the region must cope with the weakening in commodity prices of the last few years: this has been especially severe for the oil economies and their budgets, which are now being revised downwards in the light of lower revenues. In the medium and longer term, it is the issue of climate change that is a possible “game changer” unless appropriate policy action is taken as a matter of urgency. While mitigation is critical at the global level, the climate change agenda for most SSA countries must first focus on adaptation. It is fortunate that there is, according to existing evidence, a high degree of convergence between what is required to promote inclusive development and the actions needed to adapt to ongoing and expected changes in the physical environment resulting from climate change. The global community must generously assist SSA to take on the climate change challenge. Climate change will have major impacts on Africa, and adaptation is very expensive. While domestic resource mobilization has improved in SSA in recent years, foreign aid, climate funds, and private investment (and philanthropy) all have a major role to play in ensuring that Africa stays on a sustainable development path. If the international community does not help Africa in adapting to climate change, its fragility will rise, and so will the demands on already stretched budgets for humanitarian assistance.

There is, in conclusion, every reason to push decisively forward in sustainable African development over the next 20–25 years, keeping in mind that economic output will double every 23 years if the annual growth rate can be kept at around 3 percent. If SSA could achieve 7 percent—which is the growth rate that East Asia achieved—then output would double every decade. If that growth was more inclusive—providing new and more remunerative opportunities for the talents of all Africans—then the region could match East Asia’s success, and deliver a significant fall in the absolute numbers, not just the percentage, in poverty. The UN High-Level Panel on the post-2015 development agenda called for a decisive quantum leap forward in employment and livelihood opportunities. The UN Sustainable Development Goals approved by the world community in September 2015 reaffirmed this ambition. Such a leap will, however, require concerted action at all levels, including by the international community and national governments. At the same time, unless progress is successfully made, the world is going to witness even greater migration than seen so far by people in legitimate search of improved livelihoods for themselves and their families.

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Notes

- 1 The Fed funds rate went from 6.5 percent in October 1977 to 20 percent in December 1980, as the chairman of the US Federal Reserve, Paul Volcker, successfully brought down inflation, but at the cost of inducing a severe global recession. At the time, “Africa was not even on the radar screen,” Volcker stated; see www.counterpunch.org/2008/11/12/against-volcker/ (accessed September 13, 2017).
- 2 See Tarp (1993) for a detailed exposition, as well as Addison (2015).
- 3 On debt relief, see Addison (2006), and Addison *et al.* (2004). Of the 39 countries potentially eligible for debt relief under the HIPC and enhanced-HIPC initiatives, 33 were in SSA. For data on the HIPCs, see [http://web.worldbank.org/WBSITE/EXTERNAL/ TOPICS/EXTDEBTDEPT/0contentMDK:20260049~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html](http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTDEBTDEPT/0contentMDK:20260049~menuPK:64166739~pagePK:64166689~piPK:64166646~theSitePK:469043,00.html) (accessed September 13, 2017).
- 4 See also Arndt *et al.* (2016).
- 5 The triangle may not hold in specific circumstances, as discussed by Arndt *et al.* (2016). If, for example, additional domestic absorption is possible due to capital inflows (e.g., foreign aid), then the triangle is relaxed somewhat. The contrary is the case when negative terms-of-trade shocks put a squeeze on absorption.
- 6 See www.wider.unu.edu/project/inequality-giants (accessed September 13, 2017).
- 7 See Alesina and Rodrik (1994), Atkinson (2015), and Persson and Tabellini (1994).
- 8 See <http://hdr.undp.org/en/content/human-development-index-hdi> (accessed September 13, 2017), where this definition originates. The HDI, published annually by the UNDP, was not originally designed to capture inequality, which led to its successor, the Inequality-adjusted Human Development Index (IHDI; see <http://hdr.undp.org/en/content/inequality-adjusted-human-development-index-ihdi>, accessed September 13, 2017), which is sensitive to differences in inequality among countries.
- 9 See <http://hdr.undp.org/en/content/multidimensional-poverty-index-mpi> (accessed September 13, 2017).
- 10 See also Arndt *et al.* (2017) and Borat and Tarp (2016).
- 11 See https://esa.un.org/unmigration/documents/retreat/UN%20WOMEN_Indicator_vulnerable_employment.pdf (accessed September 13, 2017).
- 12 This runs counter to ILO (1973), which argued to the contrary in the case of Kenya. See Page and Söderbom (2015) for an illuminating case study of Ethiopia, asking the question “Is small beautiful?” published in the 2015 WIDER *African Development Review* special issue (edited by Jones *et al.* 2015). See also Jones and Tarp (2015), in the same issue, on priorities for boosting employment in SSA.
- 13 This includes the possibility that an inflow of foreign currency may lead to an overvaluation of the domestic currency and through this channel undermine the international competitiveness of the economy, and further the argument that aid has undermined domestic institutions.
- 14 See UNU-WIDER’s ReCom program at <http://recom.wider.unu.edu/> (accessed September 13, 2017) for comprehensive documentation of the impact of foreign aid, including a detailed position paper with extensive references. Jones and Tarp (2016) and Addison *et al.* (2017) are recent contributions.
- 15 See Davidson (1978) for a telling overview.
- 16 See Newman *et al.* (2016a, 2016b).
- 17 See Tarp (1993).
- 18 See, for example, Dalgaard and Kreiner (2003).

- 19 Institutional-quality data is usually based on assessments, and so should be interpreted carefully. This includes the World Bank assessments for public sector management, control of corruption, and the rule of law.
- 20 See <http://nationalinterest.org/blog/the-buzz/the-wars-ravaging-africa-2016-14993> (accessed September 13, 2017) for details and note the statement: “Modern conflicts in Africa are thus highly localized, and they defy simplistic explanations based on stereotypes.” See also Addison (2003), Addison *et al.* (2002), and Gisselquist (2015a, 2015b). See also Cilliers (2015) for illuminating background.
- 21 See Resnick and Thurlow (2015) and Resnick (2015).
- 22 See Addison, Grown, and Tarp (2015).
- 23 See Page’s (2016) blog on commodities, industry, and the African growth miracle.
- 24 See UNU-WIDER’s (2012) research brief.
- 25 See Osei (2012).
- 26 See Tarp (1993).
- 27 See www.nepad.org/resource/au-2003-maputo-declaration-agriculture-and-food-security (accessed September 13, 2017).
- 28 See also Arndt *et al.* (2016) for pointed cases that highlight the importance of agriculture. Thorbecke and Wan (1975) is an early study showing this in the case of Taiwan. Tarp (2017) and colleagues study the case of Viet Nam.
- 29 See also Page and Tarp (2017), Newman *et al.* (2016b), and Söderbom (2017).
- 30 The next three paragraphs draw on the excellent keynote by Dr J. Page at the UNU-WIDER conference “Public Economics for Development,” held on July 5–6, 2017, in Maputo, Mozambique. The complete set of slides is available from the conference website at: www.wider.unu.edu/event/public-economics-development (accessed September 13, 2017).
- 31 See Arndt *et al.* (2012) for a comparison of Viet Nam and Mozambique.
- 32 See NEPAD, AU, and AfDB (2011).
- 33 See the excellent keynote paper by Professor Michael Keen at the UNU-WIDER conference “Public Economics for Development,” held on July 5–6, 2017, in Maputo, Mozambique. The complete set of slides is available from the conference website at: www.wider.unu.edu/event/public-economics-development (accessed September 13, 2017).
- 34 See Microsimulation model SOUTHMOD—simulating tax and benefit policies for development (UNU-WIDER 2017a).
- 35 See the keynote paper by Dr J. Page, cited in note 30.
- 36 See Addison, Singhal, and Tarp (2015).
- 37 See UNU-WIDER’s ReCom website at <http://recom.wider.unu.edu/> (accessed September 13, 2017) for a multitude of studies carried out by UNU-WIDER under five headings: (1) Growth & Employment; (2) Governance & Fragility; (3) Social Sectors; (4) Gender Equality; and (5) Environment & Climate Change. This includes five UNU-WIDER position papers on these topics.
- 38 See Arndt and Tarp (2017c), on which the following paragraphs draw extensively.
- 39 See Bell (2017).
- 40 A useful summary is available in a UNU-WIDER overview of “Aid in a Post-2015 World,” on which this sub-section draws, available at: www3.wider.unu.edu/sites/default/files/News/Documents/ReCom-summary-aid-post-2015-world-5668.pdf (accessed September 13, 2017).
- 41 Cited from the UNU-WIDER position paper on “Aid, Environment and Climate Change,” on which this sub-section draws; see www.wider.unu.edu/sites/default/files/PP2014-Aid%2C%20Environment%20and%20Climate.%20Change.pdf (accessed September 13, 2017). See also Arndt and Tarp (2017c), Arent *et al.* (2017), Akpalu and Arndt (2015), and Tarp *et al.* (2015).
- 42 See www3.wider.unu.edu/sites/default/files/News/Documents/ReCom-summary-aid-post-2015-world-5668.pdf (accessed September 13, 2017).

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5 An overview of recent trends in official development assistance

Contradictory new directions in the relationship between DAC donors and China

Mark McQuinn

Introduction

The provision of official development assistance (ODA) is at a critical juncture. The rise of right-wing populism in a number of donor countries has led to vociferous arguments for reductions in foreign aid. It has also precipitated calls for aid policies to be driven overtly by donor self-interest, based on a securitization agenda. An anti-aid narrative is also being driven by right-wing sections of the media in donor countries, such as the UK. This focuses on ill-conceived programs and corrupt practices, along with abusive behavior by staff involved in providing assistance. In addition to these political and media-driven pressures for change, there has been a shift in the overarching perspective of traditional multilateral and bilateral aid providers.¹ At the Busan High-Level Forum (HLF4) meeting of the Organisation for Economic Co-operation and Development (OECD) Development Assistance Committee (DAC)² donors in 2011, a focus on “development effectiveness” emerged (Mawdsley, Savage and Kim 2014). This diverges from the paradigm outlined and developed at the previous three high level fora (HLF1–3), held in Rome (2003), Paris (2005), and Accra (2008). The HLF1–3 paradigm is based on using aid primarily to directly target poverty reduction. The shift by DAC donors to a broader objective of providing aid for development effectiveness is influenced by two main factors. First, a desire to increase the involvement of a wider group of actors in aid provision, particularly the private sector. Second, a need to collaborate more with non-traditional donors, in order to make achieving the Sustainable Development Goals (SDGs) by 2030 a realistic proposition. However, an important new aim of US ODA is to provide a counterweight to the influence of China in aid recipient countries. Many “U.S. foreign affairs officials have pointed to countering China’s influence as a key objective of their agency’s programs” (Igoe 2018a). There are, thus, contradictory directions developing, as the most powerful member of the DAC, the US, takes a more overtly oppositional stance to Chinese aid than other donors in the group. Irrespective of the position taken toward its aid provision by DAC members, China is of rising importance in shaping the ideology, policies and practices of aid. Ideologically, China is less influenced by a market-driven aid

model than the Western multilateral and bilateral donors. Its aid policies and practices also diverge notably from those of traditional aid providers. While China is diversifying its aid provision, infrastructure in Africa remains a key element of its assistance. China's Ambassador to Nigeria, Zhou Pingjian reaffirmed this in March 2018, stating "China's financing support to Africa is mainly invested in infrastructure construction.... We are committed to intensive development. The large infrastructure projects are planned and moved forward along with promoting Africa's industrial development" (Pingjian 2018).

This chapter provides an overview of the interrelated issues affecting ODA and situates a discussion of future trajectories for DAC-China aid relations within these complex strands. It argues that, while significant shifts in the form of DAC aid are inevitable, the direction of these changes is far from clear. Aspects of the Chinese model, based on blending aid with other forms of investment, are likely to become more widely adopted by DAC donors. However, whether the DAC donors will use blending to collaborate with Chinese development assistance in Africa to provide large physical and social infrastructure projects is more contentious. It is unlikely that DAC donors will switch their aid modalities substantively toward infrastructure projects to come more into line with the Chinese model. Ideologically, the provision of aid for large-scale infrastructure projects, such as roads and energy, draws on the structuralist model that was prevalent in the 1960s. This approach centers on providing support for state-led development of infrastructure. It is a problematic perspective for DAC donors, such as the USA and the UK, given their emphasis on the primacy of the private sector in providing aid. Any attempt at a shift toward aid based on a leading role for the state at the recipient end in coordinating infrastructure development would be strongly opposed by right-wing populist governments and the media in donor countries, as well as neo-liberal analysts of ODA.

Two main implications for future studies emerge from this overview. First, more research is required on how realistic synergies are between DAC donors and China, given their divergent ideological, economic, and political perspectives. Second, more evidence-based studies on the outcomes of Chinese aid are needed. Much analysis of Chinese development assistance remains based on broad generalizations concerning its benefits and shortcomings. There is a need for detailed analyses of the concrete outcomes for the intended beneficiaries of Chinese aid programs and projects.

The chapter is divided into six main sections. First, as ODA is currently under such concerted and aggressive attack from a number of perspectives, arguments in its favor are briefly revisited. Second, the major elements of the DAC's HLF aid paradigm are outlined, as they provide the framework for traditional ODA, which is facing intense pressure to change. Then, three critiques of the DAC model are discussed: (1) literature focusing on the gap between the rhetoric and reality of provision; (2) analyses advocating politically rooted solutions to aid failure; and (3) the neoliberal critique, arguing that ODA should be stopped and replaced by a market-led development trajectory. The next section discusses the

implications of the current attacks on aid by right-wing populists and sections of the media, linked to a move toward a securitization agenda on the part of important DAC donors. The literature on the growing significance of China as an aid provider, and its relationship with DAC donors, are assessed. Finally, the central lines of argument are brought together in the conclusion.

The case for aid in the face of the current critical onslaught

Traditional ODA, provided by Western donors, has its defenders, despite its increasing censure by neoliberals, right-wing populist political parties in donor countries, and sections of the media. Analysts make a case for the continuing provision of aid, based on two main grounds.³ While these reasons for giving ODA have been documented over a number of years, they are worth revisiting, given the intensity of the criticisms currently facing aid, which largely ignore its positive aspects.

First, giving aid has been justified on moral grounds. Following Singer's (1972) influential outline of the moral case for providing foreign aid to those in need, given the large amount of poverty and deprivation that exists globally, a number of analysts have taken a similar stance. Riddell (2008: 413, 2011), for example, argues that there is a "compelling case for governments to provide aid" on the grounds of moral duty, given the vast inequalities of wealth between rich and poor nations. Hulme (2016) adds the concept of moral responsibility to that of duty, arguing that aid is provided partly because some developed countries recognize their role in shaping the economic and political structures, which caused poverty in other nations (largely through colonialism and the slave trade).

Second, a case has been made for aid on the basis of its effectiveness in improving the lives of intended beneficiaries in the social and economic spheres. Sachs (2014, 2015, 2017), for example, points to a number of successful aid programs and projects over the years in the area of public health, including increased control of the incidence of malaria and tuberculosis in recipient countries. In 2015, Sachs reiterated his "big push" argument, first outlined ten years previously: if external donors increase aid in the form of finance, as well as skills and technology transfer, the "end of poverty" can be achieved. The developed world has the financial, technical, and institutional capacities to make transformative changes through aid: commitment is the main issue. More cautious analyses argue that aid is effective in certain contexts, to the extent that, in its absence, growth would be lower. The context in which aid works well, however, remains hard to determine (McGillivray *et al.* 2011). Nevertheless, Arndt, Jones and Tarp (2016: 446) make the important summary point that "the large majority of up-to-date empirical studies in the economics literature have found positive impacts" of aid at a macroeconomic level.

Thus, for a number of analysts, there is a moral imperative for the developed world to give aid and its provision has led to improvements in the social and economic welfare of recipients, which can be demonstrated empirically. These

two factors have combined uneasily and unevenly in influencing the aid policies and practices of traditional donors, which provide ODA under the auspices of the Development Assistance Committee (DAC) at the Organisation for Economic Co-operation and Development (OECD). The following section traces the development of the DAC model and highlights the significant problems with which it is currently grappling.

The DAC aid model

Influenced by criticisms of donor behavior in Tanzania during the 1990s (Hel-leiner *et al.* 1995; Adams 2005), DAC members have substantively revised their approach to ODA provision since 2000, at least rhetorically. Major policy documents, resulting from high-level DAC meetings, outline principles to frame the way aid should be given (OECD 2003, 2005, 2008, 2011). DAC donors emphasize the need for aid to be provided within a wider context of policy coherence for development (PCD). This entails ensuring that “the interactions among various policies in the economic, social, environmental, legal and political domains support countries on their pathway towards inclusive sustainable growth” (OECD 2015: 2). PCD further necessitates putting in place institutional mechanisms, processes, and tools to produce effective, efficient, sustainable, and coherent policies in all sectors (*ibid.*). While the rationale behind PCD is difficult to fault, a substantive issue with the approach is how to incentivize donors to turn their rhetoric into reality. It is difficult to overcome donor self-interest when attempting to situate aid within this broader framework of economic and political development policies. Among EU donors, for example, there is skepticism about the plausibility of providing aid within a PCD context. In the sphere of trade, “PCD-related measures in favour of developing countries look marginal in an overall EU strategy prioritising its economic and security interests” (Latek 2015: 1).

The codification of aid principles has been developed at four DAC High-Level Fora (HLF) on Aid Effectiveness.⁴ The overall aims of the HLF fora have been to learn the lessons of failures during the 1990s, in order to deliver aid more effectively, reduce transaction costs, and increase the capacity of institutions in recipient countries to absorb and spend ODA. HLF1 in 2003 produced the Rome Declaration, outlining the need for donors to simplify and harmonize “operational policies, procedures and practices” in order to avoid duplication (OECD 2003). Two years later, HLF2 led to the publication of the Paris Declaration (OECD 2005). As well as re-emphasizing the importance of harmonization, the Paris Declaration outlined four other fundamental aid principles for donors: (1) mutual accountability; (2) the need for alignment with the wider development objectives of recipients; (3) ownership of aid policies on the part of the intended beneficiaries; and (4) managing for achievable results. HLF3 in 2008 led to the Accra Agenda for Action (AAA), which restated the significance of the principles outlined in the Paris Declaration, emphasizing the need to ensure that aid outcomes have a “real and measurable impact on development”

(OECD 2008). The AAA also recognized for the first time civil society organizations (CSOs) as “development actors in their own right” (Oxfam 2012: 3). At HLF4 in 2011 in Busan, a wider range of actors in aid provision were recognized, particularly non-traditional donors from the South and the private sector. It was acknowledged in the Busan Partnership for Effective Development Cooperation (BPEDC) that the “Paris Declaration did not address the complexity of these new actors” and that “South-South co-operation continues to evolve, providing additional diversity of resources for development” (OECD 2011: 4). Moreover, there was a pledge to “enable the participation of the private sector in the design and implementation of development policies and strategies” (ibid.: 10).

The BPEDC concludes by asserting that DAC donors will “hold each other accountable for making progress against the commitments and actions agreed in Busan, alongside those set out in the Paris Declaration on Aid Effectiveness and Accra Agenda for Action” (ibid.: 12). To this end, a Global Partnership for Effective Development Co-operation (GPEDC) has been created, which is responsible for implementing the commitments made at Busan. Finally, a Working Party on Aid Effectiveness (WP-EFF) has been established—consisting of representatives of the DAC and other stakeholders—to work on reaching an agreement on how to put the GPEDC into practice.

Overall, the DAC aid model has evolved since the Rome Declaration (2003) to take account of the increasingly complex architecture of ODA. The need to engage with a growing range of actors involved in the contemporary “many-to-many” (Ramalingam 2013: 5) world of aid provision is foregrounded in the Busan Principles. Moreover, the core aid principles outlined in the Paris Declaration do focus on important technical ways of providing aid effectively. However, criticisms of the DAC model have proliferated in the second decade of the twenty-first century. Only one year after the publication of the Accra Agenda for Action in 2008, for example, Whitfield (2009: 4) argued that “everyone knows that foreign aid is not working as intended, and that something must change.” While shifts in aid provision have occurred since this statement, a growing range of literature has continued to highlight the inadequacies of the DAC model. Three main lines of criticism are outlined in the following section.

Criticisms of the DAC aid model

Critics of the DAC aid model can be broadly divided into two camps. First, there are reformists who support the provision of aid in principle but highlight the need to address problems with the current model, emanating from the political domain. In short, “the politics matter” (Glennie 2014: 553). Second, a number of neoliberals and right-wing populists argue that the existing aid model is fundamentally flawed and should be radically altered or abandoned. The main arguments of the two lines of criticism are discussed in turn.

The rhetoric-reality gap

Donors in practice have consistently failed to implement important principles outlined in DAC documents. The gap between the rhetoric contained in the DAC publications and the reality of aid provision on the ground remains substantive. Problems in relation to, first, harmonization and, second, ownership are used to illustrate this failing. These two concepts have been selected, as they have been highlighted as key to the success of aid by the World Bank since the late 1980s (World Bank 1988).

The first HLF (OECD 2003) in Rome had an explicit focus on the need for donor harmonization, in order to lower transaction costs. The Rome Declaration (ibid.: 10) argues that it is both possible and beneficial “[to] simplify and harmonise [aid] requirements and reduce their associated costs, while improving fiduciary oversight and public accountability and enhancing the focus on concrete development results.” However, a number of studies since the publication of the Declaration highlight the continual failure of donors to harmonize effectively. Woods (2008: 1221) argues that traditional donors are “finding coordination among themselves very challenging.” For AFRODAD (2007), harmonization in Cameroon was negatively affected by the reluctance of donors to stop interfering in aid processes, along with weak recipient strategies and institutions. Subsequent research on the issue, in a variety of empirical contexts, has produced similar results. A study of aid provision in Bangladesh by Rahaman and Khan (2010) concludes that harmonization largely depends on donor commitment and collective effort between donors and recipient governments. Winters (2012: 36), using Indonesia as a case study, also finds that harmonization is hampered because of “the strategic interests of the donors, the incentives faced by aid bureaucrats and the variation in interests within aid-recipient governments.” Leiderer (2015: 1441) argues that there remain “strong disincentives for effective coordination, even between like-minded aid providers” and this is unlikely to change until there is a shift in incentive structures, so that donors’ rhetorical commitment to harmonization will be translated into behavioral change. Olivie (2016) points out that lack of donor harmonization is caused not just by political incentives but also by the weak institutional capacity of both donors and recipients. She highlights the disorganized nature of the institutional aid architecture in some EU states, which has hindered the provision of harmonized ODA to Morocco. This is exacerbated by the lack of readiness and will to coordinate aid effectively on the part of the administration in Rabat.

Overall, studies encompassing North Africa, Sub-Saharan Africa, South East Asia, and South Asia find that aid provision continues to be based largely on individual donor self-interest, while recipients lack the institutional capacity and, in some cases, political will to engage effectively with harmonized ODA. Consequently, improved donor harmonization in providing aid has been fitful at best since its importance was highlighted in the Rome Declaration. As a result of these important donor and recipient failings, globally “the aid system supports some 15,000 donor missions in 54 recipients countries per year – and in some

countries this amounts to over 20 official visits per week” (Ramalingam 2013: 3). Moreover, Winters (2012) points out that the continued provision of ODA by donors, based on their individual concerns, weakens not only harmonization but also their claims that ownership of aid policies by recipient governments is important.

The importance accorded to ownership by the traditional donors can be gauged from the fact that it is listed as the first of the key aid principles in the Paris Declaration, the Accra Agenda for Action, and the Busan Partnership for Effective Development Cooperation. The focus of traditional donors on ownership precedes the Paris Declaration. In the early 1990s, Johnson and Wasty (1993) produced a piece of research for the World Bank, outlining detailed indicators of the concept and providing measurement criteria. This conceptualization of ownership extensively influenced later work on the topic by Killick (1997) and the World Bank itself (2004). In addition, ownership became an important part of the practice of development in 1999 when it was made a defining concept of Poverty Reduction Strategy Papers (PRSPs). As Weeks *et al.* (2002: 72) point out, “No single policy was more associated with transferring ownership to aid recipients than the Poverty Reduction Strategy Papers.” However, three years into the PRSP period, Cramer (2002) pointed out that a theory of ownership was still lacking and Boughton and Mourmouras (2002) questioned whether it could be effectively operationalized. The publication of these substantive concerns stimulated little detailed research by DAC donors on how the concept should be theorized, operationalized, and measured.

Ownership was defined by the DAC donors in 2005 in the Paris Declaration as a situation where aid recipients “determine poverty reduction strategies autonomously, as well as focusing on institutional capacity building and addressing corruption” (OECD 2005). This broad and descriptive definition lacks analytical precision and makes accurate assessment of levels of ownership difficult. There is no detailed discussion in the Paris Declaration, or any of the other major DAC documents on aid provision, of the analysis of ownership provided by Johnson and Wasty (1993) and later by Killick (1997) and the World Bank (2004). This disconnect between important traditional donors—the World Bank and the DAC—on a concept emphasized by both as vital to the success of aid, has ramifications for the level of provision. For example, McQuinn (2012), examining the case of Tanzania, finds that since the inception of PRSPs, the World Bank has not used the classification scheme devised by Johnson and Wasty (1993) (or an equivalent) to ascertain levels of ownership. The Bank measured the concept by employing broad rankings (from 1–5), assessing participation as a proxy for ownership, based on methods that have little rigor or transparency.

Critiques of ownership by policy-makers and academics have grown since its importance was foregrounded in the Paris Declaration, both at the theoretical and empirical levels (see, for example, Castel-Branco 2008; Buiter 2010; Flint and Meyer zu Natrup 2014; Rose and Wiebe 2015; Vogus and Graff 2015; Marquette and Fisher 2016; Dornan 2017). Despite this body of work, an analytically rigorous and widely accepted characterization of the concept has remained

elusive to the point where, in 2016, USAID still regarded it as necessary to support research on the topic, resulting in the production of a Working Paper entitled “Country Ownership in International Development: Towards a Working Definition” (Watson-Grant *et al.* 2016).

The examples of harmonization and ownership illustrate the significant size of the gap between the rhetoric of DAC principles and the reality of aid provision. In many cases, harmonization and ownership failures derive from wider structural power imbalances between donors and recipients, as well as the entrenched political interests of groups and individuals. The shortcomings of traditional aid through donor inability and/or unwillingness to engage effectively and equitably with political realities on the ground, have become the focus of a body of research, which is discussed in the following section.

Complex political realities as a reason for aid failure

A number of recent analyses of aid have focused on the failure of DAC donors to navigate *realpolitik* effectively and justly when providing aid. This line of research highlights contradictions between the current dictates of the traditional aid system and the complex actuality of political relationships involving donors and recipients, which makes successful provision difficult.

First, a number of studies center on aid failure because traditional donors are overly concerned with achieving value for money (VFM). The concept of VFM has recently “become more prominent in the development agenda” (Jackson 2012: 1) and can be categorized as a “re-emerging buzzword ... [with] ... a nice ring to it” (Jayasuriya 2013: 1).⁵ According to Yanguas (2018: 203), the “VFM craze” illustrates the general point that traditional donors have created a transactional model of aid. As a result, they are less concerned with transformational developmental outcomes than accounting for money expended on programs and projects. By concentrating on VFM, donors leave important and difficult political relationships and processes unaddressed, as they are not easily amenable to quantitative measurement. The transactional nature of the system ensures that traditional aid providers concentrate on upward accountability to their funders, who prefer outcomes that can be enumerated and tabulated. This focus means that downward accountability to intended beneficiaries is neglected.

Second, the current preoccupation with VFM relates to the longer-standing concern of traditional donors with corruption. Anti-corruption programs have been a substantive aspect of traditional aid since the 1990s, as part of the wider donor-driven “good governance” agenda (Grindle 2007; Smith 2007; Sundaram and Chowdhury 2012; Whaites *et al.* 2015; Dijkstra 2017). Corrupt aid (involving donors and recipients) has been discussed over a considerable number of years (see, for example, Bauer 1981; Hancock 1989). It rose to the top of the aid agenda in the latter part of 2017, driven by the critiques of neoliberals, right-wing populist politicians in the donor countries and sections of the press, emphasizing the corrupt nature of a number of programs. Corruption is clearly a verifiable problem in relation to aid provision. Manning (2012: 17), for example,

highlights the way aid can strengthen the executive branch of recipient governments at the expense of countervailing forces, with negative consequences for local accountability. In many cases, a small number of key ministers and officials at the recipient end, control aid flows and are distanced from rigorous oversight by parliaments, the media, or civil society. Danish (2016) illustrates how this has happened in Afghanistan, where “corruption consistently goes unpunished.” Kenny (2017), nevertheless, makes the point that the donor obsession with reducing corruption, fueled by a defensive attitude to aid provision, in the light of continual criticisms, has led to insufficient focus on the outcomes of programs and projects. Current approaches to curbing corruption are costly and do not measure the phenomenon accurately. Greater attention than is currently the case should be paid to how the outcomes of aid programs and projects affect the intended beneficiaries. This is a significant point, which will be returned to in the section below on Chinese aid.

Third, some research centers on how the power of traditional donors entails a loss of policy space for recipients, through the imposition of conditionalities and overbearing policy advice. This inculcates policy incoherence in recipient governments and leads to a lack of long-term strategic visions, culminating in the demise of national development planning (Oya and Pons-Vignon 2010). A study by Kentikelenis, Stubbs, and King (2016) illustrates the salience of this perspective. Their research revealed that the IMF loan agreements between 1985 and 2014 contained 55,465 individual policy conditions across 131 countries. These statistics highlight the close control the IMF maintains over the policies of aid recipients. They also add weight to the argument of Winters (2012), outlined above, that ownership of aid policies by recipients remains more at the level of rhetoric than reality.

Fourth, recent research argues that failure is inescapable, within the DAC system, since it is based on compromises between donors and recipients that are unworkable in the long term. For Swedlund (2017), shifting fads in aid delivery are attempts to overcome commitment problems that undermine policy compromises reached by providers and receivers. Incentives are needed that realistically allow donors and recipients to fulfil their aid commitments. At present this is not the case and aid policies are based on negotiated compromises between providers and recipients, which usually break down, after an initial period of enthusiasm, due to constraints at both ends. Paul (2015) illustrates this point in an examination of Performance-based Aid (PBA). She shows how donors have inadequately engaged with the fact that budgetary processes in recipient countries tend to be rigid. When donors release aid packages *ex post*, following what they have deemed to be an “acceptable performance” by recipient governments in enacting “necessary” policy reforms, a slow bureaucratic process toward final disbursement by various ministries occurs.

Overall, these critiques provide useful insights into the multiform political relationships involving aid donors and recipients, which militate against the success of programs and projects, within the current system. They stop short of calling for a halt to aid on the basis of their criticisms and argue that reform is

possible, if it takes place at a deep level and in a thoroughgoing way. Further down the critical line on aid is the neoliberal perspective, which not only highlights serious aid failings but also calls for ODA to be ended or changed beyond all recognition. This approach has been the subject of a considerable amount of analysis. However, since it has gained traction recently, core elements of the perspective are outlined in the following section.

The neoliberal critique and its current influence

Drawing on the work of Bauer (1976), the neoliberal approach centers on the argument that development can be achieved, not through the provision of aid, but by greater integration of countries into a global free market economy. For Bauer (1981: 55), “the concept of the Third World and the policy of official aid are inseparable. Without foreign aid there is no Third World.”

The neoliberal critique of aid increased in influence from the 1980s with support from prominent analysts, such as Friedman (1995). Neoliberals argue that aid is inefficient, since it typically entails market distortions in the form of subsidies and price controls. Furthermore, the provision of ODA creates a mentality of dependence among recipients and fosters corruption. It also, through ill-informed donor influence, leads to the misallocation of scarce resources, stifles innovation, and redirects the energies of entrepreneurs away from business toward lobbying to obtain aid contracts or attempting to join aid bureaucracies. Moreover, aid prevents recipient governments from having to show “good governance” to citizens and, in particular, their poor (Easterly 2016).

Moyo (2010), whose work has raised the profile of the neoliberal perspective, contends that all aid should be halted within a five-year period, given its failure to stimulate development and reduce poverty. She argues that although Africans have received more than US\$1 trillion in development assistance in the recent past, “the recipients of this aid are worse off; much worse off. Aid has helped make the poor poorer, and growth slower. Yet aid remains a centrepiece of today’s development policy and one of the biggest ideas of our time” (ibid.: xix).

This neoliberal perspective has influenced the recent move by some traditional donors to market-driven forms of aid provision. Some major traditional donors have become disillusioned with the perceived failure of state-centered aid provision and doubt that poverty can be substantially alleviated, unless private enterprise is involved in aid. There is, therefore, a trend among major donors to shift “official development assistance to their private development arms” (Anders 2016). For example, in pursuing the SDGs, the World Bank (World Bank Group 2015) states that “financing from private sources, including capital markets, institutional investors and businesses, will become particularly important.”⁶ Moreover, the UK Department for International Development (DFID) has foregrounded the importance of the private sector in the provision of UK aid. Its 2017 Aid Strategy document states that the organization will increase its use of capital “to create jobs, catalyse private sector investment and build markets in challenging settings” (DFID 2017: 10).

Overall, the neoliberal emphasis on the virtues of the free market, within which individual enterprise is key to economic success, resonates in the current climate of fierce criticisms of state-centered ODA provision by right-wing populist politicians and elements of the press. The nature of these attacks is summarized in the following section.

Media and right-wing populist attacks on aid

The rise of right-wing populism in donor countries, such as the UK and the USA has fostered a climate where foreign aid is routinely criticized in political speeches and media articles as wasteful and corrupt. Scandals involving the behavior of staff at well-known aid agencies, such as Oxfam, have exacerbated the criticisms (Foulkes 2018; Hirsch 2018; Moise 2018). In the UK, a number of right-wing newspapers and magazines have mounted concerted anti-aid campaigns over the last few years. The selection of a few headlines from publications in 2017 and 2018 in Figures 5.1, 5.2, 5.3, and 5.4 captures the nature of the attacks on aid.

Figure 5.1 *Daily Express*, October 24, 2017

Source: www.express.co.uk/news/politics/870236/uk-foreign-aid-budget-british-give-money-india-africa-taxpayer-nhs-elderly.

Figure 5.2 *The Sun*, February 20, 2018

Source: www.thesun.co.uk/news/5618203/bloated-foreign-aid-may-increase-dependency-britain/.

Figure 5.3 *Daily Express*, February 20, 2018

Source: www.express.co.uk/news/politics/921122/Foreign-aid-budget-damning-report-ICAI-Dfid-failure-monitoring-value-money.

Figure 5.4 Daily Mail, March 17, 2018

Source: www.dailymail.co.uk/news/article-5513567/China-takes-millions-aid-UK-hands-Russia.html.

Such sustained censure influences the public's perception of aid. Media coverage of the scandal involving the behavior of some Oxfam staff has been cited as causing a fall in funds raised for UK Sport Relief 2018 by one-third compared to the previous year (Siddique 2018). Moreover, these media campaigns can have negative implications for official government funding of ODA. Heinrich, Kobayashi, and Bryant (2016) show that aid cuts can occur because politicians are aware that voters place a lower priority on ODA during periods of economic uncertainty. In the UK, there is economic disquiet as Brexit approaches. Politicians, therefore, could use the negative media coverage of aid to make cuts in its funding, knowing that sections of the public will have been influenced by negative media coverage and their concerns about the economic state of the country. These influences have also precipitated calls by right-wing politicians in the UK and the USA for aid to be reoriented toward national interests.

Aid in support of donors' national interests

The argument that aid is provided primarily to promote the national (and international) interests of donors is far from new (see, for example, Hayter 1971). However, in 2017 and 2018, strikingly forceful and direct arguments that aid should be redirected to serve their national interests, as well as assisting recipients, have been outlined by important political figures from a number of DAC donors. This adds another layer of complexity to current debates concerning the future direction of ODA.

In 2018, senior politicians in the UK and the USA have made forceful and direct calls for ODA to be aligned much more closely with their foreign policy and commercial interests. Boris Johnson, then British Foreign Secretary, stated in relation to aid in that "the old jam jars are being smashed ... [and] the cash will be more sensibly distributed with a view to supporting British foreign policy" (Barnett 2017). His perspective is echoed by Penny Mordaunt, who shortly after becoming the Secretary of State for International Development in November 2017, outlined a vision for UK aid prioritizing "projects which deliver a much more explicit win for the UK's interests as well, because without that we won't be doing aid well" (Anders and Edwards 2018).

These "interests" center on security issues, as well as economic concerns. For example, the UK National Security Council (NSC) now controls substantive

funding streams for aid programs, such as the 2017 US\$1.7 billion Conflict, Stability and Security Fund (CSSF). This is a cross-governmental fund, which aims to spend 30 percent of ODA through departments other than DFID. Started in 2015, the CSSF is administered through the Foreign and Commonwealth Office (FCO). The UK government justifies this shift to a focus on aid for securitization by pointing to the vast amount of human suffering globally caused by conflict and instability. This government perspective is supported by the Independent Commission for Aid Impact (ICAI). In a 2018 review of the CSSF's aid programming expenditure, the ICAI found conflict to be "both a major constraint on development and poverty reduction, and a source of threats to the UK and its interests" (Independent Commission for Aid Impact 2018: 1).

The CSSF is composed of blended ODA and non-ODA funds, such as spending on security issues or the military. This makes oversight problematic, since the ICAI is only mandated to evaluate ODA. Concern has been expressed by the then Chief Commissioner of the ICAI, who asks "how can we ... say meaningful things about effectiveness of programing when actually there is quite a lot of blending going on?" (Anders 2017). Where ODA provided by the CSSF has been clearly delineated, its quality has been criticized. The 2018 ICAI evaluation of the CSSF's work led to the award of an amber-red assessment, signaling "unsatisfactory achievement in most areas, with some positive elements ... improvements are required for UK aid to make a positive contribution" (Independent Commission for Aid Impact 2018). The same evaluation highlights the importance attached to VFM, outlined above. One of the core recommendations of the evaluation is, "where the CSSF projects are intended to support diplomatic access and influence, the influencing objectives should be explicit and progress reported so that the value for money of the investment can be confirmed" (ibid.: 1).

As well as the UK, the securitization of aid has become a major plank of US policy. The Trump administration plans significant cuts to the 2020 aid budget, focusing on reductions in funds for humanitarian aid, refugee assistance and global health programs (Morello 2019) and aims to channel funds from development assistance into a program linked to national security objectives. "The cuts are ... indicative of the wider push to tie development aid with U.S. national security interests" (Harris *et al.* 2017: 1). In President Trump's first State of the Union speech, he pledged to limit US aid to "friends" of the country, stating "tonight, I am asking Congress to pass legislation to help ensure American foreign assistance dollars always serve American interests and only go to friends of America, not enemies of America" (Trump 2018).

There has been considerable opposition to the proposed cuts on various grounds. Konyndyk (2017), for example, makes a humanitarian case for opposing the cuts, arguing that they are "breathtakingly cruel" and will "kill people." Gaffey (2017) focuses on security issues, arguing that the cuts could lead to increased poverty and deprivation in Africa, which, in turn, will increase recruitment into terrorist groups. The possibility that the cuts could reduce US influence in recipient countries and lead to isolationism has also been outlined

(Torbaty 2017). Another line of thought is that the planned reductions could allow Chinese influence in South and Central Asia to increase (Ayres 2017). In overall terms, the Trump administration's proposals underlie a skepticism regarding the usefulness of foreign aid and a preference for the use of the military as the main way to promote US interests abroad.

At the supranational level, the World Bank is increasing its aid markedly to countries affected by conflict, violence, and fragility. In March 2018, the International Development Association (IDA) section of the World Bank committed to increasing financing to fragile and conflict-affected countries from US\$7 billion to US\$14 billion over the next three years (Igoe 2018b). The World Bank emphasizes that this is necessary because it is increasingly troublesome for the organization to combat poverty without also engaging with the violence which is at its root. According to the World Bank, by 2030, more than 60 percent of those in extreme poverty will be living in fragile states (*ibid.*).

In sum, an increasing amount of aid from the World Bank is being directed to countries affected by conflict and some influential DAC donors are shifting their assistance explicitly to address security concerns. Easterly (2010) argues that aid to conflict-affected countries has a track record of appropriation by undemocratic leaders and donors often do not address this issue. Aid has also been taken in conflict-affected countries by opposition groups using violence in their efforts to control resources and territory, as well as political power. Moreover, Moseley (2009) contends that increasing use of ODA for security purposes could lead to the "blanket militarization" of aid. However, Brown and Gravingholt (2016) make the salient point that only some donor countries are explicitly shifting aid into an instrument to pursue their national or international economic, political, and security interests. Recognizing the importance of context specificity is, thus, necessary when analyzing this issue. This section has shown that traditional aid has been subjected to increasing criticisms, and its bilateral providers driven in contradictory directions, despite their membership of a unitary body, the DAC. Contemporaneously, China has been growing in importance and influence as a supplier of foreign assistance, often blended with commercial investment in recipient countries. In the following section, notable elements of Chinese aid are outlined and the likelihood of cooperation or competition with DAC donors, in the light of their changing perspectives and modalities, is assessed.

Chinese foreign assistance

In 2018, the China International Development Cooperation Agency (CIDCA) was opened. The aims of the agency are to formulate 'strategic guidelines, plans and policies for foreign aid, coordinate and offer advice on major foreign aid issues, advance the country's reforms in matters involving foreign aid, and identify major programs and supervise and evaluate their implementation' (CIDCA 2019). CIDCA's broader task is to make coordination more transparent and effective between the Ministry of Commerce (MOFCOM) and the Ministry of Foreign Affairs (MFA), which play key roles in directing the blending of

Chinese ODA with commercial investments. A further noteworthy goal of CIDCA is to ‘allow aid to fully play its important role in great power diplomacy’ (Reuters 2018). This is another notable achievement for a country, which has raised 700 million people above the poverty line in the past 30 years (World Bank 2016), accounting for 76 percent of global poverty reduction (UNDP 2015). Brautigam (2010) makes the important point that, while there are vociferous critics of its foreign assistance, China has raised millions of its citizens out of poverty in recent history, so it is in a position to provide viable aid ideas, strategies, and models.

Research on Chinese aid is increasing but significant gaps remain. A little more than a decade ago, China was labeled a “rogue” donor and accused, along with other non-traditional aid providers, of “pricing responsible and well-meaning aid organizations out of the market in the very places where they are needed most” (Naim 2009). Since then, a number of detailed overviews have shown this to be a simplistic and single-stranded perspective. Brautigam (2010) makes the point that Western analysts need to avoid sensationalism and paranoia about Chinese aid to Africa and may be better served by addressing the shortcomings of the DAC model. She outlines innovative ways in which China is blending aid and business. She also shows that China is trying to learn from the methods used by aid donors, such as Japan, and is willing to adjust its own strategies and practices, according to outcomes. China is, therefore, far from being an ideologically-driven aid provider, which is unwilling to listen and learn from others.

Recent research by Dreher *et al.* (2017: 26) finds that Chinese aid “boosts economic growth in recipient countries.” Moreover, “Chinese, U.S. and OECD-DAC aid produce similar economic growth impacts. We also find no evidence to support the idea that Western aid is less effective at accelerating economic growth in countries that also have significant access to Chinese aid” (ibid.: 26). These findings have positive implications for a deeper aid relationship between China and DAC donors. However, for synergies between China and DAC donors to work effectively, greater depth of understanding is needed of how the former blends aid with other forms of investment. In particular, more micro-level empirical studies focusing on outcomes for aid recipients are required. Xu and Carey (2015) are among researchers who argue that greater transparency concerning the way China provides assistance to foreign countries is needed. In addition, more micro-level empirical studies focusing on outcomes for aid recipients are required. Such research would be particularly useful in the context of Africa, given China’s increasing levels of investment in, and assistance to, countries continent-wide.

Detailed studies of China’s economic and political relations with Africa—both at a continent-wide and individual country-based level—are increasing. The *China-Africa Research Initiative* (CARI), based at Johns Hopkins University, has produced evidence-based analyses of various aspects of economic and political relationships since 2014. Oqubay and Yinfu Lin (2019) have edited a wide ranging examination of Africa’s economic development in the context of its

relationship with China. The research highlights the need for context specific assessments, given the diverse nature of political economy regimes across Africa. Alden and Large (2019) have coordinated an overview of methodological and theoretical approaches to studies of China-Africa relations, outlining areas where repositioning would be beneficial. This is timely, given that a number of analyses (Ndzendze, 2019, for example) point to the lack of robust theoretical analysis, which characterizes a number of China-Africa studies. Yuan Sun (2017) has examined the role of China in the ongoing industrialization process in Africa, outlining the possible economic, political and social changes that may ensue from the growing number of Chinese-run factories on the continent.

At a nation-state level, Oya (2018) has assessed labor regimes in Ethiopia and Angola, comparing conditions and relationships in Chinese-run workplaces with those financed by domestic and other foreign capitalists. Ching Kwan Lee (2018) has produced a detailed ethnographic assessment of varieties of Chinese capital investment in the copper mining and construction sectors in Zambia. Sylvanus (2013) has researched Chinese textile traders in Togo. She shows that there are shifting and dynamic relationships between Chinese and Togolese actors and institutions, with agency significant on both sides. Mohan and Lampert (2012) also demonstrate, using Nigeria as a case study, that African actors beyond the state level are increasingly negotiating and shaping engagements with China.

These studies provide nuanced analyses, highlighting the point that China is not simply dictating the pattern of its investment in Africa. In contrast, China's strategies and policies are dynamic and increasingly influenced by the agency of a variety of African actors, not just a state-elite.

However, similarly detailed studies of Chinese aid to Africa are less in evidence. Yuan Sun, Jayaram, and Kassiri (2017) make the point that more research is necessary on the outcomes of Chinese aid in particular contexts in Africa, rather than a focus on inputs and methods. This is not a simple task, since "it is hard to identify data disaggregating China's foreign aid" (Carter 2017: 11). A few studies exist, focusing on particular sectors. King (2013), for example, has produced a study of Chinese aid to provide education and training in Africa. However, more micro-level research on Chinese aid programs and projects would act as a useful complement to the work of Dreher *et al.* (2017) and Brautigam (2010), which takes a broader sweep in examining the effects of China's ODA to Africa.

A debate between traditional DAC donors and China over aid provision is occurring. However, Yifu Lin and Wang (2017) point out that it needs to be wider, deeper, and more transparent if effective collaboration is to occur. Both parties have misgivings concerning aspects of the other's aid provision, which are not easily overcome. Yifu Lin's New Structuralist Economy (NSE) model is based on considerable evidence that, in the post-World War II period, developing economies which successfully achieved developed status, used structuralist policies, based on state-led intervention (Yifu Lin and Wang 2017). China, therefore, situates its current aid provision within an overarching vision of structural and state-centered change. Given the ideological adherence of the tradi-

tional donors to market-led aid and the increasingly critical stance of US aid agency officials toward the Chinese model, much work needs to be done if meaningful collaboration with China is to occur.

Conclusion

ODA provided by traditional donors is at an inflexion point. Important changes are being driven by a number of complex and, in some ways, contradictory influences. First, more than ten years after the publication of the influential Paris Declaration, which framed the way ODA should be provided by traditional donors, a considerable gap remains between the rhetoric and the reality of disbursement. The usefulness, therefore, as well as the validity, of the principles outlined in the Paris Declaration (and updated at Accra and Busan) are being increasingly questioned. Second, a number of recent analyses of aid have highlighted ways in which traditional donors are failing to engage effectively with the deeply political nature of aid provision. Third, traditional donors are increasingly giving primacy to private sector provision of ODA, influenced by neoliberal policy prescriptions for development. Fourth, ODA is facing concerted and trenchant criticism from a number of quarters, including neoliberal analysts, governments of major DAC providers, such as the USA, and sections of the right-wing press in donor countries. These criticisms emphasize the issues of poorly conceived programs, the ingratitude of some recipients, as well as corruption and misbehavior on the part of a number of officials at aid agencies. Fifth, largely due to the criticisms outlined above, there is a drift away from the two formative reasons for providing foreign assistance: the moral imperative, in the light of uneven levels of development globally; and the belief that aid can improve the economic and social welfare of people in recipient countries. Instead, a number of donors are overtly justifying the use of aid to pursue national interests, including economic gain and security concerns.

Within this complex scenario, China's importance and influence as an aid provider continue to increase. Evidence-based research (Dreher *et al.* 2017) has recently shown that aid provided by China is having a beneficial impact on economic growth in recipient countries. Moreover, Arndt, Jones, and Tarp (2016) have produced research demonstrating the same positive economic outcomes, resulting from aid provided by the traditional donors. Thus, as Arndt, Jones, and Tarp (*ibid.*: 472) argue, "calls for the extinction of aid and its associated institutions on the basis of poor or negative returns are unjustified." These findings raise the question of how effective complementarity between aid provided by China and traditional donors can be increased. For this to happen, first, more evidence-based research is needed on the outcomes of particular Chinese aid programs and projects. This would add weight to the recent evidence outlining positive economic growth patterns that have occurred in countries receiving Chinese aid. Second, more empirical research on how exactly China uses blending of foreign assistance with other types of investment would be useful. The publication of detailed analyses on how blending works at program and project

levels would help to dissipate the unease some traditional donors still exhibit about the nature of Chinese assistance and could provide lessons, given the shift toward blended aid on the part of traditional aid providers themselves. However, even with the publication of such research, the present ideologically-driven predilection of traditional donors for assistance led by the private sector, the recent move on the part of the Trump administration to take a more adversarial stance toward China's aid model, as well as moves on the part of some countries toward the provision of aid based on a securitization agenda, are factors complicating the possibilities of cooperation with China. Furthermore, recent research summarized in this chapter has shown that traditional donors continue to provide much aid through misguided attempts to inculcate political reform in recipient countries. The research shows that such efforts have little chance of success when they are set within the structural and financial constraints of the current aid system and the prioritization of a value for money (VFM) agenda on the part of donors. These restrictions make the provision of aid by traditional donors within an overarching policy coherence for development (PCD) agenda largely meaningless. They also reduce the possibilities of effective complementarity between the traditional and Chinese aid providers. Nevertheless, the importance attached by the traditional donors to achieving the Sustainable Development Goals (SDGs) by 2030 is an incentive for them to adjust their ideologies, strategies and practices. Substantive aid from China could increase the likelihood of achieving the SDGs by 2030. This point could incentivize traditional aid donors to work more closely with China in providing aid. Given that this is an instrumental motivation, rather than one stemming from a wholehearted desire for cooperation and compromise, the providers of Chinese aid are likely to be cautious in the way they reciprocate.

Notes

- 1 Major traditional multilateral aid donors, in the context of this chapter, are the World Bank, the International Monetary Fund, and United Nations organizations. Traditional bilateral donors refer to the 29 OECD-DAC aid providers, as well as the European Union.
- 2 Hereafter referred to as DAC donors.
- 3 Arguments in favor of ODA are covered at a broad level only to frame the debates, as it is difficult to cover the "vast array of different sub-literatures" (Riddell 2008: xviii) on aid in detail in a single book chapter.
- 4 A significant precursor to the fourth HLF was the International Conference on Financing for Development, held in 2002 in Monterey. This produced the 'Monterey Consensus' which outlines the need for aid to directly target poverty alleviation, based on developing effective partnerships between different agents of development. This was built on by the Doha Declaration on Financing for Development (United Nations Department of Economic and Social Affairs 2008) and the Addis Ababa Action Agenda (UNDESA 2015), which align global "financing flows and policies with economic, social and environmental priorities." A progress report in 2017 found "a difficult global environment has impeded individual and collective efforts, and many implementation gaps remain" (UNDESA 2017).
- 5 See, for example, DFID (2011).

- 6 Statement by the Heads of the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the Inter-American Development Bank, the World Bank Group, and the International Monetary Fund (World Bank Group 2015).

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6 Africa's quest for poverty alleviation

Lessons from and reflections on the role of China

Humphrey P. B. Moshi

Introduction

In the past 20 years the perceptions of Africa have changed dramatically from a “hopeless” to a “hopeful” continent. This change was underpinned by the movement from the negative and stagnating economic growth rates, of the 1970s and the 1980s, to positive and relatively stable ones, in the subsequent years. However, Africa's image as a continent of wars, famine, and abject poverty remains unchanged, albeit with minor spatial improvements in people's welfare. This paradox of “Africa rising,” in terms of revamped growth, amidst entrenched poverty, has been a preoccupation, for many decades, of politicians, academicians, researchers, policy-makers, and development partners, searching for policies, strategies, programs, and projects to tackle the poverty problem.

In the context of doing so, a confluence of policies have been formulated at the global, regional, and country levels, and in some cases implemented, but the speed of poverty alleviation in the continent has been adamantly slow, when compared to that of other developing regions around the globe. This gloomy picture, coupled with projections which show that the world's poor will, in the future, increasingly be concentrated in Africa, calls for urgent and concerted efforts to address the pandemic of poverty in the continent.

Indeed, there are many causes of poverty in Africa, including conflict, environmental degradation, and high population growth rate. However, the fundamental cause is that the revamped growth has neither been inclusive nor ushered in structural transformation of the countries' economies. The delayed transformation is evidenced by the dominance of low productivity agriculture sector, as the source of livelihood for the majority of the population, on the one hand, and the de-industrialization of the economies, on the other.

This state of affairs is contradictory to both theory and practice, which underscores the symbiotic relationship between the two sectors in the sense that the development of the agriculture sector, in terms of enhancing its productivity, is the surest way to alleviate poverty and promote industrialization. Indeed, the development experiences of the Asian countries, especially China, are a clear testimony to this phenomenon. Their successful industrialization experiences, which not only led to higher productivity in the agricultural sector, but also

reduced poverty and inequalities quite dramatically, must be emulated and adapted by the African countries. To the extent that China is Africa's second largest trade partner and there are a variety of cooperation arrangements between them, including the Forum for China Africa Cooperation (FOCAC) and the China Africa Think Tanks Forum (CATTF), African countries are eager to see the cooperation become a powerful platform cum force for the realization of the structural transformation agenda and poverty alleviation.

The rest of the chapter is organized as follows. The second section presents stylized facts about Africa's growth trajectory and its paradoxes. The next section seeks to analyze the gravity and the causes of poverty on the continent. A stock of past and present set of initiatives for tackling poverty is then undertaken, while the next section focuses on the challenges faced. Consequently, lessons from China's development experience are drawn, while identifying its role in Africa's poverty alleviation agenda, and, finally, the chapter concludes with a couple of recommendations to inform the way forward.

Africa's growth amidst poverty

According to ECA (2015), Africa's growth accelerated from 3.7 percent in 2013 to 3.9 percent in 2014, which was slower than had been forecast in 2014. The report noted further that East and South Asia was the only region that grew faster than Africa, at 5.9 percent. It cautioned that although the prospects for African economies in the coming years were satisfactory, the stagnation in the Euro Zone, sluggish growth in the USA, a recession in Japan, and the slowing growth in major emerging economies (notably China, Russia, and Latin America) are risk factors that could undermine growth and development in the future.

Apart from the seemingly positive aspects of Africa's growth trajectory, the quality of growth remains a major subject of debate for a number of reasons: First and foremost, the continent is yet to achieve structural transformation, a process which entails the allocation of resources from low to high productivity sectors, especially the agricultural, industrial, and services sectors. Timmer and Akkus (2012) contend that it is both the cause and the effect of economic growth. As a result, agriculture remains the dominant sector, employing about 60 percent of the workforce and contributing to only 25 percent of the continent's GDP. In addition, the sector has low productivity, given its high dependence on weather conditions and does not provide well-paid jobs. As a consequence, the majority of the active population lives below the poverty line. The well-paid jobs which are basically associated with an accelerated growth of the manufacturing sector are yet to be realized due to neglect and slow growth of this critical sector (World Bank 2012; Yameogo *et al.* 2014).

Indeed, many African countries have undergone a process of de-industrialization, with the share of manufacturing of GDP and employment declining, while the service sector remaining the strongest driver of growth, rising from 47 percent of value added in 2000 to 55 percent in 2016. The share of industry in the total GDP has remained nearly unchanged since the 1960s.

Between 2000 and 2016, industry contributed, on average, 35 percent of total value added, with the manufacturing sector contributing an average of 13 percent over 2000–2016. This is a clear indication of a declining trend of the sector's contribution to the GDP, contrary to the Asian countries' development experience which shows that industrialization is an important driver of structural transformation (ECA 2017).

The second factor, which is also a result of the first, is that the quality of growth has been non-inclusive, to the extent that the growth elasticity of poverty has been -1.57 , which is lower than any other regional average, highlighting the weak link between growth and poverty reduction. For example, in East Asia, the growth elasticity of poverty is twice as high and it is three times higher in Latin America (Fosu 2011). It is no wonder, therefore, in 2015, Africa was home to 366 million people living on less than US\$1.25 a day (World Bank 2014).

Related to the above, it is important to note that the responsiveness of poverty to economic growth is weakened by the persistent socio-economic inequalities in Africa. The widening inequalities in outcomes and opportunities significantly reduce the gains from growth accruing to the poor (Fosu 2011; Ravallion and Chan 2011). Evidence shows that Africa is the second highest region with regards to income inequality, expressed in a Gini coefficient, at 0.44, harboring seven of 10 most unequal countries globally. The poor response of poverty to growth is aggravated further by lack of decent employment opportunities for the majority of people, especially the young, given that most African economies depend on production and exportation of primary commodities, with very little value added. In this regard, Africa has a disproportionate number of employed working people earning below the poverty line. According to the ILO (2016), the share of people in vulnerable employment remains high at around 60 percent in 2014. The informal sector in Africa, excluding North Africa, contributes 55 percent of total GDP (including agriculture) and 38 percent of non-agricultural GDP. While the bulk is represented by small-scale businesses and retail traders working in manufacturing and agro-processing, some large-scale firms also operate in the informal sector. Only 16 percent of those in the workforce in Africa, excluding North Africa, have wage-paying jobs, sometimes with associated benefits. The majority work on family farms (62 percent) or in household enterprises (22 percent), which are part and parcel of the informal sector.

For the African region as a whole, informal employment has been estimated to constitute 66 percent of total non-agricultural employment. Approximately, one-third of informal employment is wage employment and two-thirds are self-employment. Evidence shows that vulnerable groups, such as women and young people, are more likely to be employed informally. For example, 74 percent of African women are informally employed, compared with 61 percent of men (Moshi *et al.* 2016).

The gravity of poverty in Africa and its causes

This section is devoted to showing the profile of poverty in Africa by focusing on both income and non-income poverty indicators, including inequalities across gender and age dimensions.

The poverty profile

Seventy-five percent of the world's poorest countries are located in Africa, including Zimbabwe, Liberia, and Ethiopia. The Central African Republic is ranked the poorest in the world with a GDP per capita of US\$656 in 2016.

According to Gallup World, in 2013, the 10 countries with the highest proportion of residents living in extreme poverty were all in Sub-Saharan Africa. Extreme poverty is defined as living on US\$1.25 or less a day. In 2010, 414 million people were living in extreme poverty across Sub-Saharan Africa. According to the World Bank, those living on US\$1.25 a day accounted for 48.5 percent of the population in that region in 2010.

Approximately, one in every three people living in Sub-Saharan Africa is undernourished. The Food and Agriculture Organization (FAO) of the United Nations estimated that 239 million people (around 30 percent of the population) in Sub-Saharan Africa were hungry in 2010. This is the highest percentage of any region in the world. In addition, the UN Millennium Project reported that over 40 percent of all Africans are unable to regularly obtain sufficient food.

In Sub-Saharan Africa, 589 million people live without electricity. As a result, a staggering 80 percent of the population rely on biomass products, such as wood, charcoal, and dung in order to cook.

Of the 738 million people globally who lack access to clean water, 37 percent are living in Sub-Saharan Africa. Poverty in Africa results in more than 500 million people suffering from waterborne diseases. According to the UN Millennium Project, more than 50 percent of Africans suffer from a water-related illness, such as cholera.

Every year, Sub-Saharan Africa misses out on about US\$30 billion as productivity is compromised by water and sanitation problems. This amount accounts for approximately 5 percent of the region's gross domestic product (GDP), exceeding the total amount of foreign aid delivered to the continent in 2003.

Due to continuing violence, conflict, and widespread human rights abuses, the United Nations High Commissioner for Refugees (UNHCR) reports that 18 million people are of concern to the agency, including stateless people and returnees.

Further, fewer than 20 percent of African women have access to education. Uneducated African women are twice as likely to contract HIV/AIDS and 50 percent less likely to immunize their children. Meanwhile, the children of African women, with at least five years of schooling, have a 40 percent higher chance of survival.

Women in Sub-Saharan Africa are more than 230 times more likely to die during childbirth or pregnancy than women in North America. Approximately, one in 16 women, living in Sub-Saharan Africa, will die during childbirth or pregnancy; only one in 4,000 women in North America will experience the same fate.

Furthermore, more than one million people, mostly children under the age of 5, die every year from malaria. Indeed, malaria deaths in Africa alone account for 90 percent of all malaria deaths worldwide. Unfortunately, 80 percent of these victims are African children. The UN Millennium Project has calculated that a child in Africa dies from malaria every 30 seconds, or about 3,000 each day.

The profile of Africa's poverty, according to future projections is predicted to worsen. For example, in 2019, some 70 percent of the world's poor will live in Africa, up from 50 percent in 2014. By 2023, Africa's share will rise to over 80 percent, up from 60 percent in 2016 (*Daily News*, 2018).

The stylized facts on Africa's poverty, presented above, show clearly that the gravity of poverty in the continent is extremely high across all dimensions. These being the case, concerted efforts are needed to address the issue.

Causes of poverty

The principal causes of poverty include conflict, environmental factor, such as drought and climate change, low productivity agriculture, and population growth (WHES 2015).

It needs to be emphasized that conflict is not only a source of misery, but also poverty and hunger. Studies show that every year of violence in a country is associated with lagging poverty reduction of nearly 1 percentage point. Likewise, people living in countries currently affected by violence are twice as likely to be undernourished and 50 percent more likely to be impoverished. Further, their children are three times as likely to be out of school (World Bank 2016). As a result of conflict, Africa had an estimated 13.5 million refugees and internally displaced persons in 2011 (UNHCR 2015).

Environmental degradation, in terms of erosion, desertification, deforestation, and most importantly, drought and water shortages, is a major challenge in Africa. These channels of destruction of the environment tend to reduce agricultural productivity and food availability, ultimately perpetuating the level of poverty in the continent.

Africa's population has been increasing rapidly, growing from 221 million in 1950 to one billion in 2009. This is yet another paradox: the world's poorest continent has the highest population growth rate. This means that a woman in Africa gives birth to an average of 5.2 children in her lifetime. This rapid growth can limit increases in per capita income, thus causing poverty and hunger (*Guardian* 2011).

Initiatives to tackle poverty

There have been a variety of initiatives to address the problem of poverty at different levels: institutional, global, regional, and country. We attempt in this section to briefly reflect on them.

The first generation of institutional poverty reduction initiatives was championed by the Bretton Woods institutions in 1999. Specifically, they were associated with the crafting of the Poverty Reduction Strategy Paper (PRSP) by a number of developing countries, including Africa, with the focus on poverty reduction. In Sub-Saharan Africa, where the incidence of poverty remains high by world standards, the PRSP approach created high expectations among policy-makers, fueled by its promise of providing concessional financing and debt relief under the enhanced Heavily Indebted Poor Countries Initiative (HIPC).

The poverty reduction strategies in Sub-Saharan Africa designed policies and programs to achieve a variety of pro-poor outcomes. These included:

- improving access of the poor to basic social services, such as education, health care, housing, and drinking water;
- strengthening; and expanding security coverage;
- providing income-generating opportunities for the poor;
- reducing income and non-income inequalities.

More specifically, pro-poor interventions took several forms, including:

- unconditional and conditional cash transfer programs;
- in-kind transfer schemes;
- public works programs (IMF 2015).

The implementation of PRSPs, notwithstanding, empirical evidence suggests that the strategy neither reduced the poverty headcount, nor raised the income share of the poorest quintile in the continent. Instead it enhanced inequality, given that the income share of the top quintile increased significantly.

A globally initiated development agenda for reducing poverty was the Millennium Development Goals (MDGs), which was time-bound and had qualified targets for addressing extreme poverty in its multi-dimensional nature. The initiative comprised eight goals, namely:

- 1 Eradicate extreme poverty.
- 2 Achieve universal primary education.
- 3 Promote gender equality and empower women.
- 4 Reduce child mortality.
- 5 Improve maternal health.
- 6 Combat HIV and AIDS, malaria and other diseases.
- 7 Ensure environmental sustainability.
- 8 Create a global partnership for development.

Indeed, Africa has made encouraging progress on the MDGs. The continent has seen accelerated economic growth, established ambitious social safety nets, designed policies to boost education and tackle HIV and other diseases, introduced women's quotas in parliament, thus leading the way to gender equality, and increased gender parity in schools. However, these positive achievements were not accompanied by significant reduction in poverty levels. Estimates indicate that poverty is still hovering around 48 percent. This is a clear indication that Africa has not achieved most of the MDGs.

Africa has also embarked on a confluence of indirect poverty reduction initiatives, which had a focus on either industrialization or agriculture development agenda or both, as detailed below.

The earliest initiative at the continental level, which has a clear focus on industrialization, was the Lagos Plan of Action (1980). The Plan proclaimed that the years 1980 to 1990 should be the Industrial Decade in Africa (OAU 1980). The Plan underscored that industrialization of Africa in general, and each of the member states in particular, constitutes a fundamental option in the total range of activities aimed at freeing Africa from underdevelopment and economic dependence. In this regard, the industrialization agenda had the following objectives.

- 1 To satisfy the basic needs of the population.
- 2 To exploit local resources.
- 3 To create jobs.
- 4 To establish a base for developing other economic sectors.
- 5 To create a basis for assimilating and promoting technological progress.
- 6 To modernize society.

Apart from this early initiative, whose main objective was not achieved, subsequent ones were also embarked upon, but were not very explicit on the issue of industrialization. For example, the New Partnership for Africa's Development (NEPAD), which is a strategic framework document designed to address challenges facing the African continent, has very general objectives, among others, that of eradicating poverty, halting the marginalization of Africa in the globalization process, and accelerating the employment of women. Indeed, industrialization was implicit in some of these objectives.

Another continental initiative with a clear focus on agriculture is the Comprehensive Africa Agriculture Development Programme (CAADP). This is Africa's policy framework for agricultural transformation, wealth creation, food security and nutrition, economic growth, and prosperity for all. The program was hatched during the Summit of the African Union held in 2003 at Maputo, hence it is called the Maputo Declaration.

The broad twin objectives of the program are: (1) to achieve a 6 percent growth rate in the agriculture sector; and (2) to encourage member countries to allocate at least 10 percent of their national budgets to the sector. These objectives are based on the conviction that enhanced agricultural growth is the key to

growth and poverty reduction, through its direct impact on job creation and increasing opportunities, especially for women and youth; improving food security and improved nutrition; and strengthening the resilience of national economies against internal and external shocks. The aims of the program are yet to be met by majority of countries. For example, a total of 28 countries have still not attained the objective of allocating 10 percent of public expenditure to the sector. It is no wonder, therefore, that the sector's growth lags behind others and thus impacts negatively on poverty reduction.

A recent initiative is the "Agenda 2063: The Africa We Want." This is an African Union Vision document which aims at "building an integrated, prosperous and peaceful Africa, an Africa driven and managed by its own citizens and representing a dynamic force in international arena." The vision is premised on seven blocks or aspirations. Of these, the first one of "a prosperous Africa based on inclusive growth and sustainable development" has an industrialization flavor, advocating well-educated and skilled citizens, a knowledge society underpinned by science and technological development. All these attributes are indeed causes and effects of agriculture development and industrialization.

In the process of domesticating institutional, global, and continental initiatives, African countries have produced their national poverty reduction policies and strategies. For example, since the early 2000s, Tanzania has had a National Strategy for Growth and Reduction of Poverty (NSGRP) which builds on the PRSP and the MDGs, including other national frameworks, such as Tanzania's Development Vision 2025. On the one hand, the aspirations of the Development Vision 2025 are those of attaining high and shared growth, high quality livelihoods, peace, stability and unity, good governance, high quality education, and international competitiveness. On the other hand, the NSGRP focuses on activities to reduce rural-urban, regional, and gender disparities, income and non-income inequalities, while bearing in mind the complementarities between them. In the course of time, the NSGRP has been mainstreamed into the medium- and long-term country planning frameworks, such as National Five-Year Development Plans. The plans are informed, among others, by national development visions, as well as by global and regional agreements, such as Agenda 2063 and Sustainable Development Goals (SDGs). Studies reveal that, in spite of the implementation of the national initiatives, they have not had a significant dent on poverty reduction, especially in the rural areas where the majority of Africa's population reside.

Challenges of poverty alleviation

The above-mentioned initiatives, notwithstanding, Africa's poverty profile has not changed significantly due to the delayed transformation of the continent's countries' economies. What then are the challenges inhibiting the poverty reduction agenda in the continent? In answering the question, we will highlight those challenges that are cross-cutting. That is, those which are not country- but continent-specific. These are basically six factors as discussed below.

One of the factors constraining African's poverty reduction initiatives is the adoption of Structural Adjustment Programmes (SAPs) spearheaded in the 1980s by the World Bank. These programs were informed by the neoliberal development paradigm which was basically obsessed with growth while de-emphasizing the quality of growth in terms of pro-poor or inclusive growth. Further, the programs did not promote industrial policy which would have transformed the economic structure of the continent's production structure. According to Stein and Ajakaiye (2009), the strong anti-industrial policy sentiment which was informed by the SAPs has had the greatest influence in Africa, over the past 25 years, as evidenced by the de-industrialization of the continent. Indeed, this is contrary to the World Bank's insistence on using market signals to ensure efficient allocation of production resources. However, evidence from Asian countries, including China, confirms the importance of a development state in "governing the market" to ensure a successful industrialization and poverty reduction agenda. Indeed, the neoliberal development paradigm prescribes a minimal role for the state in the development process, while placing an unnecessarily crucial role on the private sector.

A second factor inhibiting poverty reduction on the continent is related to the above, that of dependence on donors, both in terms of policy and financial resources. With regard to the former, such dependence entailed the adoption of policies without ensuring that they were adequately domesticated to reflect the varying contexts of either a country, a region, or the continent, consequently, weakening local ownership of the development agenda. Also, most of the programs were dependent on donors' financial resources, which were either not realized in the quantity demanded, or not delivered in time. As a consequence, the outcomes of the planned programs and projects have not been realized.

The third factor is the continued neglect of the agriculture sector, in terms of allocating the requisite resources, in spite of its critical role in the African economies, as the main source of livelihood and poverty reduction. It needs to be emphasized that, given the symbiotic relationship between this sector and manufacturing (as a source of labor, raw materials for industry, food security for industrial workers, and user of inputs from industry, etc.), the delayed modernization of the sector has had a negative impact on the speed of poverty reduction, including the development of the manufacturing sector.

The fourth factor undermining the effectiveness of the poverty reduction efforts is the failure of member countries to domesticate continental and regional industrialization cum agriculture development frameworks. In most cases, such initiatives have not always garnered the full political support of the member states.

The draining of resources from the continent by multinational corporations (MNCs) is yet another serious threat to poverty reduction efforts. In a recent report (*Daily News*, 2017), quoting the Global Justice Now Initiatives, it is claimed that, in 2015, African countries received US\$162 billion in terms of loans, development aid, and personal remittances. However, in the same year, US\$203 billion was taken from the continent, either directly through the MNCs

repatriating profits, or illegally moving money into tax havens (illicit capital outflows), or by costs imposed by the rest of the world through climate change adaptation and mitigation. This presents another paradox: a poverty-stricken continent being a net creditor to the rest of the world! This is nothing else than the plundering of Africa's wealth. A situation which results in Africa's perpetual trap in poverty.

Lastly, poor infrastructure provision, across all sectors, such as rail, road, air, water, energy, and telecommunications, is a serious challenge. Studies show that the state of infrastructure development on the continent is still below average by regional comparisons and global standards. Most African economies are still disconnected from each other, due to poor transport links, energy infrastructure deficits, dilapidated telecommunications infrastructure, poor access to ICT infrastructure, and the dilapidated and disconnected road and rail network within and between countries (Vhumburu 2014). This state of affairs remains a major challenge despite numerous initiatives to address the issue, such as the Lagos Plan, NEPAD, the Programme for Infrastructure Development in Africa (PIDA), and the Comprehensive African Agriculture Development Program (CAADP). The persistence of these challenges and the poor implementation of the enumerated initiatives have had, and continue to have, negative impacts on regional integration, growth, and industrialization.

Reflections on lessons from and the role of China

This section seeks; first, to draw lessons from how China approaches poverty reduction by making reference to President Xi Jinping's (2016) book entitled *Up and Out of Poverty*. Second, we analyze the role of China in empowering African countries to exit from poverty.

Reflections on President Xi Jinping's book

In his 29-chapter book, Xi Jinping (2016) outlines "the hows" of transforming a poverty-stricken region (Ningde Prefecture) into a prosperous region through a change of mindset, economic development and management, and good leadership. Having read the book, we feel that there are a lot of issues which appear of extreme relevance to the African context as the continent struggles to exit from poverty. However, we are not advocating their adoption but their adaptation to reflect the realities or characteristics of the African continent. This being the case, we have identified three critical areas which appear to be relevant to the African context, but conspicuously are missing from Africa's contemporary poverty reduction initiatives. These identified areas should be the critical ingredients for informing policy-makers, at various levels, in charting out the way to end poverty in Africa.

First and foremost is the need to change the mindset on the condition of poverty. That is, "poverty alleviation requires a change of attitude and mentally wearing away at the poverty mentality" (ibid.: 7). In other words, this means

that poverty is not a destiny; it can be challenged and ultimately overcome. This is both an inspiration and motivation to do something about it, given that all developed countries were also, at some point in their past, embroiled in poverty.

The second issue is with regard to the need to use the available resources to fight poverty. In most cases, in a poverty-ridden area the most abundant resources are in agriculture in terms of crops, forestry, livestock, and marine products. This being the case, the economics of developing the resources to ensure their effective and efficient use is the main conduit for lifting a country from poverty. This is the “economic chorus,” according to the Xi Jinping (ibid.: 11–12). Likewise, industrialization of such areas should be resource-based by processing the products of the agricultural sector. This aspect underscores the close connection between the two sectors, namely, agriculture and industry. In this regard, it is advised that in drafting a sound industrial policy, the focus should be on “leveraging agriculture to develop industry, while also using the developing industrial sector to support agriculture” (ibid.: 135).

Mobilization of the people and effective leadership are critical ingredients to address poverty. Xi Jinping insists that this requires “[leaders] at all levels to become deeply involved with the people in real situations, always coming from the people and going to the people” (ibid.: 17). He further outlines the qualities of an effective leadership which can drive development. The leader must be credible, disciplined, diligent, not corrupt, and humble. These attributes, according to Xi Jinping, are necessary if leaders are to enjoy the people’s trust and support. Furthermore, leaders must be a role model by being selfless, doing practical things rationally, and promoting scientific thinking and reasoning.

The role of China in Africa’s poverty alleviation agenda

Cooperation between Africa and China, through FOCAC, CATTF, and the Belt and Road Initiative (BRI), has gained momentum and triggered much interest in the recent past. This is because China is playing an increasingly prominent role in global trade, investment, finance, and governance, to the extent that Made in China is becoming a household name in Africa: a clear indication of the deepened engagement between these two societies. This deepening extends also to diplomatic and cultural relations, as evidenced by the establishment of Confucian Institutes in a number of African countries.

China has indeed become a major force in the global economic arena and, with the balance of economic power shifting dramatically over the next years, it is expected to become the world’s largest economy in the near future. Given this state of affairs and, the growing economic, political, and social engagement between Africa and China, China’s experience in the last three decades of reform provides valuable experience from which African countries, including Tanzania, can draw lessons. More importantly, this relationship has the potential to become a key source to achieve Africa’s aspirations for inclusive and sustainable growth, socio-economic transformation, and an enhanced voice in global affairs. These

aspirations are clearly stipulated in the continent's poverty reduction frameworks, including Agenda 2063.

The results of Africa–China cooperation, in the last decade or so, show that total goods trade has grown from US\$13 billion in 2001 to US\$188 billion in 2015. Likewise, Chinese stock of foreign direct investment (FDI) grew from almost zero in 2004 to US\$50 billion in 2016. Further, Chinese official development assistance (ODA) displayed an annual growth rate of 16 percent from 2012 to 2015. Further, China has become Africa's single largest bilateral infrastructure financier. For example, in 2015, Chinese commitments to infrastructure development in the continent amounted to US\$21 billion (McKinsey 2017). These achievements are a clear testimony that the cooperation is bearing fruits which may in the future make African leaders realize that “China should be the preferred development partner,” given the depth and breadth of its engagement in Africa.

Africa's resource endowments create opportunities to leverage Africa-China cooperation to realize Africa's aspirations, while drawing on the Chinese experience in promoting inclusive growth, employment, and structural transformation to reduce poverty and inequality. China's success in these areas was informed by critical fundamentals, namely,

- building human capital and improving access to assets;
- investing in infrastructure with structural transformation in mind;
- using well-designed social transfers programs to address poverty and inequality.

Given this rich and valuable experience as a role model, African countries must therefore capitalize on their cooperation with China by ensuring that the relationship is embedded within the broader effort of promoting development in the context of Africa's quest for poverty alleviation. However, in order to achieve this, Africa must, first and foremost, play a proactive role in that relationship, by developing a continental or country strategy or strategies for engaging with China. Currently, the proactive element from the African side appears to be the missing critical link in the relationship. Indeed, while the Chinese are crystal clear about what they want from Africa, the Africans are not.

Conclusion

In this chapter, we sought to analyze Africa's quest to alleviate poverty, as a way of addressing the paradoxes of the current growth trajectory, which is characterized by exclusive growth, enhanced poverty and inequalities, youth unemployment, and delayed structural transformation. An analysis of the imperative of economic transformation, through the development of agriculture and industrialization in a country's socio-economic development process was undertaken, coupled with an assessment of the effectiveness of past, present, and future poverty alleviation at the continental, regional, and country levels.

Indeed, experience shows that most of the past initiatives have failed to realize their envisioned goals and objectives, due to a series of challenges. These ranged from the absence of a committed and development-oriented leadership; poor provision of requisite soft and hard infrastructure; poor domestic initiatives and unsuccessful implementation of institutional, global, and regional initiatives, at the country level; to high policy and financial dependence on donors, especially the western countries.

Specifically, with regard to Africa–China cooperation, it is clear that over time the cooperation has deepened and the menu of areas of cooperation has diversified to the extent that it has become quite comprehensive and, in most cases, is well aligned with Africa's socio-economic aspirations, such as addressing the infrastructural deficit, low productivity agriculture, low human resource capacity, and above all, the skewed economic structure of the low level of industrialization. China's commitment to invest in these key areas provides a golden opportunity to achieve Africa's poverty alleviation. This being the case, Africa needs to leverage the cooperation to attain its aspirations. However, in order for the African countries to effectively grasp the existing and unfolding opportunities requires them to take on a proactive role, coupled with adequate commitment from and preparedness by the African leadership in terms of putting in place the requisite policies, strategies, and action plans, flanked by an effective institutional framework to monitor and evaluate progress. It is only through shouldering such a proactive role that Africa can realize its poverty reduction dream, while ensuring that Africa–China cooperation is mutually beneficial.

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7 **Strengthening Sino-African poverty alleviation collaboration through knowledge sharing**

Michael Mitchell Omoruyi Ehizuelen

Introduction

Poverty is not Africa's history, poverty interrupted Africa's history and development.

(Michael Mitchell Omoruyi Ehizuelen)

Over four decades, rapid economic transformation has lifted millions of people out of poverty in China. Development economic experts assert that China's rapid economic transformation and its impressive development trajectory may provide a model for Africa, where China's presence has grown immensely over the same period. However, it is not an easy task to learn from the experiences of other nations in terms of attaining certain development goals, because countries differ in their geopolitical conditions, cultural settings, and the mobilization of the required resources for such development. Nevertheless, in spite of the challenges, the lessons learned can be beneficial in offering required inputs to design policies with specific goals and a timeline for executing them to achieve the objectives. China's success in poverty reduction, during the past four decades, has attracted the attention of the international community. Other developing nations can take a lesson from China in fighting poverty in their own specific settings. As for Africa, the continent has a second mover advantage in using China's poverty success strategy with significant effect and prominent innovative experience, and can attain good outcomes in shared development. Ravallion (2009) offered several policy recommendations worth thinking about in an African context, emerging from the literature on how the Chinese were able to successfully fight against poverty. In another remark, Heilig *et al.* (2005) have drawn three lessons from China's experience, applicable to other poverty-affected developing nations, especially in Asia, Latin America, and Africa. First, they argue that it is important for these nations to get their economic system in order, and, second, for them to develop a clear concept of regional development. Third, there are certain poverty reduction measures that are essential and must be aimed at improving the basic living standards, health, and education of the poverty-stricken inhabitants.

The Chinese have been remarkable in terms of poverty alleviation, while in Africa, poverty has fluctuated, during the past four decades. Africa—a continent of

54 nations—has had very poor poverty alleviation experiences in recent decades, unlike China. Though the Chinese share a lot of similarities with numerous African nations, China was in a worse condition when it began its economic reforms in the late 1970s. When compared to African nations, the Chinese had a worse poverty incidence rate and there were enormous dissimilarities between the Chinese and several nations in Africa in terms of institutional structures, the level of inequality, education, and agricultural production. China's fight against poverty was as daunting as that faced by Malawi; China's GDP per capita level was similar to that of Zambia—lower than two-thirds of the African average. But since China's reform, the country has experienced an average GDP growth of approximately 10 percent per year until 2014, raising per capita GDP almost 49-fold. China's shares in the global economy rose from 2.7 percent to 16 percent; its per capital GDP rose from US\$155 in 1978 to US\$8,800 in 2017 (Ehizuelen 2018: 10), while most African nations remain besieged by dismal conditions decades later. Among the many developing nations globally, China is one of the few nations that has made headway in alleviating its total number of poor inhabitants. The Chinese official documents indicate that the number of poor people in China fell dramatically.

From 2011 to 2015, the total rural population lifted out of poverty in China was 109.92 million (Xinhua News Agency 2016). In total, 800 million people are now living a poverty-free life in the past four decades: an unparalleled accomplishment (World Bank 2016). According to World Bank report, in 2012 to 2013 alone, approximately 100 million people escaped extreme poverty. This is a quarter of a million people per day, or 200 persons per minute (World Bank 2017). That being said, China has contributed about 76 percent of poverty reduction across the world, making China the nation with the most people lifted out of poverty globally (Oluwade 2019) and demonstrating "strong leadership and dedication." China's rural poor population has decreased from about 98.99 million in 2012 to 30.46 million at the end of 2017, a decrease of 68.53 million in total, which is an annual decrease of 13.7 million; also, in 2017, the per capita disposable income of rural people in poor areas reached 9,377 yuan (US\$1,372), a rise of more than 50 percent in comparison with that of 2013 (Chan 2018). Also, the Chinese government has made great progress in improving people's livelihoods. For example, a projected 13 million urban employment opportunities are created annually, keeping the recorded unemployment rate at a low level of 4 percent over the current years (Hu, 2018). China's broad-based and high-speed economic growth helped accomplish this remarkable success. The nature of poverty in China is changing, which requires the nation to maintain moderately rapid growth, accompanied by measures that reduce inequality and put in place social safety nets for the most vulnerable. Following the process of China's phenomenal economic reforms and high rate of economic growth, the number of rural poor had fallen from 770.39 million in 1978 to 55.75 million by 2015 (see Figure 7.1), with the incidence of poverty dropping from 97.5 percent in 1978 to 5.7 percent in 2015, making China the first developing country to meet the Millennium Development Goals set by the United Nations. This spectacular achievement came as a result of the Chinese poverty reduction framework which consisted of three main components: (1) pro-poor economic

Figure 7.1 The levels of poverty in China's rural region according to the recent rural poverty standard

Source: Xinhua News Agency, 2016. Data compiled by author.

growth policies; (2) a rural social safety net; and (3) development-oriented poverty alleviation strategies and programs (Liu Jian *et al.*, 2009).

The Chinese government's accomplishment in terms of fighting poverty will figure prominently in the history of mankind's fight against poverty. China's development experience displays the significance of making sure that growth is broad-based across sectors and regions and inclusive of poor people. In terms of requirements and relevance for other developing nations, particularly in Africa, where several nations still rely on development assistance, the key aspects of China's development successes include:

- how the Chinese government cooperated with international donors;
- how China developed its agricultural sector and rural regions;
- how it expanded its infrastructure;
- how it created an attractive environment for businesses to flourish and create employment.

However, in spite of China's remarkable success, the Chinese leadership is fully aware that the fight remains tough, as of the end of 2015, there are still over 60 million rural inhabitants living below the poverty line, with 129,000 poverty-stricken villages, 14 contiguous extremely poor areas, and 832 poverty-stricken counties. The Chinese government is determined to eradicate poverty regardless of the challenges ahead, by setting a new ambitious target to provide food security and clothing, securing compulsory education, basic medicine, and housing, which in turn will lift no less than 10 million persons out of poverty yearly from 2016 and

lift a total of 43.35 million rural residents out of poverty by 2020. The Chinese leadership is aware that meeting these goals is key to maintaining their credibility among the Chinese people as well as maintaining the quality of “socialist modernization.” The Chinese government has dispensed in advance part of its 2019 poverty eradication fund to local governments. The government further asserts that the poverty reduction fund, already earmarked to 28 provinces, autonomous regions, and municipalities, totaled US\$13 billion, accounting for 86 percent recorded in 2018. Part of the allocated US\$13 billion will be used to support regions in deep poverty, including Xinjiang, Tibet, parts of Yunnan, Gansu, and Sichuan Provinces. The fund deployed under the poverty eradication campaign covers numerous areas, including funding for rural infrastructure, agricultural subsidies, and discounted loans. The broad objective for such assistance is to encourage self-development and empowerment of poor populations. The longing of the Chinese people for a better life is strong, the Chinese leadership will maintain a proactive policy stance in 2019 with a higher deficit-to-GDP ratio to leave policy space to address the poverty issue. Multi-sectoral approaches, targeted strategies, good leadership, constant innovation, such as using e-commerce to connect farmers to the markets, have been the core enablers of poverty alleviation in China. China’s achievements in poverty alleviation in the past four decades have been possible as a result of the Chinese government’s strong leadership and the mobilization of impressive levels of resources and innovation. Notably, in order to move millions of Chinese people out of poverty, the Chinese leaders made the decision to move away from the comfort zone of easy revolutionary rhetoric, took economic modernization as a central task, launched reform and opening-up, and traveled the difficult terrain of “groping through the river by feeling the stones.” With that said, while combating poverty at home, China also actively is assisting other developing nations, such as the African nations, which hope to learn from China’s experience to assist the over 400 million impoverished people in Africa exit poverty.

At the Forum on China-Africa Cooperation (FOCAC) Summit held in South Africa in December 2015, the Chinese President Xi Jinping reaffirmed his nation’s support for poverty alleviation in Africa under the three-year plan for Africa. The Chinese President asserts that China is willing to cooperate with African countries by sharing its experience in poverty alleviation. In its three-year plan (2016–2019), China pledged US\$60 billion to support the continent of Africa in its quest to alleviate poverty in a process that parallels the World Bank’s target of eliminating poverty by 2030 globally and the African Agenda that aims to create the “Africa we want” by 2063. The fact that China has managed to lift millions of Chinese out of poverty in the past four decades, something that took most industrialized nations 100–150 years to accomplish shows that China’s policies in that area are effective. Africa has expressed its appreciation of the Chinese-led initiatives, such as the establishment of the Assistance Fund for South-South Cooperation, which would facilitate the implementation of the 2030 Agenda for Sustainable Development in Africa. The 2015 Johannesburg Action Plan development included knowledge sharing on poverty eradication strategies. Moreover, one of the biggest accomplishments was to reaffirm the continuous organization of the China-Africa Poverty

Reduction and Development Conference and to endorse it as an official subforum under the framework of FOCAC. This initiative has allowed China and Africa to jointly explore poverty alleviation policies and strategies, while gradually establishing a multilevel intergovernmental and intersociety dialogue platform for alleviating poverty.

The focus of this chapter is the government-led and development-oriented poverty reduction programs in China, as well as exploring the potential for cooperation in poverty alleviation between China and the African countries, one that focuses on supporting knowledge sharing. The rest of the chapter is structured as follows: the next section presents an overview of the role of the Chinese government in terms of the different policies and programs, which are directly responsible for the rapid poverty alleviation in China. Then international cooperation for poverty alleviation as well as the development-oriented projects and programs are analyzed. Lessons are drawn from China's poverty alleviation programs as well as looking at the potential for cooperation between African nations and China on poverty alleviation, focusing on supporting knowledge sharing. The chapter concludes with some policy recommendations.

Fighting rural poverty through targeted measures

The main achievement of the Chinese leadership in alleviating poverty is rooted in a solid all-round and coordinated leadership capacity, potential determination, self-reliance, and public involvement with Chinese characteristics. It was the particular ability of the government to increasingly recognize constructive aspects of the numerous theories and ideologies that have been tried elsewhere. The Chinese government was able to espouse these theories and ideologies in their policy plans, and these can be sustained at the national level down to counties and provinces, with economic, ecological, and socio-economic diversity. This kind of development model should be a motivating factor for Africa's integration. China's overall poverty reduction efforts fall into five phases:

1. the early rural reform (1978–1985);
2. the national targeted poverty reduction programs (1986–1993);
3. the 8–7 plan (1994–2000);
4. the New Century Rural Poverty Alleviation Plan (2001–2010);
5. the national outline for rural poverty reduction and development (2011–2020).

Phase 1: Early rural reform (1978–1985)

During the opening-up policy in 1978, almost 250 million Chinese inhabitants, accounting for 30.7 percent of the total rural populace, were living in poverty (Qin and Chong 2017). Therefore, in an attempt to reduce rural poverty and bolster the rural economy, the Chinese leadership introduced the opening-up policy and launched the institutional reforms of the rural production systems and procurement prices. This development paved the way for the early period of China's economic

reforms and opening it up in 1978. The period played a remarkable role in economic development and poverty reduction in China. From 1979 to 1983, the total value of industrial and agricultural production in China averaged a remarkable annual growth rate of 7.9 percent. During the same period, the national economy and fiscal revenue also made steady headway. In terms of the rural poverty reduction, as the reform and opening-up strategy started to affect rural regions, the Chinese government launched the rural household responsibility system, which was an agricultural production system in the early 1980s. The system was useful because it permitted households to contract to hire machinery, land, and other useful facilities from collective organizations. The aim was to preserve the basic unified management of the collective economy while contracting out land and other goods to households. Households could make operating decisions independently within the limits set by the contract agreement, and could freely dispose of surplus production over and above national and collective quotas.

The peasants were responsible for the establishment of the household responsibility system which spread around the nation and the system was supported by the central government. By 1983, over 93 percent of the production teams had adopted the system. The system replaced the commune system and demonstrated the value of unified management combined with the enthusiasm of the farmers. It was suitable for the nature of agriculture and the stage of development of the productive forces in rural areas. The system empowered farmers, thereby putting rural economies on a developmental fast track. Farmers increased their income rapidly and the numbers of poor people in China's rural areas rapidly decreased during this period. The success of the reform was remarkable because the number of rural poor dropped from 250 million in 1978 to 125 million by the end of 1985, measured at the official poverty line. The poverty incidence dropped to 14.8 percent from 30.7 percent. Meanwhile, the average yearly income increased from 134 Yuan to 397 Yuan.¹

Phase 2: The national targeted poverty alleviation programs (1986–1993)

By the mid-1980s, rural economic growth and living conditions appeared to lag again, especially for the rural poor which were mainly focused on what the Chinese called *lao qu* (meaning the old revolutionary areas), *minzu zizhiqu* (meaning the minority autonomous areas), and certain inland regions, which in total formed 18 large contiguous regions. In order to address the newly appeared poverty regionality problem, the regionally targeted anti-poverty program was established by the Chinese government. The program was the largest program to be established in the developing world, the program ran from 1986–1993. The rural poverty alleviation program included a wide variety of players, initiatives, and funding channels. The program involved three major interventions: (1) the food-for-work program (*yigong daizhen*) supervised by the State Planning Commission with 75 percent of the program funds channeled toward infrastructure, and the development capital was relatively evenly spread across diverse areas

(education and health, 12 percent; agriculture; 38 percent; infrastructure, 26 percent; and industry, 18 percent); (2) the budgetary grant program (*fazhan zijin*), supervised by the Chinese Ministry of Finance; and (3) the subsidized loan program (*tiexi daikuan*) managed by the Agricultural Development Bank and the Poor Area Development Office. Most loans from the subsidized loan program went to agriculture (35 percent) and industry (56 percent) while the government budgetary grants supported investment in poor regions across all sectors (Wang *et al.* 2004). As a result of these county-focused programs, the population of the rural poverty headcounts reduced from 125 million in 1985 to 80 million in 1994 (*ibid.*; UNDP 2008).

Phase 3: The targeted 8–7 plan program (1994–2000)

The Chinese government aimed to use the targeted 8–7 plan program, initiated by the Chinese government in the third phase of poverty alleviation program, to reduce poverty by moving the majority of the remaining 80 million people living in poverty to above the government's poverty line during the seven years' period. The diminishing pace and snowballing problems in poverty alleviation revealed that greater determination and effort from the Chinese government were needed to find a solution to the clothing and food problem of the rural poor inhabitants. In 1993, to address these difficulties, the Chinese government introduced the *baqi* 8–7 National Plan for Poverty Alleviation (1994–2000), setting the “development-oriented” plan and aiming at achieving the following: (1) advance better-off regions in the coastal provinces from the newly-established list of nationally-designated poor regions; (2) attain the basic preventive, curative health care, and universal primary education; (3) assist poor households with improved access to off-farm job opportunities, help poor households with land improvement, augment cash crop, tree, and livestock production; (4) offer most townships electricity and road access; (5) improve access to drinking water for most poor villages; and (6) make “the decisions to find solutions to the clothing and food difficulties for the remaining Chinese poverty-stricken rural areas.”

Though the first phase of the region-targeted program covered a sizeable amount of the poverty-stricken areas, Park *et al.* (1994) assert that the heavy political compromise during the poor counties' selection process undermined the program's efficiency. In response to the criticisms, the government redefined the selection of the “poor” counties during the 8–7 National Plan for Poverty Alleviation and emphasized the responsibility of the local government leaders for the effectiveness of poverty reduction work in their jurisdictions. Funds for these programs are allocated primarily to officially designate the poor area under the 8–7 strategy, which is linked with poverty incidence. The plan finally covered 592 counties, which accounted for around 28 percent of the entire county-level administrative units in China. As a result of these efforts, rural net income per capita of the national poor increased from 648 Yuan in 1993 to 1,337 Yuan in 2000 (Qin and Chong 2016). Also, the rural poverty population reduced from 80 million in 1993 to 32 million in 2000 (Wang *et al.* 2004; UNDP 2008).

Phase 4: The New Century Rural Poverty Alleviation Strategy (2001–2010)

Throughout this phase, the Chinese government emphasized the necessity to rebalance the development benefits across several regions, particularly between rural and urban regions. To attain this goal, the New Century Rural Poverty Alleviation Strategy (2001–2010) was established in 2001. The aim was to implement specialized poverty reduction policies such as the entire village extension program, agricultural industrialization, transferring labor for training, relocation for poor, and offering work as a form of relief. Also, other policies were initiated and executed, such as: (1) agricultural subsidy policies for grain producers and farmers who purchase agricultural inputs; (2) social protection policies such as free compulsory education, rural cooperative medical insurance systems, and minimum living standards; (3) eco-compensation policies, such as reforestation farmland, returning grazing land to grassland, and developing ecological forests; and (4) rural fee-to-tax reform and removal of the agricultural tax. Furthermore, as the economic capacity and general income levels increased, together with the fast development of non-governmental organizations, social assistance in the form of donations and volunteering service significantly increased.

Zhao *et al.* (2016) assert that a “tri-party” poverty reduction pattern was gradually and originally created where fiscal, industry, and social policies started to play their respective roles. The aim was to pursue a balanced poverty alleviation plan in China, with the focus on developing the central and western regions, and developing the new rural areas. As a result, the number of inhabitants living in the poverty-stricken rural areas fell from 30 million to 15 million throughout the period of 2001 to 2007 (UNDP 2008). Figures 7.2 and 7.3 display the poverty headcount ratio in China from 1981 to 2010.² In 1981, the World Bank started tracking poverty in China. The percentage of people living in poverty in that year was 88.3 percent; they lived on less than US\$1.90 a day (approximately 870 million people). The number of people living in poverty was even more striking when the threshold was pushed up a little bit; it was 99.1 percent of the Chinese populace living on less than US\$3.10 a day (more than 980 million people). The last year for which the World Bank has official statistics is 2010, and the change, as can be seen in Figure 7.2, is extraordinary. In 2010, almost 11.2 percent (nearly 150 million people) lived on less than US\$1.90 a day. Not displayed in Figure 7.2 is that 27.2 percent (nearly 360 million people) lived on less than US\$3.10 a day (World Bank 2016c).

Phase 5: The National Outline for Rural Poverty Reduction and Development (2011–2020)

In 2015, the Chinese government further re-emphasized the task of wiping out poverty in the rural regions and rehabilitating the entire impoverished regions by 2020. If China is able to achieve this goal by eliminating poverty in China by 2020, then this would be another milestone for China’s reform and opening-up

Figure 7.2 Poverty headcount ratio at US\$1.90 a day (2011 PPP) (% of population)

Sources: World Development Indicators (WDIs), 2016. Data compiled by author.

Figure 7.3 Poverty headcount ratio at US\$3.10 a day (2011 PPP) (% of population)

Sources: World Development Indicators (WDIs), 2016. Data compiled by author.

strategy and would make the country the first in the world to attain Goal 1 of the United Nation 2030 Agenda for sustainable development, ten years ahead of the deadline, which is eliminating “poverty in all its forms.” As such, China’s 13th Five-Year Plan for Economic and Social Development codifies the central leadership’s poverty alleviation decision into concrete requirements and measures. This is the first time the Chinese leadership has made poverty reduction a significant part of a Chinese five-year plan, and assisting poverty-stricken communities to shake off poverty has been listed as an obligatory index in such a significant document. The documented strategy highlights the significance of rural poverty alleviation policies with the goal of moving 55.75 million rural persons out of total poverty by 2020. This plan has two significant sets of policies which are underlined for future poverty alleviation in rural regions: (1) the policies that aim to improve the targeting accuracy of poverty reduction programs; and (2) the policies that will help various poverty reduction programs center on adjacent areas with disadvantaged natural and economic conditions. The enactment of the National Outline for Rural Poverty Reduction and Development changed poverty reduction efforts from finding solutions to people’s food and clothing problems to consolidating these basic efforts as well as accelerating the motive to eliminate poverty, improve the environment, build capacity for development, and narrow the gap in China’s level of development. In 2011, poverty reduction turned out to be a vital manifestation of a human-centered approach to governance and a significant measure for Chinese leadership in balancing development between rural and urban regions, securing and enhancing people’s livelihood and enabling inclusiveness and international economic landscapes. Poverty reduction turned out to be integral to the Chinese leadership to stimulate domestic demand, accelerate the transformation of economic growth patterns, and foster sustainable economic expansion in the long run.³

President Xi Jinping highlighted the significance of targeting individuals in designing the anti-poverty programs in 2013. The Chinese president asserted that targeting poverty should be more accurate, and for this purpose, limited finance would attain the greatest effects. Since Xi’s statement, the Chinese poverty reduction policies have focused on providing opportunities by building assets for the poor and transferring assets to the poor, largely circumventing pure “handouts.” Poverty alleviation programs have sought to raise the income-generating capacity of poor rural households. In rural regions, the Chinese government has innovated a poverty alleviation mechanism that enables the government to provide increasing support to basic public services, human capital development, and significant investments in agriculture, enterprises, and infrastructure. Speaking of infrastructure, the Chinese leadership has worked out a budget to inject the sum of 5.5 billion Yuan to support and rebuild the infrastructure in regions inhabited by ethnic minority groups with a small population (see Figure 7.4) (Xinhua News Agency 2016). The Chinese government believes this will help improve the local working and living conditions of the ethnic minority groups. This new phase is one where the government and the market jointly work together to tackle poverty issues and create strategic chances to reduce poverty in China.

Figure 7.4 The improvement of infrastructure in regions populated by ethnic minority groups with a small population

Source: Xinhua News Agency, 2016. Data compiled by author.

International collaboration and poverty alleviation

The Chinese leadership has attached great significance to international cooperation when it comes to poverty alleviation. Through carrying out various kinds of international cooperation projects, China has learned from the advanced ideas and experiences of foreign nations in poverty reduction and has constantly improved its own policies and practices in fostering domestic poverty relief. The White Paper on Development-Oriented Poverty Alleviation Program for Rural China, issued by the Chinese government in 2001, asserted

China chiefly counts on its own strength to carry out poverty reduction program, but the country pays great attention to exchange and collaboration with the international organizations in the area of poverty alleviation as well. The Chinese leadership know that actively promoting cooperation with the international community will not only assist the country to fast-track to resolve the issue of offering clothing and food to its own poor inhabitants, but also help raise the overall level of China's poverty reduction work by drawing upon the poverty reduction experiences and successful practice accumulated by the international community in several years.

The Chinese government is completely aware that in order to build a harmonious society and to attain prosperity for all, long-term persistent efforts are required. As the leading champion of development among developing nations, the Chinese fight against poverty requires the efforts of the Chinese people and government,

and also assistance and backing from the international community. The Chinese leadership introduced the participatory mechanism and philosophy in the early 1990s. The Chinese were able to cooperate with numerous international financial agencies, bilateral and multilateral organizations, as well as non-governmental organizations (NGOs). The form and content of the Chinese government's external finance toward poverty reduction basically fall into four types: (1) large-scale integrated poverty reduction projects; (2) pilot and demonstration projects; (3) capacity-building projects; and (4) co-research projects (see Table 7.1).

Speaking of pilot projects, piloting projects were carried out in numerous regions to fight poverty and support rural development, and working patterns appropriate to China's situation were gradually formed. A good example of a collaborative pilot program is the Guangxi Rural Poverty Reduction Pilot Project on which China and the World Bank are cooperatively working. The World Bank has been working with Guangxi Province in the past 20 years to reduce poverty there. The World Bank, through a series of projects, such as the Poor and Rural Communities Development Project in the mid-2000s and the Southwest Poverty Alleviation Project in the mid-1990s, has been successful in terms of reducing poverty in the province (World Bank 2016a). The Chinese leadership sees collaboration as one way of reducing poverty, that is why the government has always supported international collaboration and exchanges in poverty alleviation. For that reason, the Chinese leadership listed international collaboration as a significant component of China's development and poverty alleviation program in both the Development-oriented Poverty Alleviation Program (2001–2010) and the Seven-year Priority Poverty Reduction Program for rural communities in China.

Under this guiding principle, the Chinese leadership has continuously kept an open mind to accept numerous innovations, stretched out the concept and fields of overseas-financed poverty alleviation projects, and established favorable external conditions for projects that are innovating. The Chinese government attaches huge importance to international collaboration projects because they know that international cooperation projects are a platform to draw on the experience of other nations, explore fresh techniques, and make innovations in the poverty alleviation mechanisms. One of the Chinese government's key drivers to poverty alleviation is the establishment of the government-led special poverty alleviation programs. The poverty alleviation programs and their development work have enabled the Chinese government to continuously value international collaboration in poverty alleviation and the localization of the global experience. Such cooperation has not only bolstered the strength of Chinese poverty alleviation but also has played a favorable role in teaching advanced poverty reduction ideas and management expertise to bolster the general quality of the Chinese poverty reduction effort. The cooperation between the Chinese leadership and the international community has contributed to Chinese poverty reduction and economic expansion, and offered applicable expertise to other developing nations, such as the African nations through knowledge sharing. Speaking of knowledge sharing, it is this context we turn to in the next section.

Table 7.1 Some international collaboration projects for poverty reduction in China

<i>International collaboration</i>	<i>Explanation</i>
Asian Development Bank (ADB)	ADB performs the following functions in terms of supporting the reduction of poverty: (1) ADB introduced diverse ways to give backing to rural poverty reduction projects; they also listen to the voice of the poverty-stricken inhabitants; ADB established research on China's reservoir resettlement policy; created a study on the participatory village development planning; also created a policy study on the poverty reduction program of the PRC: ADB partnered with the government in village-level poverty reduction; finally, emphasizing the trends, challenges, and future development of NGOs
Australia Agency for International Development (AUSAID)	AUSAID helps to bolster the capacity-building of agencies responsible in alleviating poverty; for instance, the Karst environment recovery and poverty alleviation agencies
Department for International Development (DFID)	DFID helps to bolster the development project in China's poverty-stricken villages
European Union (EU)	The EU helps to facilitate the practice and development research on the policies of returning farmland to forest in China
Ford Fund	The Ford Fund provides an avenue whereby numerous studies are carried out on the experience and deployment techniques of the community development fund pattern
Deutsche Gesellschaft für Technische Zusammenarbeit GmbH (GTZ) (German Agency for Technical Cooperation)	Their aim was to implement Chinese poverty alleviation in the rural communities as well as provide a platform for poverty-monitoring pilot projects in Jiangxi Province
International Fund for Agricultural Development (IFAD)	IFAD, in collaboration with the Chinese government, supported the poverty reduction project in Qinling mountainous areas; also collaboratively supported the poverty reduction programs in west Guanzhi; further collaborated with the Chinese government to support the environmental protection and poverty reduction project in Ningxia and Shaanxi; poverty alleviation project in south Gansu and poverty alleviation project in Xinjiang Autonomous Region
Japanese Bank for International Cooperation (JBIC)	JBIC collaborated with the Chinese government on the poverty alleviation project on the environment and other poverty alleviation projects as well as helping support the poverty alleviation projects in Hunan Wuling mountain area

continued

Table 7.1 Continued

<i>International collaboration</i>	<i>Explanation</i>
Kadoorie Charitable Foundation, Hong Kong	The foundation, in collaboration with the Chinese government, supports the integrated poverty alleviation pilot project in Guyang Mongolia
Oxford Committee for Famine Relief (Oxfam), Hong Kong	Oxfam collaborated with the Chinese government to support the Community Development and AIDS Caring Pilot Project in Lixin County, Anhui Province
Plan International	The organization is supporting the community-oriented development and also expanding the poverty alleviation project in Shaanxi Province
Resources Protection Committee, USA	Livelihood-connected energy utilization in China's Tibetan Area and research project in the application of alternative energy
The Nature Conservancy, USA	They engaged in supporting the study and pilot project that helped to alleviate poverty in the natural protection area and its surrounding areas
United Nations Development Programme (UNDP)	The UNDP collaborated with the Chinese government to support China Poverty and HIV/AIDS Research and Intervention program
United Nations International Children's Emergency (UNICEF)	UNICEF, in collaboration with the Chinese government, supported the study on poverty in children and woman in China
World Bank	<p>The World Bank, in collaboration with the Chinese leadership, supported China's Southwest Poverty Alleviation Project; the World Bank also collaborated with the Chinese government to support China Qinba mountains poverty alleviation project, the poverty alleviation project in Gansu and Inner Mongolia of China; the China Poor Rural Community Development Project; the China Shanxi Poverty Alleviation Project; Capacity Building to Strengthen the Poor Regions in Poverty Reduction (TCC4); the China Community-driven Development Project; Piloting Community Development Fund Projects (TCC5)</p> <p>The World Bank approved a \$100 million loan on December 2016 to increase income-generating opportunities for poor farmers in China's Guangxi Zhuang Autonomous Region, through the establishment of cooperatives and partnerships with agribusiness enterprises in agriculture value chains and rural tourism</p>

Source: www.conferences.ifpri.org.

Knowledge sharing as the core of collaboration in poverty alleviation

One of the ideas swirling around in the field of demography is a country's "demographic dividend," i.e., the benefit that a country gains by having a young population offering a large pool of workers to support a smaller dependent population. China has enjoyed this demographic dividend for the last four decades and India seems to be currently enjoying it too. With most of the world's population growth to come from Africa this century, there is reason to think that it is Africa's turn to reap the demographic dividend. The numbers are eye-watering: in 2014, the African Development Bank asserted that Africa's population was increasing rapidly, from more than one billion to an estimated 2.5 billion by 2060 (AfDB 2014). By the year 2050, the continent will have the youngest population and will be home to 30 of the 40 youngest nations globally, with 70 percent under the age of 25 (United Nations Population Division 2015). Therefore, the continent will have a young and increasingly urbanized workforce, with a projected 12 million people added to the continent workforce annually (African Economic Outlook 2017). Africa will account for *nearly all* of the growth in the world's workforce by 2100, and its share of the global workforce will grow from 10 to 37 percent, which presents an opportunity to reap the demographic dividend. If the twenty-first century is to see Africa gain a demographic dividend, then it will need to equip its expanding young population to become the workforce of tomorrow.

According to the International Labour Organization (ILO), across Africa, youth are three times more likely to be unemployed than adults (ILO 2015). For that reason, knowledge sharing that focuses on creating capacity and empowering African youth to be "job-creators" rather than "job-beggars" is necessary for poverty alleviation collaboration and should be the starting point. This is as a result of the fact that in an increasingly knowledge-based and interconnected world, sustained and shared prosperity relies not on what countries have in terms of natural resources, but on what their citizens are able to learn. Therefore, skills and the ability to learn updated knowledge could be crucial in determining the success of the new continental and globally sustainable development goals: the African Agenda 2063 and the 2030 agenda for Sustainable Development Goals (SDGs).

Therefore, harnessing and seizing Africa's demographic dividend require investing in skills, innovation, and updated knowledge. This updated knowledge will help this young and increasingly urbanized workforce to create African solutions to African challenges; creating employment opportunities, driving social mobility, unlocking Africa's wealth, reducing poverty, and adding breadth to African economies. However, the demographic challenge of making sure there are sufficient human development and job opportunities for the young African population is both the continent's biggest problem for Africa stability as well as the biggest opportunity to access wealth creation, poverty reduction, and growth prospects. As asserted earlier, China has

enjoyed this demographic dividend in the last nearly four decades, which was why China was considered a labor-plentiful nation. Arguably, the move of the unlimited and cheap labor supply from the agricultural sector with low productivity to the industrial sector with high productivity contributed enormously to the economic rise of China in the process of the Chinese export-oriented industrialization. Cai and Wang (2005) assert that the Chinese demographic dividend⁴ added 26.8 percent to the Chinese per capita GDP growth between 1982–2000.⁵

There is, however, room for improvement on the existing cooperation, and more importantly, there is great potential for expanding poverty cooperation between China and the African nations. There is extensive scope for Sino-African collaboration in poverty alleviation. In the area of poverty alleviation, the Chinese government has offered aid to nations in Africa by offering scholarships for long-term and short-term training for knowledge transfer. The Chinese government has also provided technical and financial support for agricultural projects which are closely connected to poverty alleviation in Africa. Several other Chinese forms of assistance, trade, and investment projects in African nations also have a poverty dimension.

In terms of reducing poverty, there should be a strong connection between poverty alleviation and knowledge sharing in Africa, because with a concentrated application of information and knowledge by those living in poverty, they can add value to the limited resources they own. The World Bank (1998), the UNDP (2003), and numerous agencies have deliberated on the significance of knowledge sharing to development and wealth creation. There have been disappointing results in terms of reducing poverty in Africa, in spite of the continuous spinning of fresh acronyms to describe programs targeting the poverty-stricken areas, such as the Millennium Development Goals (MDGs), the UNDP, and the Poverty Reduction Strategies (PRSPs) of the World Bank. Part of the failure of development programs targeting the urban and rural poor comes from a knowledge-sharing failure of the knowledge support structures for the urban and rural poor. Knowledge sharing is an essential tool in boosting productivity and reducing poverty in Africa.

The 2017 China Poverty Reduction Forum, with the theme of “Developing and Sharing Governance Solutions to Reduce Poverty,” held in Beijing, was co-hosted by the Food and Agriculture Organization of the United Nation (FAO), the China Internet Information Center (CIIC), the International Poverty Reduction Center in China (IPRCC), the World Bank, and the Asian Development Bank (ADB). At the forum, it was stated that in order to meet the world’s Sustainable Development Goals by 2030, sharing solutions will be a major factor in alleviating poverty globally. For that reason, FAO is strengthening its cooperation with its partners, and jointly exploring innovative ways to promote knowledge sharing (FAO 2017). The World Bank 1998/1999 Development Report gives an instance of how significant knowledge can be in transforming nations. The report asserted that the Republic of Korea and Ghana started off with a nearly similar gross national product (GNP) in 1960. Thirty years later,

the Korean GNP has risen more than six times. Half of the gap could be described in terms of traditional factor inputs, the other half, according to the World Bank report, was attributed to “knowledge” as a factor of production (World Bank 1998).

Areas of knowledge sharing in Sino-African cooperation

Knowledge sharing has always been one significant factor that was emphasized from the very beginning of Sino-Africa cooperation. During the visit of Premier Zhou Enlai to Ghana in 1964, he proposed the Eight Principles for Technical Assistance and Economic Aid to other nations in a press conference in Ghana. The principles point out that the purpose of China’s development assistance is to assist recipient nations to gradually attain self-reliance, independent development, offering them the best-quality equipment and material of its own manufacturing. It is also emphasized that in offering technical assistance, China should ensure that the workers of the recipient nation completely master such systems. Evidently, this is a knowledge-sharing process comprising multilevel factors, including the provision of technology, equipment, and training personnel. Since then, knowledge sharing has been a major part of Sino-Africa cooperation.

Speaking of knowledge sharing in Sino-Africa cooperation, the Chinese government’s strong commitment and leadership for poverty alleviation were secured by selecting poor regions of China for the execution of large-scale poverty projects, based on the belief that China’s western and central provinces are most affected by poverty. The government devised a policy of pairing the well-developed China eastern provinces with those in the west; this system is generally known as “*duikou ziyuan*,” which literally means the “pairing assistance.” Changsheng (2018: 34) asserts that the developed provinces are expected to commit resources to assist the underdeveloped provinces which they are paired with. For example,

- Guangdong has been paired with Guangxi, Dalian, Qingdao, Ningbo;
- Shenzhen has been paired with Guizhou;
- Shanghai has been paired with Yunnan;
- Liaoning has been paired with Qinghai;
- Jiangsu has been paired with Shaanxi;
- Fujian has been paired with Ningxia and Xiamen;
- Zhuhai has been paired with Chongqing.

Changsheng added that the above East-West pairing-off poverty alleviation was established to narrow the development gap between the eastern and western regions. The author further mentions that under the principle of advantage complementation, mutual benefit, long-term partnership and common development, the two sides of the pairing-off poverty alleviation have carried out multi-layer poverty alleviation partnership in several forms in the field of government assistance, enterprise cooperation, social assistance, industrial development,

cadre exchange, personnel training, and labor transfer. With that said, former Chinese President Deng Xiaoping, who is credited with the creation of the new China, pronounced that in the reform and opening-up process, the region which becomes prosperous first should help those still in poverty. The purpose of this strategy was to ensure that everyone in China achieves a common prosperity.

China is sharing the same “*duikou ziyuan*” development model that has proven successful in China with African nations. The Chinese are implementing the model in the same way within an African context by pairing a Chinese province with an African country to boost the African nation’s development. For example, Sichuan Province serves Uganda, Hubei Province serves Mozambique, and Hunan Province serves Sierra Leone and Zimbabwe, Chongqing Province serves Tanzania (Shi, 2016). Speaking of Tanzania, under former president Julius Nyerere, the nation was a major recipient of this kind of pairing system which is in the form of development assistance. As such, since 1968, China has dispatched over 1,000 medical workers from China’s Shandong Province to Tanzania as part of the early medical assistance program which twinned Chinese provinces with African nations, while medical teams from Jiangsu Province were sent to Zanzibar, a large semi-autonomous island archipelago about 40 miles off the coast from Dar es Salaam (Hsu, 2008). This shows how “pairing” has led to “clustering” of provincial Chinese actors in the continent of Africa, and how pairing and clustering are connected to China’s development assistance program. Clustering can help overcome challenges of aid sustainability; it can catalyze further technical and business collaboration with African counterparts and will have a more important influence if directed by sound policy from both sides. The impact of the various provinces in terms of economic collaboration and the alleviation of poverty may have been underestimated as provinces can really facilitate a fair amount of investment and poverty reduction for African nations. China has started sharing knowledge with Africa in the field of agriculture, medicine, telecommunications, infrastructure, and manufacturing; these areas would be very useful in achieving certain development targets, combating both extreme and moderate poverty. However, here we will focus on agriculture and manufacturing which have been identified by the African nations as the top priority areas.

Agriculture

According to a recent study, agriculture is anticipated to generate 43 percent of employment over the next half a decade (see Figure 7.5). According to a report by Forbes Insights (2016), the agricultural sector, as a result of its untapped potential for productivity gain and the creation of value-added products, will be the sector that will generate the highest number of entrepreneurs in the next half a decade. Capturing this opportunity requires updated knowledge in this field; this is why knowledge sharing should be a core element in Sino-Africa collaboration. The Chinese government with its experience in poverty alleviation is aware of this scenario, that is why the Chinese leadership has attached great significance to conducting bilateral exchanges and collaboration with Africa on

Figure 7.5 Potential sectors expected to generate the highest employment for African youth over the next half a decade

Source: Forbes Insights, 2016. Data compiled by author.

agricultural technology. China has sent delegations on study trips to Guinea-Bissau, Sierra Leone, and Zambia for potential agricultural collaboration, investment, and development. Preliminary preparations and investigations have been carried out by the Chinese leadership regarding the building of an agricultural technical demonstration center in Africa. The Chinese leadership has also developed for Mozambique and Angola agricultural plans and comprehensive disease and pest prevention and control plans for cashew production, and executed technical collaboration on mushroom cultivation in Egypt. The agricultural-technical-educational training program implemented under the collaboration between China and Nigeria stands as a successful case for Sino-Africa agricultural knowledge sharing.

In 2003, 500 Chinese experts were involved in the Nigerian National Special Program for Food Security, financed by the Food and Agricultural Organization of the United Nations.⁶ The Chinese experts, based in the 36 Nigerian states, assisted the profiting communities to overcome the dearth of water supply for drinking and irrigation while training local farmers in planting, fishing, and beekeeping skills. As of 2015, a total of 574 Chinese experts and technicians had been sent to Nigeria to provide technical assistance on crop production, aquaculture, horticulture, live-stock, and agribusiness. In another context, Brautigam (1992) describe China's efforts in an agricultural assistance program with Gambia and Sierra Leone. Though the projects used diverse methods, both projects comprised the development of upland and swamp regions for irrigated rice cultivation, with the aim of introducing intensive Chinese technology to bolster the production of rice, the key

staple food in both nations. Although these transfers did not generate the expected outcomes, as the local, economic, political, and social contexts were not given sufficient consideration during the project design stage, however, both projects were anticipated to assist individual small farmers.

We can point to another example in Burkina Faso during the late 1980s, where three rice planting areas turned out to be recognized nationwide, one changing from a small village to a town of over 8,000 populaces (Anshan 2016). In 1987, the net income of each peasant family in the region climbed from 400,000 to 800,000 African Francs (US\$1,300–2,600) (*ibid.*). Due to this achievement, farmers from neighboring nations migrated to the rice planting areas. This achievement is due to the Chinese experts' hard work, who taught the local Burkina Faso population the organizational capacity, experience, and management skills of farming. Based on the knowledge shared by these Chinese agricultural experts, the Burkina Faso government awarded them each a National Medal in 1988 (Jiang 2007).⁷ Additionally, in 2001, the Chinese and the Ethiopian Ministry of Agriculture signed a letter of intent that will strengthen the relationship of both nations as well as create a platform for collaboration in Agricultural Education and Training and Green Certificate. This will help both sides build an agricultural value chain and increase the independent grain production capacity to bolster food security, boost the competitiveness of agricultural products and other specialty industries in both nations, and, above all, strengthen their collaboration on agricultural knowledge sharing. From 2001 to 2012, the Chinese government and the Ethiopian government have jointly implemented 10 training programs. China collaborated with Ethiopia to develop vocational and technical education and training in agriculture, and China has sent over 400 staff to Ethiopia to share their knowledge with 1,800 teachers as well as 35,000 agricultural technicians in six major topics, including home economics, husbandry, crop cultivation, agricultural machinery, veterinary medicine, and the development of natural resources, with 66,000 students in training in local agricultural vocational colleges (Wan 2015). Some 10,000 Africans are trained on numerous courses in China each year; most of them in agriculture (this includes Nigerians). The most far-reaching aid program is the agricultural capacity building, a South-South Cooperation (SSC) initiative, successfully linking Nigeria, China, and the FAO, under the Tripartite Project Agreement (TPA). New agricultural techniques, crop varieties, and equipment and tools introduced by the SSC team are showing significant results, improving the production of food crops, increasing farmers' incomes, and empowering up to 5,000 young people on how to plant rice, control pests and diseases, and apply fertilizers. According to Mark (2018), in Madagascar, a China-based agricultural company, Hunan Agri, has launched an agro-technology demonstration center near Antananarivo to coach local farmers on how best to produce a new variety of rice. So as to disseminate its knowledge transfer plans to the locals, the firm also produces learning and training material in the local language, Malagasy. Tianli Agri, another Chinese company, has also set up tutoring centers run by Chinese technicians to teach cotton planting and farming techniques to locals.

Manufacturing

Research suggests that for every dollar spent in manufacturing another US\$1.81 is added to the economy; also, for every manufacturing job generated, 1.6 service jobs follow,⁸ a big plus to a nation's labor-intensive sector. This indicates that manufacturing investment has a large multiplier effect that can create a spark that ignites developing economies. As such, the international communities are recognizing the crucial role of manufacturing in eliminating absolute poverty and promoting sustainable development. This is because manufacturing in Africa will enable those nations to unlock their full potential and realize the maximum advantage from the continent's enormous natural resources. For instance, the value-added advantages of resources like gold and diamonds would permit the continent to get more in return when exporting the finished or processed products, not like the present situation where the benefits are being realized outside the continent since value added is taking place in other industrialized nations and not in Africa. The study shows that every one job in manufacturing creates 2.2 "domestic" jobs: 0.8 locally and 1.4 outside the region. That is why, directly or indirectly, the manufacturing sector supports nearly 39 million jobs—nearly 25 percent of the entire US job opportunities.⁹ In a recent report on industrialization in Africa, one of the proposed recommendations by the G20 is to inclusively promote industrialization through various mechanisms, such as multi-stakeholders' discussion, the sharing of best practices, policy measures and guidance tools as well as the knowledge-sharing platform.¹⁰ China has been active in sharing knowledge with African nations so as to facilitate their industrial development. For instance, China has offered a concessionary loan to equip the labs of 135 technical and vocational institutions with Chinese machinery in mechanical fields, electrical, lathe machining, rapid prototyping, and computer numerical control.

Thousands of Kenyan students will be trained to operate these modern manufacturing machines and produce spare parts. This marks the second phase of the program that aims to grow Kenya's labor pool in technical fields and drive the country's agenda of industrializing by 2030. The first phase, which began in 2013, involved 10 learning institutions and 15,000 students. The Made in Kenya and Study in China program aims to enlarge Kenya's portfolio of finished products that are manufactured locally and strengthen its balance of trade. It is on record that Africa produces about 75 percent of the cocoa in the world but gets just about 2 percent of the US\$100 billion per year revenue of the chocolate industry. Ghana and the Ivory Coast produce about 60 percent of the world's cocoa, but these two countries are still price takers (*Modern Diplomacy* 2018). For example, globally, of the total coffee business valued at around US\$144 billion per year (at 2008 prices), the coffee-growing nations together got just US\$15 billion for their green, unprocessed beans. The remaining US\$129 billion remains in the importing (developed) nations that add value to the coffee they themselves have not grown. Africa has been unable to extract a larger share of the global chocolate market value because it exports only raw cocoa beans. As a

result, the continent of Africa is stuck at the bottom of the cocoa value chain, dominated, rather than dominating, in spite of being the leading producer.

African governments need to know that without African intellectual capital, unfinished products excavated in the continent will continue to be manufactured in Europe and exported back to the continent at a huge cost. In order to reduce poverty, it is essential that the continent cultivates the creative and intellectual capabilities that will permit African nations to raise the value of their raw materials and break Africa's vicious cycle of poverty. Ideally, poverty in Africa should not be seen as an absence of money; rather, it should be seen as an absence of knowledge. Currently, estimates show that Africa spends US\$30 billion annually to import processed food from different regions (ECA 2016). The removal of that import cost will make available capital to assist greater development needs that can train African students and facilitate the continent's industrialization. So, the Made in Kenya initiative is one way of bridging the deficit in bilateral trade currently tilted in favor of China.

In another context, the Huajian shoe factory is playing a significant role in sharing knowledge among the local Ethiopians. In a recent development, the firm sent 86 Ethiopian graduates to China to be trained in how to make shoes. In addition, the company has a program that is working closely with the Chinese government to train 300 Ethiopians. After their training, workers can choose to remain in the company or to work for other shoe firms or, better still, start their own shoe manufacturing business. In the past, China has given a lot of concessional loans to African nations, but nowadays, China wants African people to have the capacity to create wealth for themselves, that is why training is now the basis of Sino-Africa cooperation. The continent of Africa needs a skilled workforce in order to experience growth like China. Skilled graduates are crucial for the continent to move up the value chain and attain an increase in critical productivity. There is room to learn from China through knowledge sharing, where over 40 percent of all tertiary degrees are awarded in science, technology, engineering, and mathematics (the STEM subjects). In contrast, the number of African university graduates in STEM field is closer to 22 percent (Diop 2015).

China's success in developing the skills needed to adopt technology has created the conditions to attract investment in manufacturing. It could also be argued that China's interest in Africa is timely. In order to improve economic growth in Africa, the continent needs to do what China has done in nearly 40 years at home: structurally transform itself from an agrarian to an industrial economy that produces manufactured products and services. The Chinese leadership has accomplished this transition by embracing foreign investment as a conduit for "learning by doing." As part of their investments in China, foreign enterprises transferred managerial and export marketing technology. The increased Chinese presence in Africa presents an opportunity for African leaders to learn from China's science, engineering, and technology competencies. There is a need to develop the high workforce required to compete in the global knowledge-based economy. However, Sino-Africa knowledge-sharing cooperation can become a new way of boosting a mutually beneficial cooperation

model, speed up Africa's industrialization, and improve its independent development capacity, while bringing Chinese equipment, technologies, and products to African nations through industrial capacity cooperation.

Is China a good economic role model for Africa?

China is on the right path toward attaining the Chinese dream of national rejuvenation. And being a highly successful developing nation, China has followed a remarkable development path over the past decades, fueled by strong growth, paired with investments in people to ensure that growth can translate into poverty reduction. Consider that four decades ago, China was a largely agricultural poor economy, and that today it has one of the world's largest economies, with its people moving into more skilled and knowledge-intensive sectors. Almost all segments of the population, plus the poor and vulnerable, have shared the benefits of this progress—and China has ambitious plans to reach those who are still left behind. This was the right path for China's context, and can offer lessons that are helpful for other economies. As a result, China has a huge responsibility, which is to share its experiences and cooperate with other nations through already established frameworks. These comprise the South–South Cooperation, the Belt and Road Initiative, as well as other institutional channels of dialogue, such as the Asian Infrastructure Investment Bank. Notably, China's development has been a remarkable accomplishment in terms of the country's speedy pace and international impact. The emergence of China as one of the five largest economies globally nowadays is mainly because the nation nurtured a visionary and dedicated leadership system based on orderly succession, a capable and competent bureaucracy, effective policy planning and coordination, and policy discipline. Also, China's successful narrative of reducing poverty would never have been possible without the spirit of openness and inclusion that is typical of Chinese cultural values. For that reason, there has been a sharp upsurge in assumptions that China's impressive poverty reduction programs and development trajectory may provide a useful lesson for African nations where China's presence has increased immensely since the beginning of the millennium. Although the assumption sounds good, it is vital to remember that China is dissimilar from most countries in Africa in terms of size, the impressive high rate of economic expansion attained in the past four decades, and a considerable development gap between the inland and the coastal regions. With a strong administrative system, the Chinese leadership has the capability to mobilize resources for national poverty alleviation procedure. On the other hand, the 54 countries in Africa each have their own specific social, economic, and political environment. African nations have made remarkable headway in economic recovery since the late 1980s, following an era of economic deterioration in the late 1970s and early 1980s (UNCTAD 2001). Nonetheless, there is, of course, gross inequality between Africa and the industrial world. This inequality has exploded over the last two centuries and it has made Africa fall behind other regions in poverty alleviation and economic growth.

One issue, which has been debated in the recent poverty literature, is whether China should be an “economic role model” for African nations, facing a high level of poverty. Should Africa learn from China’s astonishing success in the fight against poverty? This question is particularly vital, because some Chinese policies mirror unusual circumstances in China. Ravalion (2009) asserts that the reform period in China has seen a sequence of frequent radical economic reforms in China, which have moved the Chinese economy from being highly controlled to more market-oriented. These reforms naturally mirrored (relatively unusual) circumstances in China, and make little or no sense as a blueprint for policy-making anywhere else. Nevertheless, there are strong reasons for Africa to learn from the Chinese success in the fight against poverty. In terms of agriculture-led growth and diversification of rural family incomes, a number of lessons from the rapid development of agriculture for poverty alleviation in China can be drawn for African nations. First, the Chinese poverty alleviation programs have a strong focus on rural regions and agricultural development, as the government poverty alleviation efforts have concentrated extensively on the rural areas. Nevertheless, we should be cautious in drawing on the experiences of China’s growth and poverty alleviation strategies more broadly, given the two very different contexts.

China has been a unified nation in spite of the country’s cultural diversity and massive territory, while Africa is a continent of 54 nations with diversified social, economic political, and environmental conditions. China has had more favorable socio-political and demographic conditions than Africa has had. But the lesson to be learned is how China succeeded in improving the living standards of its rural populace. Also, African nations need to learn how smallholder-based agriculture in China has been developed, and simultaneously learn lessons on the range of difficulties related to Chinese agricultural development, such as the emergence of an unequal society with a robust urban-rural divide, unclear land rights for farmers and highly intensive farming, leading to pollution and the degradation of natural resources. Second, the sustained high economic growth, a necessary condition for poverty alleviation, has remained a challenge for African nations. The Chinese industrial and service sectors growth was truly based on the fundamental agricultural reforms initiated over nearly four decades ago. Africa can learn from these Chinese government policies on how China attracts and regulates foreign investment to support industrialization and technological development. Third, speedy economic growth and active macroeconomic, industrial, and social policies propelled China into the ranks of the upper-middle-income countries and the global economic powerhouse it is today, and African countries aspire to upper-middle-income country status, in the near future. The Chinese transformations over this period have had a snowball effect on the development path of other African nations, either directly via bilateral trade and financial flows or indirectly via growth spillovers and terms of trade effects.

Learning limitations

Nevertheless, there are four major limitations to Africa learning effectively from China's success against poverty. First, until the late 1970s, most economic resources in China were under state control, and through reforms, they were equitably distributed in rural areas. It empowered the poor. The power and political structure, in Africa, is totally dissimilar, comprising civil and military bureaucracies, political and religious forces, landed rural élites, and a strong caste system. Throughout China's reforms, the Chinese leadership has targeted the poverty-stricken areas, whereas it is hard to distribute economic resources, say, land, in poor regions of Africa, where a few families control the land. Second, as compared to China, Africa tends to have weaker state institutions, and this has an adverse effect on both the implementation of anti-poverty programs and the provision of key social services and infrastructure to the people. Third, population growth in Africa is soaring. The high dependency ratio, because of high fertility, seems to be a binding constraint on economic growth and poverty reduction. Finally, the poor law and order situation linked with extremism and terrorism could be a serious constraint to designing pro-poor policies and implementing them.

Conclusion and policy recommendations

This chapter has reviewed the poverty reduction mechanism through which China has been successful in reducing its poverty. In the last three decades, China has made great progress in poverty reduction, brought about by a high rate of economic growth, pro-poor growth policies, and government-specific poverty reduction policies and programs. The government-led poverty programs, with an emphasis on development-oriented poverty reduction, have had a significant influence on the incomes and capacities of the poor communities and poor people in China. Through a process of learning and capacity-building and through cooperation with international donor agencies, China's poverty programs have changed to be more participatory and demand-driven, with a snowball emphasis on capacity-building for the poor communities and poor people, as well as for poverty-reduction institutions. The lessons from China have important implications for the African countries. The government-led and development-oriented poverty programs have contributed to poverty reduction in China by improving the rural infrastructure and hence improving the production conditions in poor areas of China. The government poverty programs have also offered micro-loans and training to the poor, which tend to raise their incomes and improve their capacities.

China should also learn from the African nations. China and the African nations should try and strengthen their cooperation by encouraging Chinese scholars to learn more about the poverty and development in African countries and to disseminate the information in China. Knowledge sharing and increased training and capacity-building activities can be deepened by conducting joint research and exchange through increased fund input on poverty alleviation in China and the African nations.

Cooperation in poverty reduction between China and the African countries can also be extended to China's non-poverty-focused projects and programs in Africa. As the Chinese economy reaches the Lewisian Turning Point (wage and other production costs started to rise), the governments in China and African countries may encourage certain labor-intensive industries to move from China to the African countries to help certain African countries develop their manufacturing bases to provide the poor, especially those landless poor, with employment opportunities.

With China's remarkable success in poverty alleviation, the poor population has become more dispersed, and the advantages of regional targeting can no longer be actualized. In response, the Chinese government should narrow targeting from the county level so as to improve accuracy and bring the residents of poor villages within non-poor counties into the village-wise poverty program. This has the advantage of preventing poverty alleviation funds being wasted. Also, the Chinese leadership can choose a number of poor villages to carry out pilot work for a "leapfrog development" model of poverty alleviation according to the general requirement of constructing a new countryside. Because the production and living conditions of poor villages are more backward than other areas in general, employing an overall, gradual poverty alleviation and development model will require a long period of time and will not necessarily achieve the intended purpose. Using the "leapfrog development" model enables poor areas to quickly catch up. Poverty reduction funding alone may be insufficient—even unsustainable—without knowledge inputs and outputs.

Notes

- 1 Retrieved from Poverty Monitoring Report of Rural China 2000.
- 2 Statistics on this indicator are only available from 1981 to 2010 (see World Bank 2016c).
- 3 "National Outline for Rural Poverty Reduction and Development (2011–2020)" (Beijing: People's Publishing House, 2011).
- 4 Demographic dividend means output and other economic gains from having a large proportion of working-age group in the total population. See Cai and Wang, (2005).
- 5 See Cai and Wang (2005).
- 6 "China-Nigeria Bi-National Relations, Productively on High Speed – Chinese Consul General." *Vanguard*, February 7, 2015. Available at: www.vanguardngr.com/2015/02/china-nigeria-bi-national-relationsproductivity-high-high-speed-chinese-consul-general/
- 7 Jiang Xiang is a diplomat who served in several African countries and as an Ambassador in Burkina Faso.
- 8 "China's Investment in Africa and the Flying Geese Paradigm." Econfix current issues in economic blog, July, 28, 2017. Available at: <https://econfix.wordpress.com/2017/07/28/chinas-investment-in-africa-and-the-flying-geese-paradigm>
- 9 Andrew Carter, "Advanced Industries Create Economic Growth, but They Will Never Be Mass Employers." Centreforcities, February 6, 2015. Available at: www.centreforcities.org/blog/advanced-industries-create-economic-growth-but-not-new-jobs/
- 10 Li Yong, "Industrialization for a Sustainable Future." Inter Press Service News Agency, February 14, 2017. Available at: www.ipsnews.net/2016/09/industrialization-for-a-sustainable-future/

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Part IV

Southeast Asia

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8 Poverty reduction experiences of Southeast Asian countries

Peter Warr

Introduction

What drives poverty reduction? How important is economic growth and what kinds of growth are most effective? These questions have been hotly debated. One form this debate has taken asks whether the poverty-reducing propensity of economic growth depends on its sectoral composition—whether it occurs in the agricultural, industrial, or services sectors of the economy. The countries of Southeast Asia illustrate these issues very well. Over recent decades these countries have each experienced wide fluctuations in both growth rates (aggregate and sectoral) and poverty reduction outcomes. In all these countries, whether economic growth does or does not deliver sustained reductions in poverty incidence, and what kinds of growth reduce poverty the most, are questions of ongoing policy debate.

A related policy debate concerns the effect that changes in relative prices have on poverty, particularly the real price of food. Some Southeast Asian governments have protected their agricultural sectors, thereby raising the real price of food, ostensibly because higher food prices benefit poor farmers. Indonesia, the Philippines, and more recently Thailand, are examples. But changes in relative prices produce both winners and losers and both groups will include some poor people. Oversimplifying somewhat, poor farmers who are net sellers of food will benefit if real food prices increase. But poor consumers will lose and this group includes not only the urban poor but many rural poor people as well, especially landless agricultural workers, who sell their labor and buy food. Small farmers who are net buyers of food will also be harmed. The net effect of these two opposing sets of forces—producing winners and losers—is not obvious and may differ significantly between countries.

Several Southeast Asian countries enjoyed economic booms from the late 1980s until 1996 and in all the countries experiencing this rapid growth considerable progress was made in reducing poverty. But in the late 1990s, most of these same countries were affected by the Asian Financial Crisis and suffered deep recessions. Economic hardship was felt at all levels of the income distribution, but the implications for the poorest people were of special concern. Macroeconomic recovery has subsequently occurred in each of these countries, but at

varying rates and with varying outcomes for poverty incidence. Attention has thus been refocused on the variables that drive changes in poverty incidence.

In the post-crisis environment, restoration of economic growth is a policy priority in all Southeast Asian countries, but not just *any* growth (Bourguignon 2001). Reflection on the boom period, the crisis that followed it, and the subsequent recovery has convinced many policy-makers and independent observers that the quality of growth is important and not just the rate. But what is quality growth? One criterion for determining the quality of growth, though certainly not the only one, is its effects on the poor (Fields 1980). What kinds of growth are most (and least) beneficial to the poor? Much of the development economics literature has dealt with the effect of the rate and composition of economic growth on the distribution of income. This chapter explores some of these issues in the context of Southeast Asia. It asks how absolute poverty incidence changes with economic growth and how these effects depend on the characteristics of the growth, such as its sectoral composition, and changes in the relative price of food.

The analysis focuses on the eight poorest countries of Southeast Asia, all of which were affected by the 1997–1999 financial and economic crisis. The four most affected were Thailand, the first to succumb; Indonesia, the most severely harmed; Malaysia, where the crisis produced the most radical macro-economic policy responses; and the Philippines, where the pre-crisis boom was least pronounced among the four, but where the crisis itself was nevertheless significant. The four less affected, but very poor countries were Cambodia, Laos, Myanmar, and Vietnam.¹ The two richest ASEAN countries, Brunei and Singapore, are not covered in this study because their recorded levels of poverty incidence are very low. Myanmar is necessarily excluded from the quantitative analysis because, at least until recently, its national accounts data have been considered unreliable. Finally, Cambodia was also excluded from the quantitative analysis because data on sectoral growth rates were unavailable.

The six remaining ASEAN countries (Indonesia, Laos, Malaysia, Myanmar, Thailand, and Vietnam) were chosen for the quantitative analysis of this study because for each of them poverty incidence is a serious policy concern and because data on poverty incidence and economic growth are available, covering a significant time period. Nevertheless, the intervals between available data points on poverty incidence vary and are often several years long. This means that the total number of data points on changes in poverty incidence over time that are available for any one of these countries is small and statistical analysis of the relationship between poverty incidence and economic growth is highly problematic for any one of them, taken individually. But analysis of this kind becomes feasible when the data are appropriately pooled across countries.

There are reasons for thinking that pooling data for this group of six countries is reasonable. First, these countries have roughly similar economic structures. All are market-oriented economies with large agricultural sectors consisting primarily of small farming units. Agriculture dominates total employment, but not national output. In each of these countries, industrial production has

combined export-oriented production with protected production for domestic markets. All have large services sectors providing residual employment opportunities for those not employed in agriculture or industry. The rural populations dominate the total numbers of poor people, but rural to urban migration has been a prominent feature of the long-term development process. These facts suggest that the underlying relationship between sectoral growth and poverty reduction might be similar among these six countries (Indonesia, Laos, Malaysia, Myanmar, Thailand, and Vietnam), whereas this may not apply among countries whose structural features differ widely.

Second, despite their structural similarities these six countries have different economic histories. As noted above, all except the Philippines experienced growth rates above their long-term historical norms during the boom decade from the mid-1980s to the mid-1990s. Aggregate poverty incidence, both rural and urban, declined significantly. This was followed by recessions of varying depth from 1997 onwards, during which poverty incidence typically increased. But aside from this similarity, their detailed experiences have been quite different. The rates at which agriculture has contracted as a share of GDP during the process of long-term economic growth have differed, along with rates of industrialization. The above facts suggest that these countries provide six different sets of empirical experience around a similar underlying structure, the circumstances in which pooling data is most likely to be appropriate. The diversity of their experience offers a natural experiment that may have useful lessons to offer.

The chapter is organized as follows: the next section discusses some measurement issues affecting poverty measurement. Then, available data on poverty incidence in these eight countries of Southeast Asia (all of ASEAN except Brunei and Singapore) and data on economic growth in all eight countries except Myanmar are summarized. The analytical framework used to analyze the determinants of poverty reduction in these six countries is set out. The statistical method used and the results are given, followed by the conclusions.

Measuring poverty

Before we can analyze the determinants of poverty or the causes of changes in it, we must first quantify it. Seven kinds of measurement issues are crucial in assessing poverty incidence over time:

- 1 Are we discussing *absolute or relative poverty*? Measures of absolute poverty relate to that part of the population whose incomes (or expenditures) fall below a given level (the poverty line) whose value is held fixed in real purchasing power over time and across social groups. Relative poverty means *inequality*, and, to avoid confusion, it is probably better to use that term. It compares the incomes (or expenditures) of the poor with those of the rich, or some other reference group. The two concepts are different because the overall size of the economic pie may change at the same time as

its distribution is changing. Not surprisingly, when the overall size of the economic pie is changing significantly, measures of absolute poverty and inequality do not necessarily move in parallel and may not even change in the same direction.

- 2 What *variable* is used for the calculations of poverty incidence? In Thailand, Malaysia, and the Philippines, the basis has been *household incomes* per household member, adjusted for gender and age distribution of the household. Thailand has recently begun reporting separate poverty estimates based on household expenditures and household incomes, respectively, but using the same numerical poverty lines for both. Indonesia and the newer ASEAN countries—Vietnam, Cambodia, and Laos—use household expenditures. In Myanmar, household expenditures were used as the basis for the poverty estimates reported by the UNDP in 2005 and 2010, but earlier government estimates based on household incomes were also published. The latter are not reported in this study because it is not clear how the poverty lines were adjusted over time in response to changing consumer prices.

The use of household expenditures for poverty measurement is more consistent with economic theory, in that expenditures are more directly related to household welfare than incomes. In addition, the measurement of income is problematic in rural areas where subsistence agriculture is prevalent, because much of the return to labor is in kind and not easily converted to monetary values. The distinction between income-based and expenditure-based measures of poverty is especially important when we are considering the impact on poverty of a short-term change in incomes. For example, poverty measures based on expenditure should not rise as much in response to a negative income shock as measures based on expenditures because households adjust to these shocks by smoothing essential expenditures over time through borrowing, selling assets, and deferring non-essential expenditures.

- 3 What is the *poverty measure*? Most studies of poverty focus on the *head-count measure of absolute poverty incidence*, which means the proportion of the population whose incomes fall below a given threshold, held constant in real terms over time and across regions. At a conceptual level, this measure has the disadvantage that changes in it are due mainly to changes in the living conditions of members of the population with incomes or expenditures close to the poverty line. Other measures of absolute poverty incidence lacking this disadvantage have been calculated from time to time, such as the poverty gap and poverty gap squared measures, but these measures are normally highly correlated with the headcount measure.
- 4 What *data source* is used for the calculations? Virtually all countries use sample surveys to collect economic data at the household level and then use these sample-based data to estimate indicators of poverty for the overall population. The exercise is a sample survey, not a census, and inevitably involves sample error. For example, in Thailand, the periodic Socio-Economic Surveys (SES) conducted by the Thai government's National

Statistical Office (NSO) provide virtually the sole source of reliable information at the household level that can be compared over time (Krongkaew 1993; Warr 2005). In the Philippines, the corresponding survey is the Family Income and Expenditure Survey, conducted every three years by the National Statistical Coordination Board (Balisacan 2002). In Indonesia, the SUSENAS survey, conducted by the Central Bureau of Statistics, plays a similar role. It is conducted annually, but the specialized "consumption module," which provides the most reliable basis for poverty estimation based on expenditures, is conducted only every three years. In Laos, the government's Laos Expenditure and Consumption Survey (LECS), conducted by the Bureau of Statistics, is the sole reliable basis for poverty estimates but these surveys have been undertaken only every five years since 1992/93.

The statistical design and frequency of these surveys vary between countries. It is well known that sample surveys may systematically under-represent poor people because it is more difficult for enumerators to locate them and to obtain usable data from them. Statistical agencies differ in their methods for dealing with this problem. In rural areas, production for own-consumption is important and allowance must be made for this, whether income or expenditure is used as the basis for poverty measurement. Again, the methods vary.

- 5 How is the *base level of the poverty line* determined? Some concept of the minimum level of income or expenditure per person must be established for a household to be classified as non-poor. Although studies of poverty measurement often give great attention to this matter, drawing upon studies of minimum nutritional requirements (Ravallion 1994), the level of this poverty line necessarily involves a large element of arbitrariness.
- 6 What is the *poverty line deflator*? This involves the way the poverty line is adjusted over time to keep its real purchasing power constant. Although this may seem a minor technical matter, it is a central issue for poverty measurement over time and across regions where consumer prices vary. Empirical studies of poverty incidence differ in their handling of this issue. The ideal deflator uses the actual expenditure pattern of the poor to weight price changes at the commodity level. This deflator may, at times, behave differently from the overall consumer price index (CPI), which reflects "average" expenditure patterns. When the prices of food items move relative to other consumer goods prices, the two series may diverge significantly because the share of food in the poverty line basket is higher than its share in the CPI basket.
- 7 What is the *adjustment of the real poverty line over time*? In rapidly growing economies, poverty incidence measured with a poverty line held constant in real purchasing power typically declines and may fall to very low levels. Statistical agencies frequently respond by adjusting the real value of the poverty line upwards. For example, in the cases of Thailand and Indonesia, this has happened several times. For users of the resulting data, the problem

is how to undo the effect of these upward revisions to obtain a time series based on constant real poverty lines. Sometimes statistical agencies publish overlapping series, based on the different poverty lines, thereby facilitating this process, sometimes not.

Regrettably, among the countries of Southeast Asia, the detailed methods used to measure the headcount index differ widely between countries and this fact limits the degree to which the resulting measures can be compared meaningfully across countries.² Moreover, because the importance of omitted and included items may vary over time, as levels of income change, the differences may even affect comparisons across time for individual countries. Table 8.1 documents this problem by comparing the data used in the estimation of poverty for the eight developing countries of Southeast Asia, again excluding Brunei Darussalam and Singapore. They vary widely. As is well known, for a poverty line of given monetary value, income-based measures (in Malaysia, the Philippines, Thailand and Vietnam) typically show lower levels of poverty (and higher levels of inequality) than consumption-based measures (in Cambodia, Indonesia, Laos, Thailand, and Vietnam). But even within these broad measures, the included and excluded items vary.

As an example of this heterogeneity, consider the case of Laos. The Lao government statistical agency measures consumption expenditure per capita at the household level. Expenditure items are divided into food and non-food. Food consumption is recorded using a 30-day diary, which records all food consumed, whether purchased or home-produced. The value of home-produced food is imputed at current market prices. Non-food expenditures are also recorded over a 30-day period, except for: (1) 12 durable goods³ and rents (cash or imputed); and (2) a defined set of 'high-value' goods.⁴ Category (1) items are excluded from measured consumption expenditure. However, consumption expenditures on category (2) items are collected over a 12-month period, divided by 12 and then added to other non-food monthly expenditures. The excluded items, such as imputed rent from owner-occupied housing (Laos is the only example among this group of countries), and at least some seemingly income-elastic durable goods, are likely to form a larger proportion of the true expenditures of richer than poorer households. Cambodia and Myanmar also exclude many durable goods from measured expenditures, though the details vary between these three countries.⁵

Finally, the World Bank also produces estimated poverty incidence by taking data from national statistical agencies and amending them using its own statistical preferences. Unfortunately, these amendments are not fully transparent and the World Bank data contain many inexplicable errors, an even greater problem with Asian Development Bank data. This chapter focuses on the headcount measure of absolute poverty incidence—the proportion of the population whose expenditures or incomes (see below) fall below a fixed threshold, the poverty line, the monetary value of which is adjusted over time to maintain a constant real purchasing power. Wherever possible, national data are preferred, followed by World Bank data, and, finally, Asian Development Bank data when national data are unavailable.

Table 8.1 Poverty measurement data sources: Southeast Asian developing countries

<i>Countries</i>	<i>Data source</i>	<i>Income or consumption</i>	<i>Unit of observation</i>	<i>Imputed rent¹</i>	<i>Durable goods^{2, 3}</i>	<i>Latest Gini</i>	<i>Latest year</i>
Cambodia	Cambodia Socio-Economic Survey	Consumption per month	Per capita	Included	Partially included ⁴	0.29	2012
Indonesia	<i>Survei Sosial Ekonomi Nasional</i> (SUSENAS)	Consumption per month	Per capita	Included as “self-assessed rent”	Included	0.41	2013
Laos PDR	Laos Expenditure and Consumption Survey (LECS)	Consumption per month	Per capita	Excluded	Partially included ⁵	0.37	2012–13
Malaysia	Household Income and Basic Amenities Survey	Income per year	Per household	Included	N/A	0.43	2012
Myanmar	Integrated Household Living Conditions Assessment (IHLCA)	Consumption per year	Per adult equivalent	Included	Excluded ⁶	0.29	2009–10
the Philippines	Family Income and Expenditure Survey (FIES)	Income per year	Per household	Included	.	0.46	2012
Thailand	Socio-economic Survey (SES)	Income per month	Per capita	Included	N/A	0.47	2013
	Socio-economic Survey (SES)	Consumption per month	Per capita	Included	Included	0.38	2013

continued

Table 8.1 Continued

<i>Countries</i>	<i>Data source</i>	<i>Income or consumption</i>	<i>Unit of observation</i>	<i>Imputed rent¹</i>	<i>Durable goods^{2,3}</i>	<i>Latest Gini</i>	<i>Latest year</i>
Vietnam	Vietnam Household Living Standards Survey	Income per month	Per capita	Included	N/A	0.40	2012
	Vietnam Household Living Standards Survey	Consumption per month	Per capita	Included	Included	0.36	2012

Notes

- 1 Two rows appear for Thailand and Vietnam because they produce estimates using both consumption and income data. Vietnam uses consumption for international reporting and income for domestic reporting. Thailand reported only income-based estimates until 1986. Since then, both income and expenditure-based estimates have been produced.
- 2 'Included' in this column means that imputed rent for owner-occupied housing is counted as an expenditure or income item. 'Excluded' means that actual payments of rent are included but not imputed rent for owner-occupied housing.
- 3 N/A in this column means 'not applicable' because the issue arises for expenditures, not incomes.
- 4 Included items for Cambodia are: home electronics (8 items); personal transport (4 items); household equipment (13 items); furniture (4 items); computers and printers (2 items); recreation (2 items); watersport (2 items); agriculture and other production (9 items).
- 5 Included items for Laos PDR are: tables and chairs, cupboards, desks and sideboards, stools and benches, carpets, lamps, rugs, mats, pictures, stoves (non-electric), irons, electric fans, bicycles, watches, jewelry, airline tickets, expenses abroad, radio or cassettes players, cameras, other photographic and musical equipment, cellular phones and repairs of such items. Excluded items include: beds, dining and lounge suites, stoves with ovens, refrigerators, axes, sewing machines, washing machines, cars and vans, motorcycles, TVs, VCRs, and computers.
- 6 In the case of Myanmar, although the IHLCA survey collected data on durable goods user cost, this information was excluded from calculated non-food consumption expenditures.

Data on poverty incidence

Figure 8.1 and the upper half of Table 8.2 summarize World Bank data on annual rates of poverty reduction in developing countries within seven major regions of the world: (1) Southeast Asia; (2) China (listed here as a ‘region’ because of its size); (3) Europe and Central Asia; (4) Latin America and the Caribbean; (5) the Middle East and North Africa; (6) South Asia; and (7) Sub-Saharan Africa. The periods covered are 1981–2008 for most regions. The extraordinary rate of poverty reduction in China dominates all others, but Southeast Asia is second, followed by South Asia. In historical terms, the 1.2 percent annual rate of poverty reduction achieved in Southeast Asia is truly remarkable, an achievement only overshadowed by the even more rapid rate (2.8 percent per annum) achieved in China.

What could explain the huge variation among regions in the rate of poverty reduction? Figure 8.2 compares the data in Figure 8.1 with data on real GDP growth per person over the same periods. The correlation is unmistakable. Correlation does not necessarily mean causation, and it would be absurd to suggest that economic growth was the sole determinant of poverty reduction, but these data suggest that it is an important one.

Figure 8.1 Annual rates of poverty reduction (percentage points per year)

Source: Author's calculations.

Table 8.2 Developing regions and countries: annual rates of poverty reduction

Country/region	Initial year	Final year	Initial value	Final value	Difference	Difference per year
	(1)	(2)	(3)	(4)	[(3)–(4)]	[(3)–(4)]/ [(2)–(1)]
China ^a	1981	2008	88.32	14.65	73.67	2.73
Europe and Central Asia ^a	1981	2008	1.91	0.47	1.44	0.05
Latin America/the Caribbean ^a	1981	2008	11.89	6.47	5.42	0.20
Middle East/North Africa ^a	1981	2008	9.56	2.7	6.86	0.25
South Asia ^a	1981	2008	61.14	35.97	25.17	0.93
Sub-Saharan Africa ^a	1981	2008	51.45	47.51	3.94	0.15
Southeast Asia ^a	1981	2008	45.04	12.81	32.23	1.19
Cambodia ^b	2003	2012	50.2	17.7	32.5	3.61
Indonesia ^b	1976	2016	62.6	10.9	51.7	1.29
Laos ^b	1992	2012	46.0	23.2	22.8	1.14
Malaysia ^b	1970	2014	52.4	0.6	51.8	1.18
Myanmar ^b	2005	2010	32.1	25.6	6.5	1.30
the Philippines ^b	1961	2015	50.8	21.3	29.5	0.55
Thailand ^b	1969	2016	63.1	3.5	59.6	1.27
Vietnam ^b	1998	2014	54.5	13.5	41.0	2.56

Notes

a Source is World Bank, Povcal database. Poverty line: US\$1.25 at 2005 PPP, except for China, where it is US\$1.90 at 2011 PPP.

b Individual country national data sources using national poverty lines as in Table 8.1.

Initial values and final values of poverty incidence are expressed in percentage of population.

Available data on the headcount measure of poverty incidence in the eight Southeast Asian countries listed above are summarized in the lower half of Table 8.2 and in Figure 8.3. Poverty reduction was most rapid in Cambodia, followed by Vietnam, Myanmar,⁶ Indonesia, Thailand, Malaysia, Laos, and the Philippines. There is again considerable variation. Cambodia's annual rate of poverty reduction was 6.6 times that of the Philippines and Vietnam's annual rate was 4.7 times the Philippines'. Why? One reason is presumably that in these two countries national income per person grew more rapidly than in the Philippines (3.7 and 2.9 times, respectively). The correlation between annual rates of poverty reduction and annual rates of GDP growth per person is shown in Figure 8.4. Again, correlation does not necessarily mean causation, though it could mean that, even though other factors must surely have been important as well.

Figures 8.5–8.12 summarize the available data on national poverty, rural poverty, and urban poverty for Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Thailand, and Vietnam. For most countries of Southeast Asia, the absolute magnitudes of the reductions in poverty incidence, at all three levels, are stunning. The relationship between these three measures is as follows. We shall write N , N^R and N^U for the total, rural and urban populations, respectively, where $N = N^R + N^U$. Let $\alpha^R = N^R/N$ and $\alpha^U = N^U/N$ for the rural and urban shares of the total population, respectively, where $\alpha^R + \alpha^U = 1$. The total number

Figure 8.2 Annual rates of poverty reduction and economic growth (percentage points per year)

Source: Author's calculations.

Note

'Poverty Reduction' means the annual rate of poverty reduction based on the World Bank poverty line of US\$1.25 per day at 2005 purchasing power parity from 1981 to 2008 (US\$1.90 at 2011 PPP in the case of China). 'GDP growth' means the average annual rate of growth of real GDP per capita over the same period as above.

Figure 8.3 Southeast Asia: annual rates of poverty reduction (percentage points per year)

Source: Author's calculations.

Figure 8.4 Correlation between annual rates of poverty reduction and annual rates of GDP growth per person

Note

NPL Poverty reduction means the average annual rate of poverty reduction based on national poverty lines over the periods indicated in Table 8.2 and using the data summarized there. GDP growth means the average annual rate of growth of real GDP per capita over the same periods as above.

of poor people 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

$$P = N_p / N = (N_p^R + N_p^U) / N = \alpha^R P^R + \alpha^U P^U, \quad (8.1)$$

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 Equation (8.1) totally, we obtain a key relationship,

$$dP = \alpha^R dP^R + \alpha^U dP^U + (P^R - P^U) d\alpha^R. \quad (8.2)$$

From Equation (8.2), the change in poverty incidence may be decomposed into three parts: (1) the change in rural poverty incidence, weighted by the rural population share; (2) the change in urban poverty incidence weighted by the urban population share; and (3) 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

Figure 8.5 Cambodia: poverty incidence, 1994–2015

Source: Author's calculations.

Note

Dashed lines indicate interpolated data or data from sources other than national statistical agency.

Figure 8.6 Indonesia: poverty incidence, 1976–2017

Source: Author's calculations.

Figure 8.7 Laos: poverty incidence, 1992–2012

Source: Author's calculations.

Figure 8.8 Malaysia: poverty incidence, 1970–2014

Source: Author's calculations.

Note

Dashed lines indicate interpolated data or data from sources other than national statistical agency.

Figure 8.9 Myanmar: poverty incidence, 2005–2010

Source: Author's calculations.

Figure 8.10 The Philippines: poverty incidence, 1961–2015

Source: Author's calculations.

Note

Dashed lines indicate interpolated data or data from sources other than national statistical agency.

Thailand

Figure 8.11 Thailand: poverty incidence, 1969–2014

Source: Author's calculations.

Vietnam

Figure 8.12 Vietnam: poverty incidence, 1998–2014

Source: Author's calculations.

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 ($d\alpha^R < 0$). Furthermore, the incidence of poverty in rural areas typically exceeds that in urban areas ($(P^R - P^U) > 0$). Thus, the expected sign of $(P^R - P^U)d\alpha^R$ is negative. How important the Kuznets effect is as a determinant of overall poverty reduction is, of course, an empirical matter.

Table 8.3 summarizes these data by taking the mean rate of change of total poverty incidence and decomposing it as in Equation (8.2). For example, the mean annual change in the aggregate level of poverty incidence for Indonesia was -1.28 percentage points per year (i.e., an annual reduction, on average, in the nationwide headcount incidence of poverty from numbers like 20 percent to numbers like 18.72 percent of the total population). Equation (8.2) is an identity and must apply at all points in the data set. It must therefore apply at the means of the data. Equation (8.2) 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. In understanding Table 8.3, it is important that the rows "Urban" and "Rural" do not mean the average rate of poverty reduction in urban and rural areas, but these rates multiplied by their population shares, as indicated on the right-hand side of Equation (8.2).

The second half of Table 8.3 normalizes the decomposition by dividing all values by the mean change in aggregate poverty (-1.28 for Indonesia, for example) and multiplying by 100. In Indonesia, for example, reductions in rural poverty accounted for 71 percent of the overall reduction in poverty, reduced urban poverty for 24 percent and rural to urban migration for about 5 percent of the overall reduction in poverty at the national level. In all eight countries, reductions in rural poverty account for more than half of the total reduction in poverty, and in all except Malaysia and Cambodia, reductions in urban poverty were more important than migration effects.

The above calculations are, of course, merely descriptions of the data. We now turn to the question of what caused these observed changes in poverty incidence. It is hypothesized in this chapter that poverty reduction is driven by economic growth, possibly influenced by its sectoral composition, and by the relative price of food, meaning the price of food as a component of the consumer price index relative to the overall consumer price index. The average data on these variables and the correlations between them at an individual country level are summarized in Table 8.4. We now turn to a regression model intended to sort out the causal relationships among these variables.

Table 8.3 Data decomposition: mean annual changes in poverty incidence

	<i>Actual</i>							
	<i>Indonesia</i>	<i>Laos</i>	<i>Malaysia</i>	<i>Myanmar</i>	<i>the Philippines</i>	<i>Cambodia</i>	<i>Thailand</i>	<i>Vietnam</i>
National ^a	-1.281	-1.227	-0.932	-1.300	-0.695	-1.760	-1.301	-2.174
Urban ^b	-0.313	-0.129	-0.150	-0.305	-0.177	0.131	-0.191	-0.188
Rural ^c	-0.911	-1.051	-0.524	-0.973	-0.401	-1.357	-1.107	-1.887
Migration ^d	-0.057	-0.046	-0.259	-0.022	-0.117	-0.534	-0.003	-0.099
<i>Normalized (national = 100)</i>								
National ^a	100	100	100	100	100	100	100	100
Urban ^b	24.43	10.54	16.05	23.44	25.41	-7.47	14.67	8.65
Rural ^c	71.10	85.70	56.22	74.86	57.72	77.11	85.11	86.80
Migration ^d	4.46	3.77	27.73	1.69	16.87	30.36	0.22	4.55

Sources: Author's calculations, using data sources as in Table 8.1. The decomposition of the change in aggregate poverty incidence follows Equation (8.2).

Notes

National change = Urban change + Rural change + Migration. See Equation (8.2).

a Mean annual value of dP , the year-on-year (y-o-y) change in national poverty incidence.

b Mean annual value of $u^c dp^u$, the year-on-year population share-weighted change in urban poverty incidence.

c Mean annual value of $r^c dp^r$, the y-o-y population share-weighted change in rural poverty incidence.

d Mean annual value of $(p^k - p^c) da^k$, the y-o-y migration-induced change in poverty incidence.

Table 8.4 Average rates of poverty reduction, economic growth, and variable correlations

	Indonesia	Laos	Malaysia	the Philippines	Thailand	Vietnam
<i>Poverty reduction per year</i>						
Total	-1.28	-1.23	-0.93	-0.76	-1.30	-2.17
Urban	-1.12	-0.61	-0.37	-0.45	-0.65	-0.78
Rural	-1.25	-1.34	-0.91	-0.76	-1.55	-2.46
<i>Growth rate per capita per year</i>						
GDP	4.53	4.35	4.57	0.74	3.51	5.68
Agriculture	0.38	2.27	0.04	0.13	0.29	0.59
Industry	1.79	1.36	2.41	-0.03	1.81	2.88
Services	2.49	1.23	2.46	0.72	1.54	2.26
Annual food CPI/general CPI ratio	0.92	1.03	0.96	1.04	1.00	1.09
<i>Correlation between total poverty reduction per year and independent variables</i>						
GDP	-0.56	0.12	-0.53	-0.26	-0.52	0.04
Agriculture	-0.71	-0.86	-0.12	-0.18	-0.51	-0.34
Industry	-0.34	0.96	-0.51	-0.24	-0.37	-0.23
Services	-0.25	0.54	-0.23	-0.17	-0.58	0.44
Food CPI/general CPI ratio	0.45	-0.87	0.67	-0.52	0.37	0.63
<i>Correlation between rural poverty reduction per year and independent variables</i>						
GDP	-0.52	0.12	-0.56	-0.32	-0.51	-0.10
Agriculture	-0.69	-0.86	0.20	-0.23	-0.49	-0.33
Industry	-0.29	0.96	-0.47	-0.27	-0.36	-0.34
Services	-0.24	0.54	-0.43	-0.25	-0.57	0.30
Food CPI/general CPI ratio	0.39	-0.87	0.66	-0.42	0.35	0.60

continued

Table 8.4 Continued

	Indonesia	Laos	Malaysia	the Philippines	Thailand	Vietnam
<i>Correlation between urban poverty reduction per year and independent variables</i>						
GDP	-0.60	0.38	-0.32	-0.61	-0.19	0.80
Agriculture	-0.41	-0.70	0.23	-0.25	0.25	0.10
Industry	-0.13	1.00	-0.26	-0.58	-0.21	0.59
Services	-0.50	0.74	-0.28	-0.49	-0.25	0.80
Food CPI/general CPI ratio	0.51	-0.71	0.58	-0.31	0.16	0.19
<i>Years covered</i>	1976–2011	1992–2007	1970–2009	1961–2009	1969–2009	1998–2011
<i>Observations</i>	18	3	11	10	18	7

Source: Author's calculations using data sources as in Table 8.1.

Notes

All growth rates are in real, per capita terms. "Agriculture" means the per capita growth rate of real value-added in agriculture, and similarly for "Industry" and "Services." Consequently, the sectoral GDP share-weighted sum of the per capita growth rates of the three sectors is equal to the per capita growth rate of GDP. For each country, the number of observations appearing in the final row of the table is the number of observations of poverty reduction, equal to the number of observations of poverty incidence minus one.

The growth–poverty nexus

Conceptual background

Poverty incidence and its change over time depend on many factors, of which economic variables are at most only part of the story. Among the economic variables, many issues are relevant aside from simply the overall growth rate of output. Changes in commodity prices play a role, along with tax and public expenditure policies. But policy discussion in almost all countries is heavily concerned with economic growth and its sectoral composition. Policy-makers rightly wish to know the extent to which this growth is inclusive. In particular, they wish to know whether concern with growth is consistent with the goal of reducing poverty. Does economic growth cause poverty reduction, and if so, to what extent? Does the sectoral composition of that growth matter for its poverty-reducing effects? Do relative prices, especially the relative price of food, matter for poverty reduction?

Three methodological approaches can be found in the literature to address these questions empirically. Each is problematic, but in different ways. General equilibrium modeling (GEM) has the advantage of permitting controlled experiments with the models, changing only one exogenous variable at a time and finding the effects on all endogenous variables of interest. This approach permits detailed analysis of the economic mechanisms through which output growth operates on poverty incidence (Fane and Warr 2003). Since the distinction between the exogenous and endogenous variables within the models is unambiguous, by construction, there are clear *causal* relationships between changes in the exogenous variables and their effects on the endogenous variables. These models are nevertheless subject to the objection that these causal relationships are predetermined in that they are built into the structure of the models themselves. For example, the qualitative result that economic growth reduces poverty is a direct consequence of the structural assumptions of the models. Moreover, the quantitative results are a function of the chosen values of the large numbers of behavioral parameters necessarily used within the models. Although the key parameters can be varied to show their implications for the relationships of interest, the fact remains that the true values of these parameters are largely unknown.

A second approach relies solely on household survey data to construct the distribution of real expenditures across households and to analyze the relationships among variables calculated from this distribution. For example, this approach computes the relationship between changes in the mean of the expenditure data and changes in the level of poverty incidence, calculated from the same distribution. Changes in the mean of real household expenditures is taken to be a measure of (or proxy for) economic growth. These analyses have the advantage of working with internally consistent data and can provide a description of relationships among various features of the expenditure distribution. The problem is that these relationships lack a *causal* basis. It is no more valid to say that changes

in the mean of the distribution of household expenditures cause changes in poverty incidence than to say the reverse. But policy application requires knowledge of causal relationships. Statistical descriptions of relationships among variables constructed from the distribution of household expenditures do not provide that. In any case, the rate of change of mean household expenditures is not the same thing as economic growth, meaning the expansion of economic output. The link between output growth and poverty incidence is the causal relationship we wish to study. Beyond this, we wish to ask how the sectoral composition of economic growth might influence the rate at which poverty incidence declines and this is clearly impossible with this second approach.

A third approach assembles statistical data on changes in poverty incidence and data on output growth and its composition. It then regresses the former on the latter. The fact that separate data sets are involved—the national accounts for economic growth and household survey data for poverty incidence—has both advantages and disadvantages. Suppose it is found that economic growth leads to reductions in poverty incidence? It could not be said that this finding was a mere statistical artefact arising from the use of the same flawed data set to measure both variables, because quite different data sets are used to measure the two sets of variables. But this also creates problems. The frequency of the data may not be the same. National accounts data are available at least annually, but this is seldom true of poverty incidence data, which are usually available only at intervals of two to three years at least. The advantage of this approach is that it focuses directly on a causal relationship of strong policy interest (Ravallion and Datt 1996). Despite its limitations, this is the approach used in the present study.

The economic development literature has emphasized the sectoral composition of growth in relation to its implications for poverty reduction, but this emphasis has been based primarily on *a priori* theorizing, rather than evidence. The obvious argument is that in the majority of poor countries, most of the poor live in rural areas and are employed in agriculture. From this it has seemed probable that growing agriculture is more important for poverty reduction than growing industry or services. But this conclusion does not necessarily follow. Sectoral growth rates may not be independent. Expansion of capacity in one sector—say, food processing—may stimulate output growth elsewhere—say, fruit production. More importantly, people are potentially mobile; given sufficient time, even poor people can presumably move to whichever sector is generating the growth. Rural poverty may therefore be reduced by urban-based growth, drawing the poor away from rural areas (Chenery and Syrquin 1975; Fields 1980). When sectoral interdependence and intersectoral factor mobility are considered, it is not obvious whether the sectoral composition of growth is important for poverty reduction or not.

Even if labor were fully and instantaneously mobile, poverty incidence could still be affected by the sectoral composition of growth. To a first order of approximation, the level of absolute poverty presumably depends on the demand for the factors of production owned by the poor, especially unskilled labor and, to a lesser extent, agricultural land. Growth in different sectors has differential effects

on the demands for these factors, depending on these sectors' factor intensities, and may have different effects on poverty, inequality, or both. Finally, the distinction rural/urban is not synonymous with the distinction agriculture/non-agriculture. Much agricultural production may occur in full-time or part-time farming on the fringes of urban areas and much industrial and services activity may occur in rural areas.

Only careful quantitative analysis can resolve questions of this kind, but the limited availability of data that can support statistical analysis has been an impediment to the systematic study of poverty incidence and its determinants. Some recent studies have attempted to explore the relationships involved by analyzing cross-sectional data sets across 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. The time-series approach is generally preferable, in that it makes possible a direct study of the determinants of changes in poverty at an aggregate level.

Unfortunately, in most developing countries, the consumer expenditure surveys on which studies of poverty incidence must be based are conducted only intermittently. Data are thus available at most only with intervals of several years between observations. This is true of all the Southeast Asian countries. The data are most extensive for Indonesia and Thailand, but even when all national time-series observations on poverty incidence are assembled for them, the number of observations of poverty incidence for each country is only 19, giving 18 observations of changes in poverty incidence. For Malaysia, the corresponding numbers are only 12 and 11, for the Philippines 11 and 10 and fewer for other countries. These numbers are insufficient to sustain formal statistical analysis for any one of these countries, but when all Southeast Asian countries are pooled, the total number of observations of changes in poverty incidence is 67, adequate for the purposes of the present study.

In each country, the value of the national poverty line is held constant over time, but since the meaning of the poverty lines is different in each of the countries, we should not assume that the same quantitative relationship between poverty incidence and aggregate growth will necessarily exist in all Southeast Asian countries. In the present study, intercept dummy variables were used for five of the remaining six countries (i.e., the six countries listed in Table 8.4 minus Indonesia). It must be recognized that the use of dummy variables is an imperfect way of capturing the possible effects of different national poverty lines. The strong assumption being made is that the underlying relationship between changes in poverty incidence (the dependent variable) and the rate of growth (the dependent variable) is linear and with the same slope in all countries, differing only in the intercept terms.

Each interval between the data points for poverty incidence is used to construct the values of the dependent variables described below, with the calculated value divided by the number of years corresponding to that time interval. This gives an annual rate of change for the variable concerned. These annualized rates of change then become the variables used in the regression analysis described below.

Poverty and aggregate growth

We now turn to the way poverty incidence is affected by economic growth. For simplicity, we hypothesize initially the simplest possible relationship between these variables, where the total number of households in poverty, N_p , depends on the aggregate level of real income per unit of population, Y , and the relative price of food, R^F . Thus, poverty incidence is given by

$$P = N_p / N = \varphi(Y, R^F). \quad (8.3)$$

Totally differentiating this equation,

$$dP = \varphi_Y Y y + \varphi_R dR^F \quad (8.4)$$

where dP represents the change in poverty incidence, dR^F represents the change in the real price of food and lower case Roman letters represent the proportional changes of variables represented in levels by upper case Roman letters. Thus $y = dY/Y$ is the growth rates of aggregate real income per person. In this case, we estimate relationships of the kind

$$dP = a + by + cdR^F \quad (8.5)$$

and test whether the coefficients b and c are significantly different from zero.

Poverty and sectoral growth

Whether the sectoral composition of economic growth is significant for poverty reduction can be investigated as follows. The level of real GDP per person is given by

$$Y = Y_a + Y_i + Y_s \quad (8.6)$$

where Y_a , Y_i , and Y_s denote value-added (contribution to GDP) per person in the total population, measured at constant prices, in agriculture, industry, and services, respectively. The overall real rate of growth per person can be decomposed into its sectoral components from

$$y = H_a y_a + H_i y_i + H_s y_s, \quad (8.7)$$

where $H_k = Y_k / Y$, $k = (a, i, s)$, denotes the share of sector k in GDP. By estimating

$$dP = a + b_a H_a y_a + b_i H_i y_i + b_s H_s y_s + c dR^F \quad (8.8)$$

and testing whether $b_a = b_i = b_s$, we may test directly whether the sectoral composition of growth affects the rate of poverty reduction. By testing whether $c = 0$,

we can test whether the price of food plays a significant role in determining changes in poverty incidence and if so, in what direction.

Estimation results

Poverty and aggregate growth

Equation (8.5) was estimated as described above and the results are summarized in Table 8.5. Because the dependent variable is the change in poverty incidence (a negative value indicating a reduction in poverty), a negative estimated coefficient means that an increase in the variable is associated with a reduction in poverty. A positive sign indicates the opposite. In regression (1), dummy variables were estimated for all countries except Indonesia (the base country). All country dummy variables were insignificant except Vietnam. The coefficient on aggregate GDP growth was negative as expected and highly significant

Table 8.5 National poverty incidence and aggregate growth

	<i>Regression (1)</i>	<i>Regression (2)</i>	<i>Regression (3)</i>
<i>Dependent variable: Change in national poverty incidence</i>			
<i>Independent variables</i>			
GDP growth p.c.	-0.182*** (0.066)	-0.219*** (0.060)	-0.229*** (0.057)
Real price of food	4.541* (2.694)		
Laos	-0.666 (0.962)	-0.243 (0.911)	
Malaysia	-0.155 (0.592)	-0.024 (0.588)	
the Philippines	-0.702 (0.681)	-0.413 (0.649)	
Thailand	-0.814 (0.549)	-0.543 (0.512)	
Vietnam	-2.284** (0.893)	-1.638** (0.749)	-1.673** (0.721)
Constant	-3.291 (2.634)	0.094 (0.452)	-0.242 (0.292)
<i>N</i>	58	58	58
<i>R</i> ²	0.324	0.301	0.223
<i>adj. R</i> ²	0.229	0.219	0.209
<i>F</i> -statistic	3.42	3.66	16.05
<i>p</i> -value	0.0046	0.0043	0.0002

Source: Author's calculations using data sources as in Table 8.1.

Notes

'p.c.' means per capita. Standard errors in parentheses.

*adj. R*² means the *R*² coefficient adjusted for degrees of freedom.

* denotes significantly different from zero at 90 percent confidence level.

** denotes significantly different from zero at 95 percent confidence level.

*** denotes significantly different from zero at 99 percent confidence level.

(99 percent confidence level). Higher rates of GDP growth per capita induce larger reductions in poverty. The coefficient on food price was positive and significant at the 90 percent level, indicating that a higher relative price of food reduces the rate at which poverty declines. To test whether endogeneity of the food price variable is important, Equation (8.5) was re-estimated in regression (2) without this variable. If GDP growth was affecting poverty via the price of food, dropping this variable (not controlling for the price of food) should increase the estimated coefficient on GDP growth. The coefficient does increase, but not greatly.

In regression (3), the insignificant variables (except the constant term) were all dropped, in line with the general-to-specific approach of Hendry (1995), and Equation (8.5) was re-estimated. The estimated coefficient on aggregate growth remains significant. The estimated relationship is highly significant and the Ramsey RESET test suggests that it has no omitted variables, although with low degrees of freedom, this test is relatively weak. The Breusch–Pagan/Cook Weisberg test for heteroskedasticity indicates the absence of heteroskedasticity. The results indicate that more rapid growth of real GDP per capita and reductions in the real price of food are both significant sources of poverty reduction.

Poverty and sectoral growth

Is the sectoral composition of the growth important? Equation (8.8) was now estimated to capture the behavior of the dependent variable when the sectoral composition of growth appears on the right-hand side of Equation (8.8). The results are shown in Table 8.6 and follow the pattern of presentation used in Table 8.5. The findings support the notion that growth of agriculture and the real price of food are significant determinants of the rate of poverty reduction. Other components of GDP had the expected signs, but were statistically insignificant. All country intercept dummy variables except Vietnam were highly insignificant and were dropped.

An F-test of the hypothesis that the coefficients on share-weighted sectoral growth rates per capita were all equal ($b_a = b_i = b_s$) was rejected at the 5 percent level of significance. In short, the data indicate that the growth of agriculture is more important for poverty reduction than the growth of either industry or services. The data also confirm that the real price of food is an important determinant of poverty reduction: lower real food prices are associated with higher rates of poverty reduction.

A similar exercise was now conducted with changes in rural poverty as the dependent variable (Table 8.7) and changes in urban poverty (Table 8.8). In the case of rural poverty, the results are qualitatively similar to those obtained for national poverty in Table 8.6, but stronger. Agricultural and services growth contribute to poverty reduction, but the effect of industrial growth is statistically insignificant. Higher real prices of food are strongly associated with increases in poverty incidence. In the case of urban poverty (Table 8.7), the attempted explanation was unsuccessful. Only the real price of food was significant, in the same direction as above.

Table 8.6 National poverty incidence and sectoral growth

	Regression (4)	Regression (5)	Regression (6)
<i>Dependent variable: Change in national poverty incidence</i>			
<i>Independent variables</i>			
Agricultural growth p.c.	-1.232** (0.523)	-1.107** (0.526)	-0.739** (0.344)
Industrial growth p.c.	-0.096 (0.124)	-0.147 (0.122)	
Services growth p.c.	-0.206 (0.135)	-0.258* (0.133)	
Real price of food	4.436 (2.735)		6.211*** (2.256)
Laos	0.939 (1.230)	1.200 (1.240)	
Malaysia	-0.776 (0.659)	-0.515 (0.649)	
the Philippines	-1.002 (0.685)	-0.617 (0.653)	
Thailand	-1.019* (0.560)	-0.668 (0.525)	
Vietnam	-2.205** (0.898)	-1.447* (0.780)	-2.420*** (0.753)
Constant	-3.889 (2.664)	0.364 (0.481)	-6.656*** (2.175)
<i>N</i>	58	58	58
<i>R</i> ²	0.377	0.343	0.261
<i>adj. R</i> ²	0.260	0.235	0.206
<i>F</i> -statistic	3.22	3.19	4.69
<i>p</i> -value	0.0049	0.0054	0.0026

Source: Author's calculations using data sources as in Table 8.1.

Notes

'p.c.' means per capita. Standard errors in parentheses.

*adj. R*² means the *R*² coefficient adjusted for degrees of freedom.

* denotes significantly different from zero at 90 percent confidence level.

** denotes significantly different from zero at 95 percent confidence level.

*** denotes significantly different from zero at 99 percent confidence level.

Because rural poverty dominates total poverty, the findings on rural poverty largely explain the total poverty results. Growth of agriculture, and to a lesser extent growth of services, are associated with poverty reduction, along with lower levels of the real price of food. Agriculture and services are both labor-intensive sectors. Growth of output in these sectors increases the demand for unskilled labor, the principal income source for most poor people. An increase in agricultural output simultaneously raises the return to land and a surprisingly large number of poor rural people also own land. Finally, part of the effect of an increase in agricultural output operates through a reduction in food prices, also strongly associated with poverty reduction.

Table 8.7 Rural poverty incidence and sectoral growth

	<i>Regression (7)</i>	<i>Regression (8)</i>	<i>Regression (9)</i>
<i>Dependent variable: Change in rural poverty incidence</i>			
<i>Independent variables:</i>			
Agricultural growth p.c.	-1.716** (0.672)	-1.585** (0.670)	-0.982** (0.446)
Industrial growth p.c.	-0.105 (0.160)	-0.159 (0.156)	
Services growth p.c.	-0.291* (0.173)	-0.346** (0.169)	-0.362** (0.158)
Real price of food	4.646 (3.513)		7.105** (2.922)
Laos	1.458 (1.581)	1.732 (1.579)	
Malaysia	-1.139 (0.846)	-0.865 (0.826)	
the Philippines	-1.255 (0.880)	-0.852 (0.831)	
Thailand	-1.489** (0.720)	-1.121 (0.669)	-0.987* (0.566)
Vietnam	-2.614** (1.154)	-1.821* (0.993)	-2.920*** (0.975)
Constant	-3.649 (3.422)	0.805 (0.612)	-7.443** (2.817)
<i>N</i>	58	58	58
<i>R</i> ²	0.374	0.351	0.246
<i>adj. R</i> ²	0.257	0.246	0.189
<i>F</i> -statistic	3.19	3.32	4.32
<i>p</i> -value	0.0042	0.0041	0.0042

Source: Author's calculations using data sources as in Table 8.1.

Notes

'p.c.' means per capita. Standard errors in parentheses.

*adj. R*² means the *R*² coefficient adjusted for degrees of freedom.

* denotes significantly different from zero at 90 percent confidence level.

** denotes significantly different from zero at 95 percent confidence level.

*** denotes significantly different from zero at 99 percent confidence level.

Conclusion

The nations of Southeast Asia have achieved significant reductions in poverty incidence in recent decades. The achievement of poverty reduction was overwhelmingly attributable to the high rate of growth of GDP per person, but changes in the sectoral composition of the growth also had an impact. The results confirm that the poverty reduction outcome was strongly related to growth of agriculture and services, but *not* to the growth of industry. The results also indicate that reductions in the real price of food contribute significantly to poverty reduction. Increases in the real price of food do the opposite.

Table 8.8 Urban poverty incidence and sectoral growth

	Regression (10)	Regression (11)	Regression (12)
<i>Dependent variable: Change in urban poverty incidence</i>			
<i>Independent variables:</i>			
Agricultural growth p.c.	0.642 (0.461)	0.683 (0.453)	
Industrial growth p.c.	-0.082 (0.110)	-0.099 (0.105)	
Services growth p.c.	-0.143 (0.118)	-0.160 (0.114)	
Real price of food	1.460 (2.407)		3.691* (1.928)
Laos	-1.078 (1.083)	-0.991 (1.067)	
Malaysia	0.807 (0.580)	0.894 (0.558)	
the Philippines	0.133 (0.603)	0.260 (0.562)	
Thailand	0.246 (0.493)	0.361 (0.452)	
Vietnam	-0.321 (0.791)	-0.071 (0.671)	
Constant	-1.881 (2.344)	-0.482 (0.414)	-4.164** (1.859)
<i>N</i>	58	58	58
<i>R</i> ²	0.173	0.167	0.076
<i>Adj. R</i> ²	0.018	0.031	0.006
<i>F</i> -statistic	1.12	1.23	1.09
<i>p</i> -value	0.368	0.303	0.372

Source: Author's calculations using data sources as in Table 8.1.

Notes

'p.c.' means per capita. Standard errors in parentheses.

*adj. R*² means the *R*² coefficient adjusted for degrees of freedom.

* denotes significantly different from zero at 90 percent confidence level.

** denotes significantly different from zero at 95 percent confidence level.

*** denotes significantly different from zero at 99 percent confidence level.

The importance of agricultural development for poverty reduction is widely recognized but the contribution of the services sector is larger and its role has been much less widely appreciated. Perhaps surprisingly, the results indicate that the growth of industry has not contributed to poverty reduction in Southeast Asia. Similar results have been obtained using data for India (Ravallion and Datt 1996), except that in the case of India, the negative effects of industrial growth were stronger. On the other hand, earlier results for Taiwan (Warr and Wang 1999) showed that the growth of industry was strongly associated with poverty reduction.

These differences may be due to the role of industry policy. Taiwan's more outward-oriented trade policy apparently induced a form of industrial

development that was labor-intensive, small-scale, and with a large rural component. This pattern of industrialization was conducive to a massive reduction of poverty incidence, occurring in both rural and urban areas. In India, heavy protection of industry led to a capital-intensive, large-scale, and urban-based pattern of industrial development, which did not serve the interests of the poorest groups. The countries of Southeast Asia studied here are intermediate between these two extreme cases, in so far as industry policy is concerned, and the estimated results on the poverty impact of industrial growth are intermediate as well.

The principal income source of poor people is their own labor, largely unskilled. Agricultural land is also an important asset for some poor people. Development which increases the demand for these two resources raises the incomes of poor people and thereby reduces poverty incidence. This presumably explains the differences in the poverty-reducing power of growth in different sectors of the economy, as analyzed in this chapter. In the Southeast Asian countries studied here, considered as a group, growth of the agricultural and services sectors have each reduced poverty considerably, but growth of the industrial sector has not. The results support the hypothesis that an import-substitution based industry policy promotes a pattern of industrialization which does not advance the welfare of poor people because it contributes insufficiently to expanding the demand for their principal asset—unskilled labor.

Notes

- 1 They were less affected than the first four countries because pre-crisis levels of short-term capital inflows had been much smaller and they were therefore less vulnerable to a sudden capital outflow (Warr 2003).
- 2 This problem is not confined to the countries of Southeast Asia. Elbers *et al.* (2005) point out that the precise definition of what is included and excluded is almost never the same across any two countries. Because the importance of these omitted and included items may vary with the level of household expenditures, the differences can affect measured levels of inequality, making comparisons between countries tenuous and may even affect comparisons across time for individual countries.
- 3 The 12 excluded durable items are beds, dining and lounge suites, stoves with ovens, refrigerators, axes, sewing machines, washing machines, cars and vans, motorcycles, TVs, VCRs, and computers.
- 4 For the lists of included high-value items and excluded high-value items, see note 5 in Table 8.1.
- 5 In Myanmar, the 2009–2010 Integrated Household Living Conditions Assessment, conducted by the Myanmar government jointly with the United Nations Development Program (UNDP) and the Swedish International Development Cooperation Agency (SIDA), calculated durable goods user cost but ultimately excluded it from non-food consumption expenditures (IHLCA 2011). This resulted in very low estimates of the Gini coefficient 0.19 and poverty incidence of 28 percent. Subsequent calculations reported by the World Bank (2014) used the same survey data but included expenditures on both health and durable goods, along with other statistical changes, leading to substantially higher estimates of both measures: Gini coefficient 0.28; poverty incidence 37.5 percent.
- 6 It should be noted that for Myanmar only two data points (2005 and 2010) are available.

Appendix: data sources

Cambodia

Cambodia National Institute of Statistics. (2013). “Cambodia – Cambodia Socio-Economic Survey 2012.” Available at: <http://nada.nis.gov.kh/index.php/catalog/25>
Ministry of Planning, Cambodia. (2012). “Poverty Estimate in 2012 in Cambodia.” Available at: www.mop.gov.kh/LinkClick.aspx?fileticket=McAtA9QovCApercent3D&tabid=148&mid=696

Indonesia

Priebe, J. (2014). “Official Poverty Measurement in Indonesia Since 1984: A Methodological Review.” *Bulletin of Indonesian Economic Studies*, 50(2). Available at: www.tandfonline.com/doi/pdf/10.1080/00074918.2014.938406
Statistics Indonesia. (2014a). “Computation and Analysis of Macro Poverty of Indonesia 2014.” Available at: www.bps.go.id/index.php/publikasi/919
Statistics Indonesia. (2014b). “Welfare Indicators 2014.” Available at: www.bps.go.id/index.php/publikasi/883

Lao PDR

Soukhathammavong, N. *et al.* (2012). “Policies and Practices on Poverty Eradication in Lao PDR.” Paper presented at the workshop on Effective Policies and Experiences for Poverty Reduction in Asia, October 23–25, 2012. Available at: www.adbi.org/files/2013.05.08.cpp.sess3.1.poverty.eradication.lao.pdr.pdf

Malaysia

Department of Statistics, Malaysia. (2012). “Household Income and Basic Amenities Survey Report 2012.” Available at: <http://catalog.ihsn.org/index.php/catalog/5431>
Department of Statistics, Malaysia. (2015). “Household Income and Expenditure.” Available at: www.statistics.gov.my/index.php?r=column/cone&menu_id=cUp6NlNndGlaQkZhK0gwYUMyWFRxdz09
Malaysia Economic Planning Unit. (2013). “Household Income and Poverty.” Available at: www.epu.gov.my/en/household-income-poverty

Myanmar

Myanmar’s Central Statistics Office conducted Household Income and Expenditure Surveys in 1989, 1997, 2001 and 2006 (see www.myanmar.cm/myanmardata2009/22.htm), but the data were published only in aggregate form and estimates of inequality measures were not reported. Two Integrated Household Living Conditions Assessment surveys (IHLCA) were conducted in 2004–2005 and 2009–2010, with assistance from the UNDP, UNICEF, and SIDA. This has been the primary data source for poverty and inequality estimates subsequently published by UNDP and the World Bank
Integrated Household Living Conditions Assessment in Myanmar. (2009–2010a). “Technical Report.” Available at: [www.mm.undp.org/content/dam/myanmar/docs/Publications/PovRedu/MMR_FA1_IA2_Technical percent20Report-Eng.pdf](http://www.mm.undp.org/content/dam/myanmar/docs/Publications/PovRedu/MMR_FA1_IA2_Technical%20Report-Eng.pdf)

- Integrated Household Living Conditions Assessment in Myanmar. (2009–2010b) “Poverty Profile.” Available at: www.mm.undp.org/content/dam/myanmar/docs/FA1MMRPovertyProfile_Eng.pdf
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The Philippines

- Philippine Statistical Agency. (2003). “Notes on the Official Poverty Statistics in the Philippines.” Available at: www.nscb.gov.ph/technotes/poverty/concept.asp
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Thailand

- National Statistical Office. (2013). Available at: http://web.nso.go.th/en/survey/house_seco/data/Whole percent20Kingdom_13_FullReport.pdf
- Statistical Yearbook Thailand. (2013). Available at: http://web.nso.go.th/en/pub/e_book/YEARBOOK_2013/

Vietnam

- General Statistics Office (GSO). (2012). “Poverty and Migration Profile 2012.” Available at: www.gso.gov.vn/default_en.aspx?tabid=483&idmid=4&ItemID=13889
- Kozel, V. (2014). “Updating Vietnam’s Poverty Monitoring System.” In *Well Begun But Not Yet Done: Progress and Emerging Challenges for Poverty Reduction in Vietnam*. Washington, DC: World Bank Group. Available at: <http://documents.worldbank.org/curated/en/2014/09/20204926/well-begun-not-yet-done-progress-emerging-challenges-poverty-reduction-vietnam-well-begun-not-yet-done-progress-emerging-challenges-poverty-reduction-vietnam>
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9 Economic development and poverty reduction in Southeast Asia¹

Yap Kioe Sheng

Introduction

Since the 2016 US elections the merits and demerits of global free trade have been hotly debated, as Trump voters claim that it has robbed them of their manufacturing jobs. Although technological displacement appears to play a more significant role, blaming foreign countries has more populist appeal. Much of the blame targets economic policy-makers who argued that free trade is a win-win deal: competition brings innovation and economic growth. Net gain does not mean that there are no losers; old jobs are lost and new jobs are created, but many of those who lose their job do not qualify for any of the new jobs. The problem is not global free trade as such, but the way it is managed.² Politicians who support free trade tend to oppose measures that assist those directly affected by globalization, because they consider such measures disincentives for the jobless to find work.

Reflecting on the anti-globalization discourse, Quah and Mahbubani (2013) commented that globalization has benefitted the emerging economies of Southeast Asia (Table 9.1) and has lifted millions of people out of poverty, but they recognize that it dislocates workers and industries and causes income

Table 9.1 Annualized growth of GDP and GDP per capita, 1990–2007

<i>Country</i>	<i>GDP growth</i>	<i>GDP per capita growth</i>
Brunei D.	7.83	5.21
Cambodia	11.28	8.70
Indonesia	7.54	6.08
Lao PDR	9.68	7.36
Malaysia	8.63	6.20
Myanmar	7.78	6.55
the Philippines	7.18	4.92
Singapore	9.07	6.62
Thailand	6.41	5.39
Viet Nam	15.15	13.28

Source: Wikipedia: List of countries by GDP growth 1980–2010. en.wikipedia.org/wiki/List_of_countries_by_GDP_growth_1980–2010 [Sep 4, 2017].

disparities.³ They, too, believe that the policy prescription is clear: society, in their case, Singapore, should look after its poorest members, take care of its disadvantaged population, and provide retraining, and create employment opportunities for displaced workers. This is easier to do in Singapore, a small, prosperous city-state without a rural hinterland, than in the other economies of Southeast Asia. While they have, on aggregate, benefitted from global free trade, they also have their winners and losers. Economic growth is concentrated in a few megacities. Large rural populations in less-developed parts of the country continue to live in poverty or have to migrate to those cities to earn a living. The millions who escaped income poverty, pay a high social cost and their escape from poverty is not secured, as sudden shocks can push them (back) into poverty.

Reducing income poverty

Poverty reduction

In Southeast Asia, the benefits of global free trade and of the inclusion of its economies in global supply chains are undeniable: rapid economic growth, massive employment creation, and large-scale income poverty reduction. In the early 1990s, nearly one in two persons in ASEAN lived in extreme poverty (less than \$1.00 per day) and two in three persons lived in moderate poverty (\$1.00–\$2.00 per day). By 2015, about one in eight persons was affected by extreme poverty, and one in three by moderate poverty. In Indonesia and Viet Nam alone, some 100 million people moved out of extreme poverty which was virtually eradicated in Thailand and Viet Nam.⁴ One significant outcome of this growth is the expansion of the middle class. Although there is no consensus on the definition of “middle class” or middle-income population, the trend is clear. Using per capita daily consumption or income, Huynh and Kapsos (2013) estimated the poverty reduction and middle-class expansion for Southeast Asia and the Pacific over the period 1991–2015 (Table 9.2). They distinguished four classes of workers: the extreme working poor (below \$1.25), the moderate working poor (\$1.25–\$2.00), the near-poor workers (\$2.00–\$4.00) and the developing middle class and above

Table 9.2 Economic class in Southeast Asia and the Pacific, 1991–2015 (%)

<i>Economic class</i>	<i>1991</i>	<i>2000</i>	<i>2010</i>	<i>2017_p</i>
Extreme poor	47.0	33.7	13.5	6.9
Moderate poor	24.1	27.5	22.2	15.9
Near poor	16.6	22.9	34.3	33.0
Middle class	12.4	15.9	29.9	44.3
Total	100.1	100.0	99.9	100.1

Source: Huynh and Kapsos, (2013), p. 27.

Notes

Southeast Asia and the Pacific includes ten ASEAN countries, Timor Leste and the developing Pacific Island States; income/consumption at 2005 PPP; p = projected.

(\$4.00 and above). The percentage of extreme and moderate poor among workers declined from 71.1 percent in 1991 to (a projected) 22.8 percent in 2017; the size of the middle-income working population increased from 12.4 percent to (a projected) 44.3 percent.⁵

Middle-class workers tend to have a regular income and employment which allow them to spend beyond what is required for basic necessities. They can make discretionary purchases, invest in health care and education, become more productive, and live a comfortable life. Woetzel *et al.* (2014) called households with an income of \$7,500 per year (at 2005 PPP) the “consuming” class. They estimated that some 81 million households in ASEAN belong to this class and that their number could double to 163 million by 2030.⁶ If protectionism in developed countries increases, consumption by this class might compensate for a decline in export of goods from Southeast Asia to developed countries. A downside of its consumerist spending is the growth of household debt in some countries. The availability of relatively cheap credit has increased borrowing for the purchase of motorcycles, cars, and other consumer goods, but the bulk of the household debt consists of housing mortgage loans.⁷

An urbanizing region

Southeast Asia, like the rest of the world, is urbanizing, mainly due to rural-urban migration, but unlike in some other regions where rural-urban migration is a flight from drought, famine, or war, urbanization in Southeast Asia has run in lockstep with economic growth. In 1965, a very large majority of the region’s population lived in the rural areas and was engaged in farming: the share of the rural population ranged from 70.1 percent in Malaysia to 91.7 percent in Laos.⁸ Today, almost half of the region’s population lives in urban areas and it will be a majority by 2020. Between 2015 and 2020, the total population of Southeast Asia is growing at an average annual rate of 1.02 percent; the urban population is growing at 2.21 percent and the rural population is shrinking at –0.13 percent.⁹ The least urbanized countries (Cambodia, the Lao People’s Democratic Republic, Myanmar, and Viet Nam) experience the most rapid urban population growth (Table 9.3).

The scale of urbanization in Southeast Asia is unprecedented and mega-cities (with a population of over 10 million) are proliferating. Foreign direct investment (FDI), which drives much of the economic growth, favors coastal urban areas along shipping routes, resulting in the concentration of economic growth and urbanization in just one or two cities per country (Bangkok, Ho Chi Minh City, Jakarta, Kuala Lumpur, Manila). These have grown tremendously over the past few decades. In 2015, Southeast Asia officially had two mega-cities: Manila (12.9 million) and Jakarta (10.3 million),¹⁰ but their actual population is much larger. Using “built-up area” rather than administrative division, Demographia estimated the population of Jakarta at 31.8 million, Manila at 24.3 million, Bangkok at 15.6 million, and Ho Chi Minh City at 10.4 million in 2017.¹¹ Each of these cities dominates the rest of the country in demographic, economic, and

Table 9.3 Urbanization of ASEAN countries (%)

<i>Country</i>	<i>Level of urbanization (2015)</i>	<i>Annual rate of change (2015–2020)</i>
Brunei D.	77.2	1.52
Cambodia	20.7	2.73
Indonesia	53.7	2.30
Lao PDR	38.6	4.13
Malaysia	74.7	2.19
Myanmar	34.1	2.29
the Philippines	44.4	1.57
Singapore	100.0	1.50
Thailand	50.4	2.20
Viet Nam	33.6	2.59
Southeast Asia*	47.6	2.21

Source: United Nations Population Division (2015), pp. 206–257.

Note

* Southeast Asia includes Timor Leste.

socio-cultural respect, and being the national capital (with the exception of Ho Chi Minh City), they also dominate politically.

Globalization, economic development and the expanding consuming class are transforming the urban landscape. Land values in the city center are rising and shopping malls, offices, and hotels are replacing residential areas. The middle class moves to the urban periphery where land and house prices are lower and the environment is more pleasant. Real estate developers fill the periphery with housing estates and condominiums for middle-income households, while toll-roads under public-private partnership link the periphery with the city center. The middle class uses private cars to go to work and school and to visit shopping malls which house global retailers selling the latest tastes in food, clothing, and technology. Rising land values lead to the eviction of the urban poor from the city center and the demolition of their informal housing. Companies move manufacturing plants to places with lower land prices, easy access to transport hubs, and lax regulations and enforcement. Technological advances allow the urban economy to expand far beyond the administrative boundaries of the city and create mega-urban regions, consisting of networks of cities, towns, villages, and rural areas. Because of the size and the diversity of their workforce and their consumer market, the quality of their physical and social infrastructure and the strength of their support-services sector, investments and labor continue to converge in these mega-urban regions.

Urbanization of poverty

Rural-urban migration forms a significant component of urbanization. Migration decisions tend to be complex and to be made by the household rather than the individual. The move is often arranged, if not initiated, with the help of relatives

or friends in the destination, and is rarely a clear break with the place of origin. Many migrants leave close relatives behind, remit part of their income to support them, and visit them on a more or less regular basis. The intention is often to return to the place of origin after having saved sufficient money to start a small business or build a house. While the migration decision may be based on extensive information about the economic opportunities in the destination city, most migrants still face an uncertain urban future and not everyone succeeds in the city. An indication that not all migrants succeed is the apparent urbanization of poverty: the share of the poor in urban areas is rising, and in some countries, is rising more rapidly than the population as a whole. In East Asia and the Pacific (which includes Southeast Asia and China), the number of rural poor declined from 734 million to 227 million between 1990 and 2008, while the number of urban poor declined from 137 million to 37 million.¹²

Urban and rural areas (and their respective poverty levels) cannot, however, be considered separately, as they are closely connected. Cities are not full of poor, because cities make people poor, but because cities attract poor people with the prospect of improving their lot in life.¹³ The poor who come to the city are not mistaken; they come because the city offers advantages that are unavailable in the rural areas. Rural development and agricultural productivity gains play their part in rural poverty reduction, but urbanization has proven to be another pathway for rural poverty reduction. Rural-urban migration moves people from low-productivity jobs in agriculture to higher-productivity jobs in industry and services; it reduces pressure on rural labor markets and agricultural land, while urban growth boosts agricultural development by generating demand for higher-value crops.¹⁴ Remittances by migrants to their rural relatives contribute to higher rural incomes and provide capital for equipment that makes farming more productive. The head of a rural household may still claim to be a farmer, but income from urban sources forms a growing part of the rural household income.

Shifting paradigms

Rethinking urbanization

Ideas that rural-urban migration and urbanization contribute to economic growth and poverty reduction have gained prominence only in the last few decades. Earlier, there was a widespread fear of “over-urbanization,” which was thought to occur if rural-urban migrants were pushed rather than pulled into the urban areas due to population pressures in the rural areas, and would overstrain the city and its economy.¹⁵ To prevent over-urbanization, it was felt necessary to control rural-urban migration and to forestall the growth of urban poverty, the informal sector, and slums and squatter settlements. Today, it is argued that a national economy cannot develop without urbanization and that none has grown to high income without vibrant cities.¹⁶ The rush to cities may seem chaotic, but is said to be necessary. The challenge is to allow unbalanced economic growth, but

ensure inclusive development which can be achieved, the World Bank argues,¹⁷ through three policies: (1) make basic services available to everyone, regardless of location; (2) make timely and well-located investments in connective infrastructure to share the benefits of rising economic density; and (3) make spatially targeted interventions least and last, and only in combination with the other two policies.

The changed view on urbanization is articulated in policy statements by Asian leaders. In 2015, Prime-Minister Li Keqiang of China stated that industrialization and urbanization are the twin brothers of modernization, and that urbanization has gained great achievements over the past 30 years: “China is pushing forward the largest urbanization process in the history of mankind.”¹⁸ In 2016, Prime-Minister Modi of India said: “If anything has the potential to mitigate poverty, it is our cities. That is why people from poor places migrate to cities, as they find opportunities there.”¹⁹ This is quite different from what Mahatma Gandhi famously said: “The soul of India lives in its villages”; “If the villages perish, India will perish too. It will be no more India. Her own mission in the world will get lost.”²⁰

Integrating the informal sector

Migrants tend to be enterprising; their migration shows a willingness to invest and take risks. Once in the city, some migrants can use their education, skills, and enterprising mindset to find work in the formal or informal sector and escape poverty. Others find employment in the informal sector where they work long hours under difficult conditions for low wages and remain poor. Both “push” and “pull” factors make men and women join the informal sector:

- an absence of qualifications for formal employment;
- regulatory barriers to establish a formal enterprise;
- ease of entry into the informal sector;
- the flexibility that an informal activity may offer;
- the fact that men and, particularly women, need to earn an income.

Although some people resort to dangerous, dirty, and demeaning work to survive, informal workers envisage an upward path in the urban economy out of poverty, if not for themselves, at least for their children. Stokes (1962) distinguished “slums of hope” and “slums of despair.”²¹ Much of the urban informal sector is a sector of hope rather than one of despair.

When the term “informal sector” was coined in Africa in the 1970s, a dichotomy was assumed between a formal, modern sector and an informal, residual sector, and upward socio-economic mobility was thought to be realistically possible only in the formal sector. This view of the informal sector has also changed: entrepreneurship is hailed; informal own-account workers are called micro-enterprises; and the economy is deregulated, because regulations are seen as impeding private initiative, innovation, and economic growth. Rather than

informality being considered the problem, regulations which make sense for large formal enterprises are seen as barriers for informal enterprises to grow and develop. Programs are designed to overcome these barriers by extending micro-credit, training, and working space to (informal) micro-enterprises. As usual, the reality is more complex. Some regulations prevent informal enterprises from prospering, but some informal enterprises skirt regulations, particularly labor laws, to avoid taxes and increase profits.

In much of Southeast Asia, the formal and informal sectors are not separate economies, but form a continuum, ranging from purely formal (regulated and protected) to purely informal (unregulated and unprotected), with many categories in between. Workers and enterprises move along the continuum and operate simultaneously at different points of the continuum. The informal sector supplies goods and services to the formal sector, if formal enterprises are unwilling or unable to do so due to regulations, labor costs, or the small size and low purchasing power of the market.²² The informal sector is not just an integral part of the urban economy, but is often indispensable for the functioning of the city, as it supplies goods and services at low cost at the right time in an easily accessible location, and thereby keeps the cost of urban living relatively low and the city competitive in the global economy. Some informal sub-sectors have become so ubiquitous and dominant that they have been recognized and regulated by the authorities. Critical informal sub-sectors include street food vending, small-scale transport services, and informal housing.

- Street food vending is not merely a source of employment but an essential service to the urban low- and middle-income population, such as office and factory workers. Streets with vendors also tend to be safer at night time than completely deserted streets. Local governments often regulate street vending by designating areas on the sidewalks, setting times when vending is allowed or prohibited, and inspecting the hygienic conditions of food stalls.
- Informal transport is essential in cities where rapid urban growth strains formal public and private transport services and traffic congestion can last the entire day. Many cities also have hard-to-reach places at the end of long, narrow, or dead-end alleys. Using small vehicles, owned or leased and operated by an individual, the informal sector fills the gaps left by formal transport services, and takes passengers to hard-to-reach destinations, or through congestion on the main road. Motorcycle taxis are a prime example of an informal transport service in Southeast Asia.
- Informal settlements house large sections of the urban population (Table 9.4), as the public and the private sector are unable to supply affordable housing in sufficient quantities for the urban poor. Informal developers build informal housing ("slums") for the urban poor, disregarding land ownership rights and building and zoning regulations. Slums used to be feared, but the World Bank now argues that the informal sector can make a significant contribution to addressing the housing problems of the urban poor.²³

Table 9.4 Urban population living in slums (2014)

Country	Slum population	% of urban population
Cambodia	1,740,000	55.1
Indonesia	29,212,000	21.8
Lao PDR	813,000	31.4
Myanmar	7,389,000	41.0
the Philippines	17,055,000	38.3
Thailand	8,264,000	25.0
Viet Nam	8,295,000	27.2
Total	62,768,000	26.2

Source: UN-Habitat (2016), Table B3.

Note

Population living in a slum is a household that lacks either improved water, improved sanitation, sufficient living area or durable housing.

The inhospitable city

There is a significant gap, however, between economic policy and social attitude. While the urban economy welcomes rural labor, a massive influx of rural migrants and their families into the city is not appreciated by the urban elites and the urban middle class. Anthropologists observed that city and countryside in much of Southeast Asia traditionally stood in a hierarchical order to each other and that these ideas still persist today, but operate below the surface. The urban elites see the city as a special place well above the countryside and the commoners, a place for the elites only. A city person is a person of status and wealth; those in the city without status and wealth are not “of the city.” They are non-sophisticates, uncultured in speech and social habits, separated from the true urbanite by a wide socio-cultural chasm. Urbanites perceive them as a moral and physical threat to the social well-being, stability, and development of the city.²⁴ The relationship is further complicated if the division between city and countryside coincides with an ethnic division.

Over the past centuries, migrants from China and India settled in cities and towns of Southeast Asia as laborers and traders, while the native population lived in the countryside. Concerned about the development gap between rural Malays and urban non-Malays, former Prime-Minister Mahathir bin Mohamad of Malaysia encouraged Malays to urbanize to bridge the gap between the population groups, because the complex organization of the city makes, in his view, urban dwellers more knowledgeable and savvy.²⁵ In Thailand, many urban middle-class families in Thailand have Chinese heritage and have few, if any, links to the countryside; they have been educated in Bangkok or abroad and their work is often confined to the city. As migrants, their family worked hard and was successful, and they believe that the rural poor failed to succeed, because they did not work hard.²⁶ The urban middle class may also oppose any sharing of its economic and political gains with an emerging rural middle class. So, while

the labor of rural migrants is welcome in the urban economy, his or her family is much less so. Unsurprisingly, many migrants experience the city as inhospitable.

Whatever inequalities already existed, they have been deepened by global free trade and foreign direct investments. The rapid rise in property values due to urban economic growth has brought windfall profits to landowners, speculators, and private real estate developers.²⁷ In Thailand, productivity increases have accrued almost entirely to capital through increased profits.²⁸ Socially, globalization is creating an urban elite that is more closely connected and has more in common with elites in other cities of the world than with the rest of the population of its own city and the countryside. Their extreme wealth makes the elites politically powerful and enables them to shape government policies to advance and protect their interests. Setting an “international alert line” for Gini coefficients at 0.40, UN-Habitat noted significant urban income inequalities in Southeast Asia: Jakarta (2013): 0.43; Kuala Lumpur (1999): 0.41; Bangkok (2011): 0.40; Manila (2006): 0.40; Phnom Penh (2004): 0.37; Ho Chi Minh City (2012): 0.35; and Hanoi (2012): 0.34.²⁹

Redefining poverty

Many people in Southeast Asia may have escaped income poverty, particularly if the poverty line is set at \$1.00 a day, but development is more than economic growth and income poverty reduction. Sen (1999) argues that all individuals are endowed with a set of capabilities which enable them to live a long, healthy, and meaningful life, but many live in a state of “un-freedom,” unable to realize their capabilities.³⁰ He sees development as the process of removing sources of un-freedom (e.g., income poverty, lack of economic opportunities, poor health and nutrition, low education and skills, bad housing, lack of infrastructure and services, social exclusion, discrimination, lack of participation and voice) in order to secure the freedom to pursue the life that one has reason to value. Two concepts are critical: human development refers to the expansion of people’s freedoms; human security refers to the need to protect those freedoms from pervasive threats and harmful disruptions in the patterns of daily life.³¹

Protection against downside risks (“protective security”) is a core concept in Sen’s views on development, as shocks such as job loss, illness, an economic or financial crisis, an earthquake, or an extreme weather event can easily push the near-poor into poverty. One could add the unequal application of the rule of law which creates a permanent sense of insecurity and can cause a sudden economic and social shock when a person, a family, or an enterprise is randomly harassed or penalized. Besides insecurity, social exclusion as a result of unequal power relations, an unjust distribution of resources or unequal access to entitlements, can act as a barrier stopping people realizing their full capabilities.³² Insecurity and exclusion would be addressed by the World Bank’s policy recommendations to make services available to everyone regardless of location and to make timely investment in connective infrastructure to share the benefits of economic growth.³³ However, these interventions require policy decisions by those in

power, who gain from the inequalities, while the potential beneficiaries remain voiceless in slums and less-developed rural areas. Unless development and poverty reduction include increased participation in political decision-making, it is unrealistic to expect such interventions to be made large-scale.

Lagging human development

While Southeast Asia has experienced rapid economic growth and income poverty reduction, it is still lagging in some aspects of human development for sections of the population. As young women move from their village to join the urban workforce, they may be happy to leave behind their “backward” village, family pressure, and work on the farm, and hope to earn sufficient money to adopt a modern urban lifestyle and support their rural relatives. If they find work in the formal sector, they may escape income poverty, but find themselves insecure employment. Insecurity may be a way of life in the rural areas where extreme weather events destroy harvests and make markets inaccessible, pest and disease outbreaks decimate crops, price volatility of farm inputs and agricultural produce render farming unprofitable, and diseases and accidents affect health and productivity. Life in the city and work in the urban economy are supposed to be more secure, independent of weather conditions, with easier access to essential services, such as clinics and hospitals and the application of the rule of law.

Insecure employment

As economic development raises wages and makes production more expensive, and as other cities emerge as potential destinations for foreign direct investment, cities can never be complacent. In the late 1990s, Bangkok became too expensive for the textile and garment industry. Some factories moved to Ho Chi Minh City and from there to Phnom Penh and Dhaka. Other factories stayed in Thailand, but moved to the border areas with Myanmar where they disregard Thai labor laws and employ Burmese labor at lower wages than they would pay Thai workers. Burmese workers cross the border on a daily basis or live in dormitories on the Thai side, many without proper documents. Their status is often unclear, which makes them vulnerable to abuse.³⁴ Global competition can result in a “race to the bottom,” as companies cut wages and social benefits. Davies and Vadlamannati (2013) found that labor practices rather than labor laws as such enable companies to lower labor standards, implying a lack of law enforcement.³⁵ Increasingly, companies across Southeast Asia are replacing standard employment with fixed-duration (short-term) contracts, work for hourly wages, and piece-rate jobs.

Unlike standard employment, fixed-duration contracts tend to lack social protection coverage and other benefits. Employers argue that this is necessary because retailers in developed countries have adopted “just-in-time” and “fast fashion” strategies which allow them to be leaner and more responsive to

consumer demand. For the producer, it means that assignments come by leaps and bounds and that the workforce has to be constantly adjusted at short notice. A 2009 study of garment factories in Cambodia found that workers on fixed-duration contracts were often denied annual leave, maternity leave, sick leave, seniority bonuses, attendance bonuses, or severance payments. Because it occurs in the formal sector, it is referred to as “informal employment in the formal sector.”³⁶ After a number of major industrial accidents across Asia, pressure by NGOs has persuaded retailers to become more aware of the circumstances in supplier factories and to force manufacturers to improve working and safety conditions, often with good results.

Some manufacturers try, however, to evade compliance with labor laws by sub-contracting work to smaller companies, informal units, or home-based workers. Employment relationships are often disguised, intentionally kept ambiguous or not clearly defined to circumvent the law. It enables the firm to claim that a worker is not an employee, and that the firm is not responsible for a mistake a worker has made or a problem a worker is facing. Decentralized operations also have lower costs because of lower wages and overheads and less security. Accidents that injure, maim, or kill workers still happen but they are less visible, and without social protection, there is no compensation or support for the victims or their family, except from charity. Standing (2009) uses the term “precariat” for those who lack security due to short-term and casual employment without labor law protection.³⁷ The threat of unemployment rather than actual unemployment makes workers vulnerable to exploitation and abuse, and to accept unlawful working conditions.

Indispensable, yet vulnerable

Banki (2013) expands the concept of precarity beyond “labor precarity” and includes two other forms of precarity: “precarity of place” (vulnerability to removal from one’s physical location) and “social precarity” (the potential of dismantling of supportive networks).³⁸ She uses the terms in connection with international labor migrants, but they could equally refer to rural-urban migrants, workers in the informal sector, and people living in informal settlements. Because informal food supply, transport, and housing are critical for the functioning of the city, many local governments recognize their importance and regulate their operations, but recognition and regulation do not imply protection by the rule of law. The status of the informal sector is often left ambiguous; it operates at the discretion of law enforcement agents who can decide what, when, and where a law is violated. Harassment and extortion are particularly hard for the informal sector, when formal food stores, formal transport services, and formal buildings violate laws and regulations with impunity. Roy (2009) observed that formality and informality are not fixed categories based on a clear set of definitions and regulations, but are negotiated on a case-by-case basis.³⁹ Despite the praise for its micro-entrepreneurship and the critical services it provides to the city, the informal sector is often harassed and abused, causing insecurity.

Street vendors operate in an urban market economy where space, even a small part of a sidewalk, is in limited supply and valuable, particularly if many pedestrians, i.e., potential customers, pass by. Street vendors have to pay for the use of the space to people who somehow control it; these could be policemen, municipal inspectors, or influential persons in the area.⁴⁰ Moreover, policies regarding street vending tend to change constantly due to the diverging interests of the various stakeholders.⁴¹ The authorities and upper-income groups consider street vending unsightly for a city that wants to be modern and globalizing. They try to uproot street vending “to beautify the city”⁴² despite tourism promotion campaigns that praise street food in Southeast Asia as the best in the world. A “compromise” is the designated market and the night bazaar. The location of designated markets and the timing of night bazaars are suitable for tourists, but not for the local population who need to buy food near their office, shop, or factory.

In some cities of Southeast Asia, motorcycle taxis drive around in search of passengers; in other cities, drivers form groups and monopolize the area where they serve passengers. In Bangkok, motorcycle taxis mostly act as feeders for mass transit systems and buses. Motorcycle taxis are licensed, but the group tends to be controlled by an influential person who owns and trades the orange vests which identify the drivers as regular motorcycle taxis, collects money, and provides protection.⁴³ In Bandung, drivers organize to fix their number at the stand, arrange the departure sequence, and deal with the authorities, particularly the police. Larger stands have a chief who is elected by the members or self-appointed. Drivers pay a daily fee to the chief and new members at a prime location pay a joining fee. Drivers carry identity cards issued by the police which registers them and recognizes their territorial rights, but there is no formal acceptance by local government.⁴⁴ Because the work is lucrative, but unprotected by law, motorcycle taxi drivers pay middlemen (or middlewomen) for protection and the place to stand.

In rapidly growing cities, land is scarce and valuable; it is not possible to occupy land without the authorities and landowner knowing about it. Informal developers and the poor have to pay gatekeepers for the use of the land and for officials to turn a blind eye. Despite the payments, land tenure of informal settlements is insecure and there is a constant threat of eviction, particularly when land values rise; the eviction threat makes people reluctant to invest in house improvement and leaves the settlement as a “slum.” An eviction not only renders a household homeless; it disrupts the networks that provide credit, support, and a safety net. As many houses are used for income generation, an eviction also destroys the customer base. In some cities, the authorities recognize certain informal settlements and provide services, such as water supply, but this does not remove the threat of eviction. Due to the high land value, some upgraded settlements are nevertheless evicted for the construction of commercial real estate.

Weakening safety nets

In Southeast Asia, the family, particularly the daughter, traditionally has the responsibility for looking after sick, elderly, and disadvantaged relatives. Governments argue that these “Asian values” make the state the supporter of last resort only. However, the high cost of urban housing makes it impossible for many households to find affordable accommodation for an extended family. Often, only working-age family members migrate to the city, leaving children and other non-working relatives behind. Because migrants have to work hard, do overtime, or have two jobs to maximize their earnings, there is little or no time left to care for children and the elderly (Table 9.5). Moreover, by having members in the village, a small town, the large city and abroad, households try to spread the risks of unemployment or loss of income of a household member. Households in rural villages act as safety nets for migrant workers, although the very poor and the landless remaining behind do not have much to offer to their relatives in the city who lose their income and employment.

The traditional family safety net is under threat due to migration and urbanization. Many younger and elderly family members nowadays prefer to live on their own, as they find it difficult to adapt to each other’s lifestyle. As people live longer, the period the elderly need to be cared for becomes longer, and disability and disease become more likely, while the cost of care and treatment increases. Due to declining fertility, there are fewer, if any, children to look after the elderly. In urban Viet Nam, over 11 percent of people aged 80 and above live alone. Many worked in the informal sector with a low and unstable income and no savings for old age.⁴⁵ In Myanmar, many seniors depend on family support, but 60 percent of those over 60 live on less than \$3 per day and fewer than one in five have any savings. Many children are too poor to care for ailing parents, while others have migrated, leaving their parents behind.⁴⁶ Aging societies in

Table 9.5 Old-age dependency ratio (2000, 2030)

<i>Country</i>	<i>2000</i>	<i>2030</i>
Brunei D.	4.5	13.0
Cambodia	5.4	9.1
Indonesia	7.5	15.4
Lao PDR	6.7	8.3
Malaysia	6.2	15.4
Myanmar	8.4	14.7
the Philippines	6.0	11.6
Singapore	10.1	46.2
Thailand	9.3	23.1
Viet Nam	9.3	18.3

Source: International Labour Organization, *World Social Security Report 2010/11: Providing Coverage in Times of Crisis and Beyond* (Geneva: International Labour Office, 2010), p. 135.

Note

Old-age dependency ratio (%): population aged 65 years or over to the population aged 15–64.

Southeast Asia risk “growing old before they grow rich,” i.e., having an aging population, but lacking the resources for a universal social welfare system. It could make the elderly the new poor, unless the state and the family find ways to provide support.

New challenges ahead

Global free trade brought prosperity to Southeast Asia and lifted millions out of poverty, but global markets can be volatile and technological innovations can be disruptive. Natural disaster can interrupt production processes, affecting the economy in faraway places and forcing a reorganization of global supply chains. Because economies are globally integrated, local shocks can vibrate around the globe and push millions in faraway places (back) into poverty. Developments that can imperil economic growth and poverty reduction in Southeast Asia include trade barriers, automation, the growth of the “on-demand” economy, and a failure to raise a workforce with abilities to compete in the global knowledge-based economy.

Knowledge-based and on-demand economies

Workers in Southeast Asia are valued for their efficient performance of routine tasks, but not for effective problem-solving and creativity. With rising labor costs, routine tasks in labor-intensive manufacturing increasingly face the prospect of automation. In addition, brick-and-mortar stores risk displacement by e-commerce. Millions of jobs in manufacturing, clerical work, and services in the ASEAN countries are at risk due to automation which will affect women in particular, as they tend to work in labor-intensive manufacturing and services.⁴⁷ Woetzel *et al.* (2014) estimate that 6–8 percent of ASEAN’s non-farm workforce (12–17 million workers) risk being displaced by technology in 2030, including 7–9 million workers in knowledge-based jobs, ranging from clerical and customer service staff to business process outsourcing and IT workers.⁴⁸ Moreover, 3-D printing will, in the future, allow companies to bring production closer to the market where the products are sold, enabling production on demand.⁴⁹

Developments in information technology are also leading to work on demand. It allows persons to work when and where they want in flexible arrangements between the one who demands the labor and the one who supplies it. Uber is often mentioned as the prime example of the emerging “on-demand” (or sharing) economy. In *The Economist*, Schumpeter (2015) called it “a dramatic success not just for consumers, but also for workers seeking flexibility, [because] people want to work more flexible hours.”⁵⁰ In cities such as Jakarta, Hanoi, and Ho Chi Min City, smartphone apps (similar to Uber’s) enable motorcycle taxi drivers to work when they want and to be more efficient with their time, doing away with waiting idly on a street corner. A motorcycle taxi driver in Bangkok said he prefers this work over his previous factory job, because “you can come and go

from home anytime; you can get money fast, every day, without waiting for the salary.”⁵¹

The *New York Times* had a more nuanced headline on the new economy:⁵² “In the sharing economy, workers find both freedom and uncertainty,” as flexibility is a trade-off for regular employment, income, and benefits. Standing (2011) called insecurity the defining feature of globalization: economic growth requires a maximum level of competition and competitiveness which is achieved by deregulation, flexible labor markets, and the use of temporary labor that allows firms to quickly change their workforce.⁵³ It shifts any risks from the entrepreneur to the worker and from insurance sponsored by the company or the state to the family. In a tight labor market (e.g., highly specialized professionals with sought-after skills), workers can decide to become independent contractors and trade the social insurance functions of the traditional employer for higher pay and greater flexibility. In developing countries, employers have the upper hand and drive the shift to this type of arrangements at the expense of the employment security of the worker.⁵⁴ The arrangement is in fact not new at all for Asia. Many sectors, particularly the construction sector, have used sub-contracting, down to the individual workers and his wife, for decades, if not centuries.

The male motorcycle taxi driver quoted earlier can happily visit his village whenever he wants, but he is probably not responsible for the financial support of his family, unlike the woman factory worker who traditionally is expected to support her relatives. In factories of Southeast Asia, excessive overtime and working weeks of 70 hours or more are common practice among women workers. Overtime is said to be voluntary, but workers agree to it, because their basic wage is insufficient to support themselves and their family, and because they fear that their short-term contract will not be renewed, if they refuse.⁵⁵ Many workers cannot and do not want to be contractors who assume risk for profit; they seek basic economic security with limited exposure to unwanted risks and insecurity, and an ability to cope with shocks and to recover from their adverse outcomes.⁵⁶ Global economic trends are, however, moving in the opposite direction.

Education and society

Education is instrumental in expanding freedoms, as knowledge enables people not only to be more productive, find better work and earn a higher income, but also to avoid health risks, live longer and more comfortable lives, and advance their own interests, and resist exploitation.⁵⁷ Education and increased productivity ensure that the economy can grow and poverty does not return. Governments in Southeast Asia are aware that a workforce with a solid level of basic education is no longer sufficient to be competitive in a global economy. They have made educational reform a key component of their national development strategies, resulting in significant increases in enrollment,⁵⁸ but higher enrollment does not lead to better quality education. Singapore has achieved excellent results and its education system is considered among the best in the world;

reforms in other countries have been less effective. The challenge across the region is the replacement of rote learning by the development of problem-solving skills and a capacity for creativity.

A study by ASEAN in 2013 noted a persistent prevalence of rote learning in Cambodia, Indonesia, the Lao PDR, and Viet Nam, of teachers who feel compelled to teach what will be tested and of students who cannot think critically, raise questions, or solve problems in Myanmar, and a lack of basic reading, science and mathematics skills and a decline in education quality in Thailand.⁵⁹ It noted serious disparities in the quality of education between urban and rural areas and between public and private schools. It is, however, unfair to blame teachers for focusing on memorization rather than critical and creative thinking. The cultures of Southeast Asia emphasize values that differ fundamentally from the values that underlie the educational reforms.⁶⁰ Current education reflects values in society that stress respect for authority, age, rank and status: teachers dispense truth, parents are always right, and political leaders know better. Changing those values is extremely difficult, as they are deeply rooted and closely connected with the distribution of power and authority in society.

Conclusion

Global trade has accelerated economic growth in the region and lifted millions out of income poverty. Economic growth is generated in a few mega-urban regions where capital and labor converge, but unlike the movement of capital, the movement of labor is not painless. Income from urban sources contributes to poverty reduction in the rural areas, but rural-urban migration involves a departure from a familiar society and from non-working family members and offers a life of hard-work in an often inhospitable urban society. Employment is often insecure, with short-term contracts without social benefits in the formal sector, or work under difficult conditions in the informal sector, facing harassment and being unprotected by regulations and laws. In order to remain competitive, cities try to keep production costs low and firms shift economic risks to the worker, resulting in increased insecurity. At the same time, traditional safety nets are weakening.

Development is more than economic growth, and income poverty reduction removes only one set of deprivations. The primary aim of development is the removal of the various kinds of un-freedoms that leave people with little opportunity and choice to exercise their reasoned agency.⁶¹ Besides providing economic opportunities, improving health conditions, removing social exclusion, and increasing political participation, it requires education to enable people to be productive and creative, and to protect themselves against threats that jeopardize their freedom. It requires policies that guarantee livelihood security through social transfers, such as pensions for the elderly and disadvantaged, child benefits, income support benefits and/or employment guarantees for the unemployed, persons with disabilities and working poor, and universal and affordable access to essential services.

Emerging trends in the global economy such as automation and labor-on-demand risk further deepening the workforce's economic insecurity. In developed countries, there is a growing discussion about the need for a universal basic income in response to these disruptive trends. Even if it were politically acceptable, such a solution would not be financially feasible in most developing economies of Southeast Asia. Yet, it is also clear that the massive generation of employment in export-oriented manufacturing and the resulting reduction of income poverty do not suffice and need to be followed by measures to develop a society that ensures people's capabilities to live the life they value, while keeping the economy competitive. Universal access to essential services, particularly quality education, appropriate to the new economy, advances both goals, but it requires more than educational reforms. It requires fundamental changes in the way society is organized and governed and laws and regulations are applied.

Notes

- 1 The terms "Southeast Asia" and "ASEAN" are used interchangeably, given the small size of Timor-Leste which is part of Southeast Asia, but not of ASEAN (Association of Southeast Asian Nations).
- 2 Stiglitz (2016).
- 3 Quah and Mahbubani (2016).
- 4 Association of Southeast Asian Nations (2015), p. 18.
- 5 Huynh and Kapsos (2013), p. 2.
- 6 Woetzel *et al.* (2014), p. 22.
- 7 Asian Development Bank (2017), pp. 27–28.
- 8 World Bank (2017).
- 9 United Nations Population Division (2015), pp. 206–289.
- 10 *Ibid.*, pp. 80, 315.
- 11 Demographia (2017), p. 18.
- 12 Asian Development Bank (2014), p. 7.
- 13 Glaeser (2011), p. 70.
- 14 Woetzel *et al.* (2014), p. 25.
- 15 Sovani (1964), pp. 113–122.
- 16 World Bank (2009), p. 24.
- 17 *Ibid.*, p. 38.
- 18 Ministry of Foreign Affairs of the People's Republic of China (2015).
- 19 *Indian Express*, 26 June 2016.
- 20 Joshi (2002), p. 3.
- 21 Stokes (1962) pp. 187–197.
- 22 Daniels (2004), p. 505; Chen (2007), pp. 2–3.
- 23 World Bank (1993), p. 38.
- 24 O'Connor (1995) pp. 30–45; Guinness (2008), pp. 90–91; Phongpaichit and Baker (2016), pp. 6–7.
- 25 Mahathir (2008), p. 105.
- 26 Baker (2016), pp. 12–13.
- 27 Phongpaichit and Baker (2016), p. 6.
- 28 Hewison and Tularak (2013), p. 449.
- 29 UN-Habitat (2016), pp. 74, 206.
- 30 Sen (1999), pp. 3–4.

- 31 United Nations Development Programme (2010), p. 17.
- 32 Popay *et al.* (2008), p. 36.
- 33 World Bank (2009), p. 38.
- 34 Arnold and Pickles (2011), pp. 1598–1624; Pearson and Kusakabe (2012).
- 35 Davies and Vadlamannati (2013), pp. 1–14.
- 36 Chen (2005), pp. 6, 8–9; Lowenstein (2011), pp. 69–76; Chen (2012), pp. 3, 7–8.
- 37 Standing (2009), p. 110.
- 38 Banki (2013), pp. 450–453.
- 39 Roy (2009), p. 80.
- 40 Illy (1986), pp. 69–71; Bromley (2000), pp. 14, 20.
- 41 Tinker (2003), pp. 337–338.
- 42 Illy (1986), p. 67. Bromley (2000), p. 11.
- 43 Sopranzetti (2013), pp. 65, 133–137.
- 44 Syabri *et al.* (2011).
- 45 Channel News Asia, March 12, 2017. Available at: www.channelnewsasia.com (accessed September 4, 2017).
- 46 Channel News Asia, April 9, 2017. Available at: www.channelnewsasia.com (accessed September 4, 2017).
- 47 Chang *et al.* (2016), pp. 81–82.
- 48 Woetzel *et al.* (2014), pp. 23, 135, 138.
- 49 Chang *et al.* (2016), p. 81.
- 50 Schumpeter (2015).
- 51 Sopranzetti (2013), p. 118.
- 52 Singer (2014).
- 53 Standing (2010), p. 293; Standing (2011), p. 1.
- 54 Irwin (2016).
- 55 Lowenstein (2011), pp. 68–69.
- 56 Standing (2010), pp. 294–295.
- 57 United Nations Development Program (2010), p. 36.
- 58 Hallinger (2010), pp. 401–402; Association of Southeast Asian Nations (2015), pp. 20, 37.
- 59 Association of Southeast Asian Nations (2013), pp. 42–99.
- 60 Hallinger (2010), p. 402.
- 61 Sen (1999), p. xii.

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Part V

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10 The rise of China and its implications for economics and other developing countries

Justin Yifu Lin

Introduction

As is well known, China was one of the poorest countries in the world before its transition from a planned economy to a market economy in 1978. Its per capita gross domestic product (GDP) in that year was just US\$155, which was less than one-third of the average for Sub-Saharan African countries. Since 1979, things in China have changed dramatically. The annual GDP growth rate in the last 37 years was 9.7 percent per year.¹ A continuously high rate of this magnitude and for such a long period of time was something that had never before been observed in human history.

Certainly, like other low-income countries before 1979, China was inward-looking. At that time, exports accounted for 4 percent of China's GDP and imports for 5 percent. In other words, some 90 percent of Chinese GDP was not related to the global economy. Since 1979, however, the average annual growth rate of trade has been more than 15 percent. As a result of this kind of dramatic change, in 2010, China overtook Japan to become the second largest economy in the world. In the same year, China overtook Germany to become the largest exporting country in the world. In 2013, it overtook the United States to become the largest trading country in the world: the total volume of exports and imports as a percentage of GDP was larger in China than in the United States. In 2014, Chinese GDP measured by purchasing power parity (PPP) overtook that of the United States, making China the largest economy in the world. And, in 2015, China's per capita GDP was US\$7,960. From less than one-third of the average for Sub-Saharan African countries, China's per capita GDP was now some five times higher. Moreover, during this period, 700 million people were lifted out of poverty, making a very important contribution to the global fight against poverty. As is well known, after World War II, many multilateral and bilateral development institutions were set up to help developing countries grow and reduce poverty. And yet, by the year 2000, if the number of people lifted out of poverty in China were subtracted from the world total, the number of poor people in the world would have increased rather than decreased.

In this chapter, I shall draw on my book *Demystifying the Chinese Economy* (Lin 2012) to provide answers to six related questions: The first is: how was a

country trapped in poverty for centuries able to grow so rapidly for such a long time? The second is: why was it impossible for China to have a similar growth performance before 1979? Certainly people may say it was because of reform and opening-up from 1979. But it is well known that China is not the only country that since 1979 has adopted reform and opening-up. Other socialist countries and almost all developing countries in the 1980s and 1990s also embarked on reform and transition. However, instead of achieving rapid economic growth, most saw their economies collapse, stagnate, and suffer frequent crises of all kinds. The third question, therefore, is: why were there such dramatic differences in economic performance between China and other countries during the transition period? The fourth question is: what was the price that China paid for its success? Certainly, every coin has two sides. China enjoyed dynamic economic growth, but in the process it also suffered many problems. China's economic performance was outstanding, but why are there so many problems in the country? The fifth question is: can China continue this kind of dynamic growth in the years ahead? The sixth and concluding question is: what are the implications of China's experience for other developing countries and for economics?

How was it possible for China to grow so rapidly for so long?

When trying to answer this question, I often say that the best way is to go back to the work of Adam Smith. But I do not mean that we should come to the conclusions that Smith arrived at his *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776)—one should instead revisit the methodologies he used to reach his conclusions, as indicated in the title of his book.

Therefore, to understand how during the past 37 years China was able to grow so rapidly, one needs to understand the nature of rapid economic growth. Certainly, the nature of rapid economic growth means that national per capita GDP increases rapidly. As mentioned, China's per capita GDP increased continuously from US\$155 in 1978 to US\$7,960 in 2015. Making this kind of continuous growth in per capita GDP possible certainly involves continuously raising the level of productivity, while the foundation of continuous increases in productivity is without doubt technological innovation in existing industries, on the one hand, and the development of new industries with higher per capita value added to which resources can be reallocated from low value-added sectors, on the other. This process of continual technological innovation and industrial upgrading is the foundation for continuous productivity and income growth in any nation. It applies to high-income countries and to developing countries.

There are, however, some important differences between high-income and developing countries. In high-income countries, technologies and industries are already on the global technological frontiers. To upgrade, therefore, they have to invent new technologies and industries to move these frontiers forward. Invention requires huge capital expenditures and is also very risky. From the end of the nineteenth century until today, the average annual growth rate of per capita

GDP and per capita labor productivity in high-income countries was about 2 percent per year. But what about developing countries? Certainly they also need technological innovation and industrial upgrading. But at present their technologies and industries are within global technological and industrial frontiers. Developing countries can, therefore, acquire or imitate technologies and industries from high-income countries. Acquisition, imitating, and borrowing are the sources of their technological innovations and industrial upgrading.

In this way, technological innovations and industrial upgrading in developing countries involve lower costs and fewer risks than in high-income countries. This condition is the so-called latecomer advantage or advantage of backwardness. If developing countries are able to tap into that advantage of backwardness, they can achieve higher rates of technological innovation and industrial upgrading without inventing new technologies or new industries. And since they can have a fast rate of growth of technological innovation and industrial upgrading, they can have fast rates of improvement in labor productivity and fast increases in income.

In the years since World War II, 13 economies around the world have found a way to realize their potential to achieve continuous annual GDP growth rates of 7 percent or more for 25 or more years (World Bank 2008). In high-income countries, per capita output and population increased, yielding average annual GDP growth rates in the region of 3 percent. A growth rate of 7 percent or more was, therefore, more than twice that of high-income countries. If this rate is sustained for 25 or more years, the gap between the country concerned and high-income countries will decline. In 1979, China joined this group of 13 economies. The answer to the first question is, therefore, relatively simple. If one understands the nature of economic growth, it is clear that effectively exploiting the advantage of backwardness made sustained rapid economic growth for a long period of time possible.

Why did China not benefit from the advantage of backwardness before 1979?

But if this answer to the first question is correct, why did China not benefit from that advantage before 1979? The answer is that China voluntarily relinquished the attempt to exploit the advantage of backwardness. When the People's Republic of China was established in 1949, the goal of the leaders of the newly liberated country was announced by Chairman Mao Ze Dong on October 1, as "the Chinese people stand up." What did "the Chinese people stand up" mean?

Certainly one aim was to have a high income as in high-income countries. Another aim was strong national defense, as existed in high-income countries. Achieving as high an income as in high-income countries requires comparable levels of labor productivity. Comparable labor productivity requires the same types of technology and the same types of industries. Creating a system of national defense as strong as that of high-income countries requires national defense industries capable of producing equally sophisticated military equipment.

As a result, in 1952, at the time of the Korean War, China embarked on a national development program. China wanted to build the most modern industries to increase per capita GDP and strengthen national defense. The problem was that at that time these advanced industries were all in the hands of advanced countries and were in particular protected by patents. China could not acquire these technologies without incurring costs. More importantly, these industries were defense-related. The secrets of these industries were ones high-income countries were not prepared to release.

Faced with these challenges, China had to “reinvent the wheel” and to do the research in order to acquire these technologies. China, therefore, chose voluntarily to forego the potential of the advantage of backwardness. Not only so. The industries concerned were very capital-intensive. But China at that time was a poor agrarian economy. Capital was very limited in China. The industries concerned were not, therefore, the ones in which China had a comparative advantage. These industries were, moreover, costly and not profitable. China could only develop them if the government protected and subsidized them. These subsidies distorted the prices of capital and resources, while protection gave the firms concerned a market monopoly and enabled them to set monopoly prices covering their high costs of production.

These distortions allowed China to build up modern advanced industries quickly. By the 1960s, it was able to test nuclear bombs. And by the 1970s, China was able to launch satellites. These outcomes were significant achievements. However, the distortions were also associated with costs in the shape of a misallocation of resources. By the 1970s, although China had established most of the modern industries of the day, their efficiency was very low. It was this misallocation of resources that explains why by 1978, after 30 years of post-revolution economic construction, China was still a poor country. But this story is not confined to China. After World War II, all socialist countries followed similar strategies. They tried to build up large-scale modern industries. Adopting the so-called Stalinist model, other developing countries in Africa, Latin America, and South Asia also followed similar strategies because they all wanted to quickly become high-income countries. All, therefore, immediately developed similar modern large-scale industries, encountering similar difficulties to China. As a result, after World War II, while high-income countries grew at some 3 percent per year, the average annual per capita GDP growth rate of most developing countries was less than 3 percent, and so the gaps between high-income and developing countries increased rather than decreased (Maddison 2001).

Why were there such dramatic differences in economic performance during the transition period?

In the years in which China embarked on the transition from a planned to a market economy, many other countries embarked on transitions under the guidance of the World Bank and the International Monetary Fund (IMF). China, however, enjoyed stability and continuous economic growth, while other

countries suffered from economic collapse, stagnation, and frequent crises. The reasons why are twofold and relate to differences in their transition strategies.

First, other socialist countries and many developing countries followed the so-called Washington Consensus strategy. This strategy derived from the argument that socialist countries and other developing countries had not done well because excessive government intervention caused misallocations of resources. This argument led to the recommendation that to improve their economic performance these socialist and developing countries should immediately remove all distortions, end government intervention, and allow markets to function. However, the purpose of all these distortions was to protect large-scale industry. If these distortions were removed rapidly, these large-scale industries would be made bankrupt, and a large number of workers concentrated in cities would lose their jobs, undermining social and political stability. Without social and political stability, economic development is impossible. As a result, after Washington Consensus shock-therapy reform (privatization, marketization, and liberalization), many countries reintroduced subsidies and protection through the back door to preserve these large-scale industries for the purpose of providing jobs.

A second reason was that as many of these large-scale industries were defense-related, in many countries, even after privatization, governments continued to subsidize them to allow them to stay in operation.

As a result, whether it was for reasons of social stability or national defense, after privatization, liberalization, and marketization, new types of subsidies and distortions were introduced. These distortions were yet more inappropriate and even more inefficient than the explicit subsidies and protections that had been swept away.

There is convincing evidence supporting this argument. For example, in Russia today, there are eight oligopolies in military-related heavy industry sectors. After privatization, due to all kinds of crises, these oligopolistic groups received more subsidies and protection than they had received in the former Soviet Union. Similar situations prevail in other East European, Latin American, and African countries. The reason why is not so hard to understand.

Before privatization, the government employed managers and employees. If there were difficulties, these people would certainly say to the government that, without protection and subsidies, they would not survive. If the government were to provide assistance, the managers could at most increase their on-the-job consumption. Putting money into their own pockets, however, would amount to corruption and be punishable. After privatization, owners also asked for subsidies. In this case, subsidies could simply be turned into their own wealth, and there is an incentive for asking for yet higher subsidies and assistance. As a result, reform led first to a certain degree of chaos followed by stagnation and frequent crises.

China also wanted to embark on a transition from this type of distorted economy but managed to maintain stability and dynamic economic growth. The main reason why it managed to do so is that China adopted a pragmatic approach: understanding that existing sectors could not survive without

protection and subsidies, and the government continued to provide them for as long as absolutely required. However, the Chinese government also liberalized entry into new sectors. Most of these sectors were labor-intensive and small-scale traditional sectors. In the past, these sectors had been repressed. After 1979, Chinese and foreign firms were allowed to enter these industries. Indeed, the Chinese government not only liberalized but also actively facilitated and supported entry into those industries that were consistent with China's comparative advantage at that time as a labor-abundant country.

To be competitive, China also needed to provide adequate infrastructure and a good business environment. In 1979 and the 1980s, the infrastructure in China was extremely poor. Although it was desirable to improve national infrastructure as a whole, the Chinese government lacked financial resources, and so it decided to set up special economic zones (SEZs), industrial parks, and export zones, improving infrastructure in a limited number of areas. China's business environment was also very poor because China chose to retain market distortions in order to protect existing industries. In SEZs and other economic zones, however, all these distortions were removed. In addition, a wide range of services, for example, one-stop business services, were provided in SEZs or industrial parks. As a result, new industries consistent with China's comparative advantage at that time could utilize the infrastructure, business environment, and services in these zones and make themselves very competitive not only on the domestic but also on the international markets.

It was for these reasons that Chinese exports rose rapidly in the last 30 or more years. As these industries had a comparative advantage, they were profitable and accumulated capital. Gradually, China changed from a capital-scarce to a relatively capital-abundant economy. As it did, Chinese industry gradually upgraded from labor- to capital- and technology-intensive industries. And as it upgraded, China could benefit from the advantage of backwardness, maintaining stability and dynamic economic growth.

What price did China pay for its success?

Although its economic progress was extremely good, China, however, also paid a very high price for its success. In addition to environmental degradation and food safety issues, which are the results of rapid industrialization and lack of appropriate regulations, the main prices China has paid in the last 37 years were corruption and increased income disparities, which themselves were related to China's pragmatic transition strategy.

As already mentioned, the Chinese government wanted to give transitory protection and subsidies to already-existing advanced sectors so as to maintain stability. These industries were capital-intensive. One of the most important costs was the cost of capital. Before the start of transition in 1979, these industries did not pay any of the costs of fixed or working capital (including the wage fund) as these costs were covered by a government-provided fiscal appropriation. After 1979, however, the source of capital gradually changed from fiscal

appropriations to bank loans. The Chinese government set up four large state banks and a stock market to meet the capital needs of large enterprises. To survive, however, these industries required low interest rates. As a result, interest rates and capital costs were artificially repressed.

In 1979 and the 1980s, all firms in China were state-owned. Gradually, however, success in new sectors saw some domestic firms grow and become large firms. These firms could all borrow from the large state banks or could be listed on a stock market. As interest rates and capital costs were artificially repressed, whoever could borrow from the banking sector or from the emerging stock markets was therefore subsidized. These subsidies were paid for by households, farms, and small or medium-sized industrial and service firms who put their money into the banking sectors or into the stock market, and who were poorer than the owners of the enterprises they financed. The subsidization of the operation of rich people's firms by poorer people was one reason for the increasing income disparities. Moreover, the acquisition of capital at depressed interest rates generates economic rents (excess profits) for the recipients, leading to bribery and corruption of the gatekeepers who control access to these sources of finance. This state of affairs, therefore, contributed to corruption.

At the same time, in banking and in some large-scale service industries, state-owned monopolies secured monopoly rents. Private enterprises in new sectors also seek monopoly rents. In the natural resource sectors, before 1979, in accordance with the provisions of the constitution, all natural resources were "owned by the state, that is, by the whole people." Before 1979, natural resources were managed free of charge by large-scale state-owned enterprises (SOEs) and were provided to those enterprises at very low prices. After 1979, the government allowed private firms to enter the mining sectors, and liberalized controls over prices, while maintaining low concession fees. Acquisition of a concession promised overnight enrichment. The monopoly rents in service sectors, such as telecommunication and finance, were also sources of inequality and corruption, and resulted from the pragmatic approach to transition. Unless these distortions are removed, corruption will be difficult to eradicate, no matter how hard the government tries.

The main reason for maintaining temporary transitional distortions was the need to protect large-scale SOEs because they were capital-intensive and were inconsistent with China's comparative advantage. In the 1980s and 1990s, China was a poor country. Only in 2002 did it become a middle-income country. At that time, certainly protection and subsidies were a precondition for the survival of these industries. After 37 years of rapid economic growth, however, the availability of capital in China has increased significantly, and many of the industries and SOEs that were protected in the past are now consistent rather than inconsistent with China's comparative advantages. As a result, their products are competitive with those of global companies on international markets. Today subsidies and protection have changed in nature from subsidies and protection to their recipients into transformative wealth. As a

result, I think it is time for China to complete the transition and remove all these distortions. Indeed, their removal was precisely a part of the reform agenda announced by the Chinese government in the third plenary session of the 18th Party Congress in 2013. Hopefully, the implementation of a reform agenda of this kind and the removal of these distortions will eliminate some of the causes of income inequality and corruption.

Can China continue this kind of dynamic growth in the years ahead?

The question that arises is: if China completes this transition and removes all remaining distortions, for how long can it maintain dynamic economic growth? This question is hotly debated in China and closely followed globally. The reason why is that from 2010 China's annual growth rate dropped an average annual growth rate of 9.7 percent in the period of 1979 to 2015 to 6.7 percent in the first half of 2016 and that there is still strong downward pressure.

To answer the question as to whether, after more than 30 years of growth, China can maintain dynamic economic growth in the coming years, one needs to answer two other questions: how large is China's growth potential?, and what were the reasons for the deceleration of China's growth since 2010?

China's potential for rapid economic growth depends on the size of the advantage of backwardness that China still enjoys. To measure the size of the remaining advantage of backwardness, one should compare China's per capita GDP with the per capita GDP of high-income countries such as the United States because per capita GDP is a proxy for a country's average labor productivity, and average labor productivity is a measure of the degree of advancement of technology and valued-added of industries.

In 2008, according to the last data published by Maddison,² per capita GDP in China measured at PPP was 21 percent of the comparable figure for the United States in the same year. This proportion was similar to that for Japan in 1951, Singapore in 1967, Taiwan in 1975, and South Korea in 1977. All stood at 21 percent of the US figure in the corresponding years.

In the 20 years from 1951 to 1971, Japan grew at an average annual rate of 9.2 percent. From 1967 to 1987, Singapore grew at 6.6 percent. From 1975 to 1995, Taiwan grew at 8.3 percent. From 1977 to 1997, South Korea grew at 7.6 percent. These four East Asian economies were among the 13 economies referred to above as having tapped into the growth potential deriving from the advantage of backwardness and as having enjoyed high growth rates of 7 percent or more continuously for 25 or more years.

Just as these economies were able to utilize the technology gap and exploit the advantage of backwardness to grow for 20 years at between 7.6 percent and 9.2 percent per year, so too potentially can China grow for another 20 years at 8 percent per year. From 2008 to the present, 11 years have passed. Another nine years of potential growth at 8 percent per year remain. In that case, why has the growth rate continued to decline since 2010, and why does

one still not see the bottom? The potential growth rate reflects the possibilities for technological innovation and industrial upgrading. It is a supply-side issue. The realization of this potential growth rate also depends, however, on demand-side conditions.

From a demand-side point of view, growth has three components: exports, investment, and consumption. High-income countries have not yet recovered from the global financial crisis of 2008: in these countries per capita GDP is stagnant, there is a large debt overhang that they need to reduce, and consumption has increased very slowly. The stagnation of the United States, the Western European countries, and Japan has depressed international trade with a major impact on Chinese exports, as China is a major global supplier of consumption goods. From 1979 to 2015, China's annual average export growth was about 16 percent. In 2015, it was -2.8 percent. This downturn was one of the reasons for a deceleration in Chinese growth. This factor affects not only China but also many export-oriented countries.

The second reason was that in 2008 most countries adopted counter-cyclical fiscal expansion to support investment and growth. After eight years, these projects were completed. The global economy has not fully recovered, and incentives for private sector investment remain low. Without a new round of stimulus programs, investment growth rates will drop, affecting all countries: growth has decelerated not only just in China but also, and often more sharply, in other BRICS countries (i.e., Brazil, Russia, India, China and South Africa), other high-performance export-oriented economies, and in high-income countries themselves.

Fortunately, China maintains a high employment rate. Household income has continued to grow rapidly at about 8 percent per year, with consumption growing at a similar rate. The growth of consumption is the reason why the country has managed to maintain a growth rate of around 7 percent per year. China, along with other developing countries, needs to complete a transition to address domestic structural problems. Deceleration was, however, mainly due to external and cyclical factors.

Looking forward, high-income countries are very likely to be trapped in a situation similar to that of Japan after 1991 due to the lack of structural reforms. These economies are likely to grow at less than 3 percent per year. External demand is likely to remain sluggish.

Growth in China will depend on domestic demand where, fortunately, China still has a lot of room for improvement: although there is excess capacity in many sectors, as a middle-income country China has very considerable possibilities for investment in industrial upgrading, urban and inter-urban infrastructure, and environmental protection. Not only has it plenty of good opportunities for investment, but also its fiscal position is still very sound. In 2015, national, provincial, and local government debt was less than 60 percent of GDP, amongst the lowest in the world. China still has US\$3.3 trillion of foreign exchange reserves. With good investment opportunities and abundant funding, China will maintain a reasonable rate of investment growth, create jobs, and increase

household income and consumption. In these conditions, there is no reason why China cannot reach its annual growth target of 6.5 percent or more in the coming five years. If China does reach this target, it is very likely that, by as early as 2020 or as late as 2022, Chinese per capita GDP will reach US\$12,700, making China a high-income country by the standards of that time (Lin, Wan, and Morgan, 2016).

Conclusion: what are the implications of China's experience for other developing countries and for economics?

What, finally, are the implications for other developing countries? The analysis in this chapter suggests, first, that every developing country has the potential to grow dynamically and continuously for 30 or more years and to move from a low-income to a middle-income and even to high-income economy if they develop their economies according to their comparative advantage. Countries can turn their comparative advantages into national competitive advantages. Competitive industries can accumulate capital and engage in processes of industrial upgrading that tap into the potential advantage of backwardness, enabling them to grow much faster than high-income countries, maintaining growth rates of 7 percent or more for several decades, as in the case of China in the last 37 years. Although the potential is there for every country to grow, they need to have a right development strategy in order to tap into the potential.

Second, every country has a lot of distortions. These distortions involve costs, and removing these distortions is desirable. Distortions exist, however, for certain reasons, and are, in economic terms, largely endogenous. Unless the causes of a distortion are dealt with, the attempt to remove it can do a lot of harm. If there is a distortion and the economy is accordingly in a “second-best” situation, the removal of the distortion without the removal of the cause will very often make the situation even worse. A country embarking on reform should therefore be pragmatic, employing transitory and transitional protection as China did in the last 30 years to preserve stability.

A careful liberalization of entry into new sectors consistent with a country's comparative advantages and government facilitation of growth in those sectors can permit it to grow dynamically while preparing the ground for the removal of the distortions. A pragmatic approach to step-by-step development according to a country's evolving comparative advantage is of great value for developing countries.

At the same time pragmatism is required in the transition itself. The final goal is the establishment of a well-functioning market economy, but it should be a process managed by the government paying attention to the needs of all sectors and providing business opportunities for them. In this way, the World Bank's dream of a world free of poverty may be possible.

As for economics, the implication is that in the past most theories were developed in high-income country. These theories were used to help other

countries become high-income countries. The intention was good, but the results were often not very good, as the underlying theories were all generalizations from phenomena in high-income countries. The applicability of economic theory depends on the similarity of preconditions. The preconditions in developing countries are, however, different from the preconditions in high-income countries. Policies based on theories generated from the experiences in high-income countries do not, therefore, achieve the intended results in developing countries.

The analysis in this chapter shows that these types of approach will not prove rewarding and that it is very important to examine the reality of the situation in developing countries and to produce new ideas and theoretical understandings from their experiences. These ideas and theories will be more applicable to developing countries.

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Notes

- 1 Unless indicated otherwise, the statistics on the Chinese economy reported in the chapter are from the *China Statistical Abstract, 2016* (National Statistical Bureau 2016), *China Compendium of Statistics, 1949–2008* (National Statistical Bureau 2009), and various editions of the *China Statistical Yearbook*, published by China Statistics Press.
- 2 For the Maddison Project, see www.ggdc.net/maddison/maddison-project/home.htm (2013 version).

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11 Poverty reduction in East Asia

A continuing development challenge

*John Wong*¹

Changing perception of economic development

“Economic development” as a distinct academic discipline started only in the early 1950s. As many former colonies of Western powers in Asia and Africa obtained their political independence, they all set out with national economic policies to develop their countries, which were then called by a euphemistic term, the “less developed countries” or LDCs, “Economic development” was initially defined simply as increases in per-capita GDP, or just being equated with the concept of “economic growth.” Clearly, strong economic growth needs high investment, which in turns needs high savings. Policy-makers in charge of economic development had therefore set their focus on mobilizing capital for development. Many development economists were then also arguing for the “Big Push” development strategies.

After a decade or so of fairly rapid economic growth, many LDC governments were disappointed with their overall development progress. They had achieved “growth without development” in the sense that their economies had remained economically and socially backward. Worse still, they were all riddled with serious problems of income inequality, rising unemployment, and widespread poverty. Consequently, international development agencies like the World Bank and the International Labour Organization (ILO) started to redefine “economic development,” with the new meaning of development emphasizing income equality, employment and reduction of poverty, and ultimately the satisfaction of basic needs.

Technically speaking, those new meanings or new perceptions of “economic development” are fundamentally still linked to economic growth. Without economic growth, a country is not able to generate the required material resources to address those problems. But economic growth alone, in the sense of pure GDP increases, does not by itself lead to the alleviation of those problems, as many LDCs had experienced this in the 1950s and the 1960s.

The critical issue, therefore, boils down to the *nature* of economic growth or the *pattern* of economic growth. This means that national development policies must be restructured or designed in such a way that they will bring development benefits to certain target groups. This is often not easy in terms of practical

policy formulation. Most governments would still want to maximize GDP growth first, which is basically the “efficiency issue” in a market-driven economy. On the other hand, reducing income inequality or poverty is more about “equity.” Economic growth in any market economy often gives rise to some trade-off between efficiency and equity, especially in the short run. In other words, the factors that bring about maximum economic growth are often in conflict with the social aspects of growth while redistributive policies that are aimed at reducing income inequality and poverty can often slow down the economic growth process.

Accordingly, some LDC governments turned to the more realistic development strategy of “grow first, redistribute later,” which is a way of dealing with economic and social development issues separately. Others have deliberately tried to build the specific social policy variables into their overall development programs in order to deal with those specific issues like better income distribution. The case in point was the so-called “Redistribution with Growth” strategies that the World Bank had advocated in the 1970s. But this had also proved to be a difficult policy option and the outcome had not been entirely satisfactory, because many redistributive policies tended to dampen growth.

Over the decades, most governments that had embraced the market, were still giving high priority to maximize GDP economic growth. It was argued that strong economic growth would bring down unemployment, on the one hand, and create more material resources for the government to tackle those social issues like poverty.

In a sense, all market-based development strategies are inevitably biased toward more growth and less redistribution. But the hard reality is that some developing countries had actually failed on both counts: they had failed to sustain high growth while also failing to significantly reduce income inequality and poverty.

The Millennium Development Goals

In view of such “developmental failure,” the United Nations in its 2000 Millennium Declaration adopted eight “Millennium Development Goals” (MDGs) to be achieved by 2015, with the eradication of extreme poverty and hunger at the top of these Eight Goals. The World Bank, the IMF, and other international development organizations all joined in to support this endeavor. Specifically, for the alleviation of poverty, the 2014/2015 Global Monitoring Report confirmed that the first goal of cutting extreme poverty in half by 2015 had been achieved ahead of time in 2010, even though most of the achievements were recorded in a few countries like China, India, and Brazil. The MDGs expired at the end of 2015. The global development community under the UN in September 2015 mapped out the new Sustainable Development Goals (SDGs) through to 2030.

What is “poverty” anyway? It is actually quite a nebulous notion. Cases of abject “extreme poverty” in poor countries are clearly manifested in their slums or ghettos, and their homeless people or those suffering from sheer hunger. Such

is the “visible poverty,” which can actually be measured by the daily calorie intake for each poor person.

The formal definition of poverty usually requires setting a per-capita (or per household) minimum spending or consumption standard that is needed to satisfy the basic needs in terms of basic food, clothing, and shelter. Thus, the World Bank set the poverty level of US\$1 a day in 1993 prices (subsequently raised to US\$1.25 a day in 2005 prices) for developing countries to identify their poverty problems. According to the World Bank, about 17 percent of the people (or just over one billion people) in the developing world lived at or below US\$1.25 a day in 2011, compared to 43 percent in 1990 (Magstadt 2016: 250).

It must be stressed that the World Bank poverty benchmark was far more useful for general international comparisons than as a policy guideline for a specific developing country. Most governments, in formulating their anti-poverty programs, set their own standard for poverty in line with their own economic and social conditions (e.g., local living standard) and also because of the exchange rate fluctuation, as the “US\$1.25” can vary in terms of domestic currency.

Absolute vs relative poverty

It is not commonly known that poverty or even extreme poverty is actually also a problem for developed countries, including those high-income wealthy societies.

Defining “poverty” beyond the bare minimum of basic hunger (e.g., the required calorie-intake a day for a person) is obviously an arbitrary exercise. For most developing countries, their poverty policy is primarily aimed at reducing the level of absolute, extreme poverty by satisfying the basic needs of the common people. Beyond this threshold, “poverty” becomes a “relative” notion. What constitutes the “basic needs” beyond the minimum physical requirements of food and shelter can vary in both quantity and quality terms, and in different cultural and social contexts. It can also vary over time, along with economic growth and social development. Each country therefore sets its own poverty line that is appropriate for its level of economic development and social norms.

For most developed societies, their poverty is usually identified by setting up a “poverty threshold” or the minimum income level that is required to maintain an individual or family for basic needs. The US Census Bureau set the poverty threshold at three times the cost of a minimum food diet in 1963, regularly adjusted for inflation, family size, and age. Thus, the US official poverty threshold in 2013 for a family of four was set at \$23,500, which yielded the official national poverty rate at 15 percent.² This means that in that rich society, 46.5 million people were still “poor.” This is only about its national poverty rate; but many American cities have by far much higher poverty rates such as the 33 percent for Detroit and 27 percent for Miami.

Instead of using the minimum consumption standard as in the US, many developed OECD countries have defined their incidence of poverty by simply

drawing their poverty line at 50 percent of their median household income, with individuals or households falling below this line considered poverty-stricken. In 2013, Hong Kong also set its poverty line to be 50 percent of the median monthly household income before tax and welfare transfers.³ But defining the poverty line in this way needs accurate household income data.

It is sufficiently clear that the term “poverty” has increasingly become more like a social issue, especially for the developed countries. Such is the concept of the “relative poverty line,” which also applies to developing countries. In every society there will always be a certain number of people with their disposable income at the other side of the median income line. In short, there will always be “relative poverty” in any society, as manifested in the common expression: “The poor are always with us.” Defining relative poverty is no longer a precise or objective exercise.

In recent years, income distribution has got worse virtually in all market economies. This is because modern economic growth nowadays is basically guided by the market forces, which tend to go for efficiency rather than equity. It is also because modern economic growth today is mainly driven by greater capital intensity and technological progress. This follows that modern economic growth tends to reward those groups of people who possess the capital and skills. Consequently, income distribution has deteriorated even in those countries that have experienced strong economic growth, as evidenced by their rising Gini ratios everywhere. These issues are vividly discussed in Thomas Piketty’s (2014) famous volume, *Capital in the Twenty-First Century*.

With rising income inequalities, relative poverty will inevitably get worse, as a higher proportion of households will fall below the poverty line. In other words, the poverty rate or the proportion of households below the poverty line will rise. The problem of poverty is often exacerbated by rising unemployment. Consequently, the poverty rates in most developed countries have increased after the 2008 global financial crisis. In the United States, for instance, the average poverty rate increased from 12 percent in 2006 to 15 percent in 2013 (Gabe 2015).

The war on poverty will never end for both developing and developed countries. Even as the poorest nation has resolved its basic problem of absolute poverty like hunger to become a better-off society, it will continue to face the issue of relative poverty. In short, the poverty problem has become a perennial problem, partly because it is a “relative” and also because it is about a moving target!

Poverty elimination critical to Xi Jinping’s “China Dream”

At the 19th Party Congress of the Chinese Communist Party (CCP) on October 14, 2017, Xi Jinping as its General Secretary delivered his Political Report, which dealt with a wide range of political, economic, and social issues confronting China. Specifically, for his economic agenda, Xi put great emphasis on better-quality economic growth, which means not only growth with more

“green” GDP but also welfare-oriented growth based on the elimination of poverty. This pattern of growth is central to his long-term vision of the development of the Chinese economy, which in turn leads to the realization of his “China Dream for the rejuvenation of the Chinese nation.”

The economic version of the China Dream

Xi Jinping made his first reference to his favorite slogan, “China Dream” at the 18th Party Congress in 2012. This concept originally implied a strong nation with a strong military. However, Xi this time has substantiated it with concrete strategic economic targets. Thus, his vision of “China Dream” is now to coincide with his vision of the long-term development of China’s economy that is marked by three distinctive milestones:

- 1 Becoming a *Xiaokang* (moderately well-off) society by 2020.
- 2 Striving to achieve a modern socialist economy by 2035.
- 3 China to become a *Fu-qiang* (prosperous and strong) country by 2050.

Becoming a Xiaokang (moderately well-off) society by 2020

This will also coincide with the first centennial of the founding of the CCP. What is exactly *Xiaokang*? It is quite a nebulous concept based on vague and variable standards. To an ordinary Chinese, *Xiaokang* simply conveys the feeling of “neither affluent nor poor” in terms of having just satisfied his basic needs of *Wen-bao* or having enough to “wear and eat.”

Actually it was Deng Xiaoping who first used the term *Xiaokang* in December 1979 to publicize his Four Modernizations program, which would be at a bare *Xiaokang* level of living by the end of the twentieth century. Subsequently, this term had been loosely and widely used as a code-word for China’s socio-economic development. To Xi Jinping, China will have realized its *Xiaokang* society in 2020 when it will have eliminated absolute poverty.

China has long been a showcase in the global war on poverty. By 2016, over 800 million people in China have been lifted out of poverty because of its successful economic and social development over the past three decades. China today has basically eradicated open urban poverty, leaving only a small number of really poor people in the rural areas.

In 2016, the rural poverty rate also came down to 4.5 percent, with those below the poverty line living mostly in remote regions or areas populated mainly by ethnic minorities.⁴ However, the remaining rural poor still translate into 43 million or about 7.3 percent of the total rural population. In recent years, Xi Jinping has been personally involved in China’s anti-poverty war, and he wanted to eradicate China remaining poverty by 2020.⁵

What does China’s economy look like in macroeconomic terms when it becomes the *Xiaokang* society in 2020? Based on its current growth momentum, China’s economy should be able to grow at an average rate of 6.5 percent for

2017–2021. When China in 2021 has already become a *Xiaokang* society, its per-capita GDP will be about US\$12,000, or just at the threshold of the developed economy status. But this implies that China will have also escaped from the Middle-Income Trap.

In world ranking, China's per-capita GDP of US\$12,000 by then is still quite low, at about the level of today's Argentina or Poland. In total GDP, China will then be an economy of US\$15 trillion, compared to its US\$11 trillion today or the US\$19 trillion of USA.

Striving to achieve a modern socialist economy by 2035

Xi Jinping understands very well that the initial phases of a *Xiaokang* society only involve the elimination of absolute poverty or the satisfaction of people's bare basic needs. But people's basic needs everywhere vary over time and so *Xiaokang* remains a moving target.

Thus, Xi in his address called for continuing efforts to “struggle for another 15 more years” so as to build a “modern socialist economy” by 2035 on the basis of higher levels of *Xiaokang* and its extension throughout the country.

Assuming China's economy from 2020 to 2035 grows 5 percent on average—this projected rate seems realistic because of China's relative low per-capita level in 2020 and hence its strong demand-side growth potential—China by 2035 will clearly be a developed economy and also the world's largest economy with its total GDP of US\$30 trillion. But China will still not be a truly affluent society like the USA, as China's per-capita GDP by then will still be about US\$23,000, exactly the level of Taiwan's today, but only half of the USA. Precisely because of this, China is still hungry for further economic growth. Accordingly, Xi Jinping is still pressing ahead for the next stage of development!

China to become a Fu-qiang (prosperous and strong) country by 2050

The year 2049 will also be the first centennial of the founding of the People's Republic. Using similar economic growth arithmetic and assuming China's economy to grow at 3.5 percent on average for another 15 years from 2035, China by 2050 will fully realize Xi Jinping's “China Dream” of achieving rejuvenation to become rich and powerful. Being rich of course means that there is no more absolute poverty, though the question of “relative poverty” may still be there. China's per-capita GDP by then will be about US\$40,000 or the same as today's Germany's but still lower than the US level. In total GDP, China will be a gigantic economy of US\$50 trillion, almost three times more than the US total GDP today.

There is a caveat for the above. The projections above are in nominal GDP at current (2016) prices and current exchange rates. For an international comparison of GDP, purchasing power parity (PPP) (by international prices) is often used. But GDP in terms of PPP tends to exaggerate the real size of a low-income

economy. Thus, China in 2014 has already become the world's largest economy in terms of GDP by PPP!

One also needs to bear in mind that as China's economy continues to grow over time, the exchange rate of the RMB will also rise while the US dollar may eventually fall. Because of this exchange rate effect, China's per-capita and total GDP in 2035 or 2050 will be significantly larger in US dollar terms.

The challenges for China's next lap

China ended its three-decades of double-digit high growth in 2012 at 7.7 percent. Growth has since decelerated gradually at an average rate of 7.2 percent during 2012–2016. International media has grossly exaggerated or sensationalized China's such relatively lower growth as a “big slowdown.” In fact, China's current “low growth” is low only in terms of China's own historical growth track. For China's vast economy today of US\$11 trillion, any growth of 6–7 percent is still a very high growth rate.

What is important is that in its transition to its own lower growth, China has already exhausted its former growth potential, having weakened its major growth drivers. China therefore needs to cultivate its new sources of growth for the next lap. Here lies the real challenge for Xi Jinping's long-term vision of China's economy.

China's economy had performed remarkably well in its catch-up phase of development. With a declining workforce, China's future growth will depend on productivity growth, which in turn depends critically on successful institutional changes (e.g., market reform and better governance) as well as innovation and further technological progress.

Overall, Xi's long-term developmental goals look achievable from technical angles. China is clearly not lacking in capital requirement, human resources, and entrepreneurship. China in recent years has achieved remarkable progress in its science and technology. It has also made a good start, or even is leading in some areas of the New Economy, e.g., artificial intelligence and the Internet of things.

For the impact of institutional change and market reform, much depends on one's political value judgment. Xi's strong leadership can translate into strong political will to carry out needed changes and reforms. But his penchant for tighter political and ideological control could also complicate the state-market relations. There is still a lot of uncertainty in this area.

East Asian experiences in poverty alleviation

East Asia, as conventionally defined, comprises Japan, Korea, China (including Taiwan and Hong Kong) in the northeast and the 10 southeast countries that constitute the Association of Southeast Asian Nations (ASEAN). Geographically, these countries are all situated on the Western rim of the Pacific. Politically, these 13 countries constitute the “ASEAN plus Three.” Economically, most East Asian countries are well known for their dynamic economic growth, with Japan,

South Korea, Singapore, and China (including Taiwan and Hong Kong) having registered double-digit rates of growth for two to three decades. Other ASEAN countries like Malaysia, Thailand, and Indonesia had also experienced high growth performance for a long period. Even latecomers like Cambodia, Laos, Myanmar, and Vietnam have also had reasonable growth performance (see Table 11.1).

Successful economic development is, of course, fundamental to the alleviation of poverty. Since the growth performance of these East Asian economies has been uneven, the overall track records for poverty reduction in the region are also quite mixed. By and large, the developed economies like Japan, South Korea, Taiwan, Hong Kong, and Singapore have successfully done away with their absolute poverty, with their current preoccupation mainly with their kind of relative poverty.

China, Malaysia, and Thailand, thanks to their long periods of successful economic growth, are at the transitional stage of having basically resolved their absolute poverty problem, with their current poverty-fighting policy targeting certain regions or certain groups. For Indonesia, the Philippines and the new ASEAN members of Cambodia, Laos, Myanmar, and Vietnam, the main thrust of their poverty alleviation policies is still on reducing their absolute poverty in order to meet the Millennium Development Goals.

China's overall poverty eradication performance has been historically the most creditable. The World Bank had openly praised China for having lifted a record number of people out of poverty—some 500 million in the two decades following its 1978 market reform. According to the United Nations, 70 percent of the achievements of global poverty reduction came from China. By its original bare minimum standard, only 2.8 percent of China's rural populations were still considered "poor." As the government revised its poverty line upward to 2,300 yuan per person per year in 2011, the poverty rate rose to 13 percent, with additional 128 million rural poor. As urbanization is making rapid progress, China will have to address urban poverty. The government has already put in place the "Minimum Livelihood Guarantee Scheme" or *Di Bao* to provide assistance to the urban poor.

Japan is the most developed country in the region with its cities basically slum-free while it also has no serious problem of open unemployment. Japan naturally has little visible absolute poverty. Still, Japan has its own group of working poor, and the government recently put its poverty rate at 16 percent. As a rapidly aging society, Japan's poverty problem will increasingly involve its poor elderly.

For Korea, on the eve of its industrialization in 1965, its per-capita GDP was then only US\$110, with 55 percent of its population living in poverty with virtually no public assistance and no social insurance. Its absolute poverty had since rapidly declined, following successful economic growth. Much like Japan, Korea's overall poverty rate today is at about 16 percent, and the problem is also mainly confined to the elderly population, as almost half of the population over 65 are affected by poverty. As a society still with strong Confucian values,

Table 11.1 East Asia performance indicators

Countries	Population	GDP Per	Growth of GDP (%)										
	(Mn)	Capital (US\$)	(US\$ Bn) 2012										
2013	2013		Total GDP	1960–1970	1970–1980	1980–1990	1990–2000	2000–2010	2011	2012	2013		
China	1,362	6,747	8,252	5.2	5.5	10.3	9.7	10.3	9.2	7.8	7.7		
Japan	127	38,491	5,984	10.9	4.3	4.1	1.3	1.1	−0.7	2.2	1.5		
South Korea	50	24,382	1,151	8.6	10.1	8.9	5.7	4.2	2.4	2.7	2.8		
Taiwan	23	20,980	455	9.2	9.7	7.9	5.7	3.9	1.1		2.2		
Hong Kong	7.2	37,775	258	10	9.3	6.9	3.8	4.6	5.0	1.8	2.9		
ASEAN-10													
Brunei	0.4	39,942	16.9	−	−	−	2.1	1.5	1.9	2.7	1.9		
Cambodia	15.1	1,075	14.3	−	−	−	6.4	7.9	6.9	6.5	7.0		
Indonesia	243	3,590	894	3.9	7.2	6.1	3.8	5.2	6.5	6	5.8		
Laos	6.7	1,476	9.3	−	−	−	6.1	7.1	8.0	8.3	8.3		
Malaysia	30.2	10,547	307	6.5	7.9	5.3	6.5	5.5	5.1	4.4	4.7		
Myanmar*	53.3	868	54	−	−	−	6.1	10.8	5.5	−	5.5		
the Philippines	99.5	2,790	2,407	5.1	6.0	1.0	3.3	4.9	3.7	4.8	6.8		
Singapore	5.4	54,710	268	8.8	8.3	6.7	7.4	5.9	4.9	2.1	4.9		
Thailand	64.1	5,674	377	8.4	7.1	7.6	3.8	4.9	0.1	5.6	2.9		
Vietnam	89.7	1,901	138	−	−	−	7.3	7.4	5.6	5.1	5.3		
India	1,243	1,615		4.4	3.1	5.2	6.5	7.5	6.9	5.4	4.7		

Source: CIA Fact Book.

Note

* Myanmar GDP data is estimated based on 2006 figures.

Korea wants the family to continue taking up certain social obligations for poverty alleviation.

Malaysia is an upper middle-income economy that had in the past experienced a long period of successful economic development so that its absolute poverty was drastically reduced from 49.3 percent in 1970 to 1.7 percent in 2012. In particular, the government's overall development programs have since the 1970s built in strong "redistributive policies" to benefit the country's dominant *Bumiputera* ethnic group, which were originally the poorer segment of society. When economic growth came down in recent years, however, its relative poverty rate had also increased from 17.4 percent in 2007 to 20 percent in 2012. Malaysia is a multi-racial society; but its poverty has hit all racial groups. In fact, poverty has now become increasingly class-based.

Thailand is also an upper middle-income economy. Its poverty problem has been primarily a rural phenomenon, with over 80 percent of the poor people living in the rural areas. Along with rapid economic growth in the past two decades, overall poverty rates have also sharply declined, from 32.3 percent in 2003 to 13.2 percent in 2011, and further to 10.9 percent in 2013. This is a remarkable achievement, given that income inequality in Thailand has been consistently very high with the Gini coefficient at around 0.5.

On account of its huge population (the second largest in the region after China), Indonesia is still a lower middle-income economy in the region despite its several decades of industrialization efforts. But strong economic growth has reduced its incidence of poverty over the years, with the poverty rate falling from 40 percent in 1976 to 24 percent in 1999, and further to only 11.4 percent in 2013. The government even set the ambitious target of cutting it down further to 9.5 percent by 2015. Indonesia's remarkably low poverty rate is perhaps influenced by its relatively more equal income distribution. Almost alone in ASEAN, Indonesia has fairly equal income distribution as manifested in its low Gini coefficient of just around 3.8.

The Philippines is another large lower middle-income economy in the region. Despite its early start in industrialization (ahead of South Korea and Singapore), the Philippines had failed to sustain strong economic growth for a long period, for various political and social reasons. Thus, both poverty and income inequality have remained a big challenge, even though its recent economic outlook has markedly improved. Based on the US\$1.25 a day in purchasing power parity terms, the country's poverty rate dropped from 40 percent in 1985 to about 20 percent in 2012 while its Gini coefficient in 2012 still stood at a high level of 0.50. On both counts, the Philippines seem to be worse off than Indonesia.

Of the four new ASEAN members, Cambodia had the best poverty reduction performance, with its poverty rate falling sharply from 53 percent in 2004 to 20.5 percent in 2011. Vietnam had also made highly impressive progress on poverty reduction after its successful market reform, also with its poverty rate falling sharply from 60 percent in the early 1990s to just 21 percent in 2010. For Laos, its poverty reduction performance had similarly been remarkable despite being a landlocked economy, with its poverty rate falling from 46 percent in

1992 to 26 percent in 2010. Laos has achieved the Millennium Development Goal target of halving its poverty incidence by 2015.

For Myanmar, as its national priority was for many years not high on poverty alleviation (as opposed to national unity) until recently, its progress in this area had also been quite slow. According to the Asian Development Bank, at least a quarter of the population is still below the poverty line, and many more are just precariously above it. Myanmar is clearly facing a big challenge of how to step up its economic development and reduce its poverty level.

Singapore's unique approach to poverty alleviation

Singapore as a small city-state currently has the highest per-capita GDP (US\$56,000 in 2014) in the region, much higher than Japan's (US\$36,500, partly also due to the yen devaluation). Notwithstanding its high level of development and affluence, Singapore has its own challenges in confronting the poverty problem. But the Singapore government's approach to poverty alleviation is quite different from others in the EA region.

To begin with, the government has all along refused to define the incidence of poverty by publishing any official poverty line. It takes the view that setting up such a single poverty line by merely classifying a certain group of people as poverty-stricken is operationally not useful for policy purposes. All societies have a group of economically and socially vulnerable individuals who have fallen into poverty for various reasons, ranging from unemployment to family break-up or ill health. Any one-size-fits-all definition serves no practical use in terms of policy implementation. Thus, as the government argues, it would be far better to concentrate on specific policies or schemes to assist specific target groups rather than simply stigmatizing this needy group through an artificial or arbitrary definition of poverty.

However, the government has published data concerning the median household income level, income inequalities and the average household expenditure on basic needs, which have easily enabled scholars to estimate their own poverty incidence in Singapore. Among various estimates, the poverty rate of 10–12 percent for 2011 seems quite reasonable.

Notwithstanding the different poverty rates, Singapore's poverty problem is basically of the kind of relative poverty, rather than any widespread absolute poverty. Singapore long ago established the Public Assistance scheme to provide long-term financial assistance to individuals or families, who really are the "hard-core poor"—those who are permanently unable to work due to old age, disability, or other serious family problems. About 3,000 households in Singapore are presently in need of such long-term public assistance.

The main feature of Singapore's approach to poverty alleviation is its strong emphasis on attacking the root causes of poverty. This involves maintaining continuing economic growth and full employment (i.e., no job, no income), on the one hand, and supporting human resource development through education and training, on the other, so that most people can participate in the economic

development process. Such is the central idea that if someone does not take part in the development process, he or she also cannot benefit from it.

At the more fundamental social level, the government has developed public housing (Housing & Development Board flats) for 80 percent of the population; and has enrolled all workers into the compulsory pension scheme (CPF), which provides some basic retirement and health care benefits. Beyond these bare minimum social security provisions, Singapore has not put in place any other social programs such as minimum wages and unemployment benefits that are commonly available in a welfare state.

The Singapore government under the present ruling People's Action Party is fundamentally against any form of state welfarism. The government instead assists workers to stay employed as much as possible through training and other incentives, e.g., the Workfare Training Support (WTS) scheme and the Workfare Income Supplement (WIS) scheme, supplementing older workers with additional incomes. In short, the government wants to prevent society from developing an "entitlement" or "aid dependency" mentality. Such is Singapore's hard-nosed and pragmatic approach to poverty alleviation, which is unique in the region. Singapore's experience may also have some useful lessons for others.

Suffice it to say that the East Asia region as a whole, despite its stellar economic growth performance and rapid social progress, is still facing, in varying degrees, the challenge of poverty alleviation. Overall, the poverty reduction performance in the EA region is quite creditable by global standards. But the progress has been uneven. For individual East Asian countries, both the nature of their poverty and the extent of their poverty rates are not comparable, much depends on the stages of economic and social development of the individual countries as well as their special social and institutional characteristics. Nonetheless, in their "War on Poverty," many governments in the region can still share their useful experiences.

Notes

- 1 An earlier version of the chapter was originally printed in *East Asian Policy*, 7(4) (2014): 78–87. We thank the journal for granting the permission to reprint the paper in this book. The notes and references were added by the editors.
- 2 <https://aspe.hhs.gov/2013-poverty-guidelines> (accessed January 28, 2019).
- 3 Government of Hong Kong (2013).
- 4 See www.adb.org/countries/prc/poverty (accessed January 28, 2019).
- 5 See <https://foreignpolicy.com/2018/01/08/chinas-war-on-poverty-could-hurt-the-poor-most/> (accessed January 28, 2019).

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12 The impact of economic development on the social structure of the Japanese rural community

Yoshihisa Godo

Introduction

Many countries in Asia are witnessing rapid heavy industrialization. In these countries, the size of the agricultural sector and its share of total employment in the national economy are sharply declining. However, agriculture still plays an essential role in policy-making. Farmers who feel economically marginalized often cause social unrest, which can threaten the government.

In this context, Japan presents a unique example. Since the Meiji Restoration of 1868, Japan has experienced two periods of heavy industrialization: the first spanned between the 1910s and the 1930s (“pre-war heavy industrialization”) and the second between the 1960s and 1980s (“post-war heavy industrialization”).¹ The impacts of these two heavy-industrialization periods on rural communities were rather different. In the pre-war period, the income disparity between farmers and non-farmers increased, causing social unrest, such as peasant unrest in rural areas. In contrast, the income gap between farmers and non-farmers decreased in the post-war industrialization phase.

What made the difference? What is the implication of the Japanese experience for today’s international society? By studying the rural community structure behind Japan’s economic development, this chapter tries to provide answers to these questions.

In particular, this chapter emphasizes two factors that determine the social structure of the Japanese rural community: on the one hand, the collective nature of Japanese agriculture, which requires farmers’ close collaboration in the usage of water, and the investment in social overhead capital; on the other hand, capitalism, which undeniably permeates the Japanese rural community. As these two factors often contradict each other, farmers may face difficulties in addressing them simultaneously. Hence, finding a solution to this problem is key to sustainable economic development.

The remainder of this chapter is organized as follows. The next section discusses the nature of Japanese agriculture. Then the social structure of the rural community in the feudal period during which capitalism was still undeveloped is described. How farmers responded to the advent of capitalism during the light industrialization period, the pre-war heavy industrialization period, and

the post-war heavy industrialization period is discussed. Finally, the political implications of Japan's experience concludes.

The nature of Japanese agriculture

Rice is the most important crop in Japan's agricultural sector. Japanese families eat rice as part of their daily diet.² During feudal times, the economic power of a feudal domain was measured by its recognized rice yield. Many Japanese festivals celebrated even now have their origins in rice farming events.

Japan's rice production system is unique. To farm rice, farmers irrigate each parcel of a paddy field and maintain constant water speed and level according to the crop's growth stage. Although Japan gets substantial rainfall, water flows quickly to the ocean due to the country's mountainous topography. To use rain-water efficiently for rice farming, farmers in a community need to collaborate. In other words, the misuse of water by any individual farmer has a significant impact on the entire farming community.

Social overhead capital, such as irrigation facilities and agricultural experiment stations, also play a critical role in Japanese agriculture. A free market competition issue, known as the "free rider" problem, can result in the shortage of social overhead capital.

Thus, laissez-faire style market mechanisms are not effective in Japan's farming sector. How to encourage teamwork among farmers has been a chronic problem in the history of Japanese agriculture.

The manorial system before the Meiji restoration

During the Tokugawa Shogunate period (1603–1867), the rural community was under a manorial system called *Ryoshu Sei*. The lord of the feudal clan, called *Ryoshu*, was in charge of the enforcement of water use plans and investment in the irrigation system, and farmers offered their services in implementing such plans. Each farmer was obliged to engage in farming at the farmland inherited from his parents. Any farmland transaction other than inheritance, such as buying and selling, lending and borrowing, and pawning, were prohibited in principle. Additionally, farmers were not allowed to grow any crops other than rice unless they received special permission from the *Ryoshu*. As tax, farmers paid half of their harvested agricultural produce to the *Ryoshu* through their village head.

Ryoshu Sei efficiently enforced collaboration among farmers. In addition, if a village had the best harvest among its neighboring villages, farmers in the village received a reward from the *Ryoshu*. This recognition encouraged village heads to increase agricultural productivity in their villages. As a result, agricultural production increased nearly 1.5 times during the first 100 years of the Tokugawa Shogunate period (Teruoka 2003).

However, *Ryoshu Sei* had a severe flaw in that it hindered innovation in farming technologies and crop varieties. When new farming technologies and/or crop

varieties became available, agricultural productivity increased only if the water use plan was modified appropriately. However, the *Ryoshu*, who lived in a castle town and were mainly engaged in administrative work, often did not sufficient knowledge in the effective use of water for farming to be able to redesign a water use plan. They often preferred to maintain the status quo instead of taking risks associated with adopting new technologies and/or varieties. Further, it was difficult for the *Ryoshu* to find and promote new farming technologies and crop varieties because they were unfamiliar with the practical details of farming practices.

Thus, farmers who wanted to increase their productivity had to adopt new technologies and/or varieties themselves without letting the *Ryoshu* know. To obtain a reward from the *Ryoshu*, farmers who created or used new technologies and/or crop varieties also had to keep this secret from farmers in neighboring villages. For example, villagers placed guards at village borders to prevent farmers in neighboring villages from spying.

The Tokugawa Shogunate also introduced the so-called “gate system,” whereby villagers were not allowed to leave their home villages without the *Ryoshu*’s permission. The gate system was a powerful tool for enforcing the ruler’s orders on the ruled. However, it hindered the expansion of new technologies and adoption of different crop varieties.

As a result, agricultural productivity stagnated in the late nineteenth century despite the emergence of new, high-potential technologies and crop varieties (Hayami and Yamada 1991).

Self-farming landlords in the light industrialization period

In 1868, the Meiji government took power from the Tokugawa Shogunate; this event, called the Meiji Restoration, marked the beginning of the light industrialization period. As part of this change, the Meiji government launched various reforms to modernize Japanese society, which included the introduction of a Western-style market economy, a marketization policy that entailed abolishing the gate system, and a modern public transportation system, that included railways and a postal service. The Meiji government also encouraged personal exchange among veteran farmers. These reforms stimulated the spread of new farming technologies and crop varieties.

One of the most important reforms immediately after the Meiji Restoration was the Land Tax Revision, which took place from 1873 to 1881. The revision changed the federal tax, levied in proportion to quantities harvested, to the modern land tax, which was based on the value of land. As part of the reform, the government issued land certificates, which reported the owner of the farmland and the value of the land, to the landowner for each parcel of land. The owner was yearly taxed 3 percent of the land’s value. Prohibition on farmland leasing, pawning, and trading was abolished, and farmers were finally free to produce any crop they desired.

The Land Tax Revision ensured stable tax revenues to the government. In addition, this revision introduced free competition in the farmland market.

In particular, wealthy families took advantage of this change by accumulating farmland through the purchase of land certificates. This was because the financial market was still undeveloped and land was the safest assets for the first three decades after the Meiji Restoration. At that time, due to the underdevelopment of agricultural machinery and pesticides, the optimal farming size was limited to around one hectare. Thus, wealthy families self-farmed a small portion of their farmland while renting out larger portions (usually around one hectare each) to tenant farmers from whom they collected rental fees. They were called “self-farming landlords.”

The Meiji government also introduced a Western-style modern education system. However, only wealthy families could afford to send their children to high-quality schools. The wealthy families who benefited from a high-quality education functioned as gatekeepers for scientific and agricultural knowledge, which was necessary to improve agricultural productivity in their hometowns.

During this time, wealthy families were motivated to take up leadership roles in the local agriculture sector: by increasing overall agricultural productivity in their local communities, wealthy families were able to increase not only farm income from their self-farming farmland, but also payments from farmland rented out to tenant farmers.

In the meantime, wealthy families also tried to improve how they were perceived in their hometowns by showing consideration for all villagers. For example, they often functioned as a safety net provider to low-income families (e.g., giving charity to low-income families) and showed consideration for villagers by allowing late or partial payments if farmers were unable to pay their rent.

This relationship between self-farming landlords and tenant farmers reflected the political system of the Meiji government. Only wealthy families who paid a certain amount of tax obtained the right to vote in national parliamentary elections.³ The Meiji government assured wealthy families’ economic freedom. In return, wealthy families provided a social safety net, acting as a substitute for the Meiji government, whose administration was too immature to provide sufficient social security to citizens and was still in the process of modernization.

As such, the rural society in this period was characterized by favorable conditions, as villagers collaborated with each other under the leadership of self-farming landlords. However, this situation gradually became unsustainable as the Japanese economy shifted from the light industrialization stage to the heavy industrialization stage.

Social unrest in the pre-war heavy industrialization period

Japan’s light industrialization period, which started around the Meiji Restoration, ended in around 1910. World War I (1914–1918), which damaged heavy industries in European countries, provided a rare opportunity for Japan to increase its share of heavy industrial products in the international market. As a result, Japan entered the stage of heavy industrialization in the second half of the 1910s.

Heavy industrialization was accompanied by the transfer of two major economic resources—labor and financial capital—from rural to urban areas. This is because, unlike light-industry factories, heavy industry factories form large industrial complexes in urban cities where modern traffic and information systems are located.

Statistics support the view that both workers and capital underwent a significant shift from rural to urban areas from around 1915 to the 1930s. It is estimated that the population of Tokyo doubled from 1915 to 1930 (Tokyo Institute for Municipal Research 1988). Teranishi (1982) also reports a large capital flow from the agricultural to the non-agricultural sector in the second half of the 1910s and the first half of the 1920s.

Heavy industrialization also brought a significant income gap between urban and rural areas. Table 12.1 shows that, after World War I, the share of agriculture in Japan's GDP declined faster than did its representation in the workforce. The following four factors account for this rural poverty:

- 1 Changing economic concerns of local wealthy families.
- 2 Obstacles to the migration of the workforce.
- 3 Political weakness of tenant farmers.
- 4 Military reasons for sacrificing the agricultural sector.

Changing economic concerns of local wealthy families

During the light industrialization period, as mentioned earlier, wealthy families stayed in their hometowns and assumed leadership in the local agricultural industry as self-farming landlords. However, after World War I, many of them

Table 12.1 Japan's economic growth and income disparity between farmers and non-farmers

	<i>Real GDP per capita</i>	<i>Share of agriculture labor force</i>	<i>GDP</i>	<i>Farm/non-farm household income ratio</i>
	<i>1990US\$</i>	<i>(%)</i>	<i>(%)</i>	<i>(%)</i>
1885	804	73	45	76
1890	956	71	48	87
1900	1,110	68	39	52
1910	1,226	65	32	47
1920	1,590	54	30	48
1930	1,732	50	18	32
1935	1,992	47	18	38
1955	2,648	39	21	77
1960	3,815	32	13	70
1970	9,285	20	6	94
1980	12,730	11	4	116
1990	17,841	7	3	117
2000	19,926	4	1	109

gave up self-farming and moved to the urban areas to invest in heavy industry factories. Even after leaving for urban areas, many wealthy families retained their farmland in rural areas as a part of their portfolio. This new type of landlords, called “absent landlords,” became the most common type of farmland ownership.

In contrast to self-farming landlords, absent landlords did not take on leadership roles in the local agriculture sector. Accordingly, it became difficult for rural societies to organize water use and sufficiently invest in social overhead capital.

Conflicting interests emerged between absent landlords and tenant farmers. Negotiation for tenant conditions such as rental rates became tough. Absent landlords and tenant farmers often made rigorous demands of each other. Often, bitter strife arose. This was called “peasant unrest” and was recognized as one of the most serious social problems at the time. Peasant unrest began in the second half of the 1910s in western Japan, where heavy industrialization first occurred. At their peak, in Japan, the number of peasant unrest reached 7,000. Under such circumstances, it became difficult for farmers to concentrate on farming (Teruoka 2003).

Obstacles to the migration of the workforce

In spite of the large-scale labor migration from rural to urban areas, the gap in wage rates between these regions continued to widen after World War I. Using sophisticated statistical methods, Hayashi and Prescott (2006) argue that some factors hindered rural laborers’ (including farmers) migration from rural to urban areas. The authors do not specify what the factors were. Instead, they mention the possibility that the Japanese cultural trait of respecting one’s parents pressured rural residents to stay on in their parents’ residences. Thus, Hayashi and Prescott prove that rural areas suffered from an oversupply of workers during this period.

Godo (2013a) recognizes the importance of culture in influencing people’s behavior. Still, Godo argues that the need to control water distribution was the primary reason for the oversupply of labor in rural areas. Before the Pacific War (1941–1945), when electric pumps were not yet widely used, farmers needed to collaborate so labor-intensive irrigation systems would function. For example, to keep water running in creeks at a steady speed, farmers in a village took turns pumping the water wheels, called “field vehicles.” If the number of farmers decreased, there would not be enough people to pump the water wheels, the water control system would malfunction, and agricultural production would be impacted. This put implicit pressure on farmers to stay in their hometowns.

Political weakness of tenant farmers

In the 1920s and 1930s, how to cope with the peasant unrest became a top-priority issue for the government. At first, reformist bureaucrats in the Ministry

of Agriculture and Commerce, such as Gon-ichi Kodaira and Tada-atsu Ishiguro, tried to establish the Tenant Farmer Law (TFL), whereby the rights of tenant farmers were protected. However, because of the underdevelopment of democracy, a majority of politicians and bureaucrats put more emphasis on the interests of landlords (i.e., the propertied class) than those of tenant farmers (the unpropertied class). As a compromise, instead of the TFL, the Peasant Conciliation Law (PCL) was established. The PCL stipulated that each municipality should create a Peasant Conciliation Committee (PCC), which was responsible for presenting reconciliation proposals for peasant unrest. Under the PCL, the interests of tenant farmers were treated lightly because the majority of PCC members comprised landlords.

Military reasons for sacrificing the agricultural sector

In the latter half of the nineteenth century, Japan was at the risk of being colonized by Western countries. To secure sovereignty, the Japanese government adopted and kept advocating the doctrine of “developing national prosperity and military strength,” even after its victories in the Sino-Japanese War (1894–1895) and the Russo-Japanese War (1904–1905), which improved its position in the international arena; this was important to survive during the world’s competition for hegemony, which became fierce after World War I.

Triggered by World War I, new weapons such as tanks, airplanes, and poison gas were developed. To manufacture these weapons, heavy industry technologies and facilities were necessary. Thus, the promotion of heavy industries became the top priority under Japan’s doctrine of “developing national prosperity and military strength.” However, the government did not have sufficient financial resources to do so. As a result, it often sacrificed ideal conditions in agriculture to allocate more resources to heavy industry. For example, the government encouraged importing food from Japan’s colonies (e.g., Korea and Taiwan) to push down the wage rate of factory workers, whose Engel’s coefficient was high. In addition, it took steps to strengthen the yen, such as introducing the gold standard in 1930, which significantly overvalued the yen. As Japan’s heavy industry companies at that time needed to import various mother machines and raw materials, they welcomed a stronger yen. Japan’s heavy industry commodities were mainly sold in the domestic market (including Japan’s colonies), which was protected by both tariff and non-tariff barriers, and, thus, a stronger yen did not affect sales (Japan’s heavy industry products had international competitive power only when factories in European countries were damaged in World War I.) However, a stronger yen damaged the agricultural industry, which was Japan’s major exporting sector up to then.

Income redistribution policy in the post-war heavy industrialization period

The Pacific War severely damaged the Japanese economy. In particular, large factories and infrastructure in urban areas were major targets of the US bombing campaign. According to Ohkawa and Shinohara (1979), more than a quarter of physical stocks (private and public) were lost in the war, while some metropolitan cities were completely obliterated. A large number of rural workers, who had migrated to urban areas before the Pacific War, lost their jobs and were forced to return home. Japanese immigrants living in the country's colonies and soldiers in overseas wars also returned to Japan and began engaging in farming activities. Thus, Japan was significantly de-urbanized immediately after the Pacific War. Indeed, the proportion of the population living in the three major metropolitan areas (i.e., Keihin, Chukyo, and Keihanshin) dropped to 27 percent in 1945, below the 1920 levels (Godo 2013a).

However, Japan started on a path of miraculous economic recovery around 1950 and re-experienced heavy industrialization from the 1960s to the 1980s. Interestingly, during this period of heavy industrialization, the income gap between farmers and non-farmers, which had increased until the end of the 1950s, began decreasing. Farmers' income levels became equivalent to those of non-farmers by 1970 and kept rising higher after that, in sharp contrast to the pre-war heavy industrialization phase. This rise in farmers' incomes occurred due to changes in rural and urban societies after the Pacific War, as discussed below.

Rural society after the Pacific War

Japanese society was democratized in the early post-war period under the governance of the Allied Forces. In addition, the power structure of the rural community changed entirely following drastic agricultural land reforms from 1946 to 1949, whereby farmland owned by absent landlords was transferred to tenant farmers. This was recognized as one of the most significant democratization policies introduced by the Allied Forces and resulted in a large number of former tenants becoming owner farmers organized into a national network of agricultural cooperatives known as *Nokyo*. With the passing of time, *Nokyo* took a dominant position in the rural society.

Nokyo provided not only agricultural services, such as joint shipments of agricultural products, but also a wide range of non-agricultural services, such as supermarkets, gasoline stations, banks, funeral services, and hospitals. It was a de facto sub-administrative body. Moreover, agricultural subsidies were distributed to farmers through *Nokyo*, which ensured coordination among farmers and promoted the formation of social overhead capital.

Furthermore, *Nokyo* functioned as a robust vote-receiving mechanism. It was one of the most influential supporters of the Liberal Democratic Party (LDP), which was in power from 1955 to 1993. Farmers' votes were essential for the party to stay in power. Thus, LDP implemented strong income redistribution

policies that favored farmers. In the 1960s, for example, price support for agricultural commodities was the primary channel to assure income redistribution to farmers. However, the price support policy resulted in severe oversupply of agricultural commodities in the early 1970s.

In addition, the development of labor-saving farming technology increased the popularity of part-time farming. The majority of farmers farmed only on weekends and earned their living from non-agricultural jobs. For part-time farmers, LDP's price support policy for agricultural commodities was no longer attractive. Therefore, in the 1970s and 1980s, LDP distributed more money to farmers by promoting large farmland conversion projects in rural areas, such as building shopping centers, factory sites, and public facilities.⁴ Those farmland conversion projects benefitted farmers in two ways: first, their farmland was purchased at high prices; second, shopping centers, factories, and public facilities provided new, non-farming income opportunities in rural areas.

Furthermore, workforce migration from rural to urban areas occurred more rapidly in the post-war period compared with the pre-war phase. The need for labor in rural areas had reduced owing to the development of irrigation facilities like electric pumps, which made the operation of irrigation and water drainage systems less labor-intensive. Thus, in contrast to the pre-war period, rural areas in the post-war phase did not suffer from the oversupply of workers.

Urban society after the Pacific War

While some urban dwellers criticized LDP's massive income redistribution to farmers and rural areas, the majority reluctantly accepted this policy for two reasons. First, rapid rural-to-urban migration caused various social problems such as traffic congestion and shortage of public facilities in urban areas. Therefore, to protect urban living conditions, city dwellers agreed to LDP's massive income redistribution scheme for farmers and rural areas, which slowed the pace of the workforce migration from the country to the city. Second, Japanese citizens have tended to show support for agriculture. Even though the statistics show that farmers' income levels have surpassed those of non-farmers, the majority of urban dwellers have retained a nostalgic image of "poor farmers."

Manufacturing and commercial sectors after the Pacific War

Business leaders in the commercial and manufacturing sectors also supported LDP's massive income redistribution to farmers and rural areas. This is mainly because the rural market was necessary for the commercial and manufacturing sectors to sell their products. For example, Toyota, the largest automobile producer, approved LDP's rice price support policy because farmers were important customers. During the Cold War period, business leaders' biggest concern was how to prevent communism from thriving in the Japanese society; they were afraid that rural poverty would foster communism among farmer, who gained strong political power after the post-war agricultural land reforms.

Implications of Japan's urbanization experience for the international society

Before discussing the implications of Japan's experience, it is useful to briefly review the general relationship between heavy industrialization and rural poverty.⁵ Figure 12.1 shows how the political objective changes with economic development. The "food-shortage-problem stage" is defined as the stage wherein concern regarding securing low-price food dominates agricultural policies, and the "overprotection-problem stage" refers to the stage wherein concern regarding balancing farmers' and urban workers' income levels dominates agricultural policies. The "disparity-problem stage" is defined as the stage wherein both the aforementioned concerns are more or less equally important. These three stages roughly correspond to the low-income, high-income, and middle-income stages, respectively.

At the disparity-problem stage, the prime concern of politicians is to relieve farmers' poverty. However, "poverty" here means not absolute poverty but relative poverty.⁶ Absolute poverty among the farmer population is less severe in middle-income countries than in low-income countries. In the middle-income stage, where industrialization progresses by borrowing technology from developing countries, newly rich families, including the bourgeoisie in large-scale modern enterprises, form a new social class in urban areas. Observing an income difference from the newly-risen urban families, farmers become envious and eventually develop grudges against the social system that keeps them in poverty; such feelings occasionally culminate in social disruption.

Supported by the sympathy of the intelligentsia, farmers' dissatisfaction may escalate to the level of serious anti-government movements. Therefore, the government is forced to adopt agricultural protection measures. However, this protection is not strong enough to reduce the income gap between farmers and urban workers, unlike in the high-income stage. As the percentage of agriculture as part of the GDP remains relatively large, it is impossible for the government to secure sufficient financing to close the income gap. Additionally, increased food prices cause major damage to factories in urban areas, which rely heavily on

Figure 12.1 Agricultural problems at different stages of economic development

cheap labor. Developing countries can move from the low-income stage to the middle-income stage by borrowing technology from developed countries. However, successful heavy industrialization by technology transfer tends to result in disparity between farmers and newly-risen urban families.

Today, many developing countries suffer from a similar income disparity between farmers and non-farmers. Further, this income gap tends to widen following heavy industrialization. Although Japan experienced such a situation in its pre-war period, its post-war experience shows that heavy industrialization does not necessarily result in widening income disparity.

What caused the difference between the pre-war and post-war experiences? This investigation finds two major factors: labor mobility and democracy. Before the Pacific War, farmers were pressured to stay in their hometowns, and democracy was undeveloped. In contrast, after the Pacific War, farmers moved freely and gained strong voting power. As a result, the income disparity between farmers and non-farmers disappeared.

This lesson may also apply to contexts outside Japan. The large income gap between developing and developed countries is leading to greater population migration from emerging to developed economies. Owing to the fear of social conflict between native communities and immigrants, many developed countries have attempted to strengthen their border protection against population inflows from developing countries. A desirable scenario is that developed and developing countries form a world state whereby each citizen has the freedom of mobility and the same voting power. Since population in developing countries is much larger than that in developed countries, in order to survive elections, politicians will coordinate a massive income transfer from the developed countries to the developing countries. Such an income transfer has the effect of slowing down the speed of population movement from the developing to the developed countries. This means even citizens in the developed countries, who want to avoid massive population inflow of immigrants, will give grudging approval to the massive income transfer. Of course, it is unrealistic to expect that such a dream world state will be established in the near future.

Notes

- 1 The nature of Japanese agriculture began changing in the mid-1990s. This chapter focuses on the history of Japanese agriculture until the 1980s. See Godo (2017) for details of the new political dynamics of Japanese agriculture.
- 2 Strictly speaking, until the late nineteenth century, while rice was a favorite food of ordinary families, it was too expensive to eat in every meal. Rice was considered a luxury food for ordinary families, who ate mainly wild grains.
- 3 When the first general election in Japan took place in 1890, only men aged 25 or over who paid more than 15 yen in tax were qualified to vote. This category of taxpayers represented only 1 percent of Japan's total population.
- 4 See Godo (2013b) for details of the politics involved in farmland conversion in Japan.
- 5 Godo (2017) provides further discussion, based on Figure 12.1.
- 6 Concepts and measurement of poverty are further discussed in Hayami and Godo (2005).

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13 The urban informal sector and development in China

Institutions and feedback effects

Jiwei Qian

Introduction

“Structural change” is one of the most important notions in the development economics, which can be traced back to the classic paper written by Arthur Lewis (1954). “Structural change” in a developing country refers to “transition from a low income, agrarian rural economy to an industrial urban economy” (Syrquin 1988: 205). The increasing size of the urban informal sector in the process of the “structural change” has been studied by social scientists (La Porta and Shleifer 2008, 2014; World Bank 2012).

The informal sector has great relevance to economic development for two reasons. First, the majority of urban workers in developing countries work in the informal sector, after millions of people migrate from rural to urban areas (Basu 1997: 172 ILO 2018). Outcomes in the urban labor market are largely decided by the informal sector’s productivity, which is usually lower than that of the formal sector. Second, the informal sector is likely to be associated with poverty (ILO 2018, Kanbur 2017). A social safety net (e.g., social insurance programs) for the informal sector workers is important in terms of poverty alleviation. However, informal sector workers usually have difficulties accessing social insurance.

There are various ways of defining the informal sector in the literature. First, the informal sector can be defined by small-scale privately owned firms. Second, the informal sector could be also defined by the employment relation (e.g., without a written contract, flexibly employed, or self-employed). Third, it could be defined by the relation to government regulation. Fourth, the informal sector could be defined as an unregulated sector and the formal sector is defined as the regulated sector.

In China, after the dissolution of the central planning system, the size of the informal sector has been increasing since the 1990s. The urban workforce who work outside the formal sector enterprises has accounted for over half of the total urban workforce in recent years (Huang 2017; Jiang, Qian, and Wen 2018). With rapid urbanization, the numbers of the urban workforce have increased dramatically and many of them are working in the informal sector.

As is the case in other countries, low productivity and poverty are associated with the informal sector workers (ILO 2018, Kanbur 2017). From recent research

on the labor market in contemporary China, the income level of the informal sector workers is significantly lower than their counterparts in the formal sector. Also, the social protection for the informal sector is shallow in terms of both width and depth of social insurance coverage.

Labor regulations include employment law and social security law, which impose constraints on how employers and employees interact (Botero *et al.* 2004; Salverda and Checchi 2015; World Bank 2018). Similar to many other countries, there are labor regulations to provide worker protection and the social safety net for workers in China. In 2008, China enacted the Labor Contract Law to provide labor protection. In 2010, a Social Insurance Law was also enacted to provide the social safety net for workers.

It has been reported in the literature that high compliance costs for labor regulations could be associated with the size of the increasing informal sector (Botero *et al.* 2004; World Bank 2018). Regulation compliance costs refer to the costs that are incurred by firms who comply with the regulatory requirements, as well as the costs to government of regulatory administration and enforcement (OECD 2014). In this chapter, we also consider the compliance cost for workers as part of such regulation compliance costs. As suggested in the literature, a high regulation compliance cost could result in inflexibility of the labor market in employment relations for formal sector workers.

This chapter highlights the institutional reasons for understanding high compliance costs by reviewing a series of recent studies on the economic and social conditions of the urban informal sector in China. These institutional reasons include the intergovernmental fiscal system, the performance evaluation system for officials, and the household registration system (*hukou*). The intergovernmental fiscal system defines the government capacity in providing social programs and employment services as well as enforcing the social protection regulations. The performance evaluation system for officials defines the incentives for officials, especially local officials, in implementing social protection policies and enforcing labor market regulation. The household registration system (*hukou*) is another institution restricting workers' benefits claims from social insurance across regions and between rural and urban areas.

Due to these institutional reasons, regulation compliance costs are likely to be high and, consequently, the informal sector workers are less likely to access social programs. Further, the size of the informal sector is likely to be increasing. In this context, welfare losses are significant since human resources have been misallocated and are inefficient due to the institutional constraints (Whalley and Zhang 2007; Meng 2012).

However, we argue in this chapter that the welfare losses under these institutional constraints may not be as large as expected due to the existence of the feedback effects (i.e., workers respond to these institutional constraints). Anticipating high regulation compliance costs, workers may voluntarily join the urban informal sector. Informal sector workers may selectively opt out of social insurance for private insurance to have an alternative mechanism for risk pooling. With the high regulation compliance cost, the feedback effects could be very

significant. These feedback effects may offset the welfare losses to some degree. More interestingly, future policy reforms could lead to unintended consequences if policy-makers do not take these feedback effects into account.

The informal sector and development

The duality of the informal sector and the formal sector is very relevant to social and economic development. It was estimated that over 70 percent of the labor force work in the informal sector in developing countries while the share is about 5 percent in developed countries (Marjit and Kar 2012: 253–254). Informal employment accounts for more than 70 percent and 50 percent in Sub-Saharan Africa and Latin America (World Bank 2018: 125). One immediate concern is that the large size of the informal sector may lead to the loss of tax revenue since the informal sector enterprises are likely to be unregistered (e.g., see Besley and Persson 2011; Benhassine *et al.* 2018; World Bank 2018).

In this chapter, we focus instead on the implications of the informality for individual workers rather than government revenue.¹ In other words, this chapter discusses the interaction between the informal sector, the labor market outcomes, and social insurance. While the implication of the informal sector in public finance is very important, it is not discussed in detail, given the limited space.

The labor market duality could be associated with income as “the difference of the informal sector wage and formal sector wage for economically identical employees” (Rauch 1991: 34). However, it also could be associated with differences in institutional reasons, such as access to public services and differences in the level of regulation enforcement (Freeman 2010; Kanbur 2017).

Productivity is likely to be low in the informal sector and therefore the income/wage level is lower in the informal sector. For example, it was estimated in a cross-country study that value added per employee in informal firms accounted for only 15 percent of that of formal sector firms (La Porta and Shleifer 2008). Why the productivity in the informal sector is low could be the result of small-scale, inefficient management or limited resources or restricted access to credit (*ibid.*; Kanbur 2017).

Further, the informal sector workers are more likely to be associated with poverty (ILO 2018, Kanbur 2017). Similar to many poor households in developing countries, there are credit constraints and human capital constraints on the informal sector workers. With such constraints, the poor are more likely to remain poor when there is any external economic shock, in particular, adverse health shocks (i.e., the poverty trap, see Matsuyama 2008). Other reasons why informal sector workers are trapped in poverty include the lack of marketable skills, social exclusion, geographic isolation, suffering from debilitating disease, or environmental degradation (Ravallion 2015). In this case, accessing a social safety net is very important to the informal sector workers. However, when social insurance programs are implemented, secure protection from income insecurity caused by sickness, maternity, employment injury, unemployment, and old age, etc., they are more likely to cover the formal sector workers. The informal sector workers are

less likely to be covered by social programs compared to formal sector workers. For example, Figure 13.1 shows that the majority of households claiming social assistance benefit (i.e., Minimum Livelihood Guarantee Scheme) in urban China are flexible employed or unemployed (i.e., the informal sector).

Different definitions of the informal sector

How to define the informal sector is quite difficult. There are multiple types of definition of the informal sector. One definition is based on the types of ownership of the enterprises and the size of the companies. Small-scale privately owned enterprises are considered part of the informal sector. The other definition of the informal sector is based on the status of the employment relation. Individuals without a written employment contract are categorized under informal employment (Ghose 2005; Park and Cai 2011).

In the literature, the informal sector workforce can also be defined by their relation to government regulation. Informal sector workers are those for whom the labor regulation or social insurance contribution cannot be enforced (Guha-Khasnobis, Kanbur, and Ostrom 2006; Kanbur 2017). Sometimes, the informal sector consists of small-scale firms which select to “remain outside of the regulatory reach of the state” (Bardhan and Udry 1999: 51). According to this definition, the size of the informal sector could be varied with the local regulations (Kanbur 2017). For example, before 2011, the individual business was defined as businesses which hire no more than seven people in China. With a new regulation on individual businesses enacted in 2011, the seven-people threshold has been removed.²

Figure 13.1 Composition of Minimum Livelihood Guarantee Scheme beneficiaries in urban areas

Source: Ministry of Civil Affairs.

From the definition by the ownership type and size (i.e., the first definition), the urban informal sector in China includes registered private enterprises and individual businesses. The majority of private enterprises are small-scale in China and the average number of employees in a private enterprise in 2013 was approximately 10.4 (National Bureau of Statistics 2013). A nationwide survey indicated that only 1.1 percent of private enterprises had over 100 employees in 2005 (Huang 2013). In this context, private enterprises are generally considered part of the informal sector in the literature (Ghose 2005; Hu and Zhao 2006).

The size of the informal sector has increased dramatically since the 1990s. Some researchers use the Yearbook data and report the share of the urban informal sector workers was 56.8 percent in 2002 (Ghose 2005: 27) and 58.7 percent by 2004 (Hu and Zhao 2006). Before the mid-1990s, the formal sector dominated the urban workforce (e.g., the formal sector accounted for over 85 percent of the urban workforce in 1993). After the 1990s, the number of rural migrants increased significantly. Also, the number of informal sector workers increased after the SOE reform. In the 2000s, Figure 13.2 shows that the annual increase of the informal sector was at around 10 million per year. In the 2010s, the size of the workforce in China as a whole has not expanded very much. The size of the informal sector was more or less stabilized at around half of the urban labor market. In 2015, the share of the informal sector (defined by ownership type) in the total urban workforce was about 52.9 percent.

Jiang, Qian, and Wen (2018) use the definition of the informal sector by both the ownership type and employment relation. Using the China Labour-force Dynamics Survey (CLDS) 2012, a nationally representative household survey,

Figure 13.2 Increasing size of the informal sector since the 1990s

Source: China Statistical Yearbooks, various years.

Jiang, Qian, and Wen (2018) report that the size of the informal sector is estimated to be 65.4 percent of the total urban workforce. Besides workers who are working in the informal sector, the percentage of informal employment in the formal sector is 13.7 percent of the analysis sample in this paper. While many of these informal sector workers are migrant workers from rural areas, some of them have urban *hukou*. These urban workers could be local residents, or these workers have relocated from other cities. According to Jiang, Qian, and Wen, about half of the informal sector workers (i.e., 51 percent) have local *hukou*. About 28 percent of the informal sector workers are self-employed and 21 percent are unemployed or underemployed.

From another data source, the Chinese General Social Survey (CGSS), Mok and Qian (2018) define the informal sector by both employment and ownership types (i.e., including small business owners, the self-employed, and workers without an employment contract). In this paper, the share of the informal sector in the urban labor market increased from 25.7 percent in 2006 to 52 percent in 2013.

Why is the size of the informal sector increasing?

In principle, “formalization” of the informal sector can improve productivity and address the problem of urban poverty. The large size of the informal sector has significant implications for economic and social development in China. The production factors, including both labor and capital, could be misallocated in a large informal sector (Restuccia and Rogerson 2017). Also, because the informal sector workers are not likely to enroll with social insurance, this implies that many workforces could be under-protected financially for adverse shocks, such as unemployment and illness.

From the discussion in the previous section, datasets such as CLDS and CGSS suggest the very large size of the urban informal sector in China since the 2000s. The large size of the informal sector could result from rapid urbanization in China. The urban population ballooned to about 793 million in 2016, an increase from 394 million in 1997. In 2016, there were about 570 million people with the urban household registration status (*hukou*).

In this context, there are two important theoretical puzzles regarding the increasing informal sector. One puzzle is about economic growth and the size of the information sector. According to La Parto and Shleifer (2008, 2014), the size of the informal sector is likely to decrease with economic growth. The Chinese economy has grown rapidly since the late 1990s with an annual GDP growth rate of approximately 10 percent between 1998 and 2010 (Qian 2019). Moreover, the wage growth rate in China has been high during the same period. The annual real wage growth rate in the urban formal sector between 1998 and 2010 was 13.8 percent, which is higher than the GDP growth rate (Li *et al.* 2012).

However, while the economic growth rate was very rapid, the majority of the increases in urban workforce are from the informal sector in China. Figure 13.3

Figure 13.3 Increase in the urban workforce in China (millions), 2008–2016

Source: CEIC.

shows the incremental rise of the urban formal and formal sector workers. The formal sector workers include state-owned enterprises, foreign-owned enterprises and shareholding companies that account for a minority of the increase in the urban workforce between 2008 and 2016. In particular, in 2015 and 2016, the number of workers in the formal sector actually decreased and the increases in the workforce are driven by the informal sector.

Also, the other puzzle is why the size of the informal sector is increasing in the context of an expansion of social insurance. In this context, the size of the informal sector should be decreasing as most of the urban workforce have enrolled in social insurance. For example, the enrollment rate for the urban basic pension scheme has increased from about 45 percent in 2001 to over 67 percent in 2016 (Figure 13.4). Also, in 2015, the social health insurances covered more than 666 million out of 771 million urban residents (i.e., 86 percent).

However, while the coverage of social insurance is expanding, there is a variation in enrollment across social insurance plans, while it is compulsory for all workers to enroll with social insurances. Figure 13.4 shows that the enrollment rate of the pension scheme is almost 70 percent while the unemployment insurance is less than 50 percent in 2016. The Basic Health Insurance for urban employees (BHI) enrollment rate is highest at about 71 percent in 2016. One major reason for this variance is also associated with the informal sector which is not subject to the enforcement of labor protection regulations. An informal sector worker may join a social insurance plan if the worker expects that the benefit of joining the plan is greater than the contribution. One will not enroll in social insurance if the benefit of enrollment in social insurance is lower than the cost.

Figure 13.4 Divergence of social insurance enrollment, 2001–2016

Source: Ministry of Social Insurance and Security.

The institutional constraints on the “formalization” of the informal sector workers

Certainly, as in other developing countries, urbanization in China is the main reason for the large size of the informal sector. However, we argue in this chapter that besides urbanization, there are several institutional reasons to explain the large and increasing informal sector. These institutional reasons for high regulatory compliance costs are important reasons for the segmented labor market (i.e., the informal and formal sector) and the large size of the informal sector.

The first institutional reason is the intergovernmental fiscal system. There is a huge discrepancy between the local government’s fiscal capacity and its expenditure responsibility. The current intergovernmental fiscal system mandates that major tax revenue is assigned to the central government, whereas responsibilities for financing and providing public services have been delegated to the local government (Wong and Bird 2008). In 2016, the local government accounted for about 85 percent of the total government expenditure but approximately 54 percent of the total government revenue (Figure 13.5). Local government’s share in total government social expenditure reached over 71 percent in 2015 (Figure 13.6). In this context, local government, in particular, those local governments with limited fiscal capacity may not be able to provide sufficient social protection to the informal sector workers. Also, the local government may not have enough resources to enforce the regulations.

The second institutional constraint is the performance evaluation system for government officials. Since the mid-1990s, a performance evaluation system has been applied to make the incentives of local officials align with those of the upper-level government (Gao 2009; Qian 2018). Under this performance

Figure 13.5 The central-local share of fiscal revenue/expenditure, 1980–2016

Source: CEIC.

Figure 13.6 Local social expenditures and their share in total social expenditure, 2010–2015

Source: Budget Reports, Ministry of Finance, various years.

evaluation system, appointment, promotion, and demotion of local bureaucrats are decided according to whether they have fulfilled the upper-level government's requirements for various quantifiable policy targets (Li and Zhou 2005; Shih *et al.* 2012). In Ang (2016), a sample of indexes to evaluate local officials in 2009 is listed. These indexes include economic development, social development, sustainable development, livelihood, social harmony, and party and cadre discipline.

According to some recent studies, local officials in China are more likely to be promoted if they have achieved better economic performance, such as the

growth of GDP or fiscal revenue (Li and Zhou 2005; Shih *et al.* 2012; Jia *et al.* 2015). In this case, local officials may want to spend more on infrastructure building to attract investors. They lack incentives to spend on social program provision to protect the informal sector workers. Also, more equal access to the labor market for the informal sector workers is likely to increase the costs for the investors in the manufacturing sector, which may discourage the entry of investors and, in consequence, it may have a negative impact on local economic growth (Tao *et al.* 2009). In other words, the cost of enforcement of labor regulation and social security regulation may be quite high for local officials, since higher enforcement efforts for the labor regulations are more likely to discourage local investors.

The third institutional reason is the *hukou* system, a distinctive feature of social policy in China (World Bank 2013). The *hukou* system, initiated in the 1950s, registers people by their hometown origin and by urban versus rural status. *Hukou* or the household registration is defined by two features of the registration system: (1) “agriculture” and “non-agriculture” *hukou*, with the latter assigned to urban residents; and (2) *hukou* location. *Hukou*’s location allows the individuals to access public services provided in a particular locality. The *hukou* system regulates migration between cities and between rural and urban areas. Figure 13.7 also shows the gap between the number of urban residents and urban *hukou* holders.

The number of urban residents without *hukou* (i.e., the floating population), which include migrant workers and their family members, is pretty large. Most of these migrants come from rural areas. Migrant workers from other cities constitute 22 percent (World Bank 2014). Figure 13.8 shows the number of workers with agriculture *hukou* as well as the number of migrant workers who have left their own township.

Figure 13.7 Urbanization and *hukou* in China

Source: CEIC.

Figure 13.8 Number of rural migrant workers (millions)

Source: China Statistical Bureau, Monitoring Report on Rural Migrant Workers, various years.

Social programs (e.g., basic pension scheme, basic health insurance) are managed locally by the prefecture-level cities or even counties. For migrant workers, if they enroll with social insurances, they contribute to the social insurance scheme managed by their host cities, but they have difficulties claiming benefit when they return to their hometown. The major reason is that they do not have local/urban *hukou* which gives them permanent residential status in their host cities. In this case, for migrant workers, the attractiveness of social insurance is not as high as for people with local/urban *hukou*. Table 13.1 shows the contribution rate for different social insurance programs in China.

In the next section, we discuss some findings in recent studies related to the informal sector, the labor market, and social protection.

The informal sector and the labor market: institutional constraints

By using four waves of China General Social Survey (CGSS) data between 2005 and 2013, Mok and Qian (2018) find that the informal sector workers' income is about 6 percent lower on average than that of the formal sector workers. *Hukou* is an important constraint in the labor market for the informal sector workers. By using CLDS 2012 data, Jiang and Qian (2017) find that women are more likely to work in the informal sector in China, compared to male workers. Women with the rural *hukou* are even more likely to work in the urban informal sector, compared to other groups. Also, the income level of the informal sector workers with rural *hukou* is significantly lower than their counterparts with urban *hukou*. Mok and Qian (2018) find that university graduates with rural *hukou* are more likely to work in the informal sector, compared to graduates with urban *hukou*.

Table 13.1 Rates of contributions to social insurance programs in urban China, 2014

<i>Program</i>	<i>Contribution</i>		<i>Whether the benefit is proportional to contribution</i>
<i>Insurance programmes for employees</i>			
	<i>Employer (payroll)</i>	<i>Employee (monthly wage)</i>	
Basic pension (%)	≤20	≤8	✓
Basic health (%)	6	2	✗ ¹
Unemployment (%) ²	2	1	✗
Work injury (%)	1	0	✗
Maternity (%)	≤1	0	✗
Total (%)	≤30	≤13	
<i>Insurance programmes for residents³</i>			
	<i>Resident</i>		
Pension	Annual lump sum		✗
Health	Annual lump sum		✗

Sources: Adapted from Qian, Wen, and Jiang (2018)..

Notes

1. The benefit of the social pooling account is not contribution-related. But reimbursement from an individual account is contribution-related.
2. Since 2015, the contribution rate of unemployment insurance for employers has decreased from 3 percent to 2 percent. See www.gov.cn/xinwen/2017-11/11/content_5238845.htm (accessed July 10, 2019).
3. Both the contributions and benefits of resident insurance programs are in a lump sum decided by the local government.
4. Only those residents making a contribution for 15 years are entitled to claim pension benefit.

Regional variations in the labor market are also relevant to the informal sector workers. Using CLDS 2012 data, Jiang and Qian (2017) find that women are more likely to work in the informal sector in a city with a smaller amount of fiscal revenue. Also, within the informal sector across cities, workers are more likely to have higher income if they reside in a city with a larger amount of fiscal revenue.

The informal sector and social protection: institutional constraints

The *hukou* system is a significant institutional reason for the large size of the informal sector. Using CLDS 2012 data, Jiang, Qian and Wen (2018) find that workers who have urban and local *hukou* and reside in a city with large fiscal capacity are likely to enroll in social insurances. Urban and local *hukou* statuses remain significant determinants of social insurance enrollment in urban China, even within the informal sector, where the occupation-based welfare system is at its weakest.

The intergovernmental fiscal system is another significant institutional constraint of social insurance enrollment. Jiang, Qian, and Wen (2018) find that social insurance enrollment for informal sector workers is likely to be higher in a city with larger fiscal capacity. These findings are supported in Mok and Qian (2019). By using prefecture-level fiscal data from 2003 and 2012, Mok and Qian suggest that the social expenditure at the prefecture level increased with the fiscal capacity. Also, prefecture-level government social expenditure also increased with the size of the formal sector.

The performance evaluation system for officials/cadres is another important institutional reason for the increasing size of the informal sector. In another paper, using prefecture-level fiscal data, Qian and Mok (2016) find a crowding-out effect between social programs when urban informal sector workers voluntarily opt out of unemployment insurance and claim social assistance benefits instead. The misalignment of incentives and institutions in policy design and implementation between the central and local government in the context of decentralized welfare delivery is the major reason for this crowding out. In fact, while the performance evaluation system is very useful in incentivizing local officials to promote economic growth, social policy targets are not among the top priorities for evaluating local officials. Local government leaders lack incentives to coordinate government departments and allocate fiscal resources to welfare delivery.

In Gilli, Li, and Qian (2018), the crowding-out effect has been confirmed by cross-checking the status of social programs managed by the Ministry of Health and the Ministry of Civil Affairs. The incentive structure of the officials has been identified as the major reason for the inefficient allocation of resources for social programs.

Relatedly, an individual's attempts to enforce the labor regulation could be a replacement for the enforcement efforts from local government. By using CLDS 2014 data, Qian, Wen, and Jiang (2018) highlight the role of self-enforcement for the informal sector workers in social insurance enrollment. Self-enforcement refers to the case in which individual workers can proactively claim their legal right to social protection via mediation, arbitration, litigation, or other avenues (Gallagher 2017). Workers with a higher income level, a higher education level, and also workers with trade union membership are more likely to enroll with social insurances.

Regulation compliance costs and feedback effects

Due to these institutional reasons, regulation compliance costs for firms, local governments, and individual workers are likely to be high and increasing. Many local governments may not have the capacity to enforce the labor regulation, given their limited fiscal capacity. Also, many local officials lack incentives to enforce the labor regulation, as that the performance evaluation system encourages the local government to attract investors.

In this context, firms which comply with labor regulations may have a cost disadvantage compared to those which do not. For individual workers/the

self-employed, compliance with social insurance regulation may not be a very attractive option, given that in many cases they can only claim the benefits from the local social insurance plan where their *hukou* is located.

Feedback effect is defined as how the design, resources, and implementation of policies have been addressed (Mettler and Sorelle 2014). Workers could respond to high regulatory compliance costs in various ways. For example, the informal sector workers may voluntarily opt out of social insurance. Also, workers may also respond by joining the informal sector as entrepreneurs (“reverse mobility”). In this chapter, how workers respond to these institutions/regulations is defined as the feedback effects. In many cases, for policy-makers, these feedback effects can be interpreted as unintended consequences of institutions/regulations.

In Qian and Mok (2016) and Gilli, Li, and Qian (2018), it is shown that the informal sector workers opt out of unemployment insurance voluntarily, given the low benefit level of social insurances. In this case, the crowding-out may be welfare-enhancing to some degree since the opt-out behavior is voluntary.

One important note here is that workers are heterogeneous in their socio-economic determinants, such as employment status (e.g., employer or employee), education level, gender, income level, and location of *hukou*. In this case, informal sector workers with heterogeneous social economic backgrounds may have different responses to institutional constraints.

For example, according to Jiang, Qian and Wen (2018), employers in the urban informal sector have more substantial discretionary power than employees in deciding on their enrollment in social insurance programs. Compared to employees, these employers are likely to opt out of social insurance. Instead, they are more likely to enroll in private commercial insurance programs compared to employees.

Interestingly, the self-selection behavior also varies with the *hukou* status. Employers without urban/local *hukou* are more likely to opt out of social programs than those with urban/local *hukou*. That is, the former may expect that the benefit levels of social insurance programs are limited for workers without urban/local *hukou*. Self-selection in the income dimension may not be completely ruled out, although the enrollment status of employers does not vary significantly with income level. High-income employers in the informal sector are likely to opt out of the basic employee insurance and instead enroll with the urban resident social insurance, under which the amount of contributions is fixed and not income-related.

Feedback effects also vary with gender and education level. Using CLDS 2012 data, Jiang and Qian (2017) also find that women with a college degree have similar average wage rates as male workers. But male informal sector workers in general (no matter what level of education they have) have higher income in both the formal and informal sectors, compared to female informal sector workers in general. Interestingly, men with college degrees are more likely to work in the informal sector compared to female degree holders. It is consistent with the evidence from developed countries that the share of

self-employed in the total workforce is lower for women than men (Ponthieux and Meurs 2015). This distribution may be another result of self-selection.

Another type of feedback effect is that workers (in the informal sector) may choose to enforce the social insurance programs. Many labor dispute resolution institutions are designed to be individually based in China and workers can seek arbitration or mediation for issues related to social insurance enrollment (Gallagher 2017). Qian, Wen, and Jiang (2018) find that informal sector workers with higher income, a better education level, and trade union membership are more likely to be enrolled with social insurance, compared to those with lower income, less education, and without trade union membership. Compared to formal sector workers who are affiliated with work units (*Danwei*), the informal sector workers are more likely to resolve the labor dispute on their own. The results reported in Qian, Wen, and Jiang (ibid.) for the informal sector self-enforcement behavior could be stronger than the self-enforcement behavior in the formal sector.

Indeed, these feedback effects imply that welfare losses, from the segmented labor market, have to be offset to some degree with these voluntary and self-selection behaviors. Nevertheless, these feedback effects may still cause welfare losses in the long term. For example, the crowding-out effect, as a selection behavior, is likely to make the coverage of social insurance less attractive and more informal sector workers may want to opt out of social insurance programs. In the long term, the crowding-out effect may have a negative effect on the benefit level and coverage of social insurance, given that the premium contribution is likely to be decreased with the number of people opting out.

Discussion

There are a few remaining issues to be discussed further. First, as discussed earlier, there are many ways to define the informal sector. However, it is conceptually and empirically problematic to define the informal sector in China by whether they can access social insurance (e.g., whether workers are enrolled in social insurance or not). Most workers in China actually can enroll in one social insurance plan or another but they may not actually comply with the labor regulations. For example, workers and the self-employed can voluntarily enroll in social insurance for urban resident insurance in China. Even for the basic urban employee pension programs, workers, the unemployed, as well as the self-employed, can still contribute voluntarily.

Second, the local variation in social insurance coverage/benefit could be another source of misallocation in this segmented labor market. However, we argue that local variation in the social insurance coverage is defined by institutions, including the decentralized fiscal system and the *hukou* system, which is a more fundamental reason for high regulation compliance cost and resource misallocation (see Wong and Bird 2008). In other words, while individual policy changes are very useful, institutional reform is also necessary to address the misallocation under the segmented labor market (World Bank 2018).

Third, regarding the policy implications discussed in this chapter, there could be unintended consequences from the feedback effects from workers in response to high regulatory compliance costs. For example, the size of the informal sector can be increased with the nominal benefit level/contribution rate of social insurances. To make the social insurance financially balanced, increasing the benefit level of social insurance implies an increase in the contribution rate either from employers or from employees. Increasing the contribution rate for either employees or employers could imply even higher regulation compliance costs and it could result in a larger informal sector. This policy implication is consistent with the literature. For example, it has been shown that increased levels of social insurance contribution are associated with decreased employment in Eastern Europe and Central Asia (World Bank 2012). Also, in a more general case, it has been found out that countries with a more regulated economy are likely to have a larger informal economy (World Bank 2018: 95).

Conclusion

Structural transformation with more human and physical resources reallocating from a lower productivity sector (e.g., the rural sector) to a higher productivity sector (e.g., the urban sector) has been highlighted in the literature of development economics. Similar to many other developing countries, China has a large urban informal sector and the number of informal sector workers has amounted to over 200 million in recent years.

However, it has been shown that there is a significant misallocation of labor and capital in China (Whalley and Zhang 2007; Hsieh and Klenow 2009). In particular, it was reported that the size of high-productivity companies is too small in China (Hsieh and Klenow 2009). In this context, labor mobility for informal sector workers is important for economic development to increase productivity, as many development economists have argued (e.g., Rauch 1991; World Bank 2018). Social protection is also necessary to support mobility and provide social protection for these workers. However, informal workers have lower incomes and shallow social protection because there are some major institutional reasons involved when complying with labor regulations in contemporary China.

In this chapter, in reviewing recent studies on the informal sector in China, we argue that the intergovernmental fiscal system, the performance evaluation system for officials, and the *hukou* system are the major institutional reasons for high regulation compliance costs. Local government lacks the fiscal capacity to enforce the labor regulations and improve the benefit levels of the social insurances. Also, the performance evaluation system also disincentivizes local officials to meet the targets for social service provision and increase the enforcement costs for labor regulations. The household registration system is another institutional reason that incurs high compliance costs for workers since they have difficulties claiming benefit from the local social insurance where they do not have permanent *hukou*. Policy-makers may want to address the institutional

reasons for high regulatory compliance costs to achieve their policy targets for economic and social development.

However, anticipating high regulation compliance costs, informal sector workers are likely to respond (i.e., feedback effects). With the feedback effects, some policy initiatives such as increasing the benefit level of social insurance may instead be associated with a larger informal sector. Policy-makers may want to also take into account the feedback effects in future reforms.

Notes

- 1 The World Bank (2018) has some detailed discussion on the implication of informality over government revenue.
- 2 See <https://finance.qq.com/a/20111030/000681.htm> (accessed March 3, 2018).

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