

Inclusive Growth and the New Phase of Poverty Reduction in the People's Republic of China

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Despite remarkable achievements in fighting poverty in the past three decades, numerous challenges remain for the People's Republic of China. The country's antipoverty efforts are in a key phase of strategic reorientation. This paper analyzes lessons learned from poverty reduction programs in the country and identifies key areas to be addressed in the next decade. The paper proposes seven policy measures: (i) modifying the poverty threshold to redefine poverty targeting; (ii) enhancing financial institutions' participation in poverty reduction programs; (iii) providing more equitable access to education; (iv) improving health care for the rural poor; (v) improving the minimum living standard support system in both rural and urban areas; (vi) putting in place a sound public finance mechanism and improving governance in antipoverty efforts; and (vii) enhancing the role of nongovernment organizations in poverty reduction programs.

I. INTRODUCTION

During recent decades, many developing nations, including the People's Republic of China (PRC), have scored outstanding economic growth. Meanwhile, income distribution has worsened to varying degrees in many countries. People have increasingly recognized that to achieve sustainable economic growth in the long run, the world must aim for faster growth and place even greater emphasis on growth of higher quality. As an emerging concept, inclusive growth has aroused interest among a growing number of people both inside and outside the academic community.

A variety of elements and dimensions are involved in determining whether growth is inclusive. The most important dimension to examine is the effect of growth on the well-being of poor people. Poor people, who tend to find themselves in a disadvantaged position in development, can have difficulty benefiting from the results of development. Therefore, improving the livelihood of the poor is a high priority on an agenda for inclusive growth, but has proven difficult to achieve. Thus, inclusive growth has been almost equated with pro-poor growth in some literature (Kakwani, Khandker, and Son 2004). Regardless of scholars' differing viewpoints, the general consensus is that for growth to be

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inclusive, it must be pro-poor—i.e., growth that is not pro-poor is definitely not inclusive.

During the three decades since the PRC embraced economic reform and opened up to the rest of the world, the country has delivered an “economic miracle” amid booming industrialization and urbanization. Market-oriented economic restructuring has progressed remarkably. People’s living standards have improved tremendously and poverty has been reduced considerably. The PRC has been able to adequately feed and clothe most of its population. By the official PRC poverty line, the number of the country’s rural poor had fallen from 250 million in 1978 to 23.65 million in 2005. Even by the \$1-a-day poverty threshold as defined by the World Bank, the number of rural poor and the rate of poverty incidence have shown broadly identical downward trends. At the same time, education, health, and other social programs have improved to varying extents in impoverished regions. Efforts to meet the basic living needs of the urban poor have achieved initial success. The PRC has won universal acclaim from the international community for its impressive progress in fighting poverty.

However, as the implementation of the Development-Oriented Poverty Reduction Program for Rural China (2001–2010) is drawing to a close and the country is adjusting its overall development strategy, the PRC’s antipoverty efforts are moving into a new phase of strategic reorientation. Key questions confronting both the PRC government, which is pursuing a model of inclusive growth, and people involved in the country’s progress in reducing poverty, include the following.

- (i) Who will be the target for poverty alleviation initiatives after the minimum living standard support system in rural areas manages to cover the vast majority of the absolute poor?
- (ii) When efforts to build a new countryside program go into full swing across the nation, how should the development-oriented approach to poverty reduction distinguish itself?
- (iii) As the PRC has elevated its status from a low-income to a middle-income country, what changes should be introduced in the official poverty line that was developed about 20 years ago?

This paper will explore what can be done to further the PRC’s poverty reduction efforts in the new phase of development and put future growth on a more inclusive footing. The second section focuses on the concept of inclusive growth as well as some conceptual discussions. The third section addresses the current state of poverty reduction efforts and its challenges. Some recommendations for the country’s antipoverty endeavors in the new phase are offered in the last section.

II. THE CONCEPT OF PRO-POOR GROWTH

A. Definitions

While “inclusive growth” has been attracting attention as a new concept in development economics, it has yet to be defined in a uniform and universally recognized manner. One view holds that as poor people are the least likely to share the benefits of growth, improving their conditions should be a priority in pursuing inclusive growth. Inclusive growth, therefore, should be pro-poor growth. White and Anderson (2000) define pro-poor growth as a situation where poor people enjoy higher income growth than other segments of society. Under a definition offered by Kakwani and Pernia (2000), pro-poor growth calls not only for poverty reduction, but more equitable distribution of income. Dismissing the above definitions as overly tedious, Ravallion and Chen (2003) simply suggest that any growth that cuts poverty deserves to be called pro-poor. Under this definition, growth should be considered pro-poor unless incomes of poor people stagnate or decline.

Each of the three definitions has some merit and some drawbacks. Under the Ravallion and Chen definition, rising incomes of the poor alone make pro-poor growth possible even if their incomes increase by 1 percent while overall economic growth hits 10 percent. Kakwani and Pernia define pro-poor growth as economic growth from which the poor can derive more benefit than can the rest of society. However, this may lead to a situation where pro-poor growth is pursued at the expense of overall economic growth—for example, where poor people's incomes rise by 2 percent while the average growth in incomes is only 1 percent. While such growth benefits the poor more than other segments of society, the total size of the pie is so small that poor people's standard of living does not improve much.

Ali and Zhuang (2007) define inclusive growth as growth with equal access to opportunity. Specifically, inclusive growth stresses two needs: (i) for economic growth to create employment and other opportunities for development, and (ii) for equalization of opportunities for development. At the policy level, inclusive growth requires rapid and sustained economic growth; it also calls for increased social equity and inclusiveness by reducing and/or eliminating inequality of opportunity. These two dimensions complement each other. High economic growth provides opportunities, including opportunities for improved equity and greater inclusiveness. If opportunities are not equal and social inclusiveness is lacking, economic expansion is not sustainable.

Felipe (2007) links inclusive growth with employment from another perspective. In his opinion, the key to harmonious development is ensuring that the incomes of low-income poor people rise faster than those of the rich so as to bridge the gap between rich and poor. The poor have to depend on their labor for

incomes while the rich earn primarily through capital. Therefore, if the poor's incomes are to grow faster than those of the rich, the poor who have nothing other than labor must have access to full employment and enjoy wages that rise faster than the growth in the returns on capital.

B. Poverty and Inequality

After defining pro-poor or inclusive growth, an issue of more interest is what can be done to make growth more pro-poor. In other words, what kinds of policies benefit poor people more than others? Chen and Ravallion (1997) examined the effects of growth per se on poverty reduction with data from dozens of countries around the world. Their findings reveal that growth itself meant a cut in poverty worldwide. By the \$1-a-day poverty threshold, the elasticity of poverty incidence to economic growth is -2 . This means that a 1 percent increase in economic activity, on average, yields a 2 percent drop in poverty incidence.

Naturally, although growth generally leads to a cut in poverty, the effects on poverty reduction vary significantly from country to country. Chen and Ravallion (1997) found that the effects of the same 2 percent annual economic growth on poverty reduction could entail a seven-fold gap in different nations—while some countries reduced their poverty incidence by just 1 percent, others reduced it by up to 7 percent.

Thus, under what circumstances can growth have greater effects on poverty reduction? Researchers find that when considerable income inequality exists in a country, its economic growth has rather modest effects on poor people (see, for instance, Ravallion and Chen 2001 and Kraay 2004). Ravallion (2004) estimated that, on average, a 1 percent increase in economic growth led to a drop of 4.3 percent in poverty incidence in countries with modest income inequality. The same economic growth achieved much less in countries with wider rich-poor divides, yielding a fall of no more than 0.6 percent in poverty incidence. Improving a nation's income distribution, therefore, helps make growth more pro-poor.

Regarding general macroeconomic and microeconomic policies, the literature tends to examine their effects on poverty reduction from such diverse angles as international trade, government expenditure, inflation, infrastructure, education, health, viability of the legal system, and financial deepening. Generally, scholars have no doubt about the positive effects that education, health, infrastructure, low inflation, and a well-functioning legal system have on poverty reduction. Their disagreements focus on some of the other aspects. One involves the effect of increased government expenditure on cutting poverty. On one hand, rising government spending helps reduce poverty if it is allocated toward improving education, health, and infrastructure. On the other hand, if the extra government resources are just used to pay for regular administrative

expenses or to support industries or even military activities, then the resources may do little to alleviate poverty or may even have negative repercussions. Both Calderon and Serven (2003) and Lopez (2004) believed that increased government expenditures were conducive to poverty reduction.

With respect to international trade, Dollar and Kraay (2002) thought that a freer international trade contributed positively to poverty reduction while Lundberg and Squire (2003) and Lopez (2004) thought it did not. Citing Brazil's embrace of trade liberalization, Kraay (2004) pointed out that workers who were less educated saw their wages decline in the wake of trade liberalization while those with higher education secured higher salaries. That was why he concluded that an expansion of international trade worked against reducing poverty. Similar conclusions have been drawn with respect to financial deepening. Most of the research literature holds that financial deepening offers increased opportunities to the rich. Unless the authorities simultaneously push hard for such measures as microfinance and lending to small and medium-size enterprises, financial deepening tends to be counterproductive at reducing poverty (Dollar and Kraay 2002, Calderon and Serven 2003, Lopez 2004).

III. ACHIEVEMENTS AND CHALLENGES IN POVERTY REDUCTION IN THE NEW PHASE IN THE PRC

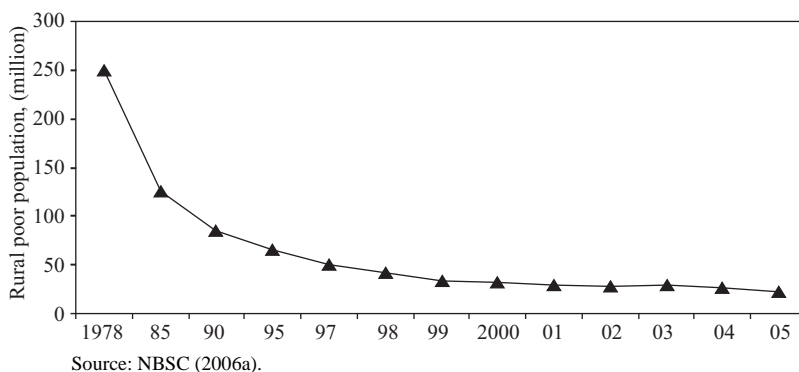
A. Achievements

That the PRC has scored remarkable achievements in fighting poverty for nearly three decades is evident. In the early days of reform and opening up, the PRC was among the world's most impoverished nations. By the official poverty line, in 1978 the country had a staggering 31 percent incidence of rural poverty (NBSC 2006a, 45). In 1981, under the World Bank's \$1-a-day threshold, 63.8 percent of the rural population was in poverty. By 2005, using the official poverty line, the country had 23.65 million poor rural residents—a poverty incidence of 2.5 percent (Figure 1). Meanwhile, education, health, and other social programs have developed to varying extents in impoverished regions. The PRC has met ahead of schedule many of the targets set forth by the United Nations's Millennium Development Goals, including enrollment of elementary and high school students and cuts in maternal and infant mortality.

Because of its impressive progress in cutting poverty in its large population, the PRC has made a major contribution to global efforts to reduce poverty. Measured under the threshold of \$1 a day, global poverty incidence fell from 40.4 to 21.1 percent between 1981 and 2001. During the same period, poverty incidence fell from 63.8 percent to below 16.6 percent. Thus, the PRC poverty incidence was 23.4 percentage points higher than the world average in 1981, but had dropped precipitously to 4.5 percentage points lower than the

world average in 2001. In 1981, the PRC's poor accounted for nearly 43 percent of the world's poor; in 2001, the proportion had dropped to only 20 percent.

Figure 1. Changes in the PRC's Rural Poor, 1978–2005



Amid the transformation of the urban economy and reform of state-owned enterprises, some urban residents moved into poverty due to layoffs and unemployment in the mid-1990s. Poverty incidence in the urban PRC showed an upward trend, especially in some old industrial areas. According to an estimate by the Asian Development Bank, the country registered an urban poverty rate of 4.7 percent in 1998. Bearing in mind the characteristics of urban poverty, government put in place an urban antipoverty scheme in which a minimum living allowance for the urban poor figured prominently.¹ Whatever poverty threshold is employed, the PRC has achieved a lot in reducing urban poverty in recent years (Zheng and Li 2006).

To adapt to the changed economic and social realities, the PRC has modified its poverty reduction policies and approaches in recent years. First, assistance intended for impoverished areas, which used to target the county level, has been shifted directly to poor villages. The government has launched a massive program to push for poverty reduction at the village level using a participatory approach. The shift in targeting from the county to village level is designed to ensure that poverty reduction programs and funds will be more responsive to the needs of the poor. Second, the government has increased the number of programs that will help poverty-stricken communities and people enhance their own capacities. For instance, the government has boosted spending on skills training in poor areas and implemented the “Sunshine Project”, which provides vocational training to rural migrant workers, on a wide scale. The numerous pro-rural policies that have been rolled out in recent years have played

¹The number of people supported by the minimum living standard support system increased from 4.02 million in 2001 to 20.64 million in 2002, and remained at that level.

a large role in reducing poverty. For example, the abolition of the agricultural tax has fundamentally lightened the burden on farmers. Given the meager income of the poor, the exemption from the agricultural tax had an immediate effect on reducing poverty. The state's policy of providing grain-related subsidies has also benefited farmers, with particular implications for the poor who primarily depend on farming for a living (Zuo 2006). By exempting rural students from tuition and fees in recent years, the state has both reduced farmers' burden of education expenditures and provided children from poor families with increased access to education. Wider application of the new type of rural cooperative medical schemes has improved the living conditions and access to health care of farmers who live in poverty due to illness. An across-the-board replication of the minimum living allowance for the rural poor, which was launched in 2007, will be able to end rural absolute poverty. Due to the combination of these policies, the number of people living under the country's poverty line decreased to less than 3 percent of the rural population in 2005. According to the latest statistics, between 2000 and 2005, the number of rural residents whose income was below \$1 a day fell from 62 million to 41 million, a decline of one third (NBSC 2006b).

As a result of the combined effects of various poverty reduction initiatives, impoverished counties achieved growth that was considerably faster than the national average growth in grain output, agricultural production, and per capita net rural incomes. From 1994 through 2004, impoverished counties achieved an annual average 7.5 percent growth in value-added terms, which was above the national annual average of 7.0 percent. Their growth in grain output averaged 1.9 percent per year—3.2 times the national average growth of 0.6 percent. Their per capita net incomes rose from CNY648 to CNY1,337 for an annual average growth of 12.8 percent—2 percentage points above the national average growth (Information Office of the State Council 2005). Between 2002 and 2005, the key villages targeted by poverty reduction efforts registered faster increases in per capita net incomes than the national average. Their per capita consumer spending and expenditure on food grew faster than those of the key counties targeted by poverty reduction efforts but more slowly than the national average (CDRF 2007).

B. Challenges

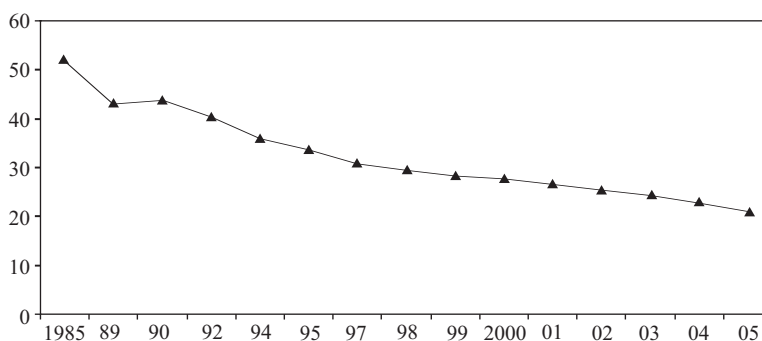
However, numerous challenges remain for the PRC's poverty reduction efforts.

1. Poverty Threshold Needs Updating

The currently applied poverty line is out of sync with socioeconomic advancement. The rural poverty line was set in the mid-1980s. The threshold was

based on the monetary value of the food needed to produce nutrition equivalent to 2,100 calories per person per day plus the monetary value of nonfood consumption (NBSC 2006b). This poverty line was compatible with the prevailing rural conditions at that time. The same threshold has been applied for more than 20 years except for some modifications based on consumer price indexes. However, per capita gross domestic product has risen several fold and real rural incomes per person have grown 1.38 fold as well. Consequently, the poverty line has dropped steadily as a percentage of per capita net rural incomes, from 52 percent in 1985 to 21 percent in 2005 (Figure 2). Some studies find that the PRC's rural poverty line as a share of its average rural incomes is among the lowest of all countries (CDRF 2007).

Figure 2. The Official Poverty Line as a Share of Per Capita Rural Incomes, 1985–2005 (percent)



Source: NBSC (2006b).

In fact, some government agencies, including the National Bureau of Statistics of China (NBSC), have started to modify the rural poverty line. NBSC has come up with an estimated low-income line, which serves as the de facto adjusted poverty line. In defining the low-income line, NBSC drew on the World Bank's \$1-a-day threshold and revised upward the share of nonfood expenditure in the poverty line.²

The poverty threshold varies depending on the level of economic development. The poverty line that is used to measure the extent of poverty should be appropriately elevated in response to socioeconomic progress. Even the threshold of \$1 a day is rather modest and is generally applied in low-income countries, whereas the PRC has joined the ranks of middle-income countries.

² The low-income line in the PRC was based on the official poverty line, but increased the share of nonfood consumption to 40 percent of total consumption. Therefore, the low-income line could be viewed as an adjusted official poverty line (NBSC 2006b).

Worldwide, middle-income nations usually adopt a poverty line that approaches or stays above the threshold of \$2 a day (Table 1).

Table 1. **National Poverty Line versus International Poverty Line** (percent)

	Share of the Population below the National Poverty Line	Share of the Population below the \$1-a-day Threshold	Share of the Population below the \$2-a-day Threshold
Low- and middle-income countries			
Brazil	22	7.5	21.2
PRC	2.5	16.6	46.7
Indonesia	27.1	7.5	52.4
Philippines	36.8	15.5	47.5
Sri Lanka	25.0	5.6	41.6
Thailand	13.1	< 2	25.2
High- and middle-income countries			
Argentina	29.0	7.0	23.0
Chile	17.0	< 2	9.3
Malaysia	15.5	< 2	9.3
Mexico	20.3	4.5	20.4
Panama		6.5	17.1
Russian Federation		< 2	12.1

PRC = People's Republic of China.

Source: World Bank (2006).

2. Targeting Failures

Another major challenge confronting the country's poverty reduction efforts has been the failure of poor people to benefit as much as the nonpoor from poverty reduction programs. The PRC's development-oriented approach to poverty alleviation is targeted at areas instead of individuals. Based on NBSC household data, the World Bank estimates that the villages that were designated as poverty-stricken in 2001 included roughly 60 percent of the country's population living in absolute poverty and 52 percent of the people below the low-income threshold. Although the designated poor villages were home to more than half of the country's total population in poverty, poverty reduction programs needed better targeting toward the intended beneficiaries. Chen and Ravallion (1997) estimate that 84 percent of the people who were living in the designated villages in 2001 were nonpoor and 72 percent were not in the low-income segment, as determined by the low-income line. The benefits associated with poverty reduction programs have often been reaped by middle- or even high-income households in the designated villages. The nonpoor residents in impoverished villages have derived more benefits than have poor residents from improved access to roads, power utilities, water supply, and agriculture-related industries that were made available under poverty reduction programs. The higher

the proportion of nonpoor people, the greater the likelihood that poverty reduction resources will miss the poor.

Furthermore, the requirement to provide local matching contributions for poverty reduction programs has excluded poor people from the programs. The requirement has been a widespread problem for poverty reduction efforts on a village-by-village basis, skills training for prospective migrant workers, credit provision oriented to poverty reduction, voluntary relocation, and application of science and technology.

3. Insufficient Financing

The third problem has been insufficient financial input. During the past two decades, the central government has invested in production-related activity over CNY150 billion of the budgetary allocation intended for poverty reduction. That comprised 2 percent of the central government's annual fiscal expenditures. The financial institutions issued over CNY160 billion in credit for poverty reduction. In addition, the central government spent over CNY10 billion on such social programs as education and health in the poverty-stricken parts of the country. Meanwhile, local governments invested a minimum of over CNY70 billion on poverty reduction efforts. Funding for poverty reduction from international institutions and civil society is estimated to be in excess of CNY100 billion (CDRF 2007).

Efforts to pursue poverty reduction on a village-by-village basis constitute a key priority on the agenda for rural poverty reduction in the new phase. The idea is to mobilize sizable funding and other resources to considerably improve infrastructure, social services, production and living conditions, and industrial development in the targeted villages within a relatively short period of time. Such efforts are also designed to achieve greater synergy by coordinating the implementation of various projects. Under the Development-Oriented Poverty Reduction Program for Rural China (2001–2010), the efforts to reduce poverty are supposed to cover all the designated villages by 2010. Yet by the end of 2005, the initiative had been implemented in just 32 percent of the poverty-stricken villages. As a result, nearly 70 percent of the planned tasks would have to be performed in the last 5 years of the time line. Vigorous measures and considerable resource inputs will be required to complete the remainder of the program by 2010.

Insufficient financial input has been the leading cause of the slow progress in the poverty reduction program. Lack of funding explains why the program was expanded to only a small number of villages each year. Furthermore, actual spending on poverty reduction has fallen far short of what was proposed in the program. Based on statistics from 16 provinces, each poor village covered by the program requires, on average, a total of CNY2.28 million in poverty reduction

funds. However, only the villages in Guangxi, Henan, Jiangxi, Jilin, Ningxia, and Xinjiang have received actual investment in excess of CNY500,000. In Hainan, Hubei, Hunan, and Qinghai, the average spending on each village was below CNY200,000. Such meager amounts cannot lift an entire village out of poverty (CDRF 2007).

4. Inadequate Financial Sector Role

The fourth problem has been the inadequate role of the financial sector in the poverty reduction program. Loans with subsidized interest have consistently represented over half of the financial input intended for poverty reduction. With the accelerating pace of the commercialization of the Agricultural Bank of China since 2001, the mismatch between the bank's pursuit of commercial gains and the government's objective of poverty reduction has grown. As a consequence, the bank has provided most of the subsidized loans to large and medium-size infrastructure projects, which are more efficient and less risky than agriculture loans; the leading profitable village-based enterprises; and rich rural households. Only a very minimal amount of loans with subsidized interest was provided to poor rural households (Zhang et al. 2006).

Microfinance has been a successful financial approach to poverty reduction in many countries. In the early 1990s, international institutions and nongovernment organizations (NGOs) introduced numerous microfinance programs in the PRC, which delivered a gratifying track record in the early days of their implementation. Many achieved a repayment rate of nearly 100 percent. However, the achievement was short-lived and, although some microfinance programs continue to operate in some areas, most of the programs have failed. Microfinance has failed to stay on track in the PRC for various reasons. Most of the programs depended on external grants and many were unable to sustain themselves when their donors switched to new programs. Microfinance programs run by governmental and quasi-governmental institutions were not guided by long-term vision and lacked sufficient incentives. Financial markets were also inadequately deregulated. Because microfinance programs could not be upgraded into formal financial institutions and because they are not integrated into the national system for financial supervision, they are not in a position to expand the scope of their services by taking deposits. As a consequence, many microfinance programs collapsed when their sources of finance dried up.

5. Inadequate Attention to Capacity Development

Fifth, the poverty reduction programs have focused on improving poor people's incomes without due regard to enhancing their capacity to prosper on their own. In particular, the government has devoted to the households in

financial distress insufficient resources in the areas of education, training, health care, and social security. Consequently, such families have been overly burdened with paying for social expenditures, with high expenses for education-related items, primarily for lodging, food, and transport. In recent years, many small rural elementary and junior high schools have been merged or abolished. While consolidation helped make educational resources more efficient, it posed a challenge to a significant number of rural school-age children, particularly in the poor areas. As many of the children from remote poor communities had to stay at boarding schools, their cost of living rose dramatically. Similar situations occurred in health care. Sample data from the poverty monitoring efforts showed that, in 2004, 14.7 percent of rural households, and 29.7 percent of rural households in absolute poverty, had family members who were ill yet had difficulty securing medical attention due to financial distress (CDRF 2007).

6. Gaps in the Urban Poverty Program

The urban poverty reduction policy that is centered on the minimum living allowance for the urban poor has played a key role in mitigating poverty in the cities; however, much remains to be done. With the expansion of the urban subsistence program across the nation, the number of program recipients started to escalate in 1998 and hit 22.47 million in 2003, which accounted for 4.3 percent of the urban population (Z. Wang 2006). The current drawback in the program is its failure to ensure that all the households living below the local urban subsistence threshold can receive an allowance so that their level of income will equal the subsistence line. Based on NBSC data from the 2004 urban enumeration survey and the minimum living allowance set by 35 large and medium-size cities, 8.13 percent of the residents in the 35 cities should be program recipients; however, the program actually covers only 3.91 percent. Thus, more than half of the population below the subsistence threshold was not covered by the program (Y. Wang 2006). Another flaw in the current program is its failure to incorporate rural migrant workers. Farmers are migrating into cities in increasing numbers, and some have joined the urban poor as they suffer from income and job insecurity and do not have equal access to social security as urban dwellers³ (Li 2003).

³The poverty rate of rural migrants was about 5.5 percent higher than the urban poverty rate. The growing migration of rural labor to urban areas could increase urban poverty.

IV. RECOMMENDATIONS FOR POVERTY REDUCTION IN THE NEW PHASE

While poverty reduction endeavors have progressed remarkably, much remains to be done if poverty is to be attacked at its roots. The country's antipoverty efforts are in the midst of a key phase of strategic reorientation. To be effective, the pursuit of poverty reduction needs to be guided by new perspectives and needs to make fresh breakthroughs. As the PRC is moving into a phase of building a moderately prosperous society in all respects, the state can afford to devote more physical and financial resources to poverty reduction than was previously possible. Also, the state is in a position to elevate the threshold for poverty reduction. However, as the PRC remains a developing nation with no more than \$2,000 of per capita gross domestic product, it has to set its antipoverty strategic objectives and specific policies in light of reality and adopt a gradualist approach if the desired results are to be achieved.

In recent years, many academics have worked with government agencies to come up with sound recommendations for the country's poverty reduction efforts. Recently, the China Development Research Foundation (CDRF) organized a group of scholars to study the poverty reduction policy in the next 10 years. The Asian Development Bank, the World Bank, and other multilateral and bilateral institutions have also shared their wisdom about the country's poverty alleviation endeavors. The following suggestions draw on these recommendations, integrated with the author's perspective.

A. Modifying the Poverty Threshold

The United Nations Development Programme and the International Labour Organisation link poverty with "basic human needs." In their opinion, such needs should include (i) basic physical needs such as food, clothing, shelter, and health care; and (ii) basic cultural needs such as education and entertainment. The scope of the needs is supposed to expand gradually. The threshold for basic needs should keep rising along with economic and social progress. That means the income required to sustain and satisfy basic needs—the threshold for absolute poverty—should be raised accordingly.

Another point of view holds that poverty is a relative concept based on comparisons between people in terms of income or standard of living. Townsend (1962) believed that poverty existed only in relative terms, which meant that as far as one segment of society was concerned, their incomes fell far below the average level for their society as a whole. In this sense, a low-income segment exists as long as income is unequal.

Under prevailing international practice, developing nations generally adopt the concept of absolute poverty whereas developed ones embrace relative

poverty. However, even the countries that define a threshold for absolute poverty would modify the standard in stages in light of social advancement.

As discussed earlier, the national poverty threshold was set in the 1980s, and is no longer compatible with the country's current level of economic and social development. Even the low-income line defined by NBSC fails to fit the PRC's status as a middle-income developing country. Given that frequent modifications to the poverty line are not desirable, the present paper recommends adopting the development poverty threshold, as suggested by CDRF, in place of the existing poverty line. The development poverty threshold includes the income needed for subsistence and to pay for average access to education and health care. The development poverty threshold for 2005 was estimated at CNY1,147 per capita (CDRF 2007). This development poverty line falls between the two international poverty lines, i.e., the \$1-a-day and \$2-a-day lines. As the development poverty threshold is a new concept, much remains to be done before it can be used to inform policy making processes. Relevant departments should set up a panel of researchers on poverty threshold to address the issue of the development poverty line so that a new poverty threshold will be adopted by the new 10-year poverty alleviation program (2011–2021).

B. Enhancing Financial Sector Participation in Poverty Reduction

To develop rural finance, it is imperative, first and foremost, to allow microfinance institutions (MFIs) and other rural financial institutions to establish their presence in the countryside and be granted legal status. The pilot program of village banks, rural mutual cooperatives, and microfinance companies that is ongoing in six provinces could be replicated in other parts of the country.

MFIs can be regulated separately from the normal commercial banks. Microfinance companies that provide loans only with their own capital may be granted increased flexibility. The requirement that commercial banks should have full ownership of microfinance companies may be scrapped. The condition that commercial banks hold a minimum 20 percent controlling stake in village banks could be relaxed. The interest rate ceilings on MFIs should be eased. As a first step, an upper limit that is not four times the benchmark interest rate could be adopted. Competitive pressures can be used to ensure that MFIs keep innovating to cut costs, improve the quality of services, and provide poor residents access to financial services on a sustainable basis.

International experience has shown that MFIs that operate on a purely commercial basis will not extend loans to communities and farmers in enormous financial distress. MFIs that are not primarily profit-driven, but are wholly or partly geared toward the public good, can do a better job operating in poverty stricken areas than can commercial finance institutions. Thus, it may be appropriate to grant freer entry to MFIs that are entirely or partly committed to

public benefits. Initially, such MFIs may be permitted to start microfinance companies that provide loans with their own capital. When they become more developed, they can be granted wholesale loans by policy-oriented or commercial banks.

Finally, a community investment law applicable to rural areas may be passed at an appropriate point. The law should specify a certain percentage of loans that must be extended to rural communities to ensure that farmers' savings are used to benefit farmers.

C. Providing More Equitable Access to Education to Combat Intergenerational Poverty

As educational attainment has dramatic effects on employment and incomes, making education universal has significant implications for the efforts to reduce poverty and prevent it from being transmitted from generation to generation. Parents in poor families are often financially unable to offer their children desirable learning conditions. Special care and policies are needed to cater to the educational needs of poor households.

In areas where rural people live in scattered communities and the students have had to travel long distances since the consolidation of elementary and high schools, a policy is needed to subsidize the boarding and living expenses of students of modest means. Such financial assistance should be sufficiently widespread and well-targeted to prevent students from having to drop out of school due to the changed education landscape in the countryside.

To facilitate equal access to education for the children of migrant workers in urban areas, special fiscal subsidies may need to be provided to the urban schools that enroll such students. The educational authorities are duty-bound to help privately run schools for migrant workers' children with poor teaching conditions improve their teaching resources and the quality of teaching. Elementary and high schools in the countryside should offer essential care and counseling services to students who are left behind by their migrant parents and thus lack family care.

Malnutrition among growing children can retard their development, with far worse consequences for them than for adults. To tackle children's malnutrition, many countries have subsidy programs for children's nutrition, with desirable successes. The PRC should launch a nutritional meal program for impoverished areas first.

A special policy is needed to make access to noncompulsory education more affordable to the children from urban and rural households in financial difficulties. It may be appropriate to significantly cut or completely abolish the tuition for such students when they attend state-run universities and vocational schools. The state can offer some subsidy to encourage banks to provide students

of modest means with loans to cover their living expenses. Private investors should be encouraged to run vocational schools for workers who have migrated into cities.

D. Improving Access to Medical Services in Rural Areas

Poverty arising from high medical bills remains a prominent challenge, especially in rural areas. While the ongoing spread of the new type of rural cooperative medical system helps alleviate the challenge to a certain extent, some problems remain. As a relatively modest portion of medical expenditures is covered by the new type of rural cooperative medical system, the lion's share of health bills continues to be paid for in cash.

Poor and low-income rural residents struggle to pay their portion of the cost. As a result, they tend to be excluded from the scheme or fail to benefit from it even if they have participated in it. Therefore, a special subsidy needs to be made available to finance the portion of poor residents' medical bills that they have to pay in cash. In addition, it is imperative to properly define the relationship between the minimum living allowance for the rural poor, the system for medical assistance, and the cooperative medical system. Functioning procedures should be put in place to enable migrant workers to reimburse their medical expenses incurred outside their area of legal residence.

The medical markets need further liberalization and monopolies should be dismantled by allowing qualified privately run medical institutions and rural physicians to enjoy equal entry to the medical services system. Fair competition can be used to keep rising medical and pharmaceutical prices at bay.

The problem of poverty caused by illnesses should be attacked at the source. Efforts are needed to improve the countryside's basic living conditions, including access to safe drinking water. To lower the incidence of diseases and disabilities, public health efforts must be boosted to prevent epidemics and widely disseminate knowledge about health care and disease prevention.

E. Improving the Social Security System in Rural and Urban Areas

For people who are poor because they are old, weak, sick, disabled, or incapable of working, the emphasis should be on putting in place and improving the social security system and the system of public services. Since 2006, considerable progress has been made in establishing a minimum living allowance for the rural poor. According to the latest statistics by the Ministry of Civil Affairs, initial successes had been achieved by the end of June 2007 in fostering the scheme in the country's 31 provinces, autonomous regions, and municipalities

directly under the central government. The system covered 20.68 million poor rural residents. To make the system viable, the eligible recipients must be properly identified and the funds intended for the scheme must be well managed. The key to a successful system of subsistence for the rural poor lies in establishing a fund management system that is prudently regulated and subject to public scrutiny as well as a system for democratic appraisal and examination at the village level.

Special attention needs to be paid to the old and the disabled living in poverty. It is imperative to explore, on an incremental basis, ways to establish a universal old-age support system and a system of annuities for the elderly. Efforts should be made to find ways to incorporate into the safety net the unemployed urban population, people working in the informal sector, and migrant workers living in cities. Rural migrant workers who have been employed for a certain period of time (say, 3–5 years) and have made social security contributions should be fully eligible for welfare benefits available to urban dwellers, including basic medical insurance, children's education, and low-rent housing. A basic social insurance program that covers all urban workers, including migrant workers, should be made mandatory. In response to the ongoing structural changes involving the foreign trade system and efforts to boost environmental protection and energy conservation, special care should be taken to properly address the well-being of laid-off migrant workers. They should be offered training for new skills and replacement job opportunities in order to prevent them from falling back into poverty.

F. Putting in Place a Sound Public Finance Mechanism and Improving Governance in Poverty Reduction Efforts

The central and provincial governments should continue to increase their transfer payments to impoverished regions. The key priorities for poverty reduction backed by fiscal funds should be an integrated rural-urban social security system and such public services as basic education, health care, and wider application of science and technology. Policies involving agriculture-related subsidies need to be appropriately geared in favor of poor rural households so that they can gain from increased output and productivity. To make poverty reduction efforts more vigorous and effective, the poverty reduction resources that are scattered among government agencies could be consolidated so they can be planned and employed in an integrated manner. More efforts should be made to improve performance assessment, oversight, and accountability over the use of fiscal funds intended for poverty reduction.

G. Involving NGOs in Poverty Reduction

Nongovernment organizations can work with much flexibility in the antipoverty sphere. They are more likely than other organizations to engage closely with grassroots communities and poor rural households. These attributes enable NGOs to implement some poverty cutting initiatives effectively. Government has good capacity to organize and mobilize resources that provide the population living in poverty with social security and basic social services. This is beyond the capacity of NGOs, hence it is essential to foster closer cooperation between government and NGOs.

To increase the efficiency with which government funds for poverty reduction are used, competition must be introduced over the use of poverty reduction resources so that more NGOs operate government-funded poverty reduction programs. Government departments responsible for poverty reduction should award resources to the most efficient competitors based on their performance and credibility and should supervise them in an open and transparent manner. For their part, NGOs should keep improving their organizational structures and capacities to work effectively so that they can do a good job in the fields where profit-driven organizations have no interest and the government has no energy to step in. NGOs need to volunteer to subject themselves to government and public scrutiny and guidance.

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