



# Learning from Success

## Understanding China's (uneven) progress against poverty

*Martin Ravallion and Shaohua Chen*

**O**VER THE past 25 years, China has made huge strides in its battle against poverty as it has transformed into one of the most dynamic economies in the world. China's poverty rate today is probably slightly lower than the average for the world as a whole. But around 1980 the incidence of poverty in China was one of the highest in the world (Chen and Ravallion, 2004a).

What might the many developing countries that have been less successful against poverty learn from China's experience? And what can China learn for its continuing efforts against poverty? Based on survey data spanning 1980–2001, we analyzed China's

record against poverty over the two decades since Chinese leader Deng Xiaoping introduced his pro-market reforms in 1978. Our study shows that, while the incidence of poverty in China fell dramatically, progress was uneven. Rural areas accounted for the bulk of the gains to the poor, although migration to urban areas helped. However, for China to make more progress against poverty, it will have to confront the problem of rising inequality.

### Measuring poverty

In collaboration with China's National Bureau of Statistics (NBS), we have worked to develop new poverty measures that better

Photo above shows a family collecting vegetables in a field in Guangzhou, southern China.

## Measuring poverty in China

In collaborative work over many years with China's National Bureau of Statistics (NBS), we have tried to enhance the quality and internal consistency of the available data on poverty and inequality in China. This has included adjustments for the changes in the methods used by NBS in processing the household survey data (notably in the valuation methods used for consumption-in-kind from farm production). We have also worked with NBS to develop new poverty lines that better reflect prevailing consumption patterns and concepts of poverty in China. The poverty lines are designed to have a fixed real value over time and between urban and rural areas, so they can be interpreted as "absolute poverty lines," rather than a relative poverty line that tends to rise with overall living standards. Region-specific food bundles are used, with separate food bundles for urban and rural areas. The bundles are scaled to reach 2,100 calories per person per day, with 75 percent of the calories from foodgrains. Allowance for spending on items other than food is factored in separately, by looking at the non-food spending of people who can just afford the food component of the poverty line.

reflect prevailing consumption patterns and concepts of poverty in China (see box). For the present study, we adopted poverty lines of 850 yuan (about \$102 at current exchange rates) a year for rural areas and 1,200 yuan (\$145) a year for urban areas, both at 2002 prices. Using these measures, Chart 1 shows our estimates of the national poverty rate in China over 1981–2001, given by the percentage of the population in each year living in households with real income per person less than these poverty lines. Over this 20-year period, the proportion of the population living in poverty fell from 53 percent to 8 percent. That is huge progress. However, there were some setbacks for China's

poor. Poverty reduction stalled in the late 1980s and early 1990s, recovered pace in the mid-1990s, but showed signs of stagnating again in the late 1990s. About half of the decline in poverty came in the first few years of the 1980s.

## Income inequality

While absolute poverty has fallen, income inequality has been rising in China, though not continuously and more in some periods and provinces. Chart 2 gives our estimates of the Gini index (a widely used measure taking the value zero when every household has the same income per capita and 100 percent when inequality is at its maximum, when the richest person has all the income). The Gini index of income inequality rose from 28 percent in 1981 to 39 percent in 2001. Note that the latter figure is somewhat lower than past estimates for China; this is because we have made corrections for urban-rural cost-of-living differences, which have tended to rise over time because of higher inflation in urban areas. Without these corrections, the Gini index for 2001 is 45 percent.

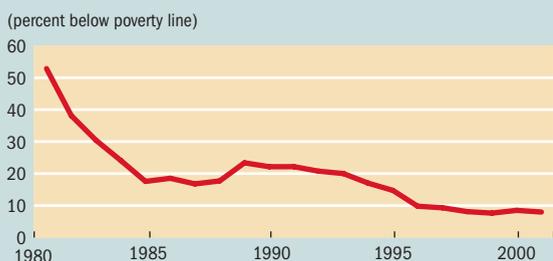
Like many developing countries, living standards tend to be lower in rural areas of China than in urban areas. In the case of China, mean income is about 70 percent higher in urban areas. However, in contrast to most other studies, we do not find that inequality *between* urban and rural areas has shown a trend increase since reforms began. This difference with past work reflects the fact that we have allowed for the higher rate of increase in the urban cost-of-living and that we have also studied a longer period of time; there were some sub-periods (such as the late 1980s to the early 1990s) when the disparity between living standards in urban areas and rural areas was rising.

The upshot of this finding is that in understanding the rise in overall inequality, one must understand what has happened *within* urban and rural areas, and particularly the latter, which naturally carries larger weight, given that 60 percent of the population live in the countryside and that 80 percent did so at the outset of the reform period.

Chart 1

### Uneven progress

The percentage of the population in China living below the poverty line fell more in some periods than others during 1981–2001.

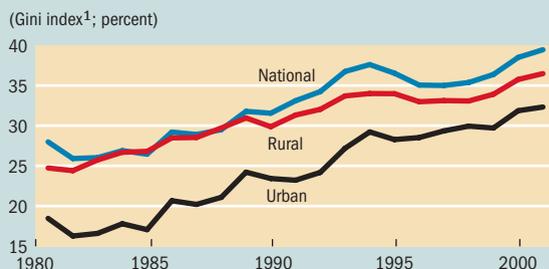


Source: Ravallion and Chen, 2004.

Chart 2

### Rising inequality

The gap between rich and poor has risen in China, although more in urban areas than rural areas.



Source: Ravallion and Chen, 2004.

<sup>1</sup>The Gini index is a measure of income inequality within a population.

## The pattern of growth

Economic growth is rarely balanced across regions or sectors of a developing economy, and China is no exception. The pattern of growth has mattered to the evolution of both poverty and inequality.

About three-quarters of the overall reduction in poverty in the 1980s and 1990s came from gains to the rural poor, stemming from growth within rural areas and remittances from urban areas. Growth in the primary sector (primarily agriculture) did much more to reduce poverty and inequality than growth in either the secondary or tertiary sectors. Thus the sectoral imbalance in the growth process (with agriculture's share of GDP falling) attenuated the impact of aggregate growth on poverty. Indeed, if the same aggregate growth rate had been balanced across these three sectors, then it would have taken 10 years to bring the poverty rate down to 8 percent, rather than 20 years.

## “Promoting agricultural and rural development is crucial to pro-poor growth in most developing countries.”

The geographic composition of growth also mattered. Progress was geographically uneven with some provinces seeing far more rapid reduction in poverty than others. The coastal areas fared better than inland areas; the trend rate of decline in the poverty rate was 8 percent per year for inland provinces, versus 17 percent for the coastal provinces. However, while provinces with higher rural income growth tended to have higher poverty reduction, by and large growth was not higher in the provinces where it would have had the most impact on poverty nationally.

The pattern of growth also influenced the evolution of inequality. Rural and (in particular) agricultural growth tended to bring inequality down. Rural economic growth reduced inequality within rural areas as well as between urban and rural areas. Rural economic growth also helped the urban poor and so reduced inequality within urban areas. As in other developing countries, the fortunes of China's urban poor are linked to rural economic growth in various ways, including migration, transfers, and trade.

### The big trade-off?

The fact that inequality tended to rise over time has often been seen as evidence that China faced an aggregate trade-off between growth and equity. By this view, rising inequality was the “price” of high growth. However, a number of our empirical findings lead us to question this view. First, the periods of more rapid growth did not bring more rapid

### A trade-off?

The periods of rising inequality were not the periods of higher growth.

	Inequality	Growth rate in household income per capita (percent a year)
1981–85	Falling	8.9
1986–94	Rising	3.1
1995–98	Falling	5.4
1999–2001	Rising	4.5

Source: Ravallion and Chen, 2004.

increases in inequality; indeed, the periods of falling inequality (1981–85 and 1995–98) had the highest growth in average household income (see table). Second, the sub-periods of highest growth in the primary sector (1983–84, 1987–88, and 1994–96) did not come with lower growth in other sectors. Finally, we do not find that the provinces with more rapid rural income growth experienced a steeper increase in inequality; if anything it was the opposite.

This lack of any evident aggregate trade-off has important implications. On the one hand, if growth in average household income does not cause a worsening in distribution, then the incidence of absolute poverty will tend to fall with growth. On the other hand, the absence of such a trade-off also means that a rise in inequality that comes with growth (even if not caused by it) will put a brake on the pace of poverty reduction. With the same growth rate over 1981–2001 and no rise in inequality, the number of poor in China as a whole would have been less than one quarter of its actual value in 2001. And the provinces that saw a more rapid rise in rural inequality saw *less* progress against poverty, not more.

### Lessons for policy

In drawing lessons for other developing countries, it is important to consider the specifics in China at the outset of the reform period. The Great Leap Forward and the Cultural Revolution had clearly left a legacy of pervasive and severe rural poverty by the mid-1970s. Yet much of the rural population that had been forced into collective farming under socialist agriculture (with weak incentives for work) could still remember how to farm individually. So there were some relatively easy gains to be had by undoing these failed policies—by de-collectivizing agriculture and shifting the responsibility for farming to households, as Deng Xiaoping did, starting in 1978. This brought huge gains to the country's (and the world's) poorest. But it was a one-time reform.

An obvious, though nonetheless important, lesson that is well illustrated by China's experience is the need for governments to do less harm to poor people, by reducing the (explicit and implicit) taxes they face. In China's case, the government has until recently operated an extensive food-grain procurement system that effectively taxed farmers by setting quotas and fixing procurement prices below market levels. This gave the Chinese government a powerful anti-poverty lever in the short term; reducing this tax by setting

the procurement price closer to the market price (as happened in the mid-1990's) helped bring both poverty and inequality down.

The importance of the pattern of growth carries a lesson for other countries. When so much of a country's poverty is found in its rural areas, it is not surprising that agricultural growth plays an important role in poverty reduction. Granted, the past efficacy of agricultural growth in reducing poverty in China reflects (at least in part) an unusual historical circumstance, namely the relatively equitable land allocation that could be achieved at the time of breaking up the collectives. However, China's experience is consistent with the view from much past research that promoting agricultural and rural development is crucial to pro-poor growth in most developing countries.

China's geographic pattern of growth was in no small measure the by-product of regional economic policy. The success of the coastal areas reflects deliberate policies that favored those areas. Inland and especially more remote rural areas have not seen the same attention from either government or private investors. The central and provincial governments have tried to (in effect) reverse this regional bias through "poor-area development programs." Many of these programs have achieved good rates of return, though the scale of the effort has not been sufficient to reverse the longer-term divergence between coastal areas and the inland regions (Ravallion and Jalan, 1999).

Turning to macroeconomic policy, China's experience suggests that macroeconomic stability (notably avoiding inflationary shocks) has been good for poverty reduction. The adverse impacts on poor people of inflationary shocks probably stem from short-term stickiness in some of the key factor and output prices determining their real incomes. That echoes findings in other developing countries.

The scorecard for trade reform is less clear. The view that greater trade openness brings rapid gains to the poor is not borne out by our data. China's periods of more rapid expansion in external trade were not associated with more rapid poverty reduction. Nor do we find evidence that the tariff reductions implemented since the mid-1990s (in the lead-up to China's accession to the World Trade Organization) have had anything but a rather minor impact on poverty and inequality; this is demonstrated by Chen and Ravallion (2004b), who use household survey data to study the welfare implications of a general equilibrium analysis of these reforms to capture both direct and indirect effects via wages and prices. However, there are two important caveats to these findings. First, there may well be longer-term productivity gains that are not captured in these calculations. Second, even though trade openness has little apparent short-term

impact on aggregate poverty, we do find that there are likely to be both gainers and losers among the poor from trade reforms. This carries important lessons for social protection policies.

It will be harder for China to maintain its past rate of progress against poverty without addressing the problem of rising inequality. To the extent that recent history is any guide to the future, we can expect that the historically high levels of inequality found in many provinces today will inhibit future prospects of poverty reduction—just as we find that the provinces that started the reform period with relatively high inequality faced a double handicap in future poverty reduction: they had lower subsequent growth *and* the poor shared less in the gains from that growth.

Other factors point to the same conclusion. We have seen that the sectoral and geographic pattern of growth is important to the rate of poverty reduction. However, it appears that

China's aggregate economic growth is increasingly coming from sources and places that bring more limited gains to the poorest. The low-lying fruit of efficiency-enhancing pro-poor reforms are possibly getting scarce. Inequality is continuing to rise *and* poverty is becoming more responsive to rising inequality. At the outset of China's current transition period to a market economy, levels of poverty were so high that inequality was not an important concern. That has changed.

It also appears that perceptions of what "poverty" means are evolving in China. It can hardly be surprising

to find that the standards that defined poverty 20 years ago have lost relevance to an economy that quadrupled its mean income over that period. China could well be entering a stage of its development in which relative poverty emerges as a more important concern than in the past. ■

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