

## Three Observations on the Challenges of Growth and Poverty Reduction in Asia\*

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I have three brief observations based on the excellent background materials that have been provided for the conference, and in light of the insightful speech by the Deputy Prime Minister of Thailand, Dr. Surakiart Sathirathai. First, we should take on board the diversity of Asia's growth experience, and not fall into the trap of thinking about *the* Asian model of success. Second, rising inequality in Asia poses a real and present threat to Asian growth prospects. Third, the rationale for development assistance to Asia will have to be rethought in light of Asian success.

### Asian Diversity

While it is natural and right that a conference such as this builds on Asian commonalities, in particular the remarkable growth performance of many countries, it is also right that we look carefully at the diversity of Asian growth experience. Most obviously, there are some countries that are *not* growing at historically high or regionally comparable growth rates. The situation of these countries is perhaps more comparable to countries in Africa or Central America than in Asia, and appropriate diagnosis and policy is called for. But even if we set aside these countries and look at the high growth countries, and for these countries we go beyond commonalities such as excellent export performance, then diversities are highlighted which should inform the policy discourse.

Let me illustrate the diversity point by focusing on India and China. The growth rate in China has been two or three or four percentage points higher than that in India, depending on the year. But the investment rate differential has been an order of magnitude higher—a difference of 10 percentage points or more depending on the year. Simple arithmetic then tells us that the productivity of investment has been significantly higher in India than in China. Of course growth can be raised by raising either the productivity of investment or the rate of investment, but this way of looking at things highlights possible difference in strategies for sustaining growth. For China, it suggests a focus on the productivity of investment, for India, the level of investment. These in turn suggest specific areas of policy focus. The general point, then, is that the binding constraint on sustaining growth can be very different across economies that have similarly high growth rates. Asia exemplifies this diversity and it should play a key role in Asia-wide discussions.

### Rising Inequality

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\* Based on comments made at the Asia 2015 conference in London, March 6-7, 2006, <http://www.asia2015conference.org/>.

One commonality across many of the fast growing Asian economies, as documented in the background papers for this conference, is rapidly rising inequality. Asian inequality levels may not be high relative to countries in Latin America or some countries in Africa, but the important point is that they are now high relative to their own historical standards, and continue to rise rapidly. This point applies not just to inequality in the standard sense of measure such as the Gini coefficient, but to inequality across regions within countries, and socio-ethnic groups within countries.

A standard way to proceed in economic thinking is to separate out the generation of growth from its distribution. In this way of thinking, inequality affects the distribution of the benefits of growth, and hence the poverty reducing impact of a given quantum of growth, which comes from somewhere else in the system. Such a separation is also seen in the structure of this conference, where the present session on challenges to growth is followed by a session which focuses on distribution. What I would like to emphasize, however, is the feedback loop from inequality to the growth process. Taking inequality in its broadest sense, to incorporate inequalities between broad groups as well as between persons, the logic of the argument is clear. It goes from inequality, to social stability to investment climate to growth. There is now a significant theoretical and empirical literature supporting this logic as well as other arguments that go from the health and education of the poor, to the productivity of the poor, to the overall growth process. What this suggests is that we should view inequality reducing or managing strategies (for example, by managing the distribution of public infrastructure between fast growing and lagging regions) as being part of a growth strategy rather than just methods for better distributing the fruits of growth.

### **Arguments for Development Assistance**

What arguments can be made to taxpayers in Britain and other northern countries to continue development assistance to Asia, at the same time that high Asian growth rates are being trumpeted, and the links between this growth a job losses among middle and low income earners in developed countries is the stuff of front page news?

The first argument is that not all of Asia is growing. For the countries whose circumstances resemble Africa or Latin America, the case for continued development assistance is relatively easy to make. However, what about those countries which are experiencing high growth rates, and which are at the center of news on outsourcing and job losses? Here the argument that will have to be made is that although there is fast overall growth in these countries, there are severe pockets of poverty—Asia is still home to the bulk of the world's poor, despite an excellent poverty reduction performance in the last two decades. But it is not clear that this argument will be fully convincing if Asian governments are not themselves seen to be making their own best efforts at using the fruits of growth to reduce poverty in their countries. Inequality comes into play here. Rising inequality can be read as a signal of lack of sufficient efforts to distribute the fruits of growth. High military expenditure, and nuclear and space ambitions are also signals. It is reasonable to ask—why should the low and middle income earners in the north support taxation for development assistance to Asia, especially as they feel their own jobs

threatened by the growth of these countries, when they see growing numbers of super rich in these countries, and governments intent on building up powerful militaries?

A more powerful argument for development assistance to Asia flows from the presence of global spillovers, and the concept of international public goods. In the interlinked world of today, the health problem of a country can become globalized very quickly. The same is true of financial contagion, environmental spillovers, or, more extremely, conflict and refugees. The logic of these cross-border spillovers is that any one country always has less incentive to address the problem than is globally optimal, since it will not take into account the spillover benefits. Its actions are an international public good, and it is well understood that there will be a tendency for underinvestment in such public goods. The role of development assistance is now clear—it is to create incentives for Asian countries to take actions that will have benefits beyond their own borders. Apart from its solid economic logic, this argument also has the potential for persuading northern taxpayers if explained appropriately.

### **Conclusion**

To summarize, while Asia's success in growth and poverty reduction is to be greatly welcomed, and should be analyzed for the lessons it has for other countries, the policy discourse should take on board three key points: (i) the diversity of Asian growth experience, (ii) rising inequality as a threat to growth and (iii) the case for continued development assistance to Asia will have to increasingly use the logic of international public goods.