Poverty Alleviation in the Developing Economies: the Leading Issues

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Abstract

Many developing countries still suffer from poverty. We are concerned with nations in which more than half of the population lives in poverty, lacking any secure margin above basic needs. The elements suggested as essential and critically important for poverty alleviation are: (1) investment in human capacity, (2) capital formation, (3) entrepreneurship, (4) international trade, (5) rural development and (6) equity and environmental quality.

There is hope, however, for a better world, if developing countries respond successfully to the challenge of poverty alleviation taking into consideration the interconnections, interdependence and importance of the critical factors involved.

Finally, in the developing world, economic development is the only hope of achieving higher standards of living, since the developed world is unwilling to allocate even one percent of its gross national product for world-poverty alleviation.

Résumé

Plusieurs pays en développement souffrent encore de la pauvreté. Il s'agit des nations dont plus que la moitié de la population vit dans la pauvreté sans aucune marge de sécurité au-dessus des besoins fondamentaux. Les facteurs clés pour lutter contre la pauvreté sont : (1) l'investissement humain, (2) la formation du capital, (3) l'esprit d'entreprise, (4) le commerce international, (5) le développement rural et (6) l'équité et la qualité de l'environnement.

L'espoir pour un monde meilleur, existe cependant, si les pays en développement arrivent à relever les défis de la pauvreté, en considérant les inter-connections, l'interdépendance et l'importance de ces facteurs clés.

Enfin, le développement économique est la seule issue permettant l'amélioration du niveau de vie puisque les pays riches ne sont même pas prêts à allouer un pour cent de leur produit national brut pour lutter contre la pauvreté mondiale.

1. Introduction

As we enter the twenty-first century, there is probably no greater challenge facing mankind than the worldwide poverty problems. Poverty is a large and growing problem in the world stemming from remoteness, lack of education and health care, insecure and unproductive jobs, high fertility and often women discrimination; resulting in an immense amount of suffering and joyless existences. As stated by Meier (1989, p. 26), it is difficult to define or measure the extent of the poverty concept. Absolute poverty, for example, means more than low income. There is also malnutrition, poor health and lack of education. Thus, the poverty trap is more than just an economic phenomenon but a social phenomenon as well. Most developing countries are faced with the problem of poverty alleviation and reduction within the proportion of people whose incomes are less than one dollar per day, and the proportion of people who suffer from hunger. Policy makers within these countries recognize the importance of the problem; they came to the conclusion that there can be no real or effective economic development without taking care of the different categories of poor people in the country (IFAD Report, 2001).

Within developing countries the basic causes of poverty are almost the same. Among these causes we can mention the increasing level of unemployment, the increasing level of child withdrawal from schools and learning facilities, the increasing level of family disintegration and divorce, the increasing level of rural to urban migration, and in general a lack of investment in human being. Indeed, strategies on how to proceed in order to fight poverty differ from one country to another. In what follows, I will try to develop from a theoretical perspective, the key elements needed to be recognized, understood and utilized for poverty alleviation in most developing nations.

2. Human Capital

It has been evident for some time that poverty rates vary inversely with the level of education. Low poverty rates are associated with high education levels and high poverty rates with low education levels. Education has become one of the fundamental tools (a powerful instrument) necessary for reducing poverty. In the last two decades, T.W. Schultz, through his studies on human capital, made economists increasingly aware of the fundamental importance of education as an investment. Considered the father of human capital theory, Schultz has two straightforward messages: (1) investment in improving population quality can significantly enhance the economic prospects and welfare of poor people and (2) knowledge is the most powerful engine of production (Schultz, 1981). For poverty alleviation a high priority must be assigned to human capital through investments in formal education, on-the-job-training, and health programs. In-

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vestment in human beings is a necessary condition to remove economic backwardness, to promote opportunities and to prepare people to solve problems and to take inventive, rational approaches to the issues confronting them. Education is also of importance in preparing people for greater individual freedom of action and choice, and hence a key to the direct objective which many persons set for economic development. In today's world, a nation's success in the global economy is not determined by the quantity of its natural resources, but by the quality of its human resources (the case of Switzerland, Singapore and Japan).

Education has been increasing in developing countries. However, more must be done to assure the right type of education for poverty alleviation. Investment in human capital calls for new approaches necessary to establish priorities for the various possible forms of useful skills: (1) general education includes the broad range of primary, secondary and higher education, (2) education for development is selective about the knowledge, abilities and skills needed for a society that wants to develop rapidly, (3) education for people of all ages gives people the opportunity for a lifetime of scientific thinking and develops their ability to continue obtaining new knowledge, learning new skills (on-the-job training), and solving new problems, (4) extension education provides farmers with the technical know-how and the results of production-increasing research, and (5) technical training is important in keeping people's knowledge up-to-date over time. According to the UNDP Human Development Report (2002), in the developing countries as a whole, the adult literacy rate (% age 15 and above, 2000) is 73.3. Therefore, each developing country must give careful consideration to its educational system, should develop an effective education policy that provides incentives and opportunities for the poor, promotes entrepreneurship (entrepreneurial talent) and accelerates the process of human resources development. In a developing society, education should be for people of all ages. In other words, since people are the real wealth of a nation in a developing society, greater access to knowledge in the perspective of an educational system for all ages throughout life, should be fostered. Continuous learning certainly is an essential for poverty reduction. But not all learning occurs in schools; in many instances, educational projects (home education) for women help them to learn better ways of caring for their families, encourage them to change positively their ways of living and to develop a more confident attitude about life in general. Finally, with respect to education, in today's fast-changing knowledge environment, older and unskilled individuals are in the greatest need of additional training.

3. Capital Formation

The productive capacity of an economy is influenced by the rate at which it invests in human capital as well as physical capital. In any economy physical capital goods are important because they help to increase the productivity of the poor and job creation. For the purpose of this analysis, capital is defined as the physical productive wealth of an economy (factories, machines, laboratories, roads, schools, trucks, telephone lines, etc.).

Expenditures on capital are referred to as gross investment. Net investment is defined to be the net addition to the stock of capital taking place during some period of time. It is the difference between gross investment and replacement investment, carried out in order to maintain the existing stock of capital operational. Thus, net investment will be positive (i.e., the stock of capital will increase) only if sufficient investment is larger than replacement investment. Sufficient net savings and investment play a major role in the functioning of the economic system. They are necessary for economic development and for breaking the poverty cycle since there is a straight relationship between higher rates of savings and higher rates in the capital stock available to the business sector.

It should be emphasized that, to a great extent, a nation's rate of growth of national output is directly related to the percentage of gross domestic product invested. In other words, the higher the percentage of output invested, the higher can be the rate of growth of output. However, poor countries, like poor families, are ordinarily unable to save and hence experience little or no economic growth (the vicious circle of poverty). These nations should afford to break the vicious circle of poverty by their own efforts to allocate greater proportions of savings over time for the purpose of accumulating capital.

In general, developing countries have low rates of capital formation since net savings and investment run between 5 and 10% of the national income (Higgins 1968, p.189). Following Geiger reasoning, one can state that:

- if 12% of GNP is saved, economic growth and poverty alleviation will be extremely difficult to achieve, as the existing stock of capital depreciates at an average rate of 10%, and population increases at 2-3% per year.
- with 15-20% of savings and capital formation, moderate growth is possible.
- if capital formation reaches 20-25%, rapid economic development will be possible at an average annual rate of 5%.
- at rates over 25%, high average growth rates of 5-10% become possible as in the case of Japan (Mansfield and Behravesh, 1995).

A nation's rate of economic growth is influenced by the rate at which it invests in physical capital as well as human capital. The relationship between physical capital and human capital is very important. It has become evident that a better-educated work force is needed to make effective and productive use of durable equipment.

Indeed, in the most fundamental sense, the importance of human resources in the economies of the developing nations can be explained using the theoretical framework within which an increase in capital may be a necessary but not a sufficient condition for an increase in output.

In economics, growth in national output is equal to the ratio of investment to output times the productivity of investment (the marginal relation between capital and output). Hence, we can write:

$$\frac{\Delta Y}{Y} = \frac{I}{Y} \cdot \frac{1}{\Delta K / \Delta Y} = \frac{I}{Y} \cdot \frac{\Delta Y}{\Delta K}$$ (Meier 1989, p. 174)

Education or human capital accounts for much of the improvement in population quality or advances in knowledge. To a considerable extent, a society's rate of growth of national output is determined by the productivity of investment, which is determined in turn by the growth in knowledge or advances in human abilities and the rate of increase of the efficiency with which a society's resources are used.

In sum, to win the war against poverty, developing countries should preserve precious savings, often saved by making sacrifices, and to invest them in the most productive manner possible. Moreover, the role of education in the process of poverty alleviation is critical. An economy that produces a highly skilled work force can be better managed, more technically progressive and more efficient. High capital formation does not necessarily lead to rapid development and poverty alleviation, unless, the capital is invested productively (effectively and efficiently).

4. Entrepreneurs and Organization's Performance

Most developing countries are still in poverty because they neglected the importance of entrepreneurs and organization's performance in promoting economic growth and in creating a more favorable business climate and conditions. In other words, most economic policies in developing countries, are not only unstimulating in this respect, but they generally discouraged, and even blocked, entrepreneurial initiative. This is mainly through bureaucratic obstacles and the high cost of the red tape needed to create a small business.

To a large degree, economic growth and poverty alleviation occur when the business climate is conducive to the emergence of a sufficient flow of successful entrepreneurs and highly skilled managers. Within poor nations, entrepreneurial activity should gain importance and policy makers should understand that the adequate entrepreneurship is the key in developing the productive powers of poor nations. The other key which makes for efficient production is a competitive business environment where the goal is to improve an organization's productivity, quality, flexibility, cost, adaptability, and response time. On the whole, there can be no doubt that the entrepreneurial function and freedom of enterprise can contribute substantially to higher efficiency and economic development.

Governments of poor countries must take responsibility for creating the institutional conditions and incentives required to encourage productivity and individual enterprise. Thus, in order to promote economic growth and to fight poverty, it is imperative that economic policies in developing countries open the door to entrepreneurs (by encouraging individual initiative) and to the formation of efficient productive organizations. " By adopting liberal economic policies, poor countries can achieve within one generation the kind of economic progress that it took rich countries 100 years to achieve" (Vasquez 2001, p. 19).

The high standard of living and the modern levels of efficiency in production in most countries cannot be achieved without the application of modern technology. Just as Japan did in many areas, poor countries can freely utilize the best final results of 100 years of technological breakthrough in the most developed countries, without the expensive research and the costly trials and errors, rich countries had to go through.

Technological progress can be considered as the engine of economic growth, provided enough capital is forthcoming to exploit opportunities for improvement to the full. Also, in any society, the rate of technical progress, and so of economic growth, depends not only on entrepreneur's availability and ability, but also on the economic environment that provides incentives and opportunities for entrepreneurs. Thus, capital accumulation, entrepreneurial function and technological change go hand in hand.

A nation's rate of economic growth depends on the rate of technological change. If we summarize the strategic perspective of technological change, we can say that technological change often takes the form of new methods of production that makes it possible to develop low-cost, high-quality, easily serviced products; and new techniques of organization, marketing, and management. The rationale for continuously improving an organization's performance is simple:

That only the most productive, high quality and rapid response enterprises are going to win in the future. If you can't produce a top quality product at the world's lowest price and get it to the market in less time than your competitors you're going to be out of the game (Cushman and King 1997).

5. International Trade

International trade is at the forefront of the development agenda, and it is a critical element of any strategy to fight poverty. Over the past two decades, developing countries that increased their integration into the world economy achieved higher growth in incomes (an average of 5 % in the 1990s), longer life expectancy, and better schooling (Hoekman, et al. 2002). Clearly, there are gains to be achieved through trade in the development process. Foreign trade optimizes production and the larger the volume of trade, the greater should be the potential for development. Moreover, developing countries should seek not merely greater trade volume, but also trade at higher export prices.

An exporting country must have something that importing countries want and need. This is the first basic requirement for international trade. Relative productivity of different countries producing different commodities is an important measure of their ability to compete for world markets. Thus, competitive advantage is the key to economic competitiveness in international trade at any given point in time or space. Vigorous participation in the world trading system is a powerful tool for developing nations in fostering economic development and in reducing poverty.

Driven by significant advances in information and communication technology, the global economy is currently undergoing a rapid change. Over the coming years, developing countries will face complex trade negotiations within the major world trading partners (the World Trade Organization, the European Union, etc.). The major challenge for these countries consists therefore in taking advantage of the opportunities to advance their development objectives in the context of international trade negotiations. For developing countries, a smooth integration into the world economy is a valuable opportunity to:

- increase the productivity and the learning rate of the economy over time
- gain and improve market shares of exports
- face competition in order to create a competitive advantage
- allow for economies of scale and overcome the diseconomies of being small
- encourage productive factors to move where there is a comparative advantage
- stimulate investment from any saving of export income
- develop both comparative and competitive advantage
- respond and take advantage of the benefit of international trade
- survive and grow economically
- improve net exports and develop a favorable balance of trade
- fight poverty.

Economic growth is the primary instrument by which developing countries reduce poverty. In the most fundamental sense, economic growth is the necessary (but not the sufficient) condition for economic development and it is concerned with policy measures aimed at expanding a nation's productive capacity (an outward shift of an economy's production-possibilities curve). The sufficient condition for economic development is the process by which a nation attains a positive transformation of its entire social system. For poverty alleviation, as rationality would suggest, economic development is a means to an end-not an end in itself. Recent studies by World Bank economists have concluded that developing nations that reduced trade barriers and increased trade liberalization over the past two decades not only enjoyed stronger economic growth, but also succeeded especially in poverty reduction (Larson 2001, p. 15). Effective integration of developing countries into the global economy will require assistance. In other words, aid for trade is needed for developing countries to build adequate and effective trade capacity, and to implement appropriate trade-related policies and strategies. To make progress in the fight against global poverty, rich country markets should be more open to the goods and services of developing nations. Also, industrial nations should respect the set of rights and privileges that apply to developing nations in order to achieve more favorable access and participation in the international economy through trade.

Theoretically, international trade is important because of the foreign-trade multiplier effect, which is the change in GNP resulting from a change in net foreign trade. This can be expressed mathematically as:

$$\frac{\Delta\ GNP}{\Delta\,(X-M)} = \frac{\Delta\ GNP}{\Delta\ NFT}$$

where
GNP = gross national product
X = exports
M = imports
NFT = (X-M) = net foreign trade.

Whenever (X-M) is positive (exports are greater than imports), a country has a favorable balance of trade. Whenever (X-M) is negative (imports are greater than exports), there is a negative balance of trade. Thus, net foreign trade (the balance of trade) exerts a powerful influence on a nation's overall economy. How great this impact is depends on the size of the net foreign trade (X-M), and on the size of the foreign-trade multiplier (Willis and Primack 1977, pp. 573-574).

Finally, a favorable balance of trade enables enterprises within developing nations to operate more efficiently via the achievement of the economies of scale that might not otherwise be possible.

6. Rural Development

Rural development requires a recognition since the problem of hunger and malnutrition in the developing countries is rooted in the problem of rural poverty.

Rural development may be defined as making rural areas a better place in which to live and work. It is a multisectoral activity which includes agricultural development, rural industry, the establishment or improvement of social infrastructure (schools, clinics, roads, rural electrification, improvement in quality of rural housing, communications, water supply), and welfare services (e.g. disease control, improved nutrition, adult literacy, family planning). Emphasis is directed to the well being of people and the quality of life rather than on economic growth itself. In the developing countries, the majority of the poor live in the rural areas and the term rural development now implies among other things, a focus on poverty problems.

Rural underdevelopment needs an explanation before any economic policy can be designed. My hypothesis says even though the situation of most developing nations is not identical, they all have this in common: rural activities are full of technical and economic inefficiency. Thus, under existing physical infrastructure and economic environment, rural areas are not capable to generate wealth and to break the poverty cycle. In order to attack rural underdevelopment we should understand two basic set of conditions. First, most of those who live in rural areas are still to varying degrees dependent on agriculture for their livelihood and farming is the most important component of the rural economy. Agricultural development is needed in almost every country of the world today where "getting agriculture moving" requires massive and long-term investments in human capital, rural infrastructure, and agricultural research. Consequently, investment in agriculture should receive special attention and any approach to development in rural areas has to be concerned largely with the promotion of agriculture. The agricultural sector is a means to an end-not an end in itself. Higher agricultural productivity requires farmers' education for development, markets for farm products, continually changing technology, credit facilities for farmers and a widespread transportation system. Second, given the seasonality in the agricultural production process, serious attention should be paid to encourage rural industrialization. In fact, there is a great potential for small-scale, labor-using light industries with low capital requirements to produce cheap and profitable goods both for import-substitution and for export. That is, the rural economy must be a mix of complementary activities. These may include craftsmanship, agro-industries, services and the promotion of tourism (eco- and agro-tourism).

A striking characteristic in the developing world is rural-to-urban migration. This situation exists because of differentials in earning power, social amenities, employment opportunities and the desire and expectations of parents to provide their children with better education and greater opportunities for a better life in urban areas. In all these countries, as a consequence of the increased rate of rural-urban migration, the rural population is declining over time. Shortages of agricultural labor supply, at least in peak seasons, have led to an increase of agricultural wage rates and have aggravated the rural poverty problem.

According to the social, economic and political conditions of each developing country, the main challenge is the design of a specific investment package needed to help achieve a specific rural-development strategy. It is important to note that the success of the development efforts relies not only on funds availability and the access to credit to undertake projects, but mainly on the preparation of the human element and the assistance needed to minimize the risks and to assure an effective and efficient implementation and management of rural development activities. Conditions have to be created to help achieve the fullest participation of women in educational, economic, and social life, on an equal basis with men.

Of course, developing countries should give top priority to public investment required to pave the way for the basic solution to make the countryside economically viable and to reduce the phenomenon of rural-urban migration.

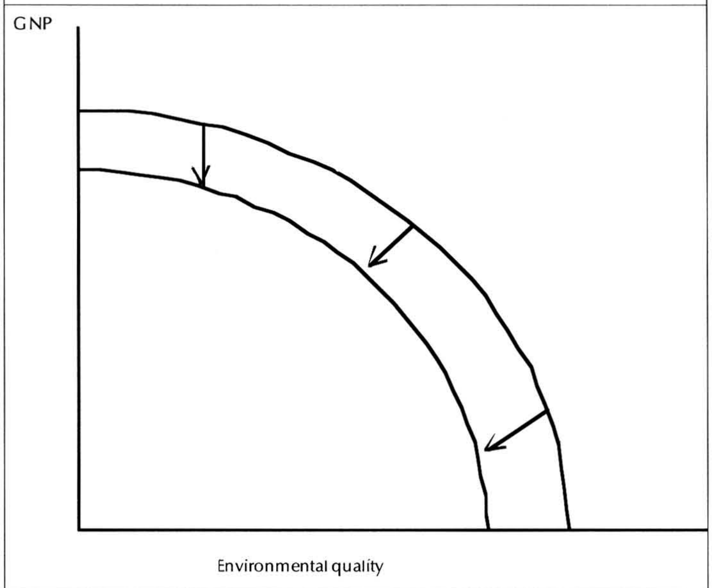
7. Equity and Environmental Quality

For poverty alleviation to be achieved reasonably, developing nations should give more emphasis to the fundamental issues of equity and environment. Equity is tied closely to the distribution of wealth in a society. Following the efficiency criteria, developing nations should recognize the need for a fair distribution of wealth. Theoretically, income equality among families means that any given percent of families receive an equal percent of family income; 10 percent of families receive 10 percent of income, 20 percent of families receive 20 percent of income, and 100 percent of families receive 100 percent of income. In the developing world, it can be observed that income is very unequally distributed. Also, in these, countries, the poorest populations should receive their fair share in the economic development process and the benefits of investment projects should be channeled to them.

All growing economies face the problem of a deterioration in environmental quality. It has become clear that massive environmental degradation has in fact occurred in the developing world. Rural areas have seen larger scale soil erosion and declining soil fertility. Urban areas have experienced seriously diminished air and water quality. Among the most important damages caused by environmental pollution are those related to human health (Field 1997, p. 135). Also, in the developing countries environmental issues are mainly related to health damages. The most widely used economic indicator of a country's standard of living is the gross national product (GNP). This indicator is mainly related to the quality of the human capital and its productivity. The ultimate effect of air pollution, for example, is a deterioration of the future productivity and skills of the victims (negative changes in human capacities). It needs to be recognized, of course, that the victims of pollution not only they face direct health damages and risk of illness, but also they pay for medical expenses in order to reduce damages and improve health conditions.

A good way of thinking about the fundamental economic logic underlying the relationship: environment and health is through the use of production possibility curves. Thus, as illustrated in the following figure, unless less polluting technologies are adopted and more resources are devoted in developing countries to improve environmental quality, changes in human capacities as a result of environmental degradation can lead to a shift of the future production possibility curve to the left and worsen the standard of living. The production possibilities curve approach sees that the environment and the economy are not so much substitutes as they are complements.

Figure 1. *Production possibility curves*



There is an important link between poverty reduction and health. Obviously, a healthier population is a more productive population. It is tempting to say that human health can be viewed as the key to economic prosperity and growth over time. Since good health is essential for poverty alleviation, developing countries need, more than anything else, a clean environment and the poorer the country, the greater is the need for a healthy environment. According to this logic, then, policies and decisions that relate to protecting or cleaning up the environment have a significant impact on poverty alleviation.

8. Conclusion

Poverty is the ultimate concern of this new century. This paper focuses on the most effective means to improve the incomes of the poor in the developing countries. Six key issues are presented. First, the critical importance of investing in people stems from the fact that knowledge can be viewed as the most powerful source of economic growth. Human capital growth, through improved basic social services including health and education, can be considered the crucial issue affecting the prospects for significant poverty reduction. Second, the accumulation of capital is a characteristic of any growing economy. A nation's output depends on brain-power and on the amount of plant, equipment and sources of technical improvement. Third, a healthy economy is an entrepreneurial society where management is the new technology. Fourth, is the discussion of the vital role of international trade in today's dynamic global marketplace. In the international marketplace, the volume of foreign trade in goods and services continues to expand as foreign markets are increasingly recognized as business opportunities. Thus, developing nations should gain a larger share of world exports. The level of economic activity within a country is directly affected by the extent of its international trade. Exports tend to increase aggregate demand directly.

The gap between rich and poor nations can serve as an engine of worldwide development. That is, the gap should help the poor to accelerate their international economic integration and compete in the export of inexpensive labor-intensive consumer goods and services. Fifth, I believe that developing countries should give top priority to rural development since the majority of the poor live in the rural areas. It is important to note that in order for rural development projects to be successful, both the problem definition and the alternative solutions must come from the rural community itself. Also, decision makers in the developing countries should help create the basic pre-conditions conducive to rapid rural economic growth and should find the right instruments that will spread the benefits of the economic reforms and investment to rural areas. Finally, with respect to equity and environmental management, developing societies should realize that it is only through a fair distribution of wealth and the judicious control of environmental degradation that the ideal of maximum social well-being can be reached.

To conclude, it is important to state that while acknowledging the differences and conditions within and among developing nations (economically, politically, and culturally), this study presents from a broad theoretical perspective what might be done in most developing economies in order to accelerate progress towards poverty alleviation.

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