

Did Business Development Reduce Poverty in China?

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[Abstract] This paper is primarily a case study of how post-Mao China reduced the poverty rates among its people. We believe that the main architect behind the efforts of poverty reduction is Deng Xiaoping who led China towards market economy after Mao passed away. Deng had a different vision for China. He envisioned a society where business competition and communism coexisted. Post-Deng China, now, has a poverty level of 20 percent as compared to the 60 percent during Mao's time. Ironically, the Gini Income Inequality Coefficient for China was low under Mao (everyone was equally poor) as compared to the current Gini Coefficient which is as high as the U.S. China's economic revival is truly a "miracle" since it achieved significant poverty reduction while creating a huge middle class at the same time. India has created a middle class of 100 million people, though its poverty rate is still high (still at 40%). We try to explain this phenomenon in this paper.

[Keyword] Deng Xiaoping; poverty reduction; foreign (FDI); entrepreneurialism

Introduction

During the last decade, there have been a lot of interest among scholars in conducting and reporting research related to global poverty measurement and its reduction (Akula 2011; Mascarenhas, Kesavan and Bernacchi 2005; Prahalad 2009; Prahalad 2011; Sen 2011; Sobhan 2005; Yunus 2007; Thorat and Fan 2007). Any credible agenda that seeks to eradicate global poverty must seek to correct the structural injustices and inequities that cause and perpetuate desperate endemic poverty. Such an agenda must aim not merely to aid the poor with grants, welfare and subsidies, but it must seek to enhance the capabilities, skills, access and opportunities of the marginalized to participate, on more equitable terms, in the dynamic process of overall economic growth. Two possible approaches are: 1) Macro social political entrepreneurship that radically innovates legislation or designs macro-policy intervention systems that can effectively dismantle existing unjust structures of social injustice and inequities – the causes that perpetuate endemic global poverty (Thorat and Fan 2007); 2) Micro social entrepreneurship that leads to catalytic innovations that alleviate poverty (McMillan and Woodruff 2002)

Recently, the world has been witnessing individual political activists (e.g., Anna Hazare and his Team in India and political activists in Libya, Egypt, and Sudan) that have been combating deeply ingrained multilayered structural injustices such as corporate fraud, bribery and corruption. These injustices ultimately cause and perpetuate desperate poverty among the marginalized billions. In the paper we distinguish between two extreme groups: The powerful who are on top of the income pyramid (TOP) and the powerless who are on the bottom of the income pyramid (BOP). Poverty originates in the structural injustices of a social and political order that incapacitates the BOP from participating in mainstream economic growth activities (Maxwell 1999, Scott et al 2011). It has been well documented that there are deep seated structural injustices and inequities that institutionalize and perpetuate poverty especially in developing nations (Sen 2000, 2011). It is where governments and many large corporations

are corrupt and we find the largest and most intractable pockets of desperate poverty (Andreasen 1975, 1982; Collier 2008; Sachs 2006). Resistance to change almost always arises from threats to traditional norms or ways of doing things. Often these norms are woven into the fabric of established power relationships. Discerning the source of resistance to change is one of the keys to alleviating global poverty.

Structure of Global Endemic Poverty

The inequalities among us were originally fueled by natural forces of the unequal distribution or endowment of humans in terms of native talent and intelligence, learned skills and committed industriousness, warrior courage and brave perseverance, etc. The gap between these two classes has widened ever since. Some believe we can do nothing about these “original” positions of natural endowments and inheritances. Nozick (1977) called this the natural entitlement theory of justice. Macro-level policy interventions can help reduce economic inequalities (Sobhan, 2005). Andrews and Leigh (2009) observed that extreme income inequalities tend to reduce social mobility (see Figure 1). Hence, to achieve social mobility, income inequalities must be reduced over time (Subramanian & Kawachi, 2003).

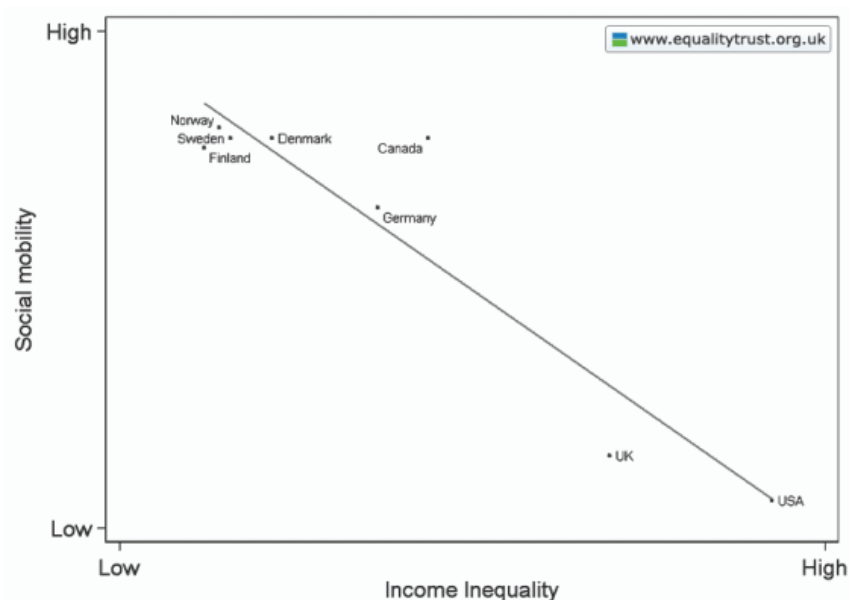


Figure 1. Income inequality & social mobility: An inverse relationship

Source: www.equalitytrust.org.uk

Systematic, connected micro project/policy interventions (e.g., catalytic entrepreneurial interventions such as Grameen bank micro-financing or Aravind Eye) can alleviate, if not totally eradicate, global poverty. While not dismantling existing and past social and political structures of injustice that cause and perpetuate global poverty (such as unjust laws, unjust discrimination, uneven distribution of economic opportunity, unjust property ownership structures, forced child labor, sweatshops, and misappropriation of agrarian land). Quadrant Three solutions empower the BOP to seek self-sufficiency via training and development of people and resources.

The Importance of Reducing Global Endemic Poverty

There has been lot of interest among scholars on the problem of growing endemic poverty levels around the world and ways to reduce the sufferings of fellow human beings (Bardhan2007; Casal 2004; Cohen 2004; Collier 2008; Naim 2007; Okin 1991; O’Neill 1986; Sachs 2006; Sobhan 2005; Collier 2008; Sachs

2006; Sobhan 2005; Yunus 2007). The problem of poverty is the gap between what “we can do” (i.e., knowledge and technology) and “what we should do” (ethics and moral imperatives). Technology and technological progress can be obtained while neglecting the poor. We need an ethical discernment to ask at every stage of a technological breakthrough – why do we need this? How will it humanize us rather than commoditize and monetize us? How will it positively impact the BOP? The field of ethics should question the human significance of any undertaking that has an impact upon the individual and upon society. With every technological advance the hungry nations of the world (BOP) cry out, yet, again, to the peoples blessed with abundance (TOP).

What is humanizing and what is dehumanizing are the two ethical criteria that must be applied to any activity. Any activity that perpetuates poverty is dehumanizing. Any activity that assaults human dignity and solidarity is dehumanizing. We must assess the great technologies and subsequent activities and movements of today such as globalization, digitization, automation, bioengineering, telecommunication, animation, global networking, and the social media from this humanization-dehumanization lens. A fortiori, we must test catalytic social entrepreneurship (CSE) solutions to endemic global poverty with the same lens. Will they humanize the people alleviated from global poverty or dehumanize them?

Education is a key determinant of economic well-being for individuals, groups, cities and villages. Despite massive diffusion of educational institutions in some nations such as India, the “rural” populations have little excess to quality education. Hence, providing a quality education for all, especially in the rural area where majority lives, is a great strategy for alleviating poverty.

Poverty Eradication as a Business Opportunity

Every single social and global issue of our day, said Peter Drucker, can be a business opportunity in disguise. Global poverty is a serious social and global issue today and can be a serious business opportunity. Aid, subsidies, grants and philanthropy are not the long-term solutions to massive global poverty. The real opportunity is local development of the private sector in BOP markets (Prahalad, 2009). This paper explores this opportunity especially the case of China.

Business opportunities abound at the bottom of the economic pyramid (Hammond & Prahalad, 2004). Successful examples of capitalizing this opportunity are documented. For instance, Muhammad Yunus founded the microfinancing Grameen Bank with the idea that small loans to poor people could fund larger businesses while lifting the poor from their poverty. Going beyond microlending, Yunus proposed a social business model that can co-exist and support even traditional for-profit businesses. His win-win model currently helps over 8 million borrowers and has eradicated poverty significantly in several developing countries that have adopted this model.

In theory, C. K. Prahalad (2009) has argued that the best win-win possibility of lifting the poor from their vicious poverty cycles is to engage them in for-profit businesses providing goods and services (e.g., bakeries, healthcare, communication and home building services) in economically disadvantaged countries and communities. He argued that businesses can profit from the BOP markets while alleviating global poverty.

“Globalization has created new inequalities between those who enjoy the power given to them by knowledge, and those who are excluded from its benefits because they have no access to that knowledge” (Nicolas 2010). Globalization is simultaneously an opportunity and a risk. If well oriented to universal human values, globalization can be a great opportunity for promoting economic progress, better equality, better harmony, peace and solidarity.

Universal Moral Values and Global Poverty Eradication

Some fundamental moral universals should ground the poverty eradication effort in order to make the latter project desirable, feasible, viable and doable (Sachs, 2008). Reduction of economic inequality should be one of many moral universals. Economic inequality within a society is associated with decreased well-being and increased poverty (Babones, 2008; Subramniam & Karachi, 2003; Wilkinson & Pickett, 2006). A required moral change of attitude for poverty eradication is the progressive eradication of

an old culture that believes that wealth is a sign of God's favor and, equivalently, that poverty is a sign of God's disfavor (Herberg, 1996). In general any economic inequality that destabilizes the equality of opportunity (a first-order moral universal) is unacceptable for the poverty eradication project. Equally strong second-order moral imperatives are entrepreneurship programs that improve health, education and entrepreneurship among the poorest of the poor (Prahalad, 2009).

Poverty Reduction

Ever since Prahalad and Hart (2002) coined the term "bottom of the pyramid," the theory of the bottom of the pyramid (BOP) has been gaining much attention among multinationals and academicians (Prahalad, 2011; Hart, 2005; Hart & Christensen, 2002; Prahalad, 2009; Prahalad & Hammond, 2002). The BOP represents billions of the world poorest who live on less than two dollars a day, amidst their lack of the basic amenities at food, water, shelter, sanitation, clothing, privacy, healthcare, and education. These inequalities result in hunger, thirst, sickness, destitution and squalor (see Figure 3).

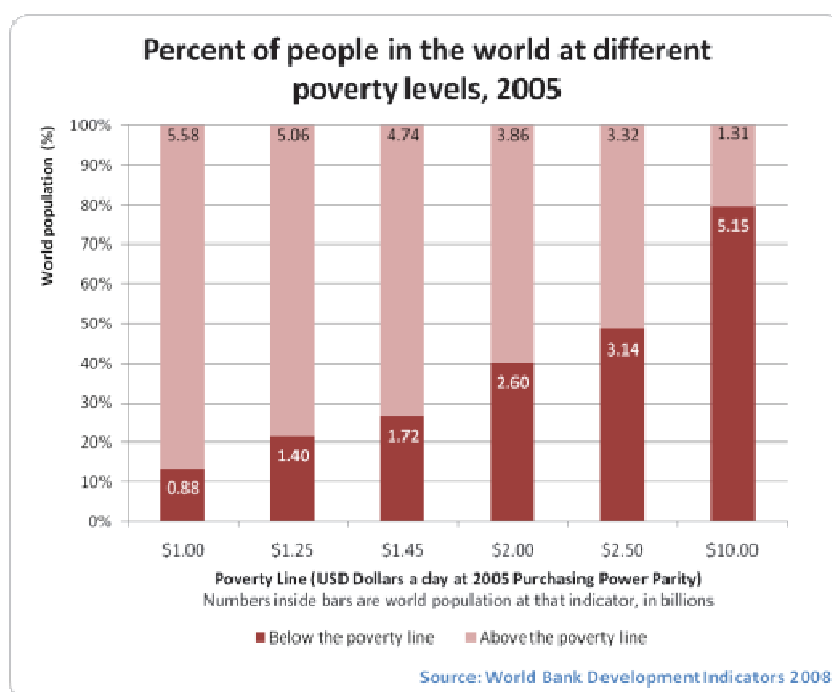


Figure 3. Percent of people in the world at different poverty levels, 2005

Given this macro-micro (quadrant three) focus, we next argue that the BOP must be the primary focus of Eradicating global poverty (EGP) and its resolution programs. Thus far, companies from high-income countries (e.g., U.S, Canada and Europe) have accessed the low-income countries (e.g., the poorest 30 countries of the world) in search of cheap labor and raw materials. One way this trend can be stopped is, as we argued before, is by enabling the low-income countries to participate a growth economies in world markets (eg. coffee farmers in Africa being offered contracts on their production and training in growing quality beans by U.S based Starbucks Corporation). Another way involves offering the BOP market high-quality-low-cost products and services that are results of catalytic entrepreneurial interventions (eg. Aravind Eye Care) to be discussed in the following section (Larson and Murray, 2008).

Table 1
Catalysts Creating Entrepreneurship Opportunities For The Poor

Catalysts	What did they do?	Outcomes
Grameen Bank (Founded by M. Yunus) http://www.grameen-info.org/	Microfinance; Tainting	Income; consumption; education; accommodation; health; women's empowerment
BRAC (Founded by FazleHasan Abed) http://www.brac.net	microfinance, education, healthcare, legal services, community empowerment	Increased self-reliance; Improved healthcare; Better education; touches lives of 126 million people in 11 countries
NFTE (Founded by S. Mariotti) http://www.nfte.com/	Class Program; teaches student entrepreneur skills; find students an opportunity and start-up fund	Increased interest in attending college; Greater occupational aspirations; Improved scores in independent reading; Saved more than 450,000 students

Entrepreneurial Innovations

Innovation is bringing new ideas and concepts to the society. These can originate from any source including governments, corporations, universities or the public. Innovation is the use of new technological and market knowledge to offer a new product or service that customers want (Afuah, 1998). Christensen et al. (2006) describe a sub-category of disruptive innovation, called catalytic innovations. Examples of catalytic innovations are many, for example the Grameen Bank for Microfinance; Ashoka and Aravind Eye Care. Specifically, Hart and Christensen (2002), Prahalad and Hart (2002), Prahalad and Hammond (2002) and Prahalad (2011) propose a way that low-income countries can participate in the major markets and economies of the developed world. This is done through active interventions by Multinationals with the cooperation of national governments to bring disruptive innovations to the BOP markets. Deng Xioping's efforts to reduce poverty by pushing for rural economic development in China is a recent example of a successful intervention by the government. Deng Xiaoping was the main catalyst and hence can be labeled as a Macro-Catalytic Entrepreneur or a visionary who was focused exclusively on the BOP.

Overall Poverty Reduction in China

The World Bank's data shows that the percentage of people in extreme poverty has fallen from 60 percent in 1981 to 49 percent in 2004. Excluding China, however, there has been no improvement. The total decreased by only 1 percent, from 50 percent in 1981 to 49% in 2004 (See Figure 4). In other words, most of the world's citizens who have been removed from poverty during last few decades are from China.

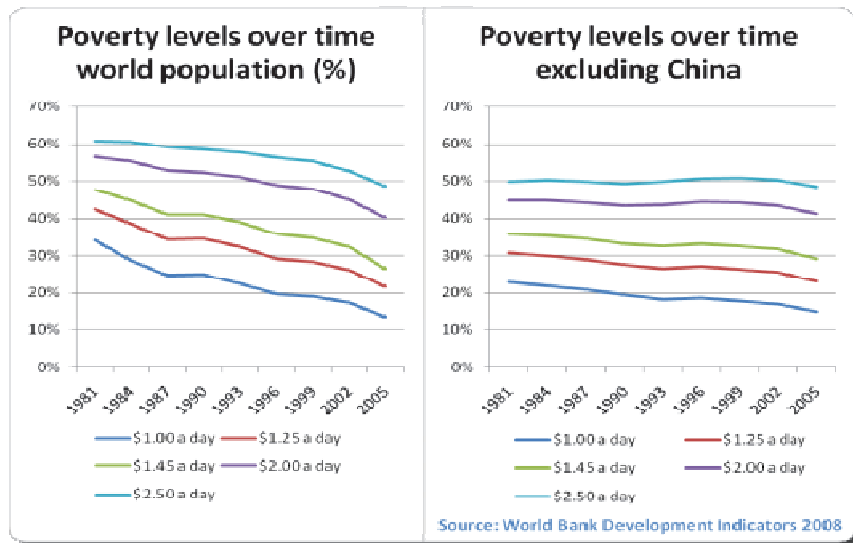


Figure 4. Changes in Global Poverty Level

Figure 5 shows clearly that the poverty level in China has been reduced significantly during the last few decades using different standards.

Headcount poverty rates for China

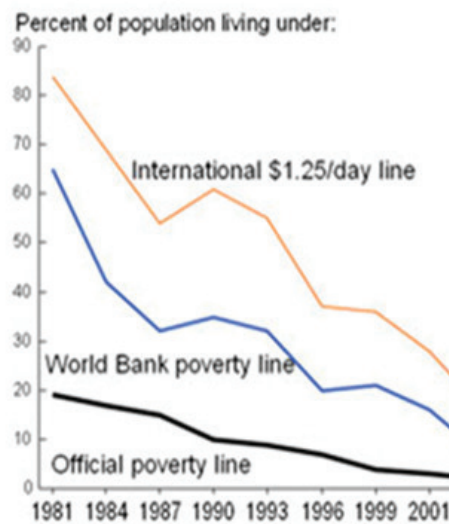


Figure 5. The Substantial Declination of Poverty in China

The two graphs above together clearly indicate that, during last 25 years, china has accomplished much in terms of poverty reduction whereas other nations have not had much improvement. In next two sections will be devoted to explaining how China could achieve such a result by applying both the Macro and Micro approaches.

Poverty Reduction in China through Macro Interventions

The massive poverty reduction in China didn't happen until the early 1980s when Deng Xiaoping decided to adopt the "open-door policy" in the form of exchange rate and tax concessions for exporters and the creation of a special-economic zone. He also decided to bring in Foreign Direct Investment (FDI), downsize state-owned enterprise and equally distribute the land to farmers.

Table 2

Deng Xiaoping As A Catalyst Creating Entrepreneurship Opportunities For The Poor

Catalysts	What did they do?	Outcomes
Deng Xiaoping (former Chinese President) (See Figure 7)	Open China's Market; Invite FDI; downsize state-owned enterprise; land distribution	Hundreds of millions people went out of poverty; vibrant entrepreneurship environment; and a staggering number of entrepreneurs

Table 3

Transition Matrix for China

	Farming	Wage emp.	Self-emp.
<i>1-Year transition rates (maximum likelihood estimates)</i>			
Farming	0.859 (6.592)**	0.081 (4.669)**	0.060 (4.612)**
Wage emp.	0.030 (3.323)**	0.938 (4.108)**	0.032 (2.591)**
Self-emp.	0.017 (2.471)**	0.013 (2.310)**	0.97 (3.457)**
<i>20-Year transition rates (calculated)</i>			
Farming	0.172	0.355	0.473
Wage emp.	0.145	0.445	0.410
Self-emp.	0.115	0.197	0.688

*Z statistics in parentheses; *** denotes significance at the 1% and ** denotes significance at the 5% level of confidence.

Source: S. Mohapatra, S. Rozelle And R. Goodhue (2006), "The Rise of Self-Employment in Rural China: Development or Distress?"

Table 3 shows that, as the economy grew, most Chinese farmers chose to leave their farms with 47.3% of them becoming self-employed, suggesting a massive urbanization. Also, 41 percent of wage employed Chinese choose to become self-employed. Deng Xiaoping was a visionary because he thought that his approach could have the freedom of capitalism by creating a mixed economy. He believed that if he ensured that poor people could live in a decent life his political party would remain in power.

Poverty Reduction in China through Micro Interventions

The total amount of FDI used in China topped US\$90 billion in 2009, a slight decrease in comparison with the amount of 2008 (see Figure 6). Its total accumulated amount of FDI actually used by 2007 was USD 943 billion since 1979. China would utilize foreign funds to encourage the dependent of new entrepreneurs. However, China still needs to improve its product and services' quality and quantity even

though it has been the largest recipient of foreign investment among developing countries for 15 years. In the years to come, China will channel its investment into research and development centers, new high-tech industries, advanced manufacturing, and energy conservation and environmentally friendly sectors. (Corporations are micro units; when FDI comes, it creates new entrepreneurs who become suppliers of foreign companies)

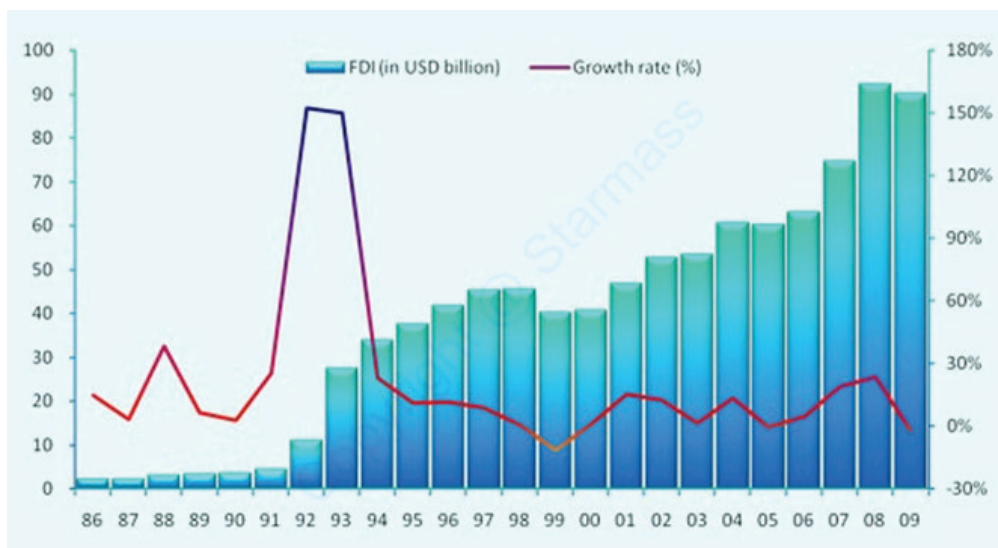


Figure 6. Total amount of foreign direct investment used in China

Source: Starmass.com

When FDI comes in, it encourages Chinese entrepreneurs to participate in the economy by becoming suppliers, hence moving those people from poverty. In such a way, as more FDI arrives, more Chinese entrepreneurs will emerge and more poor people will be hired, driving the poverty level down even further.

Self-employment in China

Headcount poverty rates for China

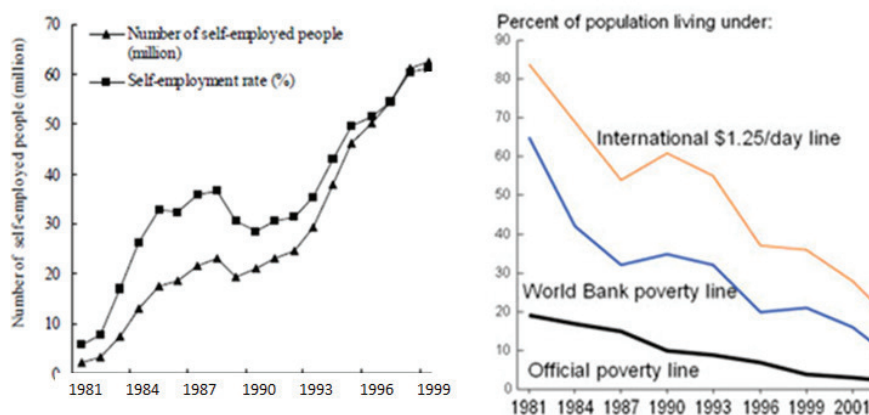


Figure 7. Deng Xiaoping’s vision helping China out of poverty through entrepreneurship
Source: China Statistical Yearbook (1981 - 2008)

Concluding Remarks

China vs. India both GDP went up but not poverty reduction. Currently, of the 7 billion people on planet earth, it has been estimated that about 1 billion earn less than \$1 a day (starvation level) and another 2 billion earn less than \$2 a day (desperate poverty). This is morally unconscionable. Global social entrepreneurship requires – governments, corporations, NGOs and the poor to co-create effective solutions to the problems of the BOP market. It mobilizes the commitment, investment and talent capacities of all stakeholder communities of the world, including the BOP, to engage in the process of transforming the world. Poverty reduction can result from co-creating a market around the needs of the poor” (Prahalad 2011). Having said that, 2 points can be made:

1) The TOP does not have to be lessened in any way by the BOP moving upward, for example, Bill Gates And Warren Buffet have collectively decided that the best usage of their extraordinary wealth and expertise is to invest in the children and the poor of the world. They also, issued a challenge to other TOP members to join them. Azim Premji, an Indian Entrepreneur who started Wipro (a leading IT firm), has already accepted this challenge by donating almost to 2 billion dollars to the cause of the BOP (Bishop 2008)

2) The improvement of the BOP is not automatic and it will not happen tomorrow. It will take the best available technology, aggressive social entrepreneurship, plenty of patience, and great deal of time.

Rome was not built in a single day and the BOP will not have its fortune reversed overnight.

Management implication of development through poverty reduction, both TOP and BOP win.

Poverty and HDI

Just because China has reduced “economic” poverty levels, doesn’t imply that its Human Development Index (HDI) is high. Chinese people crave for more freedom of speech, freedom to decide the size of their own families, to have less government intervention in their personal affairs, etc. Future researchers should focus on developing HDI with reference to China (Witkinson & Pickett, 2006).

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