Perspectives on Global Development 2012

SOCIAL COHESION IN A SHIFTING WORLD

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Foreword

The global economy looks radically different from ten years ago. More than 80 countries grew twice as fast as the OECD average in the last decade, lifting hundreds of millions of people out of poverty. This secular convergence trend has only been reinforced by the current crisis. Most emerging economies have weathered the global crisis relatively well and some of them are now the engines of the world economy.

Although this catch-up process led to a better distribution of wealth among countries, this has not been necessarily replicated within countries. In rapidly growing countries, economic and social transformation brings new stresses and strains. In this context, social cohesion becomes increasingly important, as it can underpin growth perspectives and build the foundations for a fairer society. Social cohesion is valued by citizens all over the world; it implies a sense of community and equality of opportunities.

This is the key theme of the second edition of our Perspectives on Global Development *report. The first documented the process of shifting wealth, the progressive shift in the global economic centre of gravity toward the east and south. This edition –* Social Cohesion in a Shifting World *– examines why social cohesion matters for fast-growing developing countries and discusses how it can be strengthened.*

The report argues that shifting wealth provides opportunities to strengthen social cohesion. Working towards this goal is an ambitious undertaking. It requires a long-term political commitment, capacity for co-ordinated policy making and often, a substantial fiscal effort.

The good news is that today many emerging economies have solid fiscal positions, thereby creating the necessary policy space to pursue a comprehensive social agenda. Establishing a social contract between citizens and the state, which entails more and better services in exchange for better tax compliance, can lead to a virtuous circle boosting social cohesion as well as growth.

A gradual extension of social security beyond targeted transfers, a concerted integration of the middle-class and the development of more inclusive schools are all examples of areas where a change in policies can make a difference. Cohesion needs at least equal access to education to generate equal opportunities!

As we celebrate our 50th Anniversary, the OECD has reaffirmed its strong commitment to promoting development worldwide, and we are currently designing a broader development strategy. Social cohesion is an important building block in this endeavour, one which applies to emerging and developing countries, but also to OECD countries themselves. This report is also part of our broader efforts to put social issues more firmly on the global agenda. We stand ready to support countries that continue to innovate, redesign and implement better policies that foster social cohesion for inclusive growth, development and ultimately, better lives.

Angel Gurría

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Acronyms and Abbreviations

ADB	Asian Development Bank
AfDB	African Development Bank
CCT	Conditional Cash Transfer
CSO	Civil Society Organisation
DAC	Development Assistance Committee
DfID	Department for International Development
ECLAC	Economic Commission for Latin America and the Caribbean
EITI	Extractive Industries Transparency Initiative
EPL	Employment Protection Legislation
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
HIPC	Heavily Indebted Poor Country
IDB	Inter-American Development Bank
IFI	International Financial Institution
LDC	Least-Developed Country
MDG	Millennium Development Goal
MNC	Multinational Company
NREGS	Mahatma Gandhi National Rural Employment Guarantee Scheme
ODA	Official Development Assistance
PISA	Programme for International Student Assessment
PIT	Personal Income Tax
PPP	Purchasing-Power Parity
R&D	Research and Development
SIGI	Social Institutions and Gender Index
SWF	Sovereign Wealth Fund
UISA	Unemployment Insurance Savings Account
WFP	World Food Programme
UNECA	United Nations Economic Commission for Africa

Preface

The year 2011 has seen various forms of social upheaval affect economies and politics not only in the Middle East and North Africa, but in all regions of the world. Events in 2010 and 2011 were not the purview of countries feeling most acutely the bite of the financial crisis. In fact, many of these countries weathered the crisis well, rapidly returning to strong and fast growth. Demonstrations and social unrest seem rather to be linked to a perception that the fruits of growth are not being shared equally, and to a limited scope for participation in the policy making process. Good macroeconomic management and social expenditure, while necessary, have proven insufficient if pursued in contexts where social cohesion is low or deteriorating.

Perspectives on Global Development 2012 argues that social cohesion is a means for development as well as an end in itself. A cohesive society is one where citizens feel they can trust their neighbours and state institutions. One where individuals can seize opportunities for improving their own well-being and the well-being of their children. It is a society where individuals feel protected when facing illness, unemployment or old age. This report looks at different policy principles which are essential to a social cohesion development agenda.

This report focuses on countries where growth performance in the past ten years has more than doubled that of rich countries. While the shifting centre of economic gravity brings new opportunities for these countries in the form of larger export revenues and the promise of greater fiscal space, it also comes with new challenges: rising inequalities, the movement of people, a difficult adjustment of jobs to different sectors of the economy and a need to meet citizens' rising expectations of living standards and access to opportunity.

Social Cohesion in a Shifting World draws on both analysis and policy dialogue. Regional seminars focusing on social cohesion in Africa and Southeast Asia were held, respectively, in Rabat (Morocco) and Bangkok (Thailand) and lessons learned at these events permeate the report. It further builds on a body of work undertaken at the Development Centre which explores the multi-faceted challenges for fiscal and social policy in a changing world. The *African Economic Outlook 2010* and the *Latin American Economic Outlook 2009* focused on fiscal challenges in these regions.

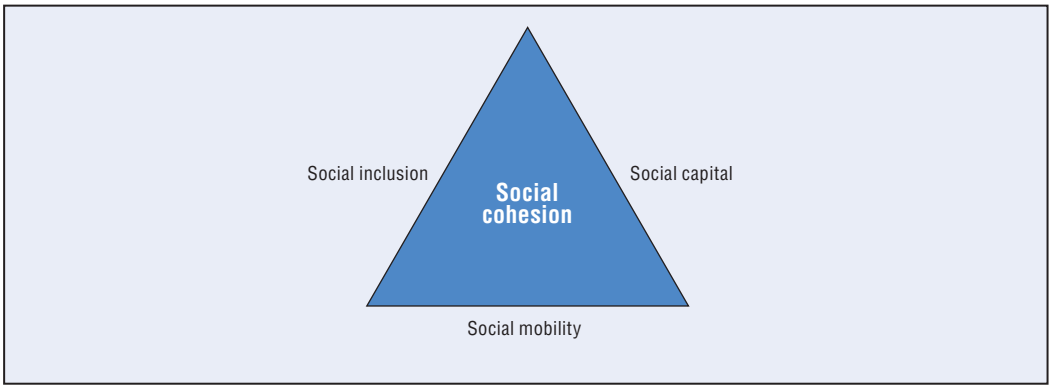
The new geography of economic growth and its associated changes affect multiple policy domains. The role of the state in managing structural transformations and the distributional pattern of development is thus crucial. To cope effectively, countries will need strong, long term development strategies, as well as a greater focus on co-ordination across different levels of government.

Mario Pezzini
Director, OECD Development Centre

Executive Summary

The world has changed markedly since the beginning of the new millennium. "Shifting Wealth" describes a phenomenon in which the centre of economic gravity of the world has progressively shifted from West to East and from North to South, resulting in a new geography of growth. The new scenario presents some major opportunities and challenges for the creation of socially cohesive societies. This report examines social cohesion in fast-growing developing countries and provides policy makers with recommendations for ways to strengthen it. A cohesive society works towards the well-being of all its members, fights exclusion and marginalisation, creates a sense of belonging, promotes trust, and offers its members the opportunity of upward mobility. This report looks at social cohesion through three different, but equally important lenses: social inclusion, social capital and social mobility.

Figure 1. **The components of social cohesion**



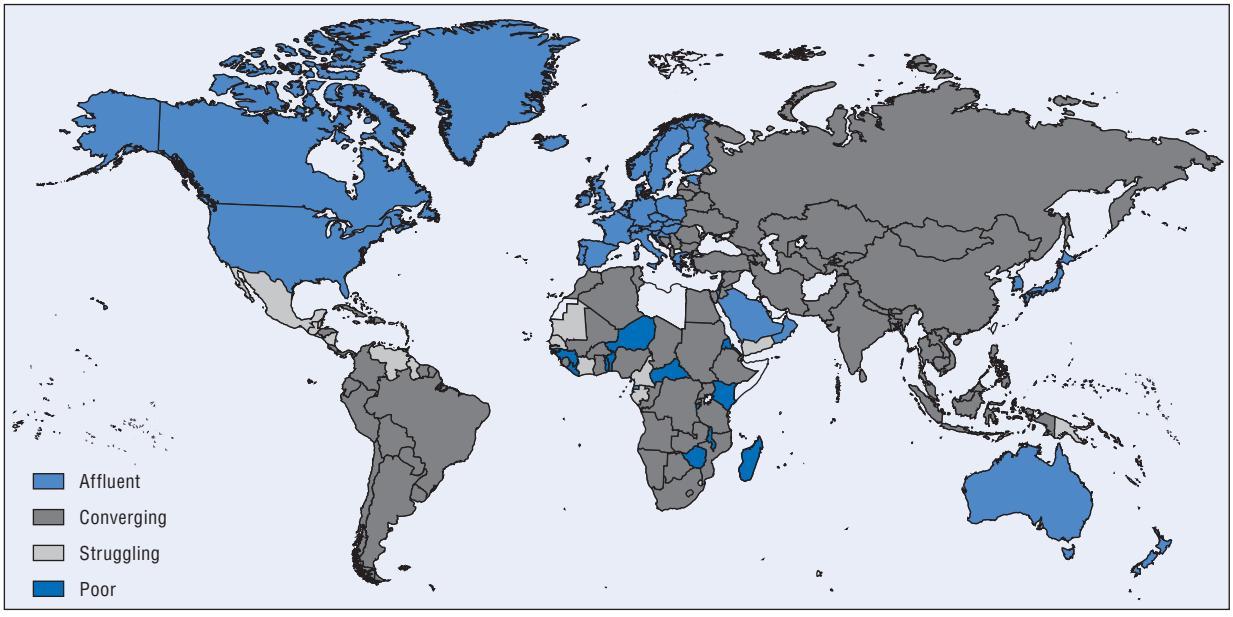
The report argues that social cohesion is a valuable goal in itself and contributes to maintaining long-term economic growth. Growth paths in which social inequalities are wide, exclusion widespread, and the scope for voicing dissent small are unlikely to be sustainable. The report stresses the need for co-ordinated policy making in fiscal and tax design, employment, social protection, civic participation, education, gender and migration. Because policies in these areas all interact with each other in their effect on social outcomes, each policy area needs to be designed with regard to the others.

Shifting wealth brings opportunities for social cohesion…

Over the last decade, developing countries as a whole have enjoyed a revival in their economic fortunes after some 20 years of missed opportunities and disappointing

performance. The 2000s were the first time in many decades that poorer developing countries grew faster than high-income economies. In the 2000s (as Figure 2 shows), as many as 83 developing countries managed to double OECD per capita growth rates (a measure used in *Perspectives on Global Development 2010* to define "converging countries"), compared to only 12 countries in the 1990s. The 2010s have begun under bleaker global growth prospects than the 2000s however, as growth has stalled in advanced economies in the midst of recovery from the crisis. With a less propitious international environment for growth, the new decade is bound to test the strength of new engines of growth and the sustainability of shifting wealth.

Figure 2. **Fast growth in the developing world in the 2000s**



Notes: See Chapter 1 for a detailed description of the country classification used. This map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.

Source: Authors' elaboration based on World Bank (2011), *World Development Indicators*, World Bank, Washington, DC.

Around 50 of those developing and emerging economies have grown at an average annual rate of over 3.5% per capita over the 2000s. Today, nearly 1 billion out of the 2 billion people living on USD 10 to USD 100 a day in the world – the global middle class – live in converging countries. This number is projected to exceed more than 3 billion in 2030. High rates of growth have brought with them new resources that could be used to promote and finance a more inclusive growth process, particularly taking into account the emerging middle classes' expectations and contributions to social cohesion.

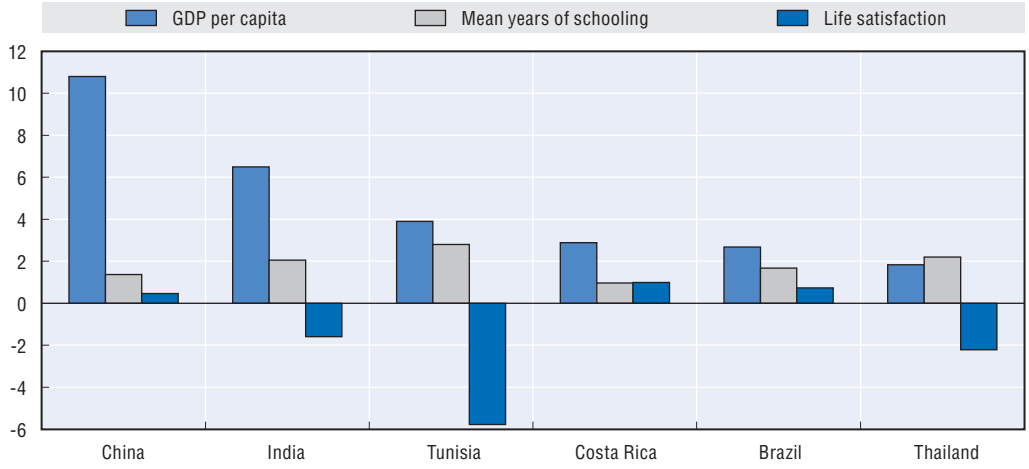
… but it also brings new challenges

Economic and social transformations during a period of fast growth bring new stresses and strains with which governments have to cope. The challenges include rising income inequalities, structural transformation, and the need to meet citizens' rising expectations of standards of living and access to opportunity. Citizens living in a fast-growing economy have rising expectations of their current and future standards of living as they seek to share in the benefits of growth. As an emerging middle class increasingly compares itself

with peers in advanced economies, its patterns of consumption and demands for quality services can be expected to change. Higher incomes, better health and improved education do not automatically translate into higher life satisfaction as the decline of life satisfaction in fast growing countries such as Thailand and Tunisia reveals (Figure 3). Governments should not ignore the toils of these emerging middle classes nor underestimate their capacity to mobilise people and exert pressure for more open and transparent governments or for an increase in standards of service provision.

Figure 3. **Changes in life satisfaction, education and growth performance in the 2000s**

Annualised percentage growth rates



Note: Life satisfaction is measured by the average value of the answers to the Cantril ladder question: "On which step of the ladder would you say you personally feel you stand at this time, assuming that the higher the step the better you feel about your life, and the lower the step the worse you feel about it? Which step comes closest to the way you feel with steps numbered from zero at the bottom to ten at the top?"

Source: United Nations Development Programme (2010), *Human Development Report*, UNDP, New York; Gallup (2010), *Gallup World Poll, Waves* 1-5, New York; and World Bank (2010), *World Development Indicators*, Washington, DC. GDP per capita growth rates: 2000-09; life satisfaction: 2005-10 (earliest and latest waves); mean years of schooling: 2006-10.

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In this context, strengthening social cohesion becomes a critical policy objective. Governments which ignore questions of social cohesion risk having to face social instability and undertake ineffective policy interventions. Recent events – ranging from pro-democracy unrest in Thailand in 2010 to the Arab Spring revolutions – lend support to the thesis that it is clearly not sufficient to apply technocratically good policy frameworks while disregarding people's desire for inclusive political processes.

Policies can make a difference

While a strong growth process throws up new challenges for converging countries, there is ample evidence that public policies can make a difference. Redistributive policies are a powerful example. OECD countries with initially high income inequalities redistribute income through taxes and transfers, while in many developing countries (*e.g.* in Latin America) tax and transfer systems have a much more limited impact on income distribution (Figure 4).

Figure 4. **Gini coefficients before and after taxes and transfers in developing countries**

Source: OECD (2008), *Growing Unequal? Income Distribution and Poverty in OECD Countries*, OECD, Paris; and OECD (2008), *Latin American Economic Outlook 2009*, OECD Development Centre, OECD, Paris.

StatLink http://dx.doi.org/10.1787/888932517629

Strengthening social cohesion requires a long-term vision and commitment. While some policy interventions or reforms can generate results relatively quickly, others do not bear fruit for some time. Building a more inclusive education system, for example, which increases the education levels of the disadvantaged and the average level of education, takes a number of years to translate into increased inter-generational social mobility. That kind of long-term vision and commitment to policies also requires a stable macroeconomic environment.

The task of co-ordinating policy across a number of domains can pose a significant challenge. Tools to facilitate co-ordination include inter-ministerial groups or commissions, *ex ante* impact assessments of laws, and theme-based horizontal budgeting. For example, gender-responsive budgeting advances gender equality by identifying the interventions required to address gender gaps in sector and local government policies, plans, and budgets.

Policy areas that are key to social cohesion

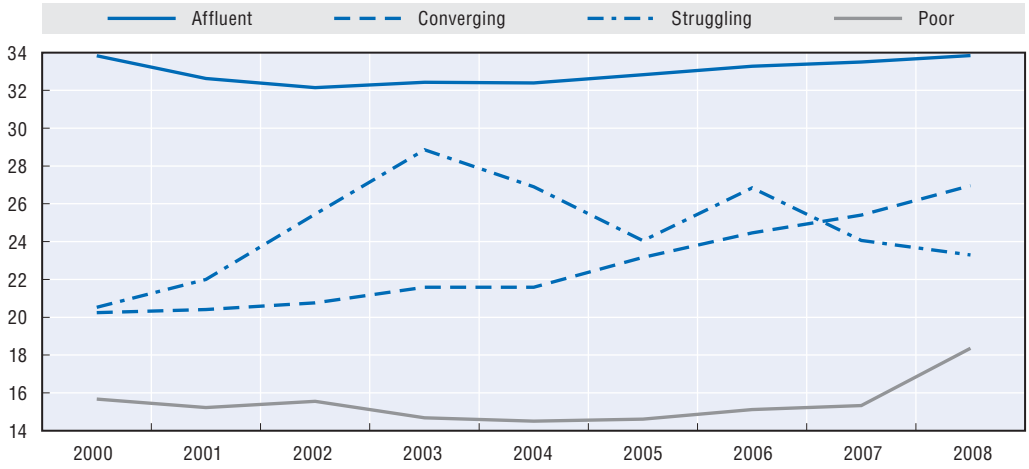
Fiscal policy

Greater fiscal space opens a window of opportunity for development and stronger social cohesion in developing countries. For opportunities to materialise, however, fiscal policy reforms are needed. Available windfall gains and resources produced by shifting wealth are a boon to finance social programmes. They are not in themselves sufficient, however: programmes should be affordable and sustainable. A critical issue in this regard is to ensure the long-term financial sustainability of social programmes, an elusive objective in the widespread context of volatile revenues dependent on fluctuating commodity prices and the prospective depletion of non-renewable natural resources. As tax revenues are still comparatively low in converging economies (Figure 5), there is room for tax reforms that broaden the tax base or increase tax rates.

However, low levels of trust – regarding how taxes are raised and how revenue is spent – often undermine reform that considers taxes in isolation from complementary expenditure and institutional reforms. A number of social factors impact significantly on

Figure 5. **Fiscal revenues as percentage of GDP, 2000-08**

Unweighted averages (%)



Source: Authors' elabotation based on World Bank (2011), *World Development Indicators*, Washington, DC.

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low state legitimacy, in particular as regards fiscal policy. This can translate into lower revenues and fiscal policies which are generally less effective at addressing inequalities and creating opportunities for upward social mobility. In addition, even where formal democratic institutions do exist, fiscal policy tends to reflect the interests of elites and powerful lobbies if large swathes of the population are excluded from the political process or have limited access to collective instruments for influencing policies.

Economic and fiscal institutions that de-link expenditures from the volatility of current revenues are key in ensuring sustainable financing of social cohesion policies. An important role of macroeconomic fiscal policy is to create the conditions for sufficient and predictable fiscal space to finance development expenditure priorities related to social cohesion, be they social pensions, unemployment compensation, education or youth employment programmes. Fiscal rules that compel governments to save during good times so they can maintain public investment during economic downturns can play an important role. Similarly, sovereign wealth funds can help non-renewable commodity exporters extend resource-linked revenues over time and across generations.

Tax administration reform is another powerful way of increasing fairness, transparency and tax morale in developing countries. In order to be effective, however, it must be part of a co-ordinated effort to strengthen the social contract. Reforms, such as setting up semi-autonomous tax collection agencies, will have a greater impact if combined with expenditure policy reform. Better and more transparent tax collection must be linked to better public services. This fiscal exchange, *i.e.* the link between services received in return for taxes paid, is essential to creating a virtuous circle for tax compliance and service delivery.

Employment and social protection

The deep transformation that shifting wealth has brought about calls for the establishment of labour market institutions that can facilitate the wage-setting, distributional and allocative roles of labour markets. Reforms setting out guarantees for workers and collective bargaining systems can begin to establish institutions that will

assist markets in adjusting prices to the new labour market regime more smoothly, while ensuring that wages reflect productivity increases. Protecting workers need not mean protecting jobs. Indeed, it is possible in emerging countries with mature social protection systems, to advance an agenda which seeks to provide income security through social protection rather than job security by offering unemployment insurance and assistance, income support while out of employment and in old age, and a range of public services, including healthcare.

In the short run, more traditional instruments of labour market regulation, and in particular minimum wages, have assumed a prominent role in the policy debate, which includes low-income countries in sub-Saharan Africa and poorer ones in Latin America. Minimum wages are a useful tool against working poverty even when compliance is limited. Indeed, minimum wage increases also spill over into the informal sector, raising wages throughout the economy. Some countries, like Brazil, have used minimum wages extensively to raise the living standards of workers. But they are not targeted instruments and tend to have wide-ranging side-effects: large increases in minimum wages can be costly or cause negative employment effects when misused. Moreover, the effects of minimum wage changes are unequal across workers, depending on the degree of enforcement and labour market segmentation. Active use of minimum wages to increase incomes should therefore not be a substitute for effective social policy and for ensuring that labour market institutions fulfil their price-setting role efficiently.

Labour market institutions and social protection systems should be judged not only in terms of their efficiency, but also their ability to prevent or mitigate duality and segmentation. Recent innovations in social protection (the expansion of cash transfers, conditional or not, social pensions, and new forms of health coverage) have helped to reduce coverage gaps in social protection. However, they can often lead to dual systems where the poorest are covered by social assistance and the wealthy by either contribution-based or private alternatives. This leaves a significant gap, a "missing middle" of coverage amongst a large segment of informal middle-income workers. Institutions will need to evolve to better reflect labour markets' realities if they are to produce fair outcomes with minimal strife. Universal entitlements de-link social protection from job status and offer the best prospects in terms of coverage levels and incentive structures for labour markets.

Universal access to basic social services may not be achievable in the short to medium term, but governments still have a number of more affordable tools at their disposal. Extending social services via targeted cash transfers for example can be comparatively affordable; programmes in Brazil, Indonesia and Mexico have attained coverage of up to one-third of the population whilst costing less than 1% of GDP. Contribution-based systems can be unbundled and opened up to uncovered workers, as is the case of unemployment insurance savings accounts in Latin America.

Fostering social cohesion via social services and other programmes is contingent on the availability of adequate resources and also on improving the efficiency of public spending. The idea that governments cannot afford measures to strengthen social protection needs to be contrasted with the fact that governments often provide large subsidies or payments which benefit the non-poor. For instance, instruments such as fuel and food subsidies can be extremely expensive and distortionary. This is particularly the case with fuel subsidies which tend to be highly regressive.

Education

Education is a vital part of any social cohesion agenda as educational outcomes affect all three dimensions of the social cohesion triangle. When opportunities for quality education are afforded across the population, schooling becomes a strong leveller of opportunities, bringing prospects for upward mobility even to disadvantaged groups. Increasing educational attainment is an important way for converging countries to reduce inequality in market incomes in the long run, particularly as returns to education have changed as a consequence of shifting wealth. Beyond enrolment, the quality of education needs to receive attention so that increases in educational outcomes effectively translate into greater productivity, better growth prospects and improved chances in the labour market.

Ensuring that children have equal opportunities to build their human capital, regardless of socio-economic background, is a key challenge to strengthening social cohesion. A number of interventions can help diminish the importance of background and encourage students from all sectors, including the most disadvantaged, to acquire more education. A key objective should be to minimise the differences in individuals' ability to benefit from formal schooling. Non-school inputs, such as early-life nutrition and pre-school programmes play a key role here: more than 200 million children are estimated to fall short of their development potential due to stunting as well as iron and iodine deficiencies.

Equally, instruments that reduce opportunity costs of continued education can improve attainment levels. Lowering the cost of schooling is an important first step in encouraging secondary completion and higher education enrolment. Conditional cash transfers and Food for Education initiatives are known to be efficient tools for increasing school attainment.

Efforts to close the gender gap in education are particularly important because, on top of the imperative of equal access to education for boys and girls, it can help break the inter-generational transmission of poverty. Indeed, maternal education has positive effects on children's health and future prospects. Gender-sensitive school policies and facilities do foster social integration.

The schooling experience itself also impacts social cohesion, as it shapes and transmits common values that underpin social capital and inclusion. How children are schooled is important for building their sense of belonging to a society. Schooling should be organised to increase the participation of children from disadvantaged groups, thus making education more inclusive. Greater inclusiveness can also result from the development of teaching techniques and curricula that foster diversity and enhance positive perceptions of others within the system and society. This applies particularly to the better integration of minorities in education. Countries where inclusion at school is greater are generally also those where trust between different groups in society is stronger. Moreover, inclusive schooling systems tend to perform better in terms of learning outcomes than segmented ones.

Gender

Despite high growth in the last 20 years, many countries have not made any real headway in improving gender equality. Cultural dynamics and the fact that social institutions lie at the root of existing power relations make challenging discriminatory social institutions a daunting task. Providing incentive for change is therefore crucial. Change should be initiated in the areas of employment, education and entrepreneurship

through, for example, increasing women's access to credit and technology and providing conditional cash transfers specifically targeted at transforming discriminatory social institutions such as forced and early marriage.

A critical starting point for addressing institutional bottlenecks in the area of gender equality is to enhance women's productive activities by guaranteeing them property and inheritance rights. Limited access to resources reduces the ability of women and girls to generate a sustainable income, and can lead them to take up more poorly paid or insecure employment. Furthermore, the lack of access to and control over land can have a negative impact on the food security of the household, increase women's vulnerability to poverty or violence, prevent them from accessing bank loans or financial services, and reduce their decision-making power.

Migration

South-South migration – migration between developing countries – has significantly increased and diversified over the last two decades and this trend is likely to intensify in the future. But the integration of immigrants is a challenge not only in rich but also in poor countries. The experience of emerging economies is symptomatic of the challenges that integration represents for immigration countries around the planet. Although they do face the same challenges as native populations, immigrants are also often deprived of access to decent public services. While limited resources in new immigrant-destination countries cause concern over the development of specific measures against the social exclusion of immigrants, the history of integration in OECD countries seems to suggest that the earlier countries address this issue, the more successful policy interventions will be.

Migration-related social cohesion must go beyond anti-discrimination measures. A smooth integration process should, in particular, include a comprehensive set of social, employment, education and housing measures. Efforts also need to be made to improve native-born citizens' perceptions of immigrants. Policies should prevent and reverse the social exclusion of immigrants, which is still the biggest single barrier to full integration; foster positive bonding between immigrants and local people; and, finally, promote social mobility for immigrants by improving labour market mobility, facilitating entrepreneurship, better skills matching, and encouraging education.

Designing and implementing social cohesion policies

Civic participation – An inclusive policy agenda

Giving space to dissenting voices is fundamental to the creation of a sustainable, socially cohesive society. The harnessing of civic participation and political feedback mechanisms is essential if growth processes are not to be derailed. This is particularly true in the context of shifting wealth, where faster economic growth and more social dislocation require innovative responses. The process of policy making is as important as the policies themselves for building social cohesion. Social cohesion will be enhanced by an inclusive, co-ordinated policy-making process.

Inclusive policy making brings in the views of all stakeholders – from those who will be implementing the policies to the final beneficiaries. The policies which result from such a process benefit from having greater legitimacy and support, factors which ultimately

determine their effectiveness. Promoting civic participation and decentralisation could prove to be a powerful tool for improving service delivery as well as something to be valued in its own right. Similarly, women are important agents of change, and facilitating their full participation in democratic life is an important policy objective.

Implementing a social cohesion policy agenda requires effective administration and co-ordinated action across multiple policy domains. Strong institutions and a quality public service underpin successful public action. *First*, countries should focus on strengthening the civil service and the quality of regulation, among others by improving human resource management in public employment and implementing "performance based budgeting" mechanisms. *Second*, horizontal cooperation across ministries is needed, as the effectiveness of different interventions is interrelated. *Third*, many emerging and developing countries are fortifying their institutional capacity through decentralisation and local capacity building, but the benefits are far from automatic. The involvement of multiple actors across different levels of government requires negotiated roles to ensure accountability. In sum, complex links between policy areas mean that tools for both vertical and horizontal co-ordination are needed, and the centre of government must take an active managing role. Institution building takes time and hence implementing a social cohesion agenda requires a long standing commitment.

Better data, better assessments, better policies

Policy making also needs to be more evidence-based. Economic and social policies to foster social cohesion in practice require a framework for *ex ante* and *ex post* assessments of their impact: Do they lead to more or less social exclusion? Do they foster trust and civic participation? Do they help to improve social mobility? Monitoring and evaluating social cohesion policies which can answer these questions requires new data. As advocated in the Sen-Stiglitz-Fitoussi commission's report in 2009, progress measurement should embrace indicators beyond GDP growth to capture other dimensions of well-being. Absolute and objective measures of progress should be complemented with relative and subjective measures for more effective assessment.

Efforts to collect data in order to calculate such measures currently focus on developed countries and are mostly carried out by private organisations. Comparability, availability and quality of data could be improved if national statistical offices (also) gathered them. However, the potential of the data can be fully exploited only if: *i*) there are international standards for data collection; *ii*) statistical capacity building is facilitated in countries where it is needed; and *iii*) data is made public as much as is possible.

Outlook: Social cohesion for long-term, sustainable growth

The structural transformation of economies brought about by integration into the world economy offers various unprecedented possibilities to foster social cohesion. The availability of greater fiscal resources can be used to develop more comprehensive social security systems to protect all sections of the population. The success of changing discriminatory institutions against women in some countries can be an inspiration to others. In a more fully integrated economy it becomes imperative to develop an educational model that enables upward social mobility.

To promote social cohesion is not to promote an apolitical vision of the challenges facing society. Fostering it as an overarching objective can only be realised if the main

stakeholders of a society – the authorities, business organisations and civil society groups – are involved and actively work together to jointly address collective action. Donors can lend their support by helping to develop an environment where people can actively participate and speak out and where the government is being held accountable. The transition process that many converging countries are now undergoing is likely to be turbulent and prone to conflict. If managed carefully, however, it offers the opportunity to address long-standing inequalities, develop a more inclusive social security system, create a sense of belonging and thereby strengthen the potential for a long-term, sustainable growth path.

PART I

Opportunities and Challenges for Social Cohesion

Living in Costa Rica seems to be enjoyable: its per capita income makes it only a middle-income country, but its life expectancy is comparable to that in the United States and access to higher education is equal to that in France or Norway. What is more, Costa Ricans seem to value the country's achievements – according to Gallup World Poll data more than 80% of the population report being satisfied with their living standards in 2010, as compared to 73% in high-income countries. Costa Rica has achieved this partly through a concerted investment in education and health expenditure, a consensus which, although with different perspectives, neither of the two major political parties has seriously tried to undermine. With the country's commitment to inclusive growth, human development and civic participation, it exemplifies the idea of a cohesive society.

This report examines the links between shifting wealth and social cohesion in fast-growing developing countries. The patterns of growth and economic dynamics of the last 20 years have lifted more than 500 million people out of extreme poverty. But this new economic environment has also brought about a number of new challenges in the form of increased income inequality, unevenly distributed benefits of growth, and higher food prices, as well as the need for sound management of the new macroeconomic environment. Increased prosperity itself also transforms some long-standing social challenges, from poverty to gender equality to governance, and makes addressing them both more feasible and more urgent.

Against this background of changing global development architecture this report addresses the following key questions:

- What are the opportunities and challenges provided by the new geography of growth to strengthen social cohesion in fast-growing countries? How is the structural transformation, that is changes in commodity prices, labour markets and fiscal revenues and expenditures, affecting social cohesion?
- What are the key policies of an agenda aiming to promote social cohesion in times of shifting wealth?

Social cohesion is a useful conceptual framework for integrating the multiple social concerns – social inclusion, social capital and social mobility – that are instrumental in achieving key development objectives, including growth and poverty reduction, and are policy objectives in their own right. A "cohesive" society works towards the well-being of all its members, creates a sense of belonging, and promotes social mobility. The transformation process might exacerbate already existing differences in values and priorities, in particular relating to the possibility of participating and influencing political processes by all members of society, potentially leading to conflict.

This report argues that social cohesion is crucial for the peaceful management of collective action problems that naturally arise in transforming societies. The creation of trust and solidarity and the nurturing of the belief that everybody, regardless of his sex, age or ethnic identity can benefit from these new opportunities is essential. It does not argue for a monolithic perspective of societies, whereby individuals are expected to subsume their own

values and beliefs under the heading of a united vision. On the contrary, social cohesion is necessary for upholding a pluralistic society.

Part I of this report presents the opportunities and challenges that shifting wealth brings for enhancing social cohesion.

Chapter 1 documents how shifting wealth opens up opportunities by expanding sources of development finance and national savings for converging countries through increased trade, foreign direct investment, remittances and aid flows. The financial and economic crisis has accelerated the trend of per capita income convergence across countries with a growing number of developing and emerging economies growing faster than high-income economies. As a result, for the first time since the 1960s, emerging and developing countries converged significantly to high-income countries' GDP per capita in the 2000s.

A favourable economic environment offers opportunities to enhance social cohesion. Chapter 2 documents the impact of social cohesion on development outcomes such as reducing transaction costs, easing business relations and protecting against life risks. Social cohesion is hence an end in itself but is also a means which can help achieve other development outcomes, including more robust growth.

As well as opportunities, the growth patterns and transformations brought about by shifting wealth bring with them a number of challenges for social cohesion, which are addressed in Chapters 3 and 4 respectively.

Chapter 3 discusses key challenges related to the need for the creation of a sufficient number of good jobs, changing relative factor and commodity prices, in particular those of food, as well as the intensification of urbanisation, bringing an increase in the number of people living in slums. Chapter 4 focuses on the topic of distributional challenges. Fast growth is often associated with an increase in inequalities in countries, which raises the question of how the proceeds of growth can be shared in an equal manner.

Chapter 1

Shifting Wealth: A Window of Opportunity

While it is a potential challenge to social cohesion, the shift in the centre of economic gravity from west to east – shifting wealth – also opens a window of opportunity for more inclusive development and stronger social cohesion. The financial and economic crisis has, if anything, further accelerated the ongoing structural transformation where emerging and developing economies recovered more rapidly to pre-crisis levels of economic activity compared to advanced economies. The process of shifting wealth made available a greater range and amount of resources, e.g. *larger fiscal revenues, higher export earnings, the continuing build-up of foreign exchange reserves and rents from natural resources. Policies are crucial for the financial sustainability of social protection programmes in a context where gains are potentially volatile and, in some cases, dependent on non-renewable resources (subject to depletion and exhaustion).*

Introduction

Over the last 20 years the global economy has undergone a structural break: the centre of economic gravity has swung gradually from West to East, emerging and developing economies have driven global growth, and South-South linkages have intensified, leading to new patterns of trade, foreign direct investment (FDI), and aid flows. *Perspectives on Global Development 2010* referred to this new phenomenon as "shifting wealth" (OECD, 2010a) and discussed the set of policies required to harness opportunities and benefits and to mitigate the risks and challenges for emerging and poor countries that shifting wealth has generated. The financial and economic crisis has, if anything, further accelerated per capita income convergence across countries as a growing number of developing and emerging economies grew faster than high-income economies. Earlier financial crises in developing countries usually had a regional concentration, *e.g.* the East Asian crisis of 1997-98 or the Latin American "tequila" crisis of 1995. This time, however, the epicentre of the crisis lies deep inside the developed economies.

An attendant risk of the transformation process is that it actually exacerbates existing differences in values and priorities. Such differences could, as the introduction to this report argues, lead to conflict, particularly if citizens are denied the possibility of participating in and influencing the political process. Recent events – ranging from protests in Thailand in 2010 to the Arab Spring in 2011 – lend support to the thesis that peaceably managing the problems of collective action which naturally arise in changing societies is crucial to sustain growth and reduce poverty. In other words, if history is the yardstick, it cannot be taken for granted that shifting wealth will necessarily lead to improvements in social cohesion.

While it is a potential challenge to social cohesion, shifting wealth also opens a window of opportunity for development and stronger social cohesion. The new geography of growth – where around 50 developing and emerging economies have grown at an average annual rate of over 3.5% in the last decade – has seen an increase in available resources which could, in turn, be used to promote and finance a more inclusive development process. Such resources include larger fiscal revenues, higher export earnings, the continuing build-up of foreign exchange reserves, and rents from natural resources.

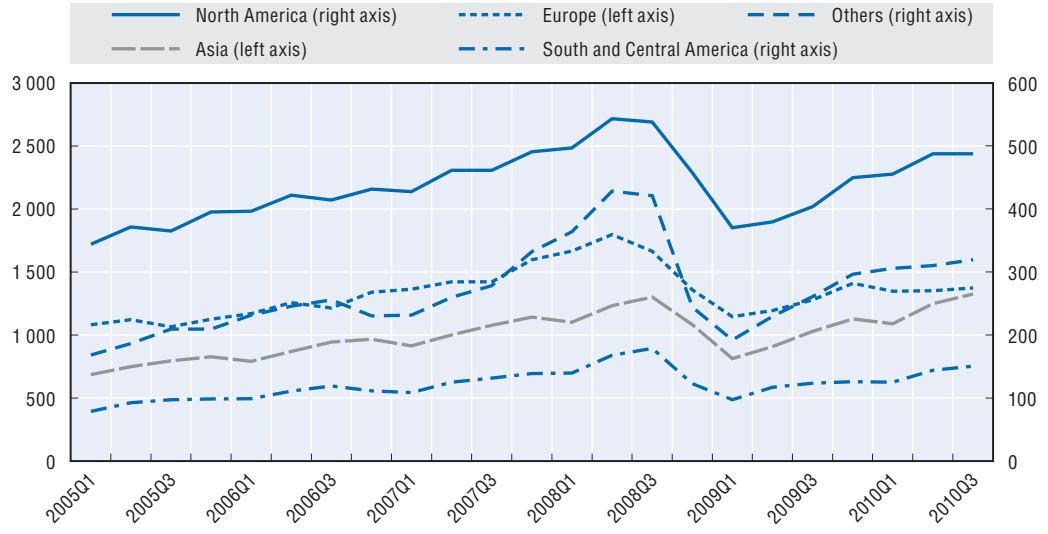
This chapter explores how the financial and economic crisis has accelerated shifting wealth. It addresses the question through analysis of the geography of economic growth up to 2010 in the so-called "four-speed world" (OECD, 2010a). It also considers the key factors that have contributed to emerging and developing economies generally outperforming high-income countries. The chapter then examines how the process of shifting wealth that occurred in the 2000s made available a greater range and amount of resources, *e.g.* higher export earnings, larger national savings, greater fiscal revenues. However, these gains are potentially volatile and, in some cases, dependent on non-renewable resources (subject to depletion and exhaustion). Policies are therefore crucial for the financial sustainability of social protection programmes in the long run. Key issues for fiscal policy are further discussed in Chapter 5; Chapter 9 examines the challenges for the affordability of social protection programmes.

Shifting up a gear: The spread of convergence in the developing world

Most of the developing world weathered the financial crisis of the late 2000s relatively unscathed and, by the end of 2010, many emerging market economies had recovered, or were close to recovering, their pre-crisis growth levels (World Bank, 2011a). A number of high-income economies, however, still face high unemployment rates, weak and uneven growth, and substantial fiscal consolidation requirements (OECD, 2010b). By 2010, for instance, Asia's export volumes were almost back to what they had been prior to the crisis (Figure 1.1), unlike those of North America and Europe. Similarly, developing and emerging economies have come through the collapse in FDI inflows better (Figure 1.2).[1]

Figure 1.1. **Export flows by region**

USD billion



Note: "Others" includes African and Middle Eastern countries.

Source: WTO (2010).

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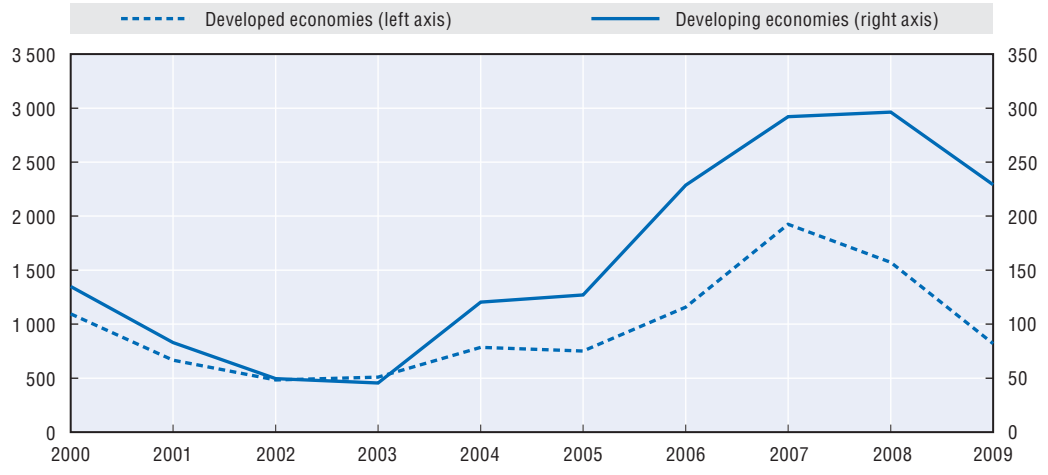
Figure 1.2. **Foreign direct investment inflows to developed and developing economies**

USD billion at current prices and current exchange rates



Source: UNCTAD (2010).

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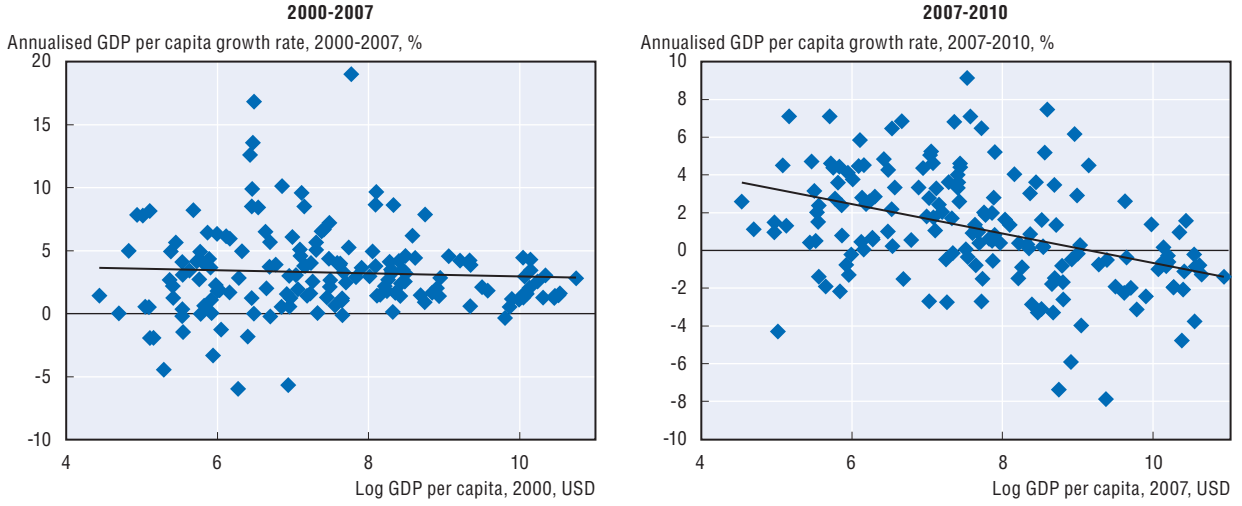
The superior economic performance of emerging and developing economies in the aftermath of the financial and economic crisis has had two major consequences. First, Asia has emerged as the driving force of global GDP growth. Not only did developing countries' contribution to growth not falter during the downturn of 2008-09, the shift in the centre of economic gravity from West to East further accelerated. Already the most dynamic region in the developing world with 30% share of total global growth, Asia accounted for almost 50% of global growth in 2010 and is projected to reach 55% by 2015.[2]

The second consequence is that, for the first time since the 1960s, emerging and developing economies converged significantly to high-income countries' GDP per capita in the 2000s. The negative correlation depicted on the left-hand side of Figure 1.3[3] shows that poorer countries have grown faster than richer countries – in other words, their per capita income has converged to the levels of the richer economies in the period 2000-07.[4] Income convergence strengthens and becomes statistically significant once analysis focuses on 2007-10, which includes the years of the crisis (right-hand side of Figure 1.3).[5]

Figure 1.3. **Income convergence in the 2000s**



Source: Authors' elaboration based on World Bank (2011b).

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Extending the analysis to the period of the financial and economic crisis, many more low- and middle-income countries have climbed the four-speed ranking (OECD, 2010a) to join the group of converging countries – those whose per capita growth rate in the last decade was more than double that of high-income OECD countries (Table 1.1 and Figure 1.4). The number of converging countries has increased from 65 to 83, of which 49 are growing at a GDP per capita rate that is greater than the 3.5% considered in this report – albeit arbitrarily – as "fast".[6]

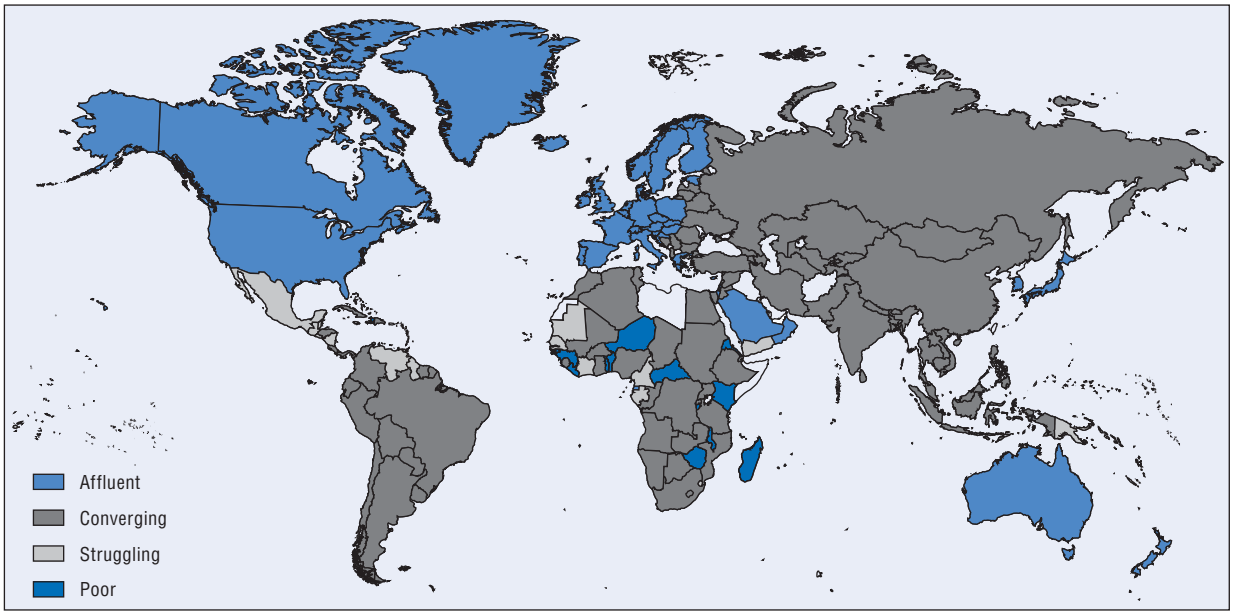
Several factors motivate why most developing and emerging economies recovered more rapidly than high-income countries to pre-crisis levels of economic activity.

- Quite remarkably, given the chequered history of financial crises in the developing world in the 1980s and 1990s (Reinhart and Rogoff, 2009), the epicentre of the financial crisis, this time, lay deep inside the developed economies. In fact, the last instances of financial turmoil in developing countries were the Argentinian and Turkish crises of 2001, since when the developing world has not suffered a single major incident of financial turbulence.

Table 1.1. **The four-speed world classification**

INCOME \ GROWTH		
	AFFLUENT – Countries in the World Bank's high-income grouping. (> USD 9 265 Gross National Income (GNI) in 2000 for the 1990s and > USD 12 276 GNI in 2010 for the 2000s)	
	STRUGGLING – Countries with less than twice the high-income OECD rate of GDP growth for the respective periods and – Classified as middle-income at the end of the period. (USD 755 to USD 9 265 GNI in 2000, USD 1 006 to USD 12 275 GNI in 2010)	**CONVERGING** – Countries with GDP per capita growing more than twice the high-income OECD growth rate indicative of strong convergence to high-income OECD countries. (> 3.75% for the 1990s, > 1.8% for the 2000s)
	POOR – Countries with less than twice the high-income OECD rate of GDP growth for the respective periods and – Classified as low-income at the end of the period. (≤ USD 755 GNI in 2000, ≤ USD 1 005 GNI in 2010)	

Figure 1.4. **The four-speed world classification in the 2000s**



Note: This map is for illustrative purposes and is without prejudice to the status of or sovereignty over any territory covered by this map.
Source: Authors' elaboration based on World Bank (2011b).

- In the past, global financial crises have had an extremely negative impact on commodity prices, as global demand collapsed and investors fled the markets. In the 2008-09 downturn, however, and despite a sharp initial fall in the final quarter of 2008, commodities had bounced back by mid-2009 and had recovered to pre-crisis levels by 2010 – boosting the earnings of primary commodity exporters.[7]
- Generally speaking, developing countries entered the crisis with better macroeconomic fundamentals, with most of them exhibiting less external vulnerabilities than in previous downturns (OECD, 2010a). They enjoyed lower inflation and lower debt; they

Table 1.2. **Growing number of converging countries in the 2000s**

Number of countries

	1990s[1]	2000-07[1]	2000-10
Affluent	34	40	42
Converging	12	65	83
Struggling	66	38	31
Poor	55	25	16
Total	**167**	**168**	**172**

1. On the basis of OECD (2010a).

Source: Authors' elaboration based on World Bank (2011b).

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had more manageable fiscal and current account deficits with more room for policy and less binding financing constraints; and they held higher international reserves.[8] Their economic recovery was swifter, characterised by bigger fiscal stimuli, stronger pre-crisis fundamentals, and faster-growing trading partners (IMF, 2010a; IMF, 2010b).

- Finally, developing countries have been progressively decoupling their growth performance from their traditional partners – *i.e.* the advanced economies – and strengthening their economic ties with other emerging economies, especially China. Because the large Asian economies (together with some other regional drivers like Brazil) withstood the crisis relatively well, economic growth in other developing countries suffered much less. In an important sense, then, these countries acted as shock absorbers for the global economy.[9]

Shifting wealth: New resources for development

The proliferation of growth poles in the emerging and developing world is both the cause and the result of the intensification of economic linkages and flows, adding and expanding potentially available resources to sustain a virtuous cycle of economic development. For instance, in regions like South America, sub-Saharan Africa and East Asia, trade balances visibly improved in the last decade compared to the 1990s. This positive picture is not limited to trade flows, but extends to financial flows such as net FDI, workers' remittances, and South-South assistance, which expanded rapidly in the 2000s. As sources of development finance and national savings in converging countries have multiplied, shifting wealth has helped widen tax bases. Together with declining debt ratios and lower debt service, fiscal space in converging countries has, in general, expanded. In principle, this report argues that some of these new resources could be channelled towards the implementation and extension of social programmes so as to make economic growth more inclusive and lock in its benefits.

However, although the availability of windfall gains and resources produced by shifting wealth may be necessary for the financing of social programmes, it is not sufficient in itself – programmes should be affordable. A critical issue is to ensure their long-run sustainability – an elusive objective in the twin context of volatile revenues dependent on fluctuating commodity prices and the prospective depletion of non-renewable natural resources.

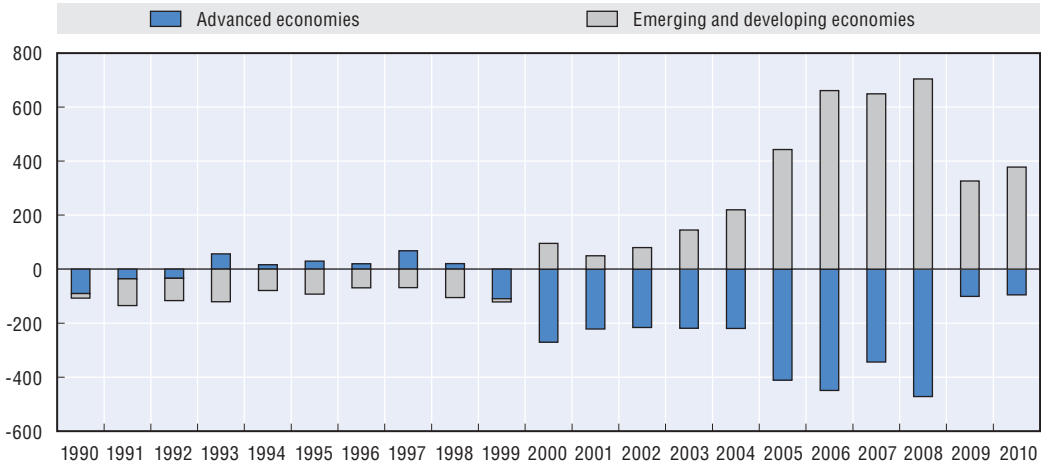
The following section looks at some facets of the rise in resources which has accompanied the shifting wealth process – in particular development finance flows (trade, FDI, aid and workers' remittances, and foreign exchange reserves[10]) – and their repercussions on the fiscal space. Flows are analysed by comparing average performance in the 1990s – a decade of sluggish growth, financial crises, and structural adjustment programmes in the developing world (OECD, 2010a) – with the 2000s, when developing and emerging economies experienced their most robust economic growth since the 1960s.

Greater development finance flows

Growing current account surpluses in emerging and developing countries since the beginning of the 2000s have mirrored rising current account deficits in advanced economies (OECD, 2010a), as Figure 1.5 shows. While reaching their peak before the crisis hit in 2008, current account imbalances became clear in the early 2000s. The relative positions of advanced and emerging/developing economies were dramatically reversed compared to the 1990s, when emerging and developing economies were running slight current account deficits mirrored by small surpluses in advanced economies.

Figure 1.5. **Current account balance, advanced *vis-à-vis* emerging and developing economies, 1990-2010**

USD billion



Source: IMF (2011a).

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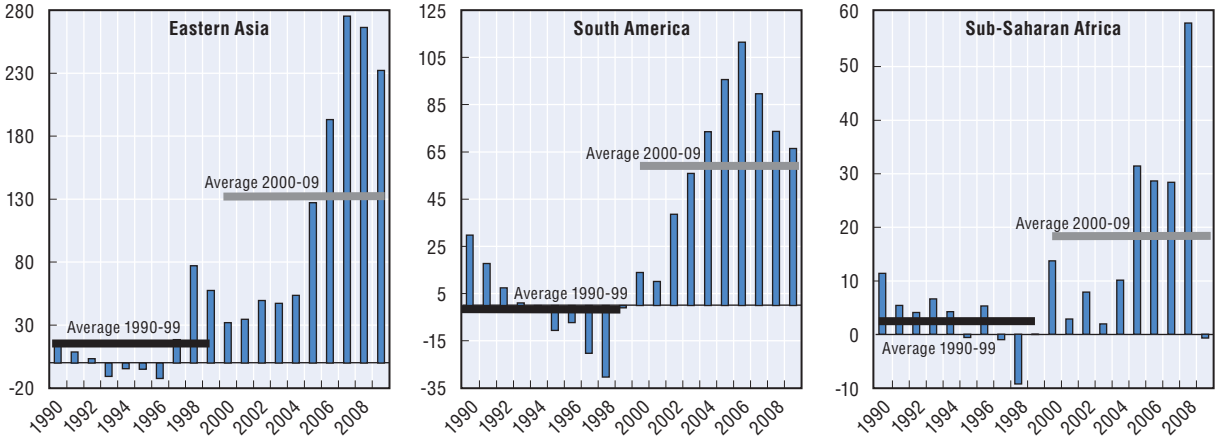
What were the major underlying factors behind these overall trends? First, regional trade balances dramatically improved in developing regions such as East Asia, sub-Saharan Africa and South America from the 1990s to the 2000s (Figure 1.6). The regional average burgeoned nearly tenfold in East Asia (from just under USD 15 billion to

Figure 1.6. **Trade balances in Eastern Asia, sub-Saharan Africa and South America, 1990-2009**

USD billion



Source: Authors' elaboration on the basis of UNCTAD (2010).

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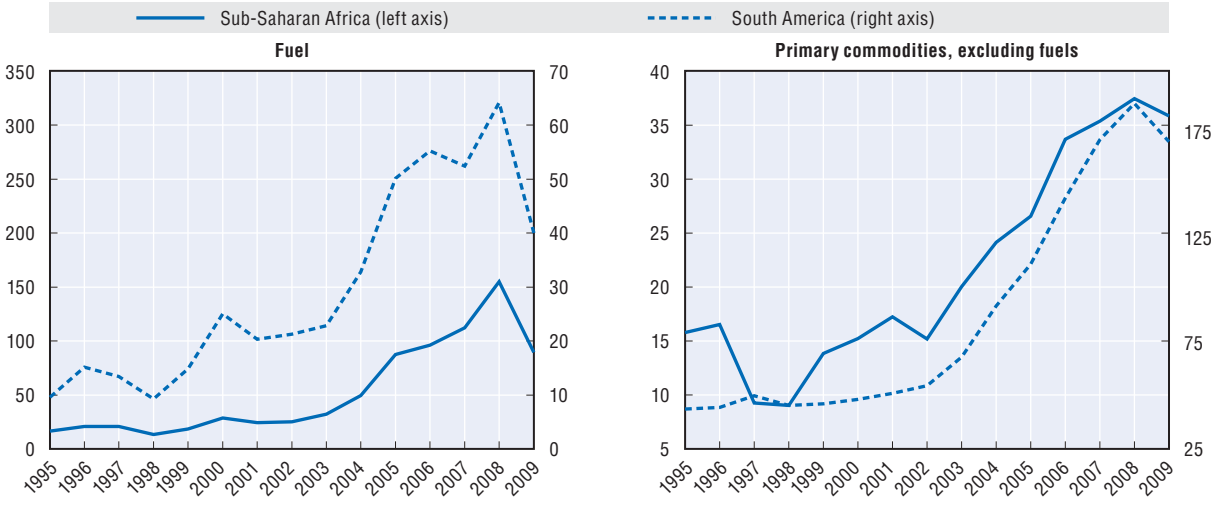
USD 130 billion) and sevenfold in sub-Saharan Africa (from USD 2.5 billion to USD 18 billion), roughly 2% of the regional GDP. In South America, too, the picture changed markedly: the moderate current account deficit of the 1990s (USD 1.4 billion on average) became an overall current account surplus of over USD 60 billion in the 2000s (again roughly 2% of GDP).[11]

A powerful driver behind these trends was the high food and fuel commodity prices from 2003 to mid-2008 which, despite the sharp fall in the last quarter of 2008, had bounced back by mid-2009, partly in response to continued demand from the large Asian economies. As Figure 1.7 shows, both sub-Saharan Africa and South America experienced a sharp rise in their trade surpluses for non-fuel primary commodities (more accentuated in South America) and fuel (especially in sub-Saharan Africa). The sharp worsening in the fuel trade balance in both regions in 2008 and 2009 exemplifies the volatility of revenues in the shifting wealth process, closely linked with fluctuations in commodity prices.

Figure 1.7. **Trade balance by primary commodity in sub-Saharan Africa and South America, 1995-2009**

USD billion



Source: Authors' elaboration on the basis of UNCTAD (2010).

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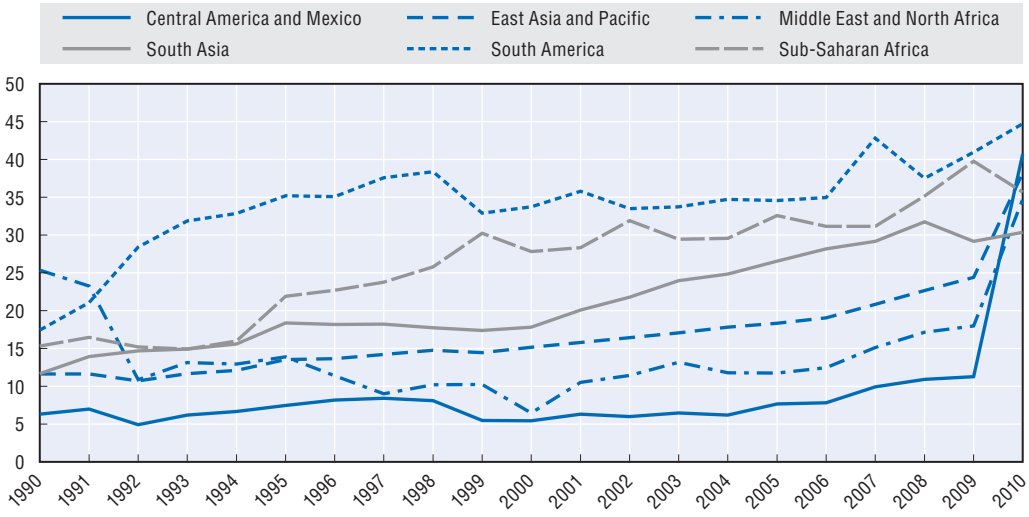
A second important underlying factor, and one of the most dynamic, was the growing share of exports towards other developing countries (Figure 1.8), which rose significantly in 2009 when the crisis seriously curtailed import demand in advanced economies (OECD, 2010a; UNCTAD, 2005; 2009; World Bank, 2010). From an average 15% share of total exports in 1990, South-South trade by region had risen to an average of nearly 40% by 2009. In addition to its central role in intra-regional trade – which usually accounts for the bulk of South-South trade – East Asia was the premier export destination for South America, South Asia and sub-Saharan Africa. Rising South-South trade is driven by the integration of large emerging markets into the global economy (notably China who joined the WTO in 2001), the boom in regional integration processes, and the progressive cutting of *ad valorem* tariffs on South-South trade, even though they remain visibly higher than those levied on trade flows between OECD countries (Mold and Prizzon, 2011).

Figure 1.8. **Share of exports to developing countries, by region**

Percentage



Source: Authors' elaboration based on UN COMTRADE (2011).

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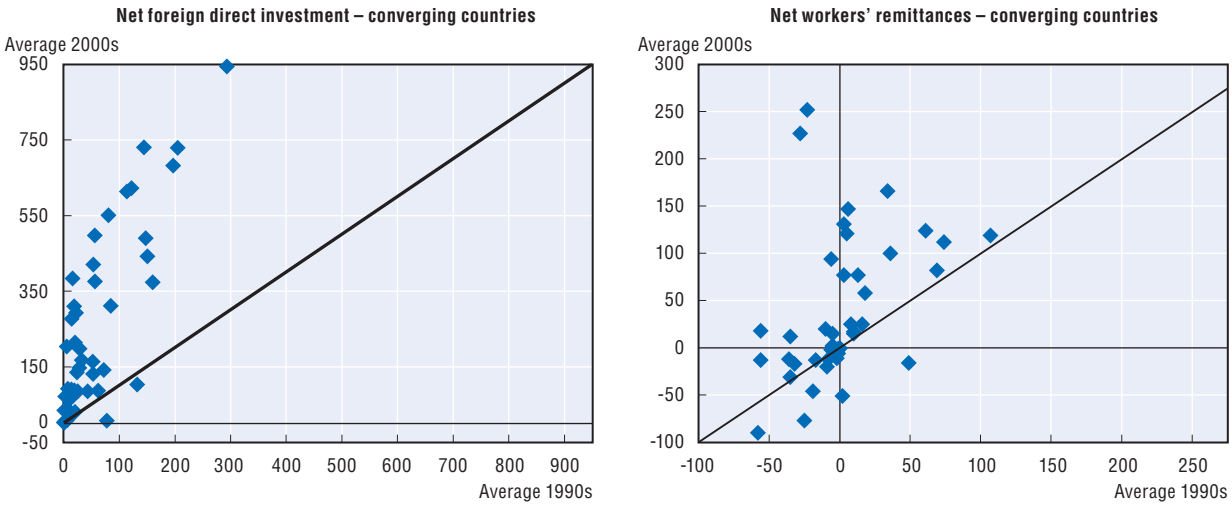
Trade balance surpluses were not driven solely by high commodity prices in the period 2003-08, nor were they restricted to net primary commodities exporters. Structural reforms, the reduction in the costs of doing business, and an acceleration in trade liberalisation all helped boost export competitiveness in many developing countries. In East Asia, production sharing takes place in the form of triangular trading patterns: countries produce intermediate inputs for export to other countries where they are further processed before being re-exported as final goods to developed countries (Gill and Kharas, 2007; OECD, 2010a). One example is the trade flow between Vietnam and China which is predominantly in manufacturing goods. In Bangladesh, manufactured exports (garments) accounted for more than 90% of total exports in 2006, the manufacturing sector having grown by an annual 7% in the period 1991-2005 (Narayan *et al.*, 2007). Another example is Mauritius, whose export performance has been remarkable, especially in the garments sector where FDI [especially in Export Processing Zones (EPZs)] has contributed considerably to export development (Ancharaz, 2009).

Such positive trends are not restricted only to trade flows: net FDI and net workers' remittances[12] also rose considerably in the 2000s. Figure 1.9 compares average levels of net FDI and net workers' remittances for converging countries, where flows in the 2000s grew at a significantly faster pace than in the 1990s. Plainly, the 2000s were characterised by progressive capital account opening (OECD, 2010a), the intensification of migration flows (see Chapter 3), and rising shares of South-South FDI. More than one-third of FDI inflows to developing countries now originate in other developing countries (World Bank, 2011c). Needless to say, the effects of resources transferred through FDI are also indirect, *e.g.* technology transfer and human capital formation.

Official bilateral aid from emerging donors (Table 1.3) has gradually grown since 2005, riding the financial and economic vicissitudes experienced by advanced countries (OECD, 2010a). Although modest compared to total official development assistance (ODA) disbursed by the Development Assistance Committee (DAC) and estimated at

Figure 1.9. **Net foreign direct investment and net workers' remittances in converging countries in the 1990s and 2000s**

Average by decade (USD million)



Note: Countries above the bisecting line had higher average flows in the 2000s than in the 1990s.

Source: Authors' elaboration on the basis of World Bank (2011b).

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Table 1.3. **Official development assistance in Brazil, India and South Africa**

Current USD million

	2005	2006	2007	2008	2009
Brazilian Development Co-operation	158.1	277.2	291.9	336.8	362.2
India's Aid and Loan Programme[1]	414.5	381.4	392.6	609.5	488
South African Development Co-operation Expenditure[1]		49.1	75.4	112.6	108.7

1. Fiscal years not adjusted.

Source: Zimmermann and Smith (2011).

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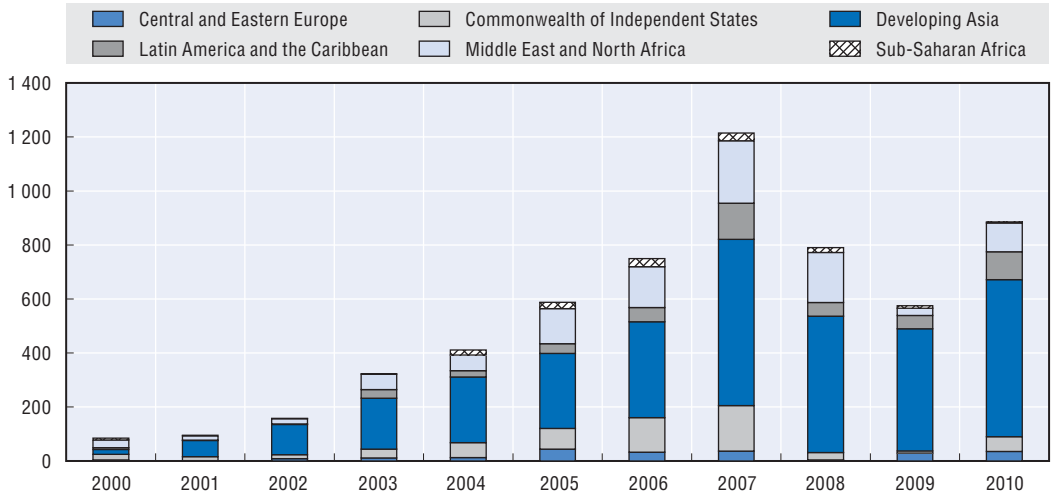
approximately 10% of total ODA, assistance from emerging donors is not restricted to development finance, which can in principle ease budget constraints in the same way as traditional assistance (AfDB *et al.*, 2011). Bilateral aid from non-DAC donors typically takes the form of technical support, a practice favoured by Brazil and India (Zimmermann and Smith, 2011), and which is essentially the provision of technology and expertise to bolster the economic and social welfare of other developing countries.

The recent build-up in international reserves has revived old debates about what is the appropriate amount of reserves for an open economy (Rodrik, 2006; OECD, 2010a; Wolf, 2011). At the beginning of 2011, emerging and developing economies still held nearly 65% of global foreign exchange reserves after amassing them at an annual rate of over USD 800 billion in the previous five years (Figure 1.10). A build-up of foreign exchange reserves to levels sufficient to weather short-term debt and sudden stops and reversals in capital flows and to safeguard for up to one year against currency turmoil and speculative attacks (Akyüz, 2008) is one of the lessons drawn from the Asian crisis by emerging markets (Aizenman and Lee, 2005; Stiglitz, 2006).

That foreign exchange reserves were effective in mitigating macroeconomic risks during the financial and economic crisis is evidenced by the emerging economies' relative

Figure 1.10. **Change in foreign exchange reserves (absolute value) by region**

USD billion



Source: IMF (2011a).

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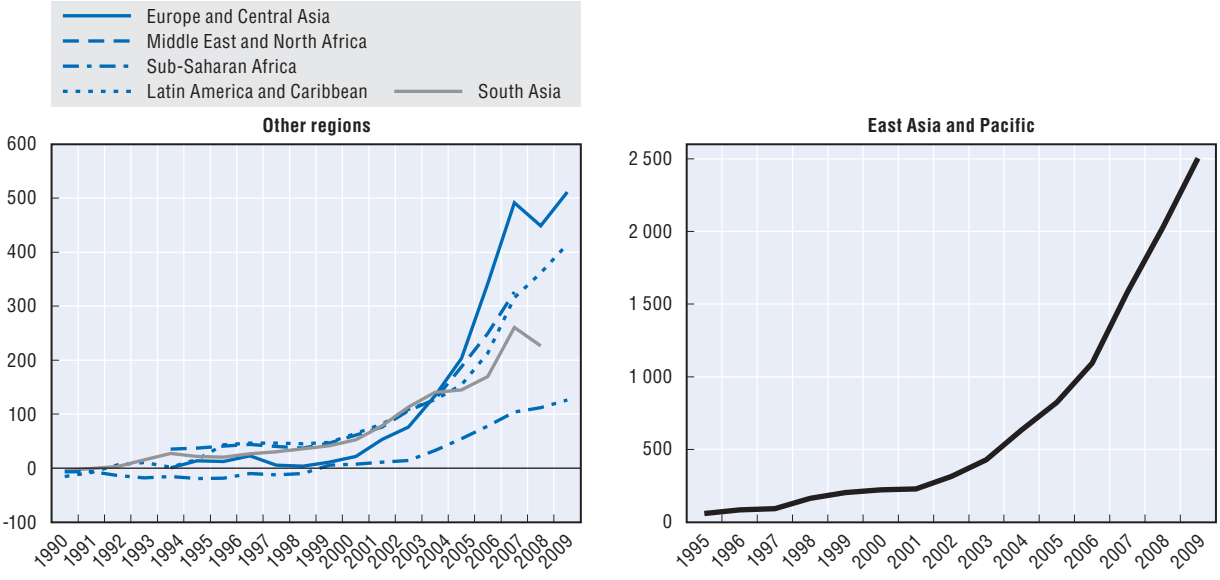
resilience to the turmoil (Wolf, 2011). Nevertheless, the opportunity cost of holding reserves could be high (Dadush and Shaw, 2011; IMF, 2011b). The so-called "Greenspan-Guidotti rule" is a simple rule of thumb for identifying the level of reserves sufficient to cover short-term foreign debt.[13] Once reserves had been set aside for prudential and macroeconomic regulation, as Greenspan and Guidotti advocated, developing countries as a whole held more than USD 4 trillion of foreign exchange reserves in 2009, driven principally (but not exclusively) by the East Asian region and, in particular, by China (Figure 1.11).

Figure 1.11. **Reserves beyond short-term precautionary conditions**

USD billion



Note: The Greenspan-Guidotti rule is met once foreign exchange reserves are greater than external short-term debt.

Source: Authors' elaboration on the basis of World Bank (2011b).

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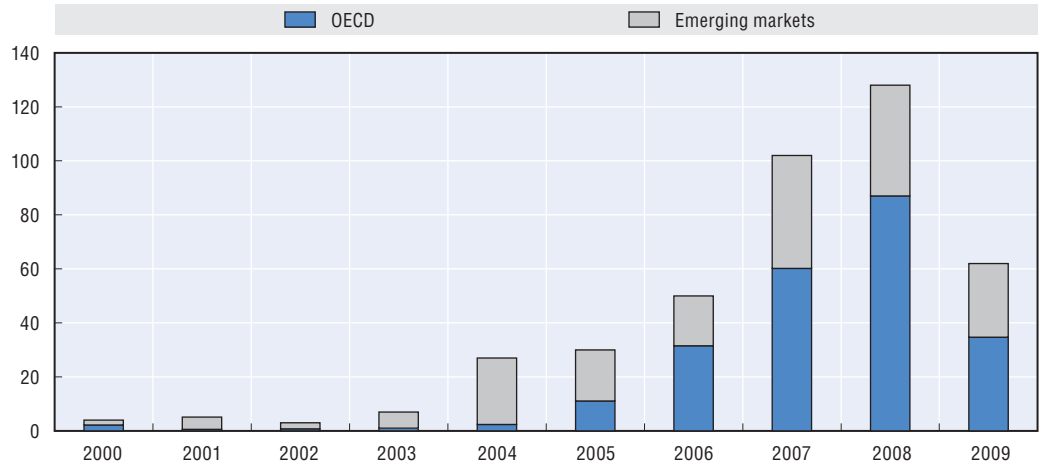
Sovereign wealth funds (SWFs) are one way in which resource-rich countries smooth consumption and channel resources as part of efforts to promote growth and investment in the domestic economy (Reisen, 2008; OECD, 2010a; Kunzel *et al.*, 2011). In 2007, the Chilean government, for instance, replaced its Copper Stabilization Fund with the Economic and Social Stabilization Fund (ESSF), in which it invests fiscal surpluses that exceed 1% of GDP. Altogether, SWF investments expanded from the second half of the 2000s, with emerging countries accounting for roughly half of total flows (Figure 1.12).

Figure 1.12. **Value of SWF investments by target region, 2000-09**

USD billion



Source: Authors' elaboration on the basis of FEEM (2010).

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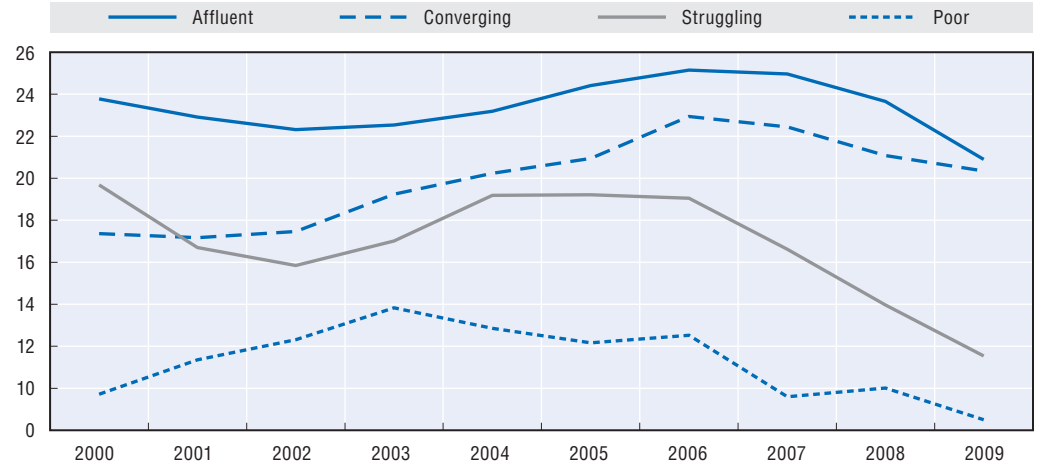
Greater fiscal space

The rise in and diversification of sources of development finance in converging countries that have accompanied shifting wealth have also led to an increase in national savings ratios. Converging countries have gradually expanded their average savings ratio since the early 2000s and, by 2009, they were as high as in affluent countries (Figure 1.13).

Figure 1.13. **Savings as ratio of GDP**

Weighted averages (%)



Source: World Bank (2011b).

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China in particular stands out: its private and public savings rose, respectively, from 33.3 and 5.7% of GDP in 1992 to an estimated 44.7 and 6.7% in 2008 (World Bank, 2011c). But China is not alone – India also possesses high and rising levels of national savings, which include rapidly growing corporate savings. Higher savings rates endow converging countries with a greater capacity to confront the major challenges of investment in human and physical infrastructure. In contrast, struggling and poor countries' saving ratios recorded average drops of 8% and 2% respectively from 2000 to 2009.

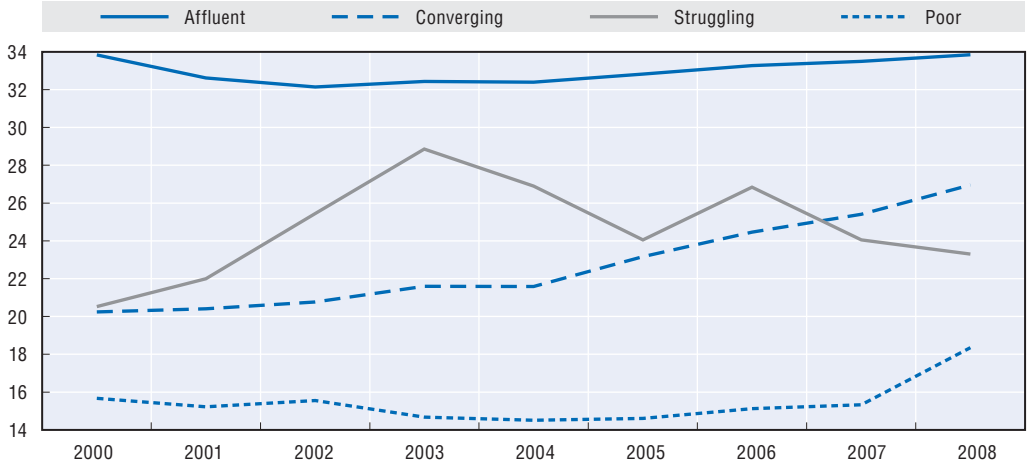
Shifting wealth has – through the rising export value of primary commodities and the intensification of trade linkages and capital movements – supplied converging countries with additional new resources which could sustain the development process. The traditional yardstick for assessing the availability of resources is fiscal space. Heller (2005) defines fiscal space in these terms: "The availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of the government's financial position." Determining fiscal space requires a government to analyse both revenue and expenditure structures, its initial fiscal position, the composition of its outstanding debt obligation, the prospects for external financing and the structure of the economy, all of which is inherently a very country-specific assessment.

In principle, there are several ways to increase fiscal space: raising additional resources through tax measures or improved tax administration, reducing low-priority expenditures, increasing borrowing, seigniorage and receiving grants. Raising revenue and reallocating expenditure are one of the options for national government policy makers seeking to build a lasting fiscal space for social protection. This report focuses on the following approaches to creating greater fiscal space: increasing government revenues (and additional revenues from resource-intensive activities), taking tax-related action and lowering debt obligations.

Growth has yielded tax revenues in converging countries that have risen at a faster pace than in struggling and poor countries (Figure 1.14). Nevertheless, they do fall well short of average fiscal revenues in high-income OECD countries, where they are above 35% of GDP. Converging countries gradually raised their fiscal revenues from 20% on average in 2000 to 27% in 2008.[14] Although their fiscal revenues were as high as in converging countries, struggling countries have generally seen them decline since 2003.

Figure 1.14. **Fiscal revenues as percentage of GDP, 2000-08**

Unweighted averages (%)



Source: World Bank (2011b).

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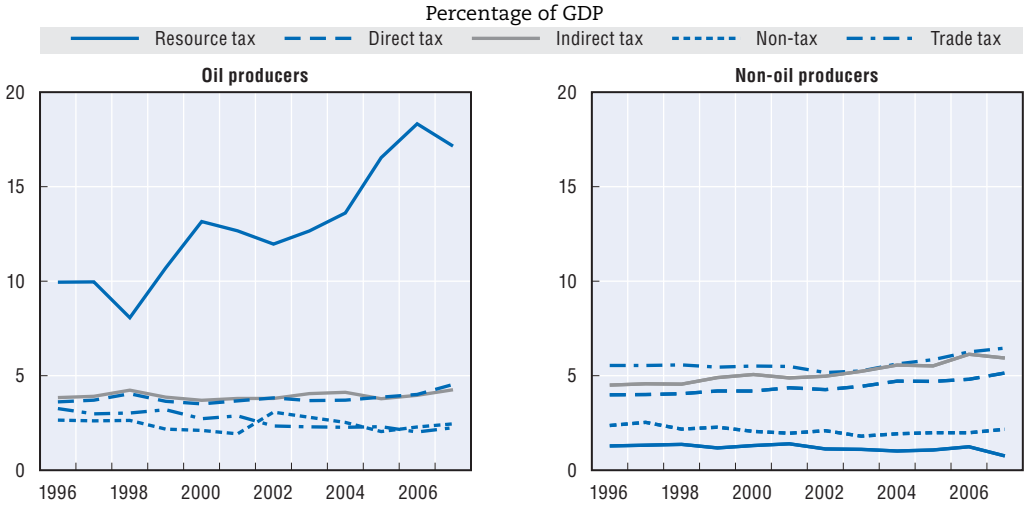
In resource-rich countries the commodity price super-cycle contributed to higher resource-related tax revenues (Figure 1.15). Resource taxes in Africa, for example, increased from an average of 6% of GDP in 1996 to 13% in 2007 (AfDB *et al.*, 2010). There is a strong dichotomy between oil producers and oil importers both in the ways they collect taxes and the structures of their tax mixes. Resource-rich countries, including those who have recently discovered oil or minerals, have a tendency to substitute resource-related tax revenues for other direct and indirect taxes or trade taxes. Such is the practice in Algeria, Angola, Botswana, Congo, Chad, Equatorial Guinea, Gabon, Libya and Nigeria. Sub-Saharan African exports of oil alone are nearly three times larger than its aid receipts and new discoveries are ongoing (*e.g.* Ghana and Uganda), potentially making a big difference to their net resource position (Van der Ploeg and Venables, 2011). Moreover, tax revenues in resource-rich economies seem to be closely correlated to metal and oil prices (IMF, 2011b), raising key policy challenges for governments seeking to stabilise their resource revenues and sustain social programmes.

Figure 1.15. **Tax ratios of African oil producers *versus* non-oil producers by tax source**



Source: AfDB *et al.* (2010).

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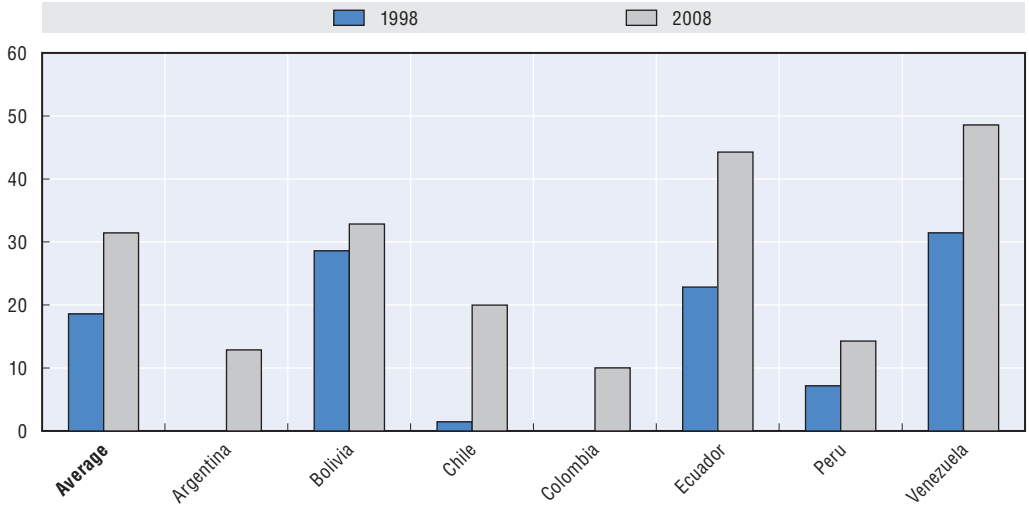
In Latin America, too, the share of natural resources in total revenues increased in the ten-year period between 1998 and 2008 in all commodity-exporting countries except Mexico (Figure 1.16). The reason was not only higher prices, but a swell in production volumes of oil and non-oil commodities and increased tax rates on minerals in Chile, Peru and Bolivia (Sinnott *et al.*, 2010).

From the perspective of governments endeavouring to optimise their natural resource revenues, a combination of royalties and profit-sensitive taxes is often the most appropriate solution. Schemes of this kind are in place in Angola, Mozambique and Namibia for petroleum, and in Botswana, Liberia and Malawi under general mining legislation (IMF, 2011c). While royalties can distort extraction and investment decisions, they do pass on additional risk to investors – who may be better placed to accept them than the governments of many lower-income countries – and secure governments early, visible revenue returns. Profit-sensitive taxes can ensure that the government shares visibly in any rents, not least when prices are high. This arrangement is both fair in itself and conducive to sustainable, credible tax regimes, with the proviso that transfer-pricing

Figure 1.16. **Fiscal revenues from natural resources in Latin America and the Caribbean**

Natural resource revenue as a share of total fiscal revenue (%)



Source: Sinnott *et al.* (2010).

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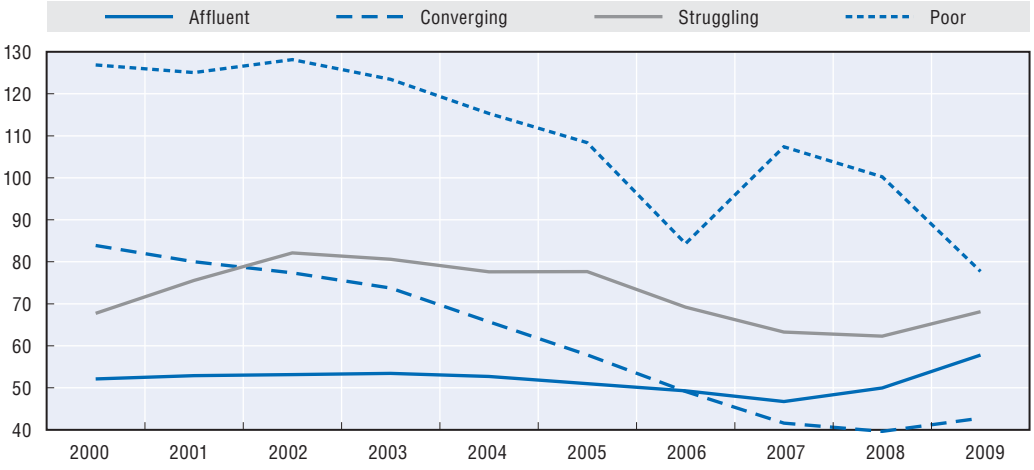
activities can undermine the capacity of developing country governments to reap the benefits from this kind of taxation (Mold, 2004).

Does the surge in revenues mean that these resource-rich countries have more room for manœuvre? A way to address this question is to analyse the evolution of public debt, which is a useful indicator not just of solvency but also of financing capacity (*i.e.* the use of future fiscal resources to fund expenditure today) and the availability of public savings. While debt in converging countries fell from around 81% of GDP on average in 2000 to less than 39% in 2009, the underlying drivers and situations were extremely diverse (Figure 1.17).[15] The sharp reduction in debt ratios was partly driven by debt relief in heavily indebted poor

Figure 1.17. **Debt-to-GDP ratio in the four-speed world**

Percentage



Note: Debt refers to gross general government debt.

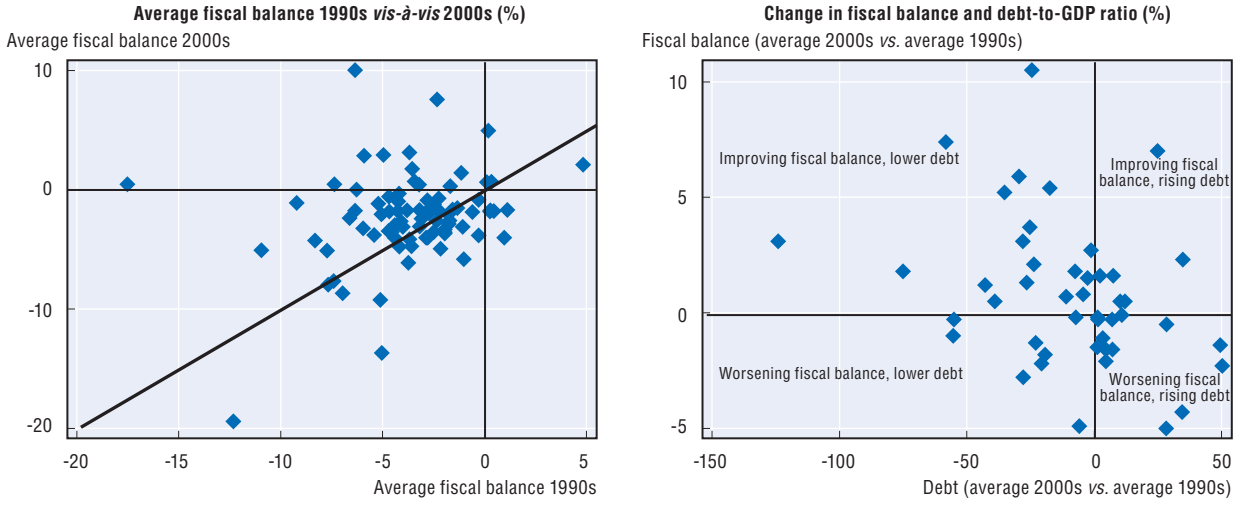
Source: Author's elaboration based on (IMF, 2011a).

StatLink http://dx.doi.org/10.1787/888932517952

countries (HIPCs) like Mozambique, Sierra Leone, Rwanda and Uganda and even by some sovereign defaults (*e.g.* Ecuador in 2008). These situations are very different from other fast-growing countries like China that maintained low levels of debt (around 17% of GDP), or others like Russia that reduced their debt substantially thanks, in part, to high commodity-linked revenues (from almost 60% in 2000 to 11% in 2009). Some converging countries were, in fact, unable to reduce their debt burdens, maintaining high debt-to-GDP ratios throughout the 2000s despite strong economic growth. Such countries include India and Lebanon with debt-to-GDP ratios of 71.1 and 146.4%, respectively.

Not only did converging countries generally improve their fiscal revenues and reduce their debt burdens from the 1990s to the 2000s, they also increased their fiscal balances, as illustrated in the left-hand graph of Figure 1.18 (those above the bisecting line). Moreover, many also reduced debt obligations which, combined with lower interest rates and stronger growth performance, improved debt sustainability (the fourth quadrant in the right-hand graph in Figure 1.18).

Figure 1.18. **Average fiscal balance and debt ratios in converging countries in the 1990s and 2000s**



Note: The line is the bisecting line in the left-hand side graph.
Source: Authors' elaboration based on IMF (2011a).

To sum up: analysis shows that converging countries have very different degrees of fiscal space. While some countries have seen their revenues rise and enjoy such low debt levels that they have more fiscal space, others still face severe fiscal restrictions despite fast growth. However, in the last decade, the majority of converging countries expanded their fiscal space by increasing their tax revenues, cutting their debt ratios, and improving their fiscal balances.

Conclusion: Towards resource availability and sustainability

This chapter has sought to chart how the financial and economic crisis has, if anything, further accelerated the shifting wealth process. Developing countries have generally weathered the storm better than developed countries and staged faster recoveries to pre-crisis levels of economic activity. In the 2000s, the number of converging countries – those whose GDP per capita growth rate grew twice as fast as in high-income OECD economies – had risen to 83 by 2010, whereas there were 65 of them in 2007, just before the crisis hit.

Development finance flows and fiscal space rose in many converging countries over the last decade. They are a necessary, but far from sufficient, condition for sustaining inclusive growth policies and enhancing social cohesion. Policies should address three different critical dimensions.

First, while in principle providing resources that can be channelled into investment, higher consumption, and skills and technology transfers, rising development finance flows – namely trade, FDI and workers' remittances – do not go directly into public coffers. This is particularly true of resources generated by the extraction of natural resources. One policy option is a transparent combination of royalties and profit-sensitive taxes.

Second, fiscal revenues originating from natural resources and primary commodities can be volatile, as they are governed by future trends in commodity prices. The affordability of social programmes in the long run is a pre-requisite for their sustainability (see Chapter 9). Particularly as regards non-renewable resources, policies require a strong forward-looking perspective, where wealth and windfall gains are channelled, for instance, into investment in infrastructure and education as well as diversification of the economy. Needless to say, the stabilisation of fiscal revenue is critical to the long-term affordability of programmes – especially those that ensure social protection. A potential solution, as this chapter argues, might be to smooth expenditure over time and to channel resources into such investment as SWFs.

The *third* reason is that, even if potentially available additional resources do translate into higher fiscal revenues and prove stable in the long run, decisions on how to free up more fiscal space ultimately depend on political priorities. Nonetheless, while shifting wealth does bring opportunities and resources for development, it can pose potentially serious challenges to different aspects of social cohesion – from growing income inequality to limited job creation and rising job informality. Chapter 3 discusses some of these risks. However, what really matters is how governments channel the resources brought by shifting wealth to tackle and stem threats to social cohesion. In this sense, time is of the essence in implementing policies and prioritising budgets, a theme explored in Chapter 9. Moreover, additional spending requires a macroeconomic framework able to withstand the demand pressures that increased public spending is likely to stimulate (see Chapter 5).

Notes

1. Foreign direct investment inflows fell by 21% from 2007 to 2009 in developing economies, while the fall was nearly 60% in developed countries over the same period (see Figure 1.2).
2. On the basis of IMF (2011a) data.
3. In this section we focus on "beta convergence", where poorer countries tend to grow faster than richer ones.
4. Despite the spread of new growth poles and the narrowing equality gap between countries, the per capita income gap between high-income OECD and developing and emerging countries is still wide, even if purchasing power parity (PPP) values are taken into account. If high-income OECD economies continue to grow at the same average rate as in the 2000s, then Azerbaijan will close the income gap in 19 years at its current rate of growth, Turkmenistan in 26 years, and China in 31 years – and these are the most favourable scenarios among developing and emerging economies. Only 15 countries would be able – on current assumptions – to close the income gap in less than 70 years. Countries like the Kyrgyz Republic, Nigeria, Rwanda, Uganda and Tanzania would not converge to high-income countries' GDP levels for 150 years at best.
5. The beta coefficient is –0.10 for the period 2000-07 and is not statistically significant. When only the period 2007-10 is considered the coefficient – significant at the 1% confidence level – becomes

strongly negative: 0.78. Figure 1.3 describes "unconditional convergence". Previous analysis only supported strong evidence for "conditional convergence", where countries were found to converge – but along different long-run paths (see Barro and Sala-i-Martin, 1992).

6. Comparison between the 2000-07 and the 2007-10 analyses is also affected by changes in income classification: some low-income countries graduated to middle-income level (Côte d'Ivoire, Ghana, Lao People's Democratic Republic, Mauritania, Pakistan, Papua New Guinea, Sudan and Uzbekistan). These modifications could alter the four-speed world classification (OECD, 2010a) when a country fails to meet the condition for convergence (twice the average per capita GDP growth in high-income economies over the decade).
7. Conversely, those struggling and poor countries that are net importers of primary commodities – principally fuel and food – have experienced worsening external accounts as well as further challenges to food security. Among other risks to social cohesion from shifting wealth, Chapter 3 elaborates on the consequences of high food prices on food security.
8. The accumulation of foreign exchange reserves helped protect against the sharp rise in global risk aversion, but with decreasing effect at high levels of reserve holdings (IMF, 2010).
9. Levy-Yeyati (2009) finds that emerging economies' growth was more closely linked to Chinese growth than to that of the G7 economies in the 2000s. Conversely, he notes a strong correlation with G7 growth performance in the 1990s, while linkages with China were not significant. This would suggest that the performance of emerging economies is rooted in well-founded, long-term economic trends. Moreover, Garroway *et al.* (2010), and Banga (2011) support the evidence that the correlation of Chinese growth with low- and middle-income countries grew significantly in the 2000s while the correlation with OECD countries' growth performance significantly dwindled from the 1990s to the 2000s. Nevertheless, the strong, sustained growth of the Asian giants drove up commodity prices and maintained global demand.
10. Moreover, the build-up in international reserves revives old debates about the appropriate level of reserves governments should hold in an open economy (Rodrik, 2006; Wolf, 2011). Though there is some controversy over the size and costs of this reserve accumulation, the strategy adopted can be seen as a logical reaction to major financial crises which afflicted developing countries during the 1990s – the central banks of many developing countries have become extremely risk adverse.
11. Because of its comparative advantage in raw materials, South America is seemingly one of the most complementary trading partners for China (Lall and Weiss, 2006; Santiso, 2006). Countries like Bolivia, Chile and Venezuela suffer less from Chinese competition; Brazil, Colombia and Peru are in an intermediate position, while Central America and Mexico are the most exposed to Chinese competition (Blasquez *et al.*, 2006). In the case of sub-Saharan Africa, the analysis of comparative advantage would indicate a limited scope for trade with Asian countries such as China, where trade flow evidence shows a positive, significant trend of exports from sub-Saharan Africa to China (see Figure 1.7, which focuses on primary commodities). While sub-Saharan Africa may benefit from imports through access to cheaper consumer and capital goods, some countries (for example Ghana and South Africa) have seen their exports of clothing and textiles displaced by Chinese exports (Kaplinsky and Messner, 2008).
12. Net remittances correspond to remittances received *minus* those paid.
13. For a more accurate methodology to include risk aversion, the size and the probability of sudden stops, and the opportunity cost of holding foreign exchange reserves, see Jeanne and Rancière (2008).
14. However, this average increase includes several different situations. For example, while in Sri Lanka revenues as a share of GDP declined by around two percentage points of GDP, their ratio to GDP increased by almost 17 percentage points in Lesotho. In particular, Lesotho increased its tax revenues as a share of GDP from 36% of GDP in 2000 to 57% in 2008, an impressive tax take by international and regional standards. However, most of the revenues come from the distribution of the Southern Africa Customs Union (SACU) tariffs (AfDB *et al.*, 2010).
15. Combined with the high accumulation of foreign reserves in several converging economies, net public debt would in general be at even lower levels. For example, Chile's net position was –11.6% of GDP *versus* its gross debt of 6.2% as of 2009.

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Chapter 2

Social Cohesion and Development

A society is "cohesive" if it works towards the well-being of all its members, fights exclusion and marginalisation, creates a sense of belonging, promotes trust, and offers its members the opportunity of upward social mobility. As such, this report looks at social cohesion through three different, but equally important, lenses: social inclusion, social capital and social mobility. The measurement of these dimensions should not only involve traditional measures, such as 1.25 dollar-a-day poverty, but should integrate subjective measures such as people's perception about their own feelings as well. Social cohesion is both a means to development and an end in itself and is shaped by a society's preferences, history and culture. Shifting wealth provides new opportunities and risks for the development of social cohesion in emerging economies – addressing them requires a holistic policy approach, particularly in the areas of fiscal, employment and social policies.

Introduction

The issue of "social cohesion" has, over the last ten years, been analysed from various perspectives of research and policy making (Dayton-Johnson, 2001; Osberg, 2003; ECLAC, 2007; Council of Europe, 2008; OECD, 2011a). A common thread of the existing literature is that social cohesion is both a means to ends such as inclusive growth and an end in itself. Different societies have different understandings – shaped by the beliefs and values of their citizens – of what social cohesion actually means and how it can be fostered. This chapter introduces the concept of social cohesion as used in the current report, documents its potential impact on development outcomes, and provides a simple framework that ties it into policy areas. The 2012 edition of *Perspectives on Global Development* departs from past work on social cohesion. It considers the issue through the lens of shifting wealth, focuses on converging (*i.e.* fast-growing) countries, and pays particular attention to the joint impact of policies and implementation challenges.

This chapter first tackles the elusive task of defining social cohesion, built as it is on three different, but overlapping, interacting dimensions: social inclusion, social capital and social mobility. It then goes on to consider how to measure social cohesion and probes the question of subjective measures of progress, which are attracting growing interest as complementary information for policy making. Social cohesion is just such a subjective variable, lending itself naturally to measurement by an assessment of perceptions. Finally the chapter considers whether social cohesion, beyond its intrinsic desirability, actually has a use, *e.g.* economic pay-off. The conclusion gathers together the various strands at work in social cohesion, sketching its various connections with development outcomes such as growth, poverty reduction and policy effectiveness.

Defining social cohesion

In his seminal book *The Division of Labor in Society,* the French sociologist Émile Durkheim (1893) describes how the transformation of societies changes the nature of cohesion. In a traditional society, social interactions are generally built on a kind of "mechanical solidarity" among its members which arises from the relative homogeneity of their activities. As the society develops, however, interaction shifts towards "organic solidarity" as people engage in different, specialised labour. The main features of this profound change in cohesion can still be observed today: traditional forms of social security based on balanced reciprocity – "I help you today on the understanding that you help me tomorrow if I am in trouble" – come under pressure when societies open up (Platteau, 2000). Introducing modern forms of social protection such as micro-insurance schemes have an impact on traditional forms of social cohesion and it is important to take this into account when implementing them.

At the end of the 1980s, social cohesion started to take its place in the policy agendas of countries such as Australia, Canada, Denmark and New Zealand (Ferroni *et al.*, 2008). Today, France has its Minister of Solidarity and Social Cohesion, while both the European

Union (EU, 2007) and the Council of Europe (Council of Europe, 2008) have made it a strategic priority. The Inter-American Development Bank (IDB, 2006) and the United Nations Economic Commission for Latin America (ECLAC, 2007) have also contributed to this debate, highlighting the crucial role of social cohesion in inclusive growth and development. There are other recent concepts linked to social cohesion, such as the "big society", an idea put forward by David Cameron in 2009, then leader of the opposition and now British Prime Minister (Norman, 2010).[1]

There is no single accepted definition of social cohesion but there are a few common threads:

- Social cohesion is a broad concept, covering several dimensions at once: sense of belonging and active participation, trust, inequality, exclusion and mobility.
- The notion of social cohesion is often associated with the narrower concept of "social capital" (Helliwell and Putnam, 1995; Ritzen, 2000). In her definition of social capital, Narayan (1999) states that it is a necessary, albeit insufficient, condition for a society to be cohesive. Social capital refers to a group of individuals, while social cohesion is a more holistic concept extended to the level of the entire society.
- The challenges of a precise definition of social cohesion are often side-stepped by focusing on the conditions in which social cohesion is considered absent or undermined (a negative definition of the concept). Examples include studies that highlight the dimensions of income inequality (Wilkinson and Pickett, 2009) or those that show the negative impact of violence or civil conflict (*e.g.* Acevedo, 2008; Cardénas and Rozo, 2008) and the prevalence of anti-social behaviour (Durkheim's classic 1897 study of suicide), or more recent social cohesion indicators such as bullying (OECD, 2009).

The current report calls a society "cohesive" if it works towards the well-being of all its members, fights exclusion and marginalisation, creates a sense of belonging, promotes trust, and offers its members the opportunity of upward social mobility. This view is very similar to the definition volunteered by the Club de Madrid (2009):

> "Socially cohesive or 'shared' societies are stable, safe and just, and are based on the promotion and protection of all human rights, as well as on non-discrimination, tolerance, respect for diversity, equality of opportunity, solidarity, security and participation of all people, including disadvantaged and vulnerable groups and persons."

Both this report's and the Club de Madrid's concepts of social cohesion are different from narrower ones that highlight the bonding nature of networks and institutions that shape collective action. The definition of social cohesion adopted in this report can also be understood in the context of Rawls' (1971) notion of a "well-ordered society". His vision embodies a political conception of justice which enables co-operation among a society's members in economic matters, while generating and sustaining social norms and tolerance. Pointedly, it is essentially a pluralistic view of society: regardless of conflicting religious or personal beliefs, Rawls believed that an "overlapping consensus" would be possible, as long as members of society were open to compromise, *i.e.* were "reasonable".

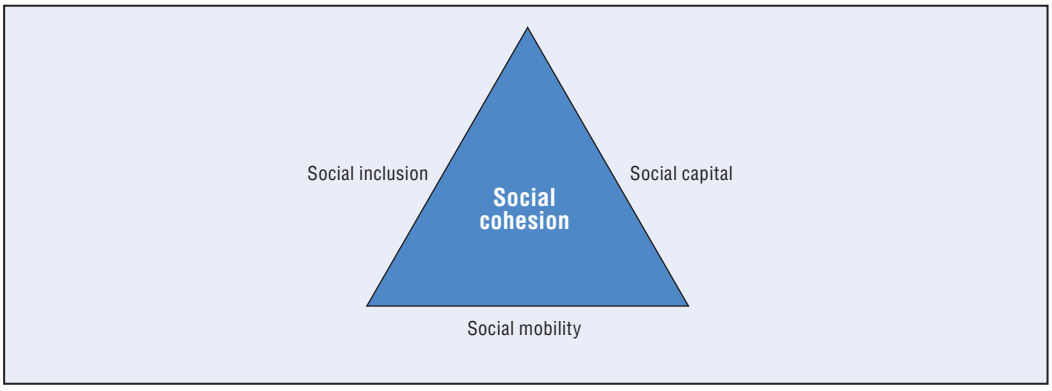
This reports looks at social cohesion through three different, equally important, lenses:

- Social inclusion: measured by such aspects of social exclusion as poverty, inequality and social polarisation.
- Social capital: combines measures of trust (interpersonal and societal) with various forms of civic engagement.

- Social mobility: measures the degree to which people can or believe they can change their position in society.

The triangular figure below denotes that while each of the three dimensions is considered important in itself, a holistic view of social cohesion is required to assess its state in a given society.

Figure 2.1. **The components of social cohesion**



The triangle illustrates the way in which the current report assesses and analyses social cohesion within the boundary of the nation state. All three dimensions are key, though different societies might emphasise one rather than another. The "American dream", for instance, amplifies in a stylised fashion the idea of social mobility – you can start as a dish washer and become a millionaire if you only work hard – while the Nordic welfare model relies heavily on trust in government institutions, so enabling them to finance part of the public spending through comparatively high taxes. In addition, the triangular framework documents that there might also be potential trade-offs between social cohesion dimensions. For instance, promoting social mobility through skills upgrading can improve the dimension of social mobility, while potentially risking to reduce social inclusion as a higher skill premium potentially deepens marginalisation.

Framing policies through the lens of social cohesion makes it possible to think about trade-offs between different policy interventions, *e.g.* in the area of fiscal, employment and social policies (as this report discusses in further detail). Such policies move away from "residualist" approaches to social problems (*e.g.* designing specific interventions targeted only at the "dollar-a-day" poor) towards one that includes all spectrums of policy which may impinge on social outcomes. It denotes a particular concern for poverty and social exclusion not as separate categories, but rather as a continuum – hence, for instance, the concern with the status of lower-middle classes, prone to slipping back into poverty. Against the backdrop of shifting wealth this is a more fruitful way of understanding the social challenges now confronting many developing countries.

Traditional and subjective measurement of social cohesion

The measurement of social cohesion to date has traditionally made use of a common set of recurrent variables.

- *First*, income inequality. Together with such deprivation measures as the poverty gap, it is often considered essential to measuring and monitoring the evolution of social cohesion.
- *Second*, a society's level of cohesiveness. This depends on the participation of its members in the productive economy, where the unemployment rate, another widely used variable in assessing social exclusion, serves as a thermometer for monitoring levels of life satisfaction and the risk of civil tensions.
- *Third*, well-being measures. These are both gauges of a cohesive society's inclusiveness and equality (examples are life expectancy at birth and literacy rates) and instruments for supporting wider, fuller participation in civil society and political life.
- *Fourth*, measures of social capital. They generally include group membership and interpersonal trust.

The debate on social progress has highlighted the need to move beyond economic measures of well-being and quality of life and to increasingly integrate perception-based measures into policy making, as Stiglitz *et al.* (2009) argue. In May 2011, the OECD launched the Better Life Initiative to measure well-being and progress. It includes *Your Better Life Index*, which takes "Life Satisfaction" – a subjective measure of the quality of life – as one of its eleven indicators. Subjective well-being (SWB) measurement has acquired a central role in measuring the progress of social frameworks because it provides a summary measure of well-being and may yield additional information to that produced by objective living standard measurements (insofar as subjective and objective measures are not perfectly correlated, that is). The use of SWB measures makes it possible to incorporate people's feelings about their own well-being into traditional measurement of economic growth and social performance. Social scientists – especially economists – have been slow to integrate people's perceptions into their methodologies, often preferring positivist or deductive methods. Yet there are many reasons why subjective measures are of fundamental importance, both because of their intrinsic value (what people perceive and feel is important in itself) and because they can be instrumental in creating better developmental outcomes (Box 2.1).

Box 2.1. **Can subjective well-being data inform policy in developing countries?**

Since the release of the Stiglitz-Sen-Fitoussi Commission's report in 2009, measures of well-being that go beyond such traditional measures of progress as income or GDP growth have been growing in popularity among policy makers. Data sources such as the European Values Survey, World Values Survey, and Gallup World Poll ask respondents to directly assess their own lives in terms of perceived quality, satisfaction, and happiness. While most of this research still focuses on industrialised countries, could it not be used to understand social cohesion in developing countries? Interestingly, one of the longest-running debates in subjective well-being literature relates directly to developing country issues, such as income per capita growth.

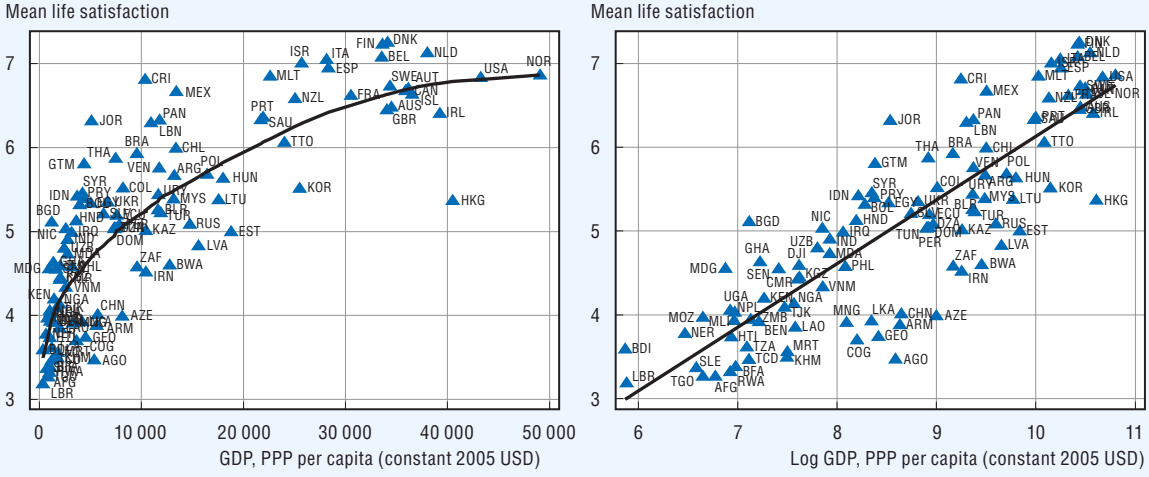
The Easterlin Paradox (Easterlin, 1974) holds that, within a given country, people with higher incomes are more likely to report being satisfied, even though mean life satisfaction in international comparisons does

Box 2.1. **Can subjective well-being data inform policy in developing countries?** *(cont.)*

not vary with income – at least in countries where PPP per capita is above the USD 20 000 bracket, as Figure 2.2 shows. What the Easterlin Paradox implies is that, although wealthier people generally express higher levels of life satisfaction, there are diminishing marginal satisfaction with respect to income, as demonstrated by the curve in Figure 2.2. This means that people's perceptions of their well-being depend not only on their absolute income levels, but also on their relative positions within income distribution (Clarke and Senik, 2010).

Figure 2.2. **Absolute *versus* relative economic gradient of life satisfaction across countries, 2008**

Cantril ladder, mean value



Note: The Cantril ladder is measured on a scale from 0 to 10.

Source: Authors' elaboration based on Gallup Wave 3 (2010) and World Bank (2011).

Criticisms of subjective well-being have pointed to problems with self-reported well-being measures. Besides the issue of respondents providing the socially desirable answer to survey questions, there is the possibility – particularly in developing countries – that poor people cannot provide an adequate assessment of their own well-being because they have no reasonable alternative with which to compare their limited resources (Sen, 2008).

Recent empirical research seems to suggest, however, that cultural differences in answering questions play less of a role than expected. In fact, the determinants of subjective well-being outcomes seem to be fairly consistent, regardless of the cultural context (Helliwell and Barrington-Leigh, 2010). In this context, Layard (2005) argues:

> "[U]nless we can justify our goals by how people feel, there is a real danger of paternalism. We ought never to say: this is good for you, even though it will never make you or others feel better. On the contrary, if we want to measure the quality of life, it must be based on how people feel."

While these measures provide valuable additional information, caution should be exercised in order to avoid sweeping conclusions and comparisons between subjective well-being data without placing them in their appropriate context. Indeed, policy makers should not ignore such data simply because they are complex to interpret. On the contrary, used in the right way they can inform and supplement traditional well-being measures, helping to paint a broader picture of how citizens in developing countries value their lives and to whom they compare themselves.

Besides measures that are specific to subjective well-being, other subjective measures are particularly useful for analysing aspects of social cohesion that are very hard to measure objectively or for which objective measures do not exist. They can be used to measure attitudes, beliefs, and perceptions, especially "sense of belonging", "trust", and people's attitudes towards the state and its role.

While subjective data are interesting in themselves – and only they can be used to address some dimensions of social cohesion – the various chapters in this report combine traditional measures with subjective assessments in order to gain a more profound understanding of a country's degree of social cohesion at a specific moment of time. For example, subjective measures can help yield better insights into the social cohesion goals of fiscal policy by enabling measurement of individuals' perceptions of the state and attitudes towards certain policy choices, such as their preference for redistribution. Similarly, subjective measures can improve understanding of the social cohesion impacts of economic issues such as unemployment or informal employment. From a social cohesion perspective, having a good job is not solely about being suitably paid, but also about individuals' happiness and sense of well-being, which further reflects the degree to which they feel included in their society. The broader issue of civic participation can be measured more adequately with subjective measures than with traditional objective measures, such as voting turnout. Individuals' trust in and sense of belonging to their society can only realistically be measured using subjective measures.

Finally, if, as we shall argue in the next section, social cohesion has an intrinsic value beyond its instrumental use as an enabler of improved development outcomes, then social cohesion and its components can themselves be considered dimensions of social progress. Better understanding social cohesion can, therefore, also help to better understand how to measure society's progress. In particular, social cohesion may be expected to influence well-being positively and more cohesive societies to be more satisfied, happier, and better-off.

Why does social cohesion matter?[2]

This report argues that social cohesion is not something of a luxury that should only be aimed at countries that have achieved a certain level of development. A famous Deng Xiaoping quote goes: "Let some people get rich first", which suggests that when a country is growing, increasing inequality up to a certain level is a natural part of a development process. Yet, in spring 2011, the Beijing city authorities banned all outdoor advertisement of luxury goods on the grounds that they might contribute to a "politically unhealthy environment". Clearly, social cohesion and the absence of socially divisive influences contribute to desirable development outcomes such as growth, poverty reduction, stability, peace and conflict resolution. What is more, social cohesion helps make policies more effective. If a society integrates minorities, has a relatively strong sense of belonging, and provides opportunities for upward social mobility, the effectiveness of its public policies will obviously be greater than in socially fragmented societies.

The economic argument for building a cohesive society seems obvious, according to the Club de Madrid (2011):

> "If sections of society are marginalised they will contribute less to the economy. They will have poorer education and limited skills to contribute. They have less capital to invest. They may also be less willing to contribute to a society which they feel does not respect them and treat them as full citizens. They may go farther and resist the *status quo* and it

may cost the state a good deal of its surplus wealth to maintain the *status quo*. The state may resort to increased security measures, such as enlarged security forces, enhanced equipment for the security services, larger and stronger prisons. External capital is unlikely to invest in a society if it seems unstable and tension is high."

The Club de Madrid concludes with this observation: "While this type of analysis seems self-evident, it does not seem to have much impact on many current leaders."

Social cohesion, an end and a means

Social cohesion is both a desirable end and a means to achieve development outcomes like growth. As an end in itself, it is a part of progress, just as much as development. Surveys show that citizens see social cohesion as a valuable goal in itself. When asked to name the most important child qualities, most respondents name those related to society and social cohesion – "tolerance and respect for other people" and "sense of responsibility". As Table 2.1 shows, they score highest – at over 70% – among respondents from a sample of 57 developed and developing countries, well ahead of more individualistic traits such as hard work and thrift.

Table 2.1. **Preferred child qualities, 2005-08**

Quality	% respondents
Feeling of responsibility	72.6
Tolerance and respect for other people	71.1
Hard work	56.2
Independence	51.9
Obedience	43.0
Religious faith	41.5
Thrift saving money and things	38.9
Determination perseverance	38.1
Unselfishness	34.3
Imagination	23.4

Source: WVS (2011).

StatLink http://dx.doi.org/10.1787/888932518921

Social cohesion is also a means that enables citizens to live in societies where they enjoy a sense of belonging and trust. The inference is that the absence of social cohesion may result in instability. For example, high income inequality can give rise to social pressures and conflicts which, in turn, generate unstable economic policies and lower investment (Larrain and Vergara, 1997). Acevedo (2008) estimates that violence in Central America cost the equivalent of 7.7% of GDP in 2006. Even the fear of crime has a price tag. A study in the UK (Dolan and Peasgood, 2007) estimates that it causes stress-related conditions which lead to an annual health cost of GBP 19.50 to GBP 56.25 per person.

Conversely, perceived increases in social cohesion can have a positive impact on the economy. Foa (2011) constructed a social cohesion index using a sample of 155 countries and found that each point increase was associated with a rise of 14% in potential GDP over a period of 20 years.

The positive impact of social cohesion can be explained by the fact that public policies are often more effective in socially cohesive societies, resulting in greater poverty reduction and a more stable growth process. Easterly *et al.* (2006) refer to politicians' narrow "room for

manœuvre" in societies with low social cohesion that hampers efforts to implement redistributive policies. Consider the implications of high income inequality for growth. There is a body of literature which shows that countries with initial unequal income distribution experience slower growth (Birdsall and Sabot, 1994), whereas inter-generational social mobility – promoting equal opportunity for individuals – enhances growth by putting all society's human resources to their best use (OECD, 2010b; Causa *et al.*, 2009). A number of authors find a positive correlation between cross-sectional income inequality and inter-generational income or wage persistence, suggesting that countries with the most equal distribution of income at one point in time also exhibit the highest income mobility across generations (Björklund and Jäntti, 1997; Aaberge *et al.*, 2002; Andrews and Leigh, 2008).

Social cohesion affects not only the rate, but the quality and the sustainability of growth, especially in the context of sharp, frequent changes in external conditions. The Inter-American Development Bank (IDB) discusses the example of Argentina when, at the time of the crisis in the early 2000s, society's capacity to organise itself – reflecting high levels of social capital – produced externalities that were essential to meeting the basic needs of the population and beneficial to the chances of an economic recovery (IDB, 2006). The natural resilience of societies and communities to social disruption is, in fact, increasingly recognised, although "coping strategies" can be overplayed. Ultimately, policy needs to address vulnerabilities if social cohesion is to be maintained.

Conversely, growth and development help maintain and enhance social cohesion. For example, greater available public resources can be used to support more inclusive health and education programmes, while better education can, in turn, strengthen participation in decision making and reinforce the sense of belonging to a community. In fact, in addition to determining growth, public education also indirectly reduces income inequalities and instils common norms (Gradstein and Justman, 2000).

Table 2.2. **Selected empirical evidence of the relation between social cohesion and development**

Social cohesion dimension	Design of studies[1]	Main findings	Reference
Social exclusion	Method: OLS/IV-2SLS Sample: 2 rural Indian villages	Low-caste households living in low-caste dominated villages have a higher income than those in villages dominated by a high caste	Anderson (2011)
Social mobility	Method: OLS Sample: 74 developing countries	Social mobility has a significant impact on GDP per capita growth	Temple and Johnson (1998)
Social mobility and Social exclusion	Method: OLS Sample: 16 developed and developing countries	Men raised in more unequal countries in the 1970s had experienced less social mobility by the late 1990s	Andrews and Leigh (2008)
Social capital	Method: Panel analysis Sample: 51 developed and developing countries	Trust significantly interacts with investment in both physical and human capital	Dearmon and Grier (2009)
Social capital	Method: Tobit model Sample: More than 30 000 Italians	In high social capital areas, households are more likely to use cheques, invest less in cash and more in stock, have higher access to institutional credit, and make less use of informal credit	Guiso *et al.* (2004)
Social capital	Method: OLS Sample: 29 market economies	Social capital has a significant impact on growth performance and increases output per worker	Knack and Keefer (1997)
Social capital	Method: OLS Sample: 40 developing and developed countries	Trust has a significant and large impact on performance of social institutions	La Porta *et al.* (1997)

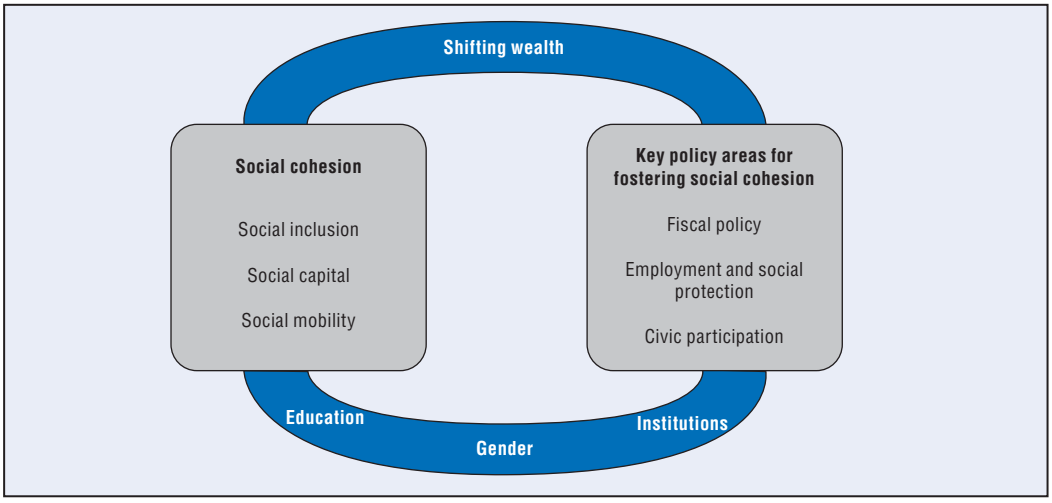
1. OLS stands for ordinary least squares. IV-2SLS stands for an instrumental variables estimation using two-stage least squares.

In the mutually beneficial interplay between social cohesion, growth and development, social cohesion's influence on growth and development is amplified by the sheer fact that its components reinforce each other. Improving the quality of life of all citizens reduces inequalities and fosters the efficiency and accessibility of public mechanisms of social protection (Baliamoune-Lutz, 2009). Similarly, high-quality formal institutions enhance trust and norms of civic participation, while polarisation weakens them (Murphy *et al.*, 1996; Knack and Keefer, 1997; La Porta *et al.*, 1997; Beugelsdijk *et al.*, 2004; Roth, 2009). Trust depends on the social, economic and institutional environment in which transactions occur. It rises in equitable societies and falls, for example, when there is wage discrimination based on non-economic factors (Zak and Knack, 2001).

Shifting wealth, social cohesion and development – A simple framework

Having defined social cohesion and its key dimensions, it is important to understand the conceptual structure of *Perspectives on Global Development 2012* (Figure 2.3). The starting point is the transformation of the global economy and the emergence of growth poles in the South and East, spearheaded by the integration of China and India in the world economy.

Figure 2.3. **Shifting wealth, social cohesion and development: A simple framework**



Different points of interaction are then considered. Fundamentally, the structural changes in economies induced by shifting wealth and its growth path shape social cohesion and development outcomes. The effects of these profound changes can have a positive or a negative effect on the three dimensions of social cohesion. While high growth rates and improvements in human development can reduce exclusion through job creation, enhance trust, and foster social mobility, they can also lead to greater inequality and the break-up of traditional mechanisms of solidarity. A particular challenge is rising inequality alongside strong growth. Moreover, cumbersome institutions can act as bottlenecks, preventing parts of the population from benefiting from new opportunities and thereby undermining social cohesion. Hence the need for policies that offset negative effects and take advantage of the newly created opportunities.

From a policy perspective this report highlights four key areas of particular interest: fiscal and macro considerations, labour market and social protection, equal and unequal

opportunities, and civic participation. As outlined in Chapter 1, shifting wealth opens up new opportunities and resources that can be used to finance social risk-sharing arrangements, so helping to cushion people against shocks and enabling them to take an active part in new opportunities. Offering equal opportunity and looking at income distribution as a whole is as important as setting up mechanisms that allow people to voice their dissent and engage in public life.

Besides the four policy areas mentioned in the previous paragraph, social cohesion is determined to a great extent by institutions (in particular by informal ones that have been in existence for centuries), as well as by two cross-cutting factors – education and gender equality. Strengthening social cohesion is intrinsically linked to access to good quality education, while the way in which educational services are delivered and financed has a bearing on a society's degree of social cohesion. The distribution of the new opportunities created by shifting wealth and the sharing of the potential costs between men and women are decisive factors in social cohesiveness. Existing divisions that lie along the gender lines could be aggravated during the ongoing period of high growth if there is no political will to address the deep causes of gender inequality.

Conclusion

It has become increasingly clear that governments who ignore the broader questions of inclusion and social cohesion do so at the peril of social instability, ineffective policy interventions and, ultimately, a possible loss of political power. Social cohesion is a useful conceptual tool for reminding policy makers to pay as much attention to the qualitative side of development as to harder economic questions.

The unprecedented changes in the global economy have bred plenty of opportunity for the converging countries as well as many risks. Mere improvements in growth and development that neglect inclusion run the risk of undermining social peace and stability and long-term growth. Social cohesion as a broad-based concept offers the chance to analyse various aspects of the transformation process and its impact on social inclusion, social capital and social mobility.

Notes

1. Core to the "big society" concept is the redefinition of the boundaries between state and society. As part of a wider political project, it has generated considerable controversy in the UK. See Norman (2010).
2. This section is largely based on Prizzon (2011).

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Chapter 3

The Challenges for Social Cohesion in a Shifting World

While bringing opportunities and resources to fuel a more inclusive growth process, shifting wealth poses a series of challenges and risks for the cohesiveness of societies. This chapter focuses on four distinctive areas. First, the processes of shifting wealth and globalisation have been accompanied by structural transformation in fast-growing economies with implications for social inclusion, social capital and social mobility. Second, shifting wealth has not necessarily been associated with sufficient employment creation, more formal jobs, or better gender outcomes. Third, the (re-)emergence of new growth poles has intensified both the pace of urbanisation and South-South migration, which exacerbates the challenges that social cohesion faces in integrating immigrants. Finally, by threatening food security, both the steep increase in food prices observed in the 2000s and the large land-purchases occurring in many developing countries – as fast growing, land-scarce developing countries try to secure access to food – could also potentially compromise social cohesion.

Introduction

Shifting wealth brings with it the structural transformation of economies, raising both opportunities and challenges for social cohesion. Although shifting wealth can – through the provision of new resources – foster social cohesion, it is important to look at the challenges specific to converging countries. While many challenges are related to levels of development (high informality, relatively weak institutional capacity, etc.), there are also risks inherent in the process of shifting wealth.

The objective of this chapter is to set out the main challenges that shifting wealth poses for social cohesion. The first – important – challenge is the structural transformation of economies. The chapter looks at the principal patterns of structural change over the last two decades and links them to social cohesion. Second, the chapter offers an overview of the implications for labour market outcomes, considering the key challenges of employment creation, informality and gender discrimination. Third, the (re-)emergence of new growth poles has intensified both the pace of urbanisation and South-South migration, which exacerbates the challenges that social cohesion faces in integrating immigrants. The chapter then focuses on the impacts of internal and international South-South migrant flows. Finally, two areas of shifting wealth are examined which are of particular concern to many developing countries and both of which relate to agricultural development. The first is the steep increase in food prices observed since 2007, the second is the big land purchases occurring in many developing countries, as fast-growing, land-scarce developing countries try to secure access to food. Both issues are analysed from the perspective of their effect on social cohesion.

Structural transformation challenges

Analysing patterns of structural change in an economy is of fundamental importance in understanding social outcomes. By modifying the relative share of economic activities and employment, structural transformation influences how individuals, groups and communities are integrated into economic life, with implications for people's livelihoods and social cohesiveness. At the same time, by facilitating effective government strategies, higher levels of social capital associated with social cohesion can help countries and communities cope better with structural change, especially in the case of developing countries where institutional mechanisms needed to facilitate the transformation and ease associated stresses are lacking (Lall, 2002). In addition, structural change influences both intra- and inter-generational social mobility, affecting the demand for skills and incentives for investing in education.

Globalisation – understood as the process of economies opening up to global factor movements, trade and technology – is reallocating resources between and within countries and driving the expansion of some sectors and the contraction of others.[1] The process of structural change has been particularly pronounced in the fast-growth developing countries since 2000. It is quite different from the historical experience of the now industrialised countries in the 19th century which grew at a relatively modest pace

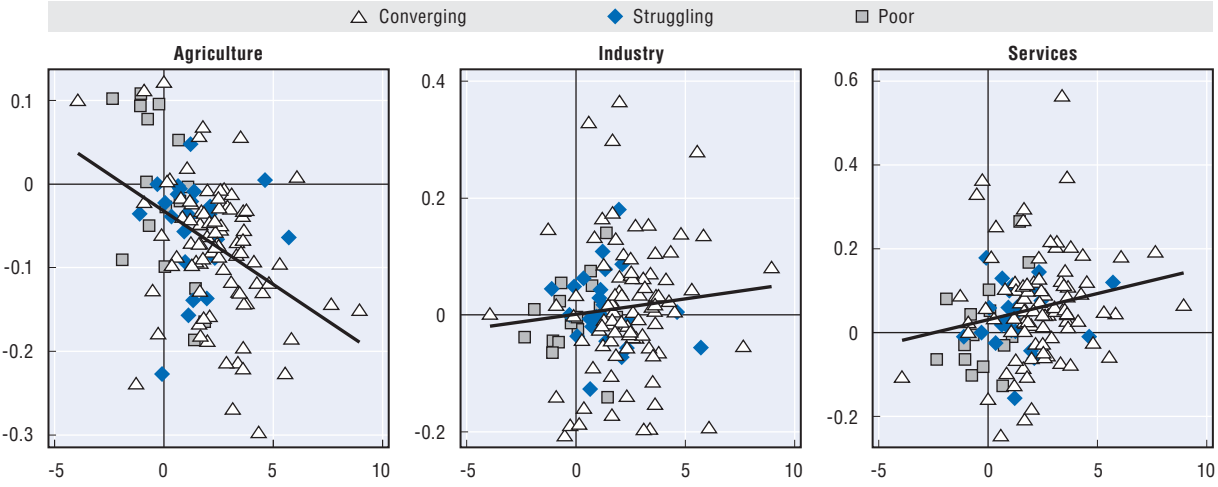
(Dadush and Shaw, 2011). For people living outside these societies, the social dislocation caused by such rapid growth is difficult to comprehend.

With sustained high growth rates over several decades, the depth of structural change in large Asian economies such as India is remarkable and without historical precedent. Although countries like Japan in the 1950s and South Korea in the 1960s have achieved similar patterns of fast growth, no large populous country such as India has ever done so (Kaplinsky, 2005). High-growth economies can be distinguished from poorly performing ones in that resources – labour in particular – tend to be highly mobile across sectors (El-Erian and Spence, 2008). At the same time, there are winners and losers within countries, which exerts concomitant impacts on income distribution. By reallocating the labour force across sectors and from rural to urban areas, structural change shapes social cohesion outcomes.[2]

In order to understand how structural transformation impacts on various forms of social cohesion, it is important to consider the underlying trends. Three stand out. First, the average share of agriculture[3] in total value added decreased across countries from 24% in 1990 to 20% in 2009.[4] Industry's average share increased only slightly over the same period from 27 to 28%,[5] while the average contribution of the services sector to value added rose from 49 to 53%: both these changes are positively associated with per capita income growth (Figure 3.1).[6]

Figure 3.1. **The pace of structural change by sector in developing economies, 1990-2009**

Changes in share of VA (%) *vs.* annualised GDP per capita growth (%)



Source: Authors' elaboration based on UN (2011).

The second trend, as Table 3.1 illustrates, is that in the last 20 years the process of structural transformation has been more pronounced in converging countries than in both struggling and poor countries. Converging economies show a larger drop in agriculture's share

Table 3.1. **Average changes in shares of value added by sector and by speed, 1990-2009**

Percentage

	Converging	Struggling	Poor
Agriculture	–7.8	–5.3	–1.5
Industry	1.4	1.1	–0.1
Services	6.5	4.1	1.5

Source: Authors' elaboration based on UN (2011).

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of value added and a steeper rise in the shares of industry and the services. Poor countries are characterised by both sluggish rates of growth and relatively stable productive structures.

The third development is that emerging and developing countries – especially China and India – have been driving growth in labour productivity at global levels: their average labour productivity growth rate rose gradually from 2% in 1998 to 5% in 2010, while in advanced economies it fell from 2 to 1% (Conference Board, 2011). This being said, average productivity levels nevertheless remain much lower in emerging and developing economies than in advanced ones (OECD, 2010a).

Over the last two decades, globalisation – together with shifts in global patterns of comparative advantage towards China, India and other developing countries – has been challenging the traditional paradigm of structural transformation (Stiglitz, 2010). No longer is the only viable option the trajectory of structural change followed by the high-income economies during their spurts towards development – *i.e.* from agriculture to manufacturing and then services, and from self-employment to formal wage earning. There are now other paths to growth-enhancing structural change (UNRISD, 2010): structural transformation increasingly seems to involve a direct shift from agriculture to services in developing countries, skipping the traditional stage of reallocation to the industrial sector. This raises concerns about the possibilities of jobless growth and "premature deindustrialisation" (Dasgupta and Singh, 2006; Palma, 2007). Yet the services sector can also be characterised by economies of scale and technological innovation and it can determine backward and forward linkages, which may have positive impacts on the productivity of the industrial sector (Singh, 2008; UNRISD, 2010).

Structural transformation in China and India has played an important role in sustaining labour productivity gains. From 2000 to 2008, the primary sector's share of total employment dropped from 50 to 39%, while industry and services increased their shares in equal proportions (OECD, 2010b). Given the higher productivity of the modern manufacturing sector in China, these figures translate into a significant increase in labour productivity. In India employment has shifted to services rather than to manufacturing and labour reallocation has actually increased productivity by about 0.9% per year (OECD, 2007). However, labour has also moved from formal to informal employment, which offsets the positive impact on productivity. In most other countries, structural transformation has not led to large shifts in sector-based labour shares since 1990. In Vietnam, for example, manufacturing's share of output climbed during the 1990s as state-owned enterprises were restructured, shedding 800 000 jobs in the process. Nevertheless, the manufacturing sector has remained very capital-intensive and rather inefficient. The result is that, after initial adjustment, changes in sectoral shares of output have not yet translated into a profound change in the structure of employment.

How does the process of structural transformation affect social cohesion? First, as illustrated by the aforementioned examples, it has direct impacts on social inclusion through its effect on both the quantity and quality of employment opportunities, which has immediate implications for standards of living and vulnerability to poverty (Box 3.1). Structural change can also have significant direct social costs, the most evident being persistently high unemployment (see Chapter 6). Growth trajectories – rather than overall growth rates – are crucial in explaining poverty reduction and income inequality, as rapid growth usually leads to expansion in the more labour-productive secondary and tertiary sectors at the expense of the primary sector (particularly agriculture).

Box 3.1. **Beating the resource curse**

Though controversy remains over the extent to which it has benefited their citizens, shifting wealth is linked with a huge turn-around in the economic fortunes of resource-rich countries across the developing world, as governments and producers have reaped the benefits of higher commodity prices (see Chapter 1). Such gains could yield further opportunities and resources for developing public infrastructure, sustaining manufacturing and enhancing export diversification, so making the use of natural resources an even more critical item in the development agenda (Cornia, 2011). Whether the opportunity is seized, however, or squandered, as happened during the last resource-led boom in the 1970s, is a major challenge for governments in resource-rich countries (Mold, 2011). Countries with a strong comparative advantage in natural resources are particularly prone to falling into the trap of growth-reducing structural change – what is popularly known as the "resource curse", shorthand for a complex combination of interactions which undermine development performance. The resource curse includes excessive appreciation of the real exchange rate, with a resulting contraction of labour-intensive export sectors in manufacturing and agriculture. There are also many other factors which impinge negatively on governance in countries, leading to a weak "social contract" and governments' high dependence on mineral or oil wealth for their revenues.

These structural issues are related to several major policy challenges for improving social outcomes (Sachs and Warner, 2001; Gylfason, 2001; Van der Ploeg , 2010):[1]

- Dependence on the mineral sector often not only limits positive spillover effects (*e.g.* forward and backward linkages) that benefit other sectors of the economy, it also crowds out non-resource exports and foreign direct investment, so restricting diversification. Higher wages in the natural resources sector may compromise both entrepreneurial activity and innovation in other sectors.
- Job creation in the extractive industries is often disappointingly meagre. The dominant players are often transnational firms that use capital-intensive technologies and employ only a small, skilled workforce.
- Natural resource dependence can also foster corruption and rent-seeking behaviour through the granting of exclusive licenses to exploit and export natural resources (Sala-i-Martin, 1997).
- Resource wealth has been associated with systematic underinvestment in human capital (*e.g.* in education and health).
- The exploitation of natural resources is often linked to rapid rises in countries' urbanisation and population flows towards their resource-rich areas.
- Income inequality is often much higher in resource-rich economies. Certain types of natural resources ("point resources", intensively exploited key resources located in a few specific geographical areas, *e.g.* oil, diamonds and plantation crops) can more easily be captured by an elite, simultaneously exacerbating social tensions and weakening institutional capacity (Isham *et al.*, 2004).
- Finally, and perhaps most importantly, excessive dependence on mineral wealth undermines the social contract between citizens and government (see Chapter 5), whereby tax is paid in exchange for a set of public services. The old adage of the American independence struggle, "no taxation without representation", is easily reversed to "no representation without taxation" – one way in which politicians can be held accountable for their actions.

Box 3.1. **Beating the resource curse** *(cont.)*

Better institutions are thus key to turning a natural resource curse into a blessing (Collier and Goderis, 2007; Mehlum *et al.*, 2006; Arezki and van der Ploeg, 2007). Institutional development, measured by the degree of democracy and the quality of institutions, seems the crucial link between resource endowments and economic outcomes (Murshed, 2002; Collier and Hoeffler, 2005). One successful example of how the resource curse can be prevented is Botswana, which put in place appropriate policies to protect private property and ensure the rule of law; ran a relatively efficient bureaucracy; invested heavily in infrastructure, education and health; and adopted a prudent fiscal policy[2] (Acemoglu *et al.*, 2003; UNRISD, 2010).

1. On natural resource curse, see also Gelb (1988), Karl (1997), Auty (1997) and Wood (1999).
2. As Acemoglu *et al.* (2003) stress, there is almost complete agreement that Botswana achieved this spectacular growth performance because it adopted good policies. However, the country still has a series of challenges to face: a high level of unemployment (a consequence of limited job creation and especially of migrant flows from rural areas) a low level of industrialisation, one of the highest adult incidences of AIDS in the world, and high income inequality.

The countries with the most success in poverty reduction encourage patterns of growth that make efficient use of labour and invest in the human capital of the poor (World Bank, 1990). It is, for example, a widely held opinion that rapid diversification into manufacturing fundamentally drove the first wave of economic development in East Asian countries. Yet most of them also boasted dynamic agricultural sectors, fuelled by a combination of very rapid progress in technology, high levels of support for public investment, and high rates of human capital accumulation (World Bank, 1993; Huang, 2008). China has understood the close link between poverty reduction and agricultural growth, while India's modest achievements in poverty reduction may be associated with the relatively poor performance of its agricultural sector (Chatterjee, 1995; Bardhan, 2010). At a time of deep concern over food security, the message from these experiences should not be lost – agricultural development is a fundamental pillar for strong economic performance and accelerated poverty reduction.

Employment challenges

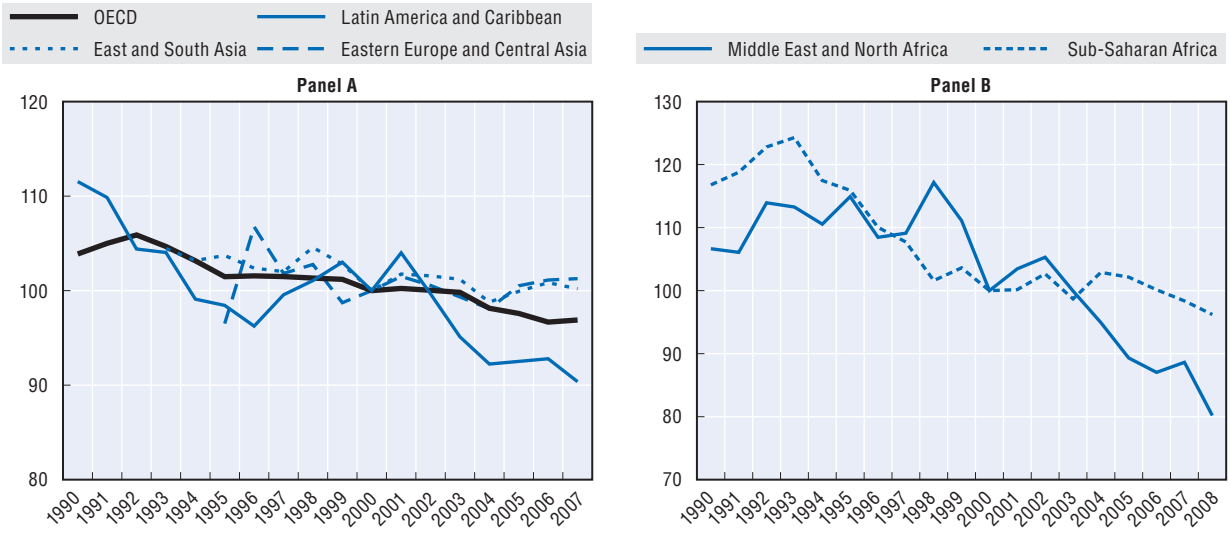
The reduced share of labour in value added

One contributory factor to the rise in inequalities is related to the dwindling share of labour income in total value added. It is a long-term downward trend which has accelerated in the recent period (ILO, 2008; Rodriguez and Jayadev, 2010) and may be contrasted with 1960-80, when the share of labour in the national incomes of OECD countries rose.[7] These trends suggest that the benefits of growth are not being equally shared – over time workers are enjoying less and less of them. The trends are also consistent with the stagnation in the real wages of low-skilled workers observed in the United States, where they have not improved at all over the last three decades (Rodrik, 1999). With the exception of Russia, the share of labour compensation in value added has fallen, sometimes markedly, in major converging countries.[8]

In industrialised countries, labour's falling contribution to national incomes is consistent with a trade-induced equalisation of factor payments prompted by the acceleration of globalisation.[9] Labour shares of total income have a cyclical component: they tend to fall in upturns and increase in downturns, as the employment market tightens

Figure 3.2. **Labour income as a share of value added by region, 1990-2008**

Labour income share in 2000 = 100



Note: Simple country averages of indexed shares of wage income in gross value added. The labour shares in Panel A are adjusted for self-employment, those in Panel B are unadjusted.

Source: Authors' elaboration based on KILM, OECD and national statistics.

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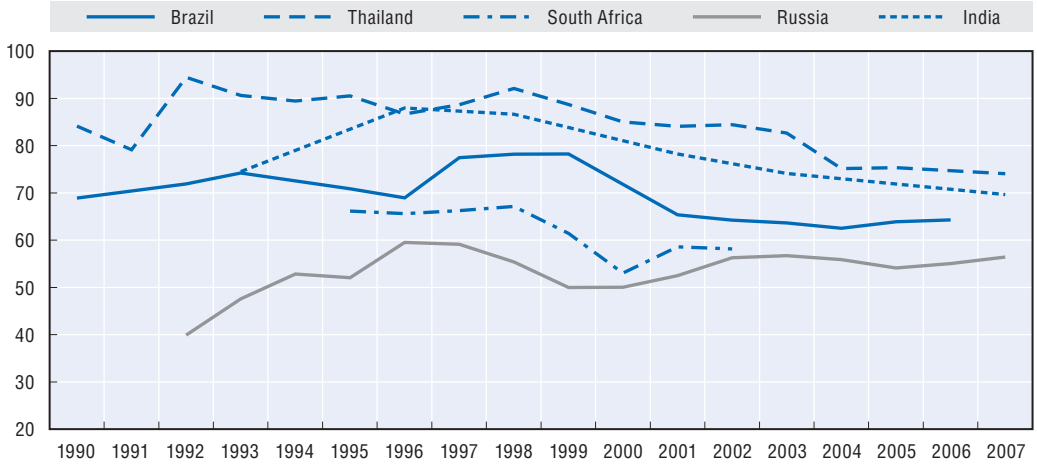
Figure 3.3. **Labour income as a share of value added in selected countries, 1990-2007**

Wage shares of value added (%)



Note: The labour shares are adjusted for self-employment.

Source: Authors' elaboration based on data from ILO, *UN National Accounts* and *OECD Economic Surveys*.

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then relaxes with a time lag behind output. The falling trend could, in part, be the result of a long cyclical upswing in a number of countries during the 2000s. However, the length of the trend – and the fact that it has remained steady even through events such as the Asian crisis – suggests that it is also driven by structural factors. For developing and emerging countries, the trend runs counter to the predictions of factor payment equalisation: theory has it that increased openness should prompt developing countries to specialise in labour-intensive production and push up relative wages by making relative labour remuneration in developed and developing countries equal.

Two global transformations have contributed to the trend in labour income shares: the shift in the global capital-to-labour ratio and accelerating technological change. The "Great Doubling" (Freeman, 2005) of the world's labour force with the influx into the global market economy of nearly 1.5 billion workers in the early 1990s tilted the balance between labour and capital (Freeman, 2006; OECD, 2010a). The spread of labour-saving technological change has also contributed to labour's dwindling share. Structural transformation could also, in theory, explain part of the fall in labour shares.

Labour shares have also fallen within sectors, as Rodriguez and Jayadev (2010) show. They find that intra-sector movements in factor shares drove the fall in labour shares during the 1990s. Furthermore, recent growth has not been equally shared among workers, and there has been mounting concern about two trends in emerging country labour markets: low job creation and rising or persistent wage inequalities, especially between groups.

Job creation is weak

Changes in sector-related labour productivity and allocation contribute to structural transformation. The three dimensions of social cohesion – social inclusion, social capital and social mobility – are also affected by the evolution of labour markets and employment which are, in turn, challenged by new trade patterns and global value chains in the context of shifting wealth. Employment rates have lagged behind output in a number of countries, fuelling concerns that growth during the period of shifting wealth has not generated enough jobs. Employment elasticities – which measure the rate of increase in employment induced by increases in output – suffered a significant decline in the period 2002-09 compared to the period 1995-2001 – with the exception of the industrial sector (Table 3.2).

Table 3.2. **Global employment to output elasticities by sector, 1995-2009**

	1995-2001	2002-09
World	0.47	0.31
Agriculture	0.29	0.09
Industry	0.24	0.31
Services	0.61	0.44

Source: Authors' elaboration based on ILO (2010) and World Bank (2011a).

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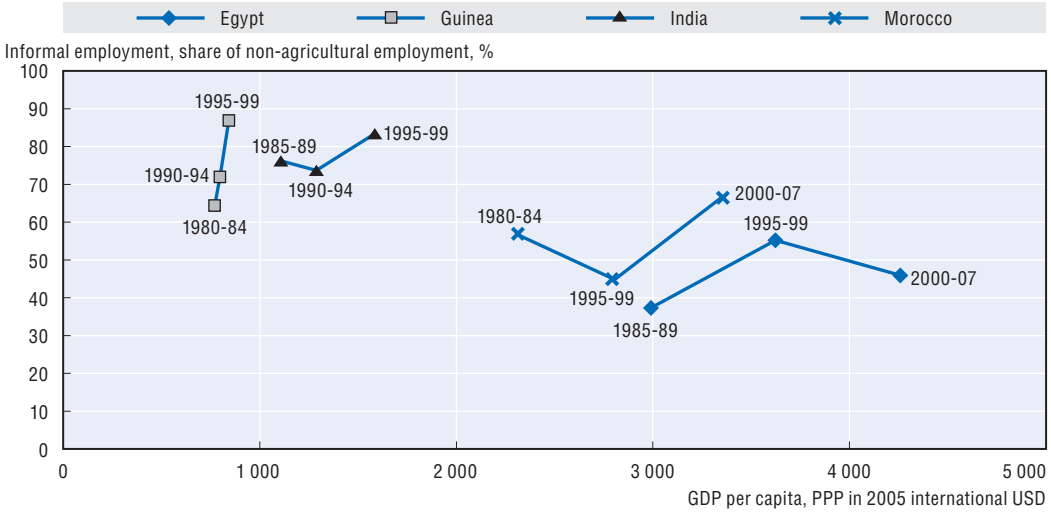
In the latter part of the 2000s, global employment elasticities were greater for services (0.44) than industry (0.31) or agriculture (0.09). If this pattern is valid for individual countries, it presents a significant challenge for countries undergoing structural transformation. Growth in agriculture would appear to be entirely driven by productivity increases, with hardly any net impact on employment. Job creation in industry is also low, and even in the services employment elasticity is declining. Nevertheless, low employment elasticities of growth need not lead automatically to adverse labour market outcomes. For example, employment elasticities in East Asia (which includes China) remained low (0.18) by international standards throughout the 1990-2003 period (Kapsos, 2004). Increases in productivity rather than in employment have led growth in East Asia, together with high rates of physical capital accumulation and remarkable rates of human capital accumulation. However, given China's demographic profile and the growing number of students in higher education, the result has not been greater unemployment.

Jobless growth, when it happens, can have skill-biased effects. In South Africa, despite growth in employment across all major sectors over the 1995-2005 period, the overall employment growth rate of 2.6% per annum was insufficient to absorb the growth of the working age population. Although the government has made employment a top priority, the official unemployment rate in South Africa has stood above 20% for the last 10 years (World Bank, 2010). Moreover, job creation has been markedly skills-biased. Employment growth among skilled categories rose 43% between 1995 and 2005, while the figure for low-skilled workers was only 26%. Although such imbalances can ultimately lead to skills upgrading policies, they leave a vast pool of unskilled workers unemployed over the medium term, resulting in the rapid growth of the informal tertiary sector (Bhorat and Oosthuizen, 2008). Developing countries faced with this situation must rise to the considerable challenge of upgrading their workforces' skill sets, an effort that ties in with the educational challenges identified in Chapter 8.

Informality continues to constitute a major challenge

The shift from informal to formal employment is one of the expected consequences of traditional patterns of structural transformation. However, the resilience of informal work stands out among aggregate employment trends of the past 20 years. Particularly striking is its persistence in countries that have experienced sustained growth (Figure 3.4), which can be partly explained by insufficiently dynamic job creation in formal enterprises.

Figure 3.4. **Increasing informality in growth periods**



Source: Informality data is from Jütting and de Laiglesia (2009), GDP data from World Bank (2011a).

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In developing countries, on average, 55% of employment outside agriculture is informal (Jütting and de Laiglesia, 2009). Informal employment is neither observed nor protected by labour legislation. It includes the self-employed in unincorporated enterprises, but also salaried workers who have no contracts. Given the nature of the phenomenon, data are patchy and generally have limited country coverage. Jütting and de Laiglesia (2009) gather available information across countries to paint regional pictures. They find that informal employment is most prevalent in sub-Saharan Africa, where it

accounts for more than 80% of employment in many countries, and in South Asia, particularly India, where, again, over 80% of employment lies in the informal sector.

The persistence of informality presents a challenge for alleviating rising inequality. Not only are informal worker earnings and job conditions outside the direct purview of labour legislation, but insurance mechanisms that would allow them to avoid income shortfalls and social security transfers have very limited reach. Lacklustre job creation and informality are particularly worrying if they limit the opportunities of new entrants in the job market. In particular, they are likely to diminish returns to labour even from educated youth. Because more qualified jobs are more difficult to sustain in self-employment, the result is not only high levels of youth unemployment, but also a skills mismatch and possible fracture within labour markets where many young people have no access to decent, formal jobs.

In most emerging and developing countries, unemployment insurance and benefits are non-existent or have very limited coverage, often below 10% of the unemployed (OECD, 2010c; OECD, 2011a).[10] Severance pay is more widespread, but is in practice limited to the formally employed. Without income support during periods of unemployment and job seeking, individuals respond by creating their own jobs. This explains the low levels of open unemployment and high self-employment in many developing economies. On average, informal workers earn less and are all but prevented from accessing contribution-based social protection mechanisms.

Gender gaps in the labour market are still pronounced

Greater female education, declining fertility, growing urbanisation, and shifts in the sectoral components of production have changed the nature of women's participation in the labour force over the past two decades. In some countries, however, discrimination still prevents women from participating in the labour market on equal terms with men. There are far fewer women in the labour force in countries with high levels of discrimination (OECD, 2010d). Using the *Social Institutions and Gender Index* (OECD, 2009) to measure gender discrimination shows that the average female labour force participation rate for high-discrimination converging countries is just 37% (dropping to 31% when China is removed), compared to 53% for the other countries.

Due, in large part, to the changes brought about by shifting wealth (Barnes *et al.*, 2011), gender inequalities in employment are now determined less by the lower numbers of economically active women in work than by the quality of jobs available to men and women (ILO, 2009a). As a result of their lower educational attainment, domestic responsibilities, and socially prescribed gender roles, women are more likely to work not just in informal employment, but in its lower echelons, particularly as unpaid family workers (Kucera and Xenogiani, 2009). Because men tend to enjoy greater mobility, they also benefit more from structural transformation (Luci, 2009). Many of the new jobs being created, particularly within industries such as manufacturing, call for increasingly highly skilled workers. Women are thus at a disadvantage, even in sectors they had previously dominated in export-oriented countries.

The declining share of the agricultural sector in the production of value added since the 1970s has coincided with its gradual "feminisation" (Boserup, 1970; World Bank, 2008; Kucera and Xenogiani, 2009). In a number of countries, as men started looking for better-paid jobs in the manufacturing sector, so female participation in the agricultural sector

rose. In some developing economies agriculture commonly employs women and is their largest source of income. Rural women in Africa produce 80% of the food (ILO, 2005),[11] while cash crops remain a male preserve with men more likely to be involved in machinery-driven or export-oriented agriculture (Jütting and de Laiglesia, 2009). The feminisation of agriculture goes together with the feminisation of "bad quality" jobs (Jütting *et al.*, 2010), as agricultural workers tend to be deprived of institutional services, unlike workers in industry who generally enjoy better access to education and training, new technologies and market information. Female employment in agriculture shares a common feature across regions: women have less access than men to assets – namely land, livestock, labour, education, financial services, and technology. According to an FAO estimate, closing the gender gap in agriculture would increase farm yields by 20-30% and agricultural output by 2.5-4%, and would cut the number of undernourished people by 12-17%, depending on the region (FAO, 2010a). The lack of control of resources and production factors – particularly access to land – is an obstacle to the achievement of the Millennium Development Goals (MDGs). This "missing dimension" – together with violence against women – is a key factor in the development outcomes measured by the MDGs (OECD, 2010e).

Despite high rates of economic growth and structural transformation over the last decade in most of the converging countries, female workers remain at a relative disadvantage in the manufacturing sector. When industries upgrade technologically it is the female workforce that is often displaced, while in Export Processing Zones (EPZ) worldwide, women account for the vast majority of employees – up to 70% and even 90%, according to some estimates (Milberg and Amengual, 2008). Female employees in EPZs are reputed to work for lower wages, belong less to organised labour, and show greater endurance in monotonous production work (Milberg and Amengual, 2008). EPZs could in fact foster overall equal pay in the urban economy if they enabled women to move out of low-wage informal employment to better paid jobs (Glick and Roubaud, 2004). However, when EPZs shift to higher technology production – such as electronics or business services – the proportion of female workers declines because women are, on average, less skilled (Milberg and Amengual, 2008). The expansion of service sector jobs, like those in call centres, have benefited women to some degree at least. Such jobs, however, tend to be of poor quality, characterised by low wages, limited benefits, and low levels of unionisation (Kucera and Xenogiani, 2009).

The gender pay gap remains wide. It exists in all countries[12] and there is evidence that gender discrimination is a significant factor. In Brazil, a woman with more than 13 years of schooling is likely to receive only 66.4% of the wages of a man educated to a similar standard (Ventura-Dias, 2010). Research carried out by the ILO (ILO, 2009b) among more than 41 000 workers in Bangladesh found that even when allowing for differences in age, education, industry, occupational type and location, women still earned 15.9% less than men per hour.

Migration challenges

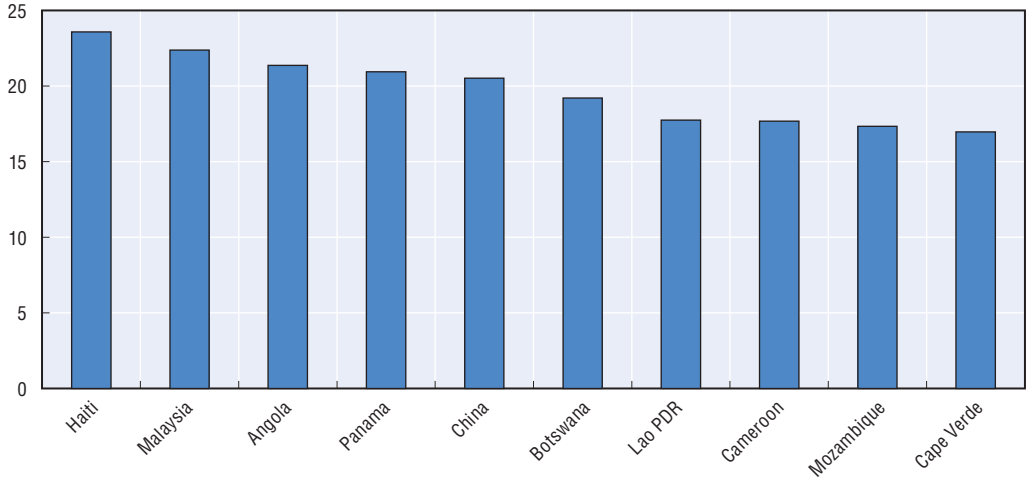
Internal migration: Urbanisation and social dislocation

As urbanisation rates continue to increase around the world and change the economic landscape of many countries, debates on its benefits and costs have resumed centre stage in policy debates (McKinsey, 2010; World Bank, 2011b). According to McKinsey, India's

urbanisation over the next 20 years will be on a scale unprecedented anywhere except China, with an additional 250 million people living in cities. Figure 3.5 shows the ten emerging and developing countries where urbanisation is fastest. These are countries whose urban populations grew more than 15% in the period from 1990 to 2010. In the case of China, this growth represented some 636 million people in 2010, 150 million of whom were rural-to-urban migrants (UN/DESA, 2010; Meng and Zhang, 2010). In sub-Saharan Africa, Lagos will soon be the continent's largest city with an estimated 12.5 million inhabitants by 2015, with Kinshasa not far behind. But the biggest pressures will be felt in the fastest growing cities elsewhere in Africa – Dar es Salaam, Nairobi, Luanda and Addis Ababa, to name but a few. They are forecast to grow by more than 50% over the next 15 years. Managing the disruptive effects of such massive growth and population flows is a daunting challenge for developing country governments.

Figure 3.5. **The top ten urbanising countries in 1990-2010**

Change in the share of urban population (%)



Source: UN/DESA (2010).

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The factors which influence internal migration can be explained by "push and pull factors". Push factors are conditions in migrants' place of origin which they perceive as detrimental to their well-being or economic security. Pull factors are those that attract them to new destinations. Broadly speaking, however, urbanisation has been taking place at a similar pace in fast- and slow-growth developing countries. Across countries and time, income growth accounts for only 5% of the variation in rates of urbanisation (Fay and Opal, 2008). However, the sustained growth of economies in Asia – notably China, Cambodia, Indonesia and Vietnam – has been linked to rapid urbanisation. As urbanisation also gathers pace in sub-Saharan Africa (UN-HABITAT, 2010), it is estimated that by 2030 more people will be living in urban than in rural areas on every continent.

Urbanisation affects social cohesion in many complex ways. The most immediately obvious, as is often argued, is that it helps improve quality of life because it is easier to provide infrastructure and social services to urban residents than to rural populations (Kenny, 2011). But it also generates considerable social stresses and strains which can undermine social cohesion. Observing data on subjective well-being in 2002, for instance,

Gunatilaka and Knight (2010) find that the average happiness scores of rural migrant households who had settled in urban China were lower than those of country dwellers. They posit that the terrible living conditions of rural-urban migrants in cities and their high aspirations, influenced by new reference groups, explain the unhappiness.

The concentration of people in slums is a significant negative effect of urbanisation: more than 800 million people – over one-third of the world's urban population – live in slums. Slums generally produce unhealthy living conditions, enforce the segmentation of workers in formal and informal jobs, and undermine social mobility and formal job creation. In addition to the direct human cost there is the heavy environmental cost: poor sanitation and health facilities lead to pollution that damages much of the environment in and around slums. The eradication of slums is an important component of the 7th Millennium Development Goal to ensure environmental sustainability.[13]

A further adverse impact is rising the inequality between rural and urban areas. Three-quarters of the world's poor live in rural areas (Chen and Ravallion, 2007) where poverty rates increase more rapidly than in urban areas (Ravallion, 2001). As a group, rural-urban migrants tend to be more productive and have higher human capital than country dwellers that stay at home. As a consequence, rural regions suffer from even lower growth, a phenomenon that has been linked to food security (*e.g.* Kenya). Members of rural communities left behind by migrants may be badly affected by dislocation. Separation can break families up, with the elderly too weak to take care of themselves properly and children too young. Yet their parents are away working in the cities.

Urbanisation is also associated with interethnic and sectarian tensions, particularly in countries made up of multiple ethnic, linguistic and religious groups, as exemplified by the February 2008 Maharashtra clashes between locals and Bihar migrants in Dadar, India. In times of crisis local inhabitants may vent their anger over inefficiencies in public services on migrants. Cultural differences and consequent segregation often lead to inequality of income and – perhaps most importantly – of opportunity (Gagnon *et al.*, 2009).

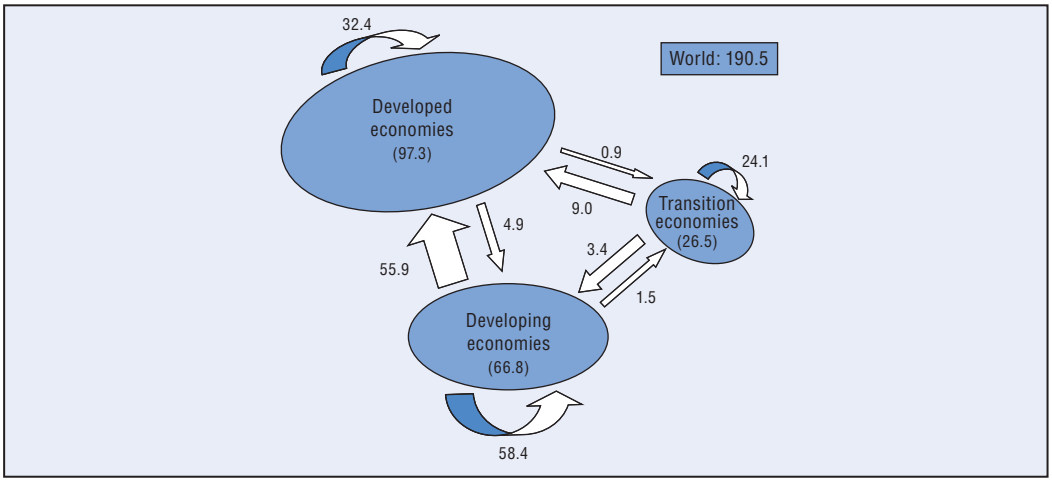
International migration: Growing South-South pressures

Shifting wealth is characterised by growing South-South trade and factor movement. Migratory flows are no exception to this pattern: migration between developing countries has significantly increased over the last two decades. Contrary to popular belief, most migrants from the South are found in the South (Figure 3.6). In 2005, an estimated 58.4 million migrants from developing countries (50.5% of all migrants from such countries) lived in another developing country, *versus* 55.9 million (48.2%) in developed economies and 1.5 million (1.3%) in transition economies.[14] Moreover, South-South migration flows are likely to rise relatively faster in the future, in part because migration policies in developed economies are increasingly restrictive, but also because the fast-growing economies of the South are new magnets for potential migrants.

South-South migration flows are thus more prevalent than South-North movements: 45 out of 63 developing countries (71%) whose emigrants have as their first destination another developing country share a border with this country. Even though transport costs are falling worldwide, a common land border is easier to cross and affords opportunity at a cheaper cost. In general, migrants who move to adjacent countries come from the less privileged sections of society (Bakewell, 2009; Gindling, 2009).

Figure 3.6. **Global stock of international migrants, 2005**

Million



Notes: "Transition economies" include Albania, the countries of the former Soviet Union (*minus* Estonia, Latvia and Lithuania) and of the former Yugoslavia (*minus* Slovenia). "Developed economies" encompass all European countries (with the exception of transition economies), plus Australia, Canada, Israel, Japan, New Zealand and the United States (including Puerto Rico and US Virgin Islands). "Developing economies" refers to all other countries.

Source: Authors' elaboration based on Ratha and Shaw (2007) and World Bank (2010a). The categorisation between developed, transition and developing countries is based on UNCTAD (2010).

The South is geographically diverse and emigrants face very different challenges according to whether they settle in Africa, Asia, or in Latin America. There is also great political diversity and host countries can just as easily be autocratic regimes as democracies, although the latter obviously offer greater opportunities for integration. Although emigrants (particularly refugees) are more likely to head for politically stable countries, unstable ones also attract them. This is particularly true of some resource-rich countries, where immigration coexists with civil unrest and low levels of freedom. In Equatorial Guinea, for instance, government sources estimate that up to one-third of the population are immigrants, drawn to the country by its high rates of economic growth (AfDB *et al.*, 2011).

The South is characterised by strong economic diversity, with major oil and manufacturing exporters, for example, lying next to extremely poor neighbours, all of which has consequences for immigrants' standards of living. Migrants choose their destination according to their own characteristics. In other words, the poorest tend to head to the poorest – and closest – countries, thus reducing their chances of socio-economic mobility. By contrast, the wealthiest migrants, who have high initial levels of financial and human capital, move to richer countries and therefore benefit from the best opportunities. They also have a higher probability of integrating into their host societies (Hawkins *et al.*, 2011; Münz *et al.*, 2007; Syed, 2008).

South-South migration is posing a growing challenge to social cohesion in many developing countries. As in developed countries with longer traditions of immigration, local populations do not always view the arrival of foreign workers favourably. As a result, they may serve as scapegoats for the economic and social problems of the country. They are blamed for rises in unemployment and insecurity and, in extreme cases, can be victims of anti-immigrant riots, like those which occurred in South Africa in 2008. Moreover, immigrants in developing countries often lack basic protection of their rights, particularly social and civil rights. The situation of refugees and transit migrants is most worrying, above all in cases where their "temporary" status tends to become permanent.

Although intra-regional flows account for a significant share of migration between developing countries, primarily in Africa, cultural and linguistic differences between home and host countries can still be significant. The diversification of flows and subsequent increase in intercontinental South-South migration accentuates such differences, which can slow the integration process as has happened in the North, and expose migrants to discrimination (Jalal *et al.*, 2010; Lucassen, 2005; Ozyurt, 2009). Many Gulf countries, for instance, practice official discrimination and ban freedom of religious expression, which particularly affects the mainly Christian Filipino immigrants working as domestics or in the oil industry.

In most cases, however, discrimination is the result of inadequate legal protection and enforcement of civil rights. It can take the form of lower wages, the denial of access to jobs, housing, and services and, at its most extreme, human trafficking and labour exploitation. In 2010, for instance, human Rights Watch (HRW) reported labour rights abuses in Thailand against migrant workers from Cambodia, Laos and Myanmar. It also denounced the incapacity – and unwillingness – of local authorities to investigate complaints related to labour exploitation.

Local discrimination against immigrants weakens their place in society, particularly in times of crisis when they become scapegoats for all manner of ills. If they are not properly integrated or, worse, marginalised, immigrants constitute one of the easiest targets for government blame and the anger of local workers. Although during the recent financial downturn it was primarily in the North that the scapegoating of immigrants received media attention, it was also happening in the South. In 2008, the governments of the Dominican Republic and Malaysia used anti-immigrant sentiment fostered by the financial crisis as an opportunity to expel thousands of undocumented immigrants; a similar political reaction occurred during the 1997-98 Asian financial crisis (Koser, 2009).

Resentment and rejection force immigrants to seek or create enclaves in poverty-stricken ghettos. Unbeknown to or unheeded by authorities, many immigrants in India, Malaysia and Pakistan live in slums outside city limits, segregated from other neighbourhoods (Sadiq, 2009). Why do immigrants crowd together if it exposes them to finger pointing? Familiarity is a prime factor as migrants prefer to seek the comfort of their own kind rather than venture into the unknown. Local perceptions of immigrants also tend to lead to stereotyping and eventually discrimination, while in enclaves immigrants have a greater chance of being treated as equals. Furthermore, enclaves may enable undocumented immigrants to live and work in a country without undue exposure to authorities.

Poor integration affects not only immigrants, but societies as a whole. As ghettos develop, they become increasingly exclusive as their inhabitants take action to protect themselves against xenophobic attacks. Pockets of extreme poverty breed disease and circular poverty traps, and nurture growing negative sentiments against native workers and host governments. There is a risk that the social contract erodes as organised crime and popular justice develop, while immigrants' rising infringement of local laws and customs incurs costs for the host country which has to provide more public services (*e.g.* police) to maintain law and order. In some cases, tensions escalate into violence, as seen in Libya in 2011 and South Africa in 2008. Ethnic and racial tensions can generate civil unrest and long-term political instability, as the case of Côte d'Ivoire illustrates.

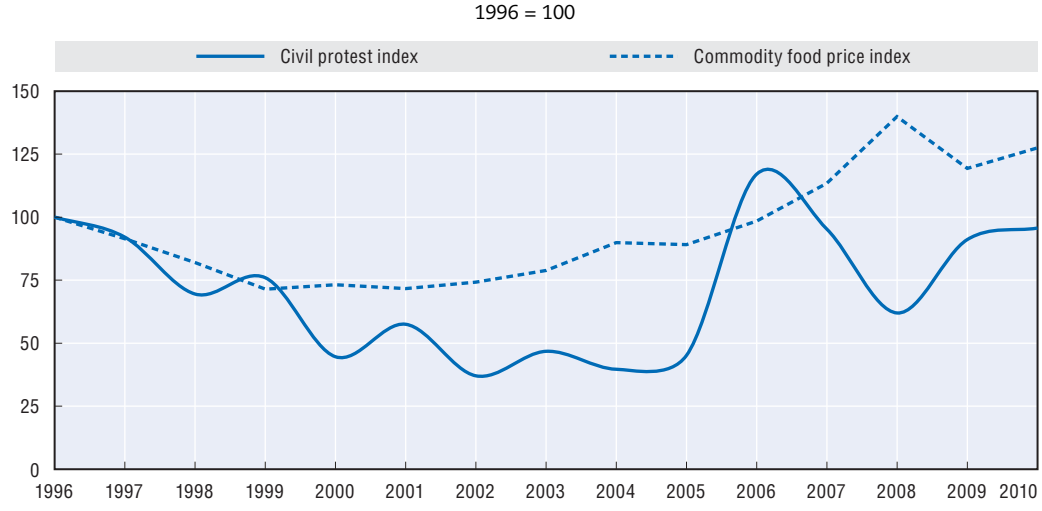
Agricultural challenges

High food prices

Food insecurity can be a major threat to social cohesion. Although the riots in developing countries caused by steep food price increases in 2007-08 received much media attention, food shortages have been a persistent cause of social unrest throughout history. When peoples' lives and well-being are at stake it can take only a slight shortage or price increase to trigger civil disturbance, and it is the poor who are most vulnerable.

In many countries, the sharp rise in food prices has made governance more difficult. According to one recent econometric study (Arezki and Brückner, 2011), increases in international food prices in 120 low-income countries during the period 1970-2007 led to a significant deterioration in democratic institutions and a sharp increase in the incidence of anti-government demonstrations, riots and civil conflict. The *African Economic Outlook*'s (2011) indicator on civil disturbances seems to confirm the existence of a link between civil unrest and rising food prices in 2007-08 (Figure 3.7). Guaranteeing food security thus needs to be a priority for any government aspiring to foster a socially cohesive society.

Figure 3.7. **Civil unrest caused by rising food prices?, 1996-2010**



Source: AfdB *et al.* (2011) on the basis of AFP information and IMF (2011).

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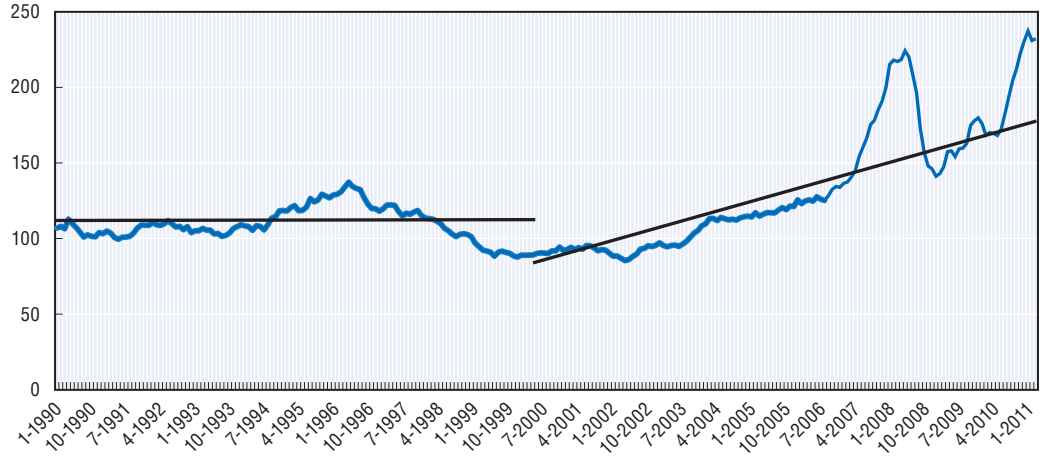
Following the drop in food prices at the end of 2008, there was a fresh rise in 2010, exceeding the 2008 peak in early 2011. From a long-term perspective it seems that, unlike the 1980s and the 1990s, food prices in the 2000s have undergone a structural change (Figure 3.8). In 2010, a total of 33 countries suffered from chronic food insecurity, 16 of which had been in this position for a decade or more (FAO, 2010b). As many as 82 countries are defined as food deficitary countries, meaning that they import food to a greater calorific value than the food they export (FAO, 2010c). Africa, for instance, was a net food exporter in the 1970s, but became a net importer by the early 1990s. The shift from net exporter to net importer status is not a problem in itself, but can be so when it is the consequence of agriculture's weakness rather than a result of shifting of agricultural resources into more remunerative activities. Many of the affected countries are poor, with low levels of human development and little capacity to buy the food they need on international markets. These

Figure 3.8. **Structural break in food prices in the 2000s**

Monthly food price index, 1990-2011



Note: Straight line represents trends by decade.

Source: FAO (2011).

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countries are now expected to adopt appropriate "coping strategies", such as social safety nets or larger foreign exchange reserves (see Chapter 1), while less attention is being given to the underlying causes of instability – namely productive weaknesses.

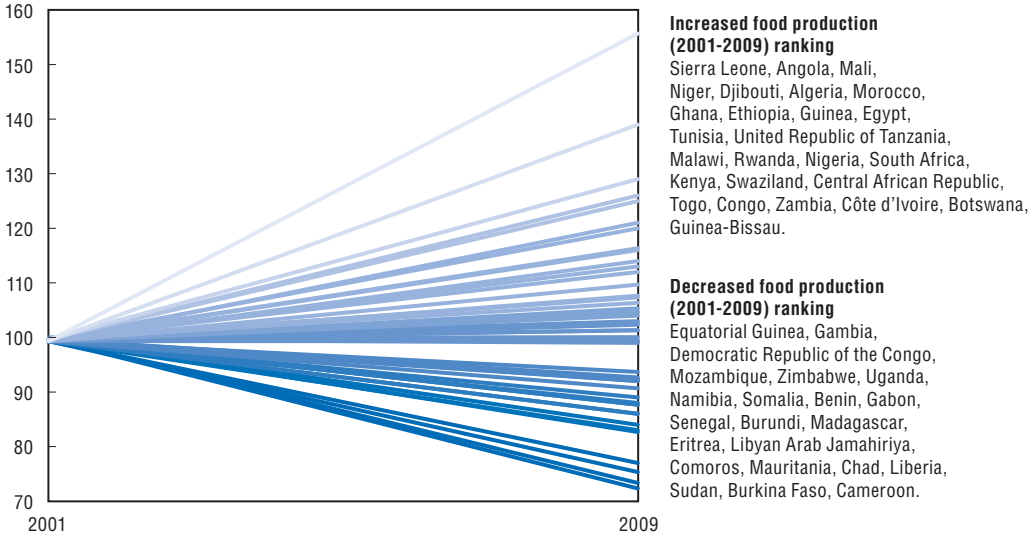
The price spike of 2007-08 was the result of shifts in both supply and demand conditions. On the demand side, rising prices were fuelled by growing demand as incomes grew in emerging markets, combined with rapidly changing consumption patterns (in particular the rise in demand for high-protein foods, the production of which is highly land-intensive). The demand for food and feed crops for the production of biofuels is another significant factor (OECD, 2011b).

Both temporary and more structural changes in supply-side conditions impacted on prices – the former related to adverse weather events including drought in Australia and weak harvests in Russia, Ukraine and the United States, and the latter related to the declining yield growth in cereals witnessed over the last two decades. At the time of writing, the consensus is that prices will for the foreseeable future remain at a higher plateau than the prevalent levels of the late 1990s and early 2000s. OECD/FAO (2010) forecasts suggest that, for a range of agricultural products, prices in the 2010s will remain approximately 40% higher than the levels that prevailed in the 2000s. Higher food prices are something which policy makers will have to learn to accommodate, raising issues of difficult trade-offs between agricultural policy, social security schemes, subsidies, trade policy and employment policies.

National food production performance varied widely in the 2000s, as exemplified by Africa, where 23 countries experienced declines in per capita food production over a decade of high food prices (Figure 3.9).[15] In a global market it should not matter too much that a country's own production declines, as deficitary countries should be able to purchase their requirements on international markets. Since 1990, global food production per capita has expanded more than 20% (FAO, 2011). To meet projected demand (based on the combined factors of rising population and changing dietary preferences), it is estimated that global cereal production will have to increase by nearly 50% and meat

Figure 3.9. **A wide range of national food production outcomes over the last decade**

Food production per capita in African countries, 2001-09 (2001 = 100)



Source: Authors' elaboration based on FAO (2010d).

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production by 85% between 2010 and 2030 (World Bank, 2008). As a consequence, not only must yields rise (there is relatively little spare land and remaining forests must be conserved), they must do so sufficiently rapidly to compensate other negative trends, such as climate change and deteriorating soil fertility (Green, 2008). The problem has been compounded in the last few years by a clear tailing-off in agricultural productivity, suggesting that, unless strenuous efforts are made on the supply side, global per capita food production could decline.

The consensus opinion on what causes food shortages (and, in their extreme manifestation, famines) has been much influenced by Sen's concept of "entitlements", whereby the poor may go hungry and even die of starvation simply because their access to food is restricted through, say, a collapse in their source of income (Sen, 1981). Clearly, the idea that there is sufficient food in the world but that it is simply badly distributed is a powerful one.

Where purchasing power is sufficient, trade is a major mechanism for the redistribution of food. However, the ability of poorer countries to buy food on international markets can be seriously constrained, and it is here that food aid takes on an important role. But it too has its limitations. In the past, food aid has been much criticised – it can create dependency, undermine local food production, and divert consumption patterns away from traditional crops (Cassen and Associates, 1994; Riddell, 2007). Moreover, while acknowledging the importance of Sen's insights, it should also be recognised that food shortages can stem from localised failures in food production systems. For instance, eastern, northern and southern Ethiopia were affected by severe drought in 2008, while the western part of the country went largely unscathed. In such circumstances, weaknesses in infrastructure and the lack of sufficiently developed commodity markets were the principal obstacles to achieving food security at the national level. Similarly, in Mozambique aggregate food production figures mask wide regional variations in food output and security: the crop-producing areas of northern Mozambique, which supply

much of the country's food surplus, increased their output considerably in 2010, with maize production up by 12%. But in the south, which has much poorer agricultural potential and greater reliance on off-farm incomes, production fell by 38% due to early season drought, particularly in coastal areas (EIU, 2010). Although the good national harvest put downward pressure on food prices, this was more than offset by the higher cost of imported foods, attributable to a weak Mozambican currency and the withdrawal of subsidies. Cases like this suggest that local food availability decline (FAD, to use Sen's terminology) can still play a major role in explaining famine and hunger (Nolan, 1993). It is misleading therefore to argue that production is not a problem: regional variations in the production of food are still important factors to take into account.

In studies of the implications of rising food prices (*e.g.* Aksoy and Isik-Dikmelik, 2010), there is growing recognition that the rural poor are not a homogenous class, a uniform group of people in similar circumstances facing similar problems. Those classified as poor may include casual agricultural wage workers, unionised plantation workers, deficit food farmers who supplement self-provisioning with food purchased in the market from their wages as part-time labourers, small peasant farmers producing cash crops, and other workers such as fishermen, herdsman and artisans. These diverse groups of people are affected differently and respond differently to rising food prices (Griffin, 1999). For instance, surveys in Ethiopia, Kenya, Mali, Mozambique, Rwanda, Senegal, Somalia, Tanzania, Zambia and Zimbabwe between the mid-1980s and 2002 found that in no country were more than half of the smallholders net sellers of staples. The average was closer to one-third.[16] Data from household surveys in Ghana, Nigeria, Malawi and Madagascar revealed similar patterns, with the amount of land owned being the strongest correlate of households' net sales positions – in other words, bigger farmers were more likely to be net sellers (Zezza *et al.*, 2006).

Table 3.3. **Net buyers of staple foods**

Percentage

	All households			Poor households		
	Urban	Rural	All	Urban	Rural	All
Albania, 2005	99.1	67.6	82.9	*	*	*
Bangladesh, 2000	95.9	72.0	76.8	95.5	83.4	84.2
Ghana, 1998	92.0	72.0	79.3	*	69.1	*
Guatemala, 2000	97.5	86.4	91.2	98.3	82.2	83.1
Malawi, 2004	96.6	92.8	93.3	99.0	94.8	95.0
Nicaragua, 2001	97.9	78.5	90.4	93.8	73.0	79.0
Pakistan, 2001	97.9	78.5	84.1	96.4	83.1	85.4
Tajikistan, 2003	99.4	87.0	91.2	97.1	76.6	81.4
Vietnam, 1998	91.1	32.1	46.3	100.0	40.6	41.2
Unweighted average	96.4	74.1	81.7	97.2	87.9	78.5

Note: An asterisk (*) indicates insufficient data.
Source: RIGA data (FAO, 2009).

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Such analyses seem to suggest that, because net buyers of food outnumber net sellers in rural areas and because, almost by definition, all urban dwellers are considered net buyers, higher food prices have, on balance, a negative impact in many developing countries, with both poverty and social cohesion adversely affected. This is not, however, an unchallenged conclusion (Box 3.2).

Box 3.2. **Rising food prices – Every cloud has a silver lining?**

For a number of reasons the story of rising food prices is not all negative and, on balance, it may well be that higher food prices actually contribute to net poverty reduction (although inevitably some groups in society will be negatively affected).

Drawing on household surveys in nine countries, Aksoy and Isik-Dikmelik (2010) find that in eight of the nine countries studied, the average incomes of net food buyers are higher than the average incomes of net food sellers. Moreover, although there are more poor net food buyers than sellers, about half of these are only marginal buyers, *i.e.* households whose net purchases of food account for a small share of their income. Food price rises therefore have only a slight effect on their welfare. Aksoy and Isik-Dikmelik conclude that on average higher food prices transfer income from better-off households to poorer ones. In this sense, higher prices could be considered "pro-poor".

Unlike 2007-08, the price rises of 2010-11 have not affected food alone, but all agricultural commodities, including the main exports of many poor developing countries – cocoa, coffee and tea, cotton, palm oil, sugar, and rubber. As a consequence, the price rises may actually enhance the income of countries which are tropical commodity exporters, even once the higher food import bill has been factored into the calculation. Many tropical commodities are produced by smallholder farmers for whom higher prices represent windfall gains. They are likely to spend their gains on local goods and services, exerting strong multiplier effects in the form of additional jobs and revenue for low income earners. In a study of five developing countries, Wiggins (2010) finds that the gains for their economies are substantial – 3% of GDP for Burkina Faso, over 2% for Nicaragua, and over 1.5% for both Ghana and Indonesia. Only in Kenya are the positive impacts marginal.

Higher food prices are once again helping to focus attention on the importance of agricultural development. Because a high proportion of the poor still live in rural areas and are at least partially reliant on agriculture, faster agricultural growth and development is crucial to a more inclusive growth path in many developing countries. Farming is by far the single most important economic activity in most poor countries. Numerous studies support the finding that promoting agriculture can help the poor to a greater extent than economic growth alone (Dorward *et al.*, 2004; Mellor, 1995). Yet for a quarter of a century, neither national governments nor donors have given sufficient attention or resources to issues of agricultural development. Between 1980 and 2004, spending on agriculture as a share of total government expenditure fell from 6.4 to 5% in Africa, from 14.8 to 7.4% in Asia, and from 8 to 2.7% in Latin America (Green, 2008). Total aid to agriculture from DAC donors dropped from 11.4% of all aid in 1983-84 to 3.5% in 2008-09 (OECD, 2010a). There are signs that these trends are now being reversed. Over the past two years, the World Bank and donor countries have doubled the money they put into farming in poor countries. Developing countries are focusing renewed attention on mobilising resources for agricultural development in accordance with commitments like the 2003 Maputo Declaration on Agriculture and Food Security.

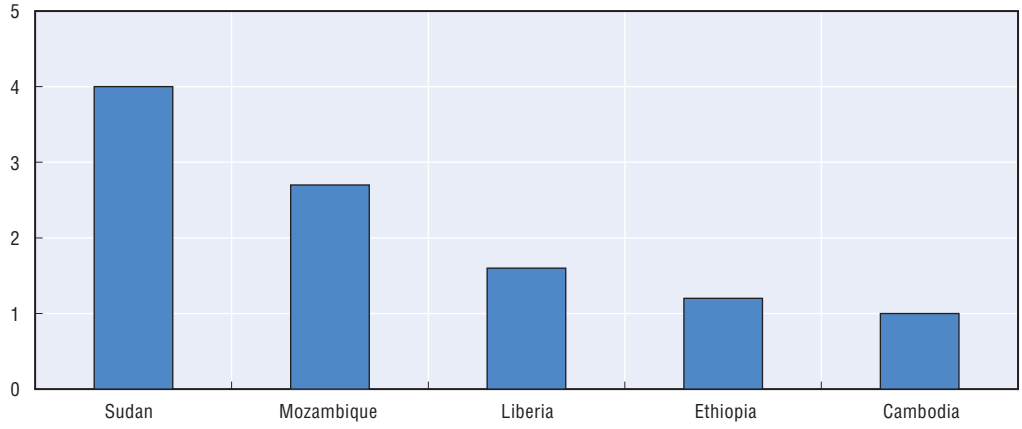
Are higher prices for food unequivocally bad news for poor countries? They certainly present many countries with the serious challenge of mitigating negative effects on poor consumers. Politically, too, the issue can be very sensitive, as governments are forced to choose in the short term between expensive food subsidies and/or better-targeted policies of social protection (Chapter 9). Minimum wage policies also come into play as a way of attempting to compensate poorer consumers for losses of income (Chapter 6).

The challenges of land deals

In the context of shifting wealth, large land deals in Africa and Asia are an important sign of a growing mistrust in world markets. Food importers that can afford to do so – countries like Saudi Arabia, Kuwait, China, South Korea – are increasingly opting to grow food on land they own or control abroad rather than importing it from international markets. While welcome from the point of view of increasing overall investment in agriculture, there are a number of negative effects on social cohesion.

Figure 3.10. **Officially recorded land transfers, 2004-09**

Millions of hectares



Source: Committee on World Food Security (2010).

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Large-scale land purchases have had much more impact than initially expected (World Bank, 2010b). Only three years after the first deals were struck, the land bought runs to 65 million hectares – one-eighth of the World Bank's own estimate of total available land (and one-third of more modest estimates). In 2009 alone, foreigners purchased between 15 million and 20 million hectares of farmland in poorer countries for between USD 20 billion and USD 30 billion (Headey, D. *et al.*, 2010).[17] Some of the basic characteristics of such purchases are summarised in Box 3.3.

Box 3.3. **Some characteristics of recent land purchases**

- Main form of investment: land purchase or long-term lease.
- Share of total land assets owned by foreigners is small.
- Major investors: Gulf States, China, Republic of Korea.
- Main target region: Africa, but also Latin America.
- Investors: mostly private sector, but governments also involved.
- Investment partners in host countries: mainly governments.
- New focus: production of basic foods and animal feed.

Source: FAO (2009).

The job creation potential of such projects is evidently great, as they tie production into international markets, bringing in an important source of foreign exchange. The benefits of foreign investment could also spill over into the domestic sector, triggering a synergistic relationship with existing smallholder production systems and value-chain players like input suppliers (Committee on World Food Security, 2010). Gains would also spring from capital inflows and technology transfer, which would lead to innovation, increase productivity, upgrade domestic production and improve quality. Further benefits would be backward and forward linkages and multiplier effects as labour and other inputs are sourced locally, outputs are processed, and the production of food for the domestic and export markets (possibly) increases. The fact that many developing countries are seeking to attract inward investment suggests that governments see such benefits as real and desirable.

However, there are also associated risks which governments cannot afford to ignore. Investors often target countries where the rule of law is weak, buying arable land at low prices and failing to deliver on promises of jobs and investments (Buffet, H., 2010; World Bank, 2010b).[18] Another assumption that needs questioning is that available agricultural land is surplus to requirements. Host governments often convey this impression in an effort to attract investors.[19] However, the idea that the governments will redistribute only unused land is challenged by evidence from empirical studies which has shown that usable land is very likely to be occupied or farmed by local communities in a variety of ways important to livelihoods and food security, if not cultural identity (Taylor and Bending, 2009; Cotula, 2011). Virtually no large-scale land allocation can take place without displacing or affecting local people. In particular, local populations who use the land for non-arable purposes such as grazing their herds or hunting and gathering are sometimes ignored in the negotiations over the allocation of new land rights to foreign purchasers. Furthermore, the authorities often apparently disregard the ecosystem services such land provides to the wider population.

Controversial practices with regard to land acquisition are not of course restricted to Africa. The most contentious issue in Chinese villages in recent years has been the way in which local village officials have taken land from farmers – often with highly inadequate compensation – for purposes of commercial property development (Bardhan, 2010). The practice (now restricted) has been a lucrative source of "extra-budgetary revenue" for local governments and has allegedly fuelled corrupt dealings between local officials and developers. Anger at such practices has resulted in thousands of local disturbances every year. Similarly, in India, there have been numerous outbreaks of civil unrest in rural areas in recent years as the government has tried to acquire land for industrial and mining uses. What is perceived as inadequate compensation and inefficient efforts to resettle and redeploy farmers has been an issue of considerable political debate and protest (Bardhan, 2010).

Conclusion

This chapter has addressed a series of complex structural changes that have taken place during the period of shifting wealth with a profound impact on social cohesion in many developing countries. As a result, policy makers in developing countries have had to rise to the major challenge of managing the social stresses and strains that accompany rapid economic growth. The chapter has sought to focus attention on the problem of social cohesion from three important perspectives – employment challenges, migratory issues, and problems related to higher food prices and land acquisition.

Notes

1. See, for instance, Kuznets (1955) and Chenery (1979) on structural transformation.
2. By 2009, for example, there were 150 million rural migrants working in Chinese cities. They accounted for around one-third of the urban labour force, posing a significant challenge to the authorities trying to manage processes of accelerated migration (Meng and Zhang, 2010).
3. "Agriculture" includes farming, hunting, forestry and fishing in accordance with ISIC Rev. 3, divisions 01-05. "Industry" covers mining and quarrying, manufacturing, electricity, gas and water supply, and construction in accordance with ISIC Rev. 3, divisions 10-45. "Services" encompasses all other economic activities in accordance with to ISIC Rev. 3, divisions 50-99.
4. Controlling for the initial share of value added in 1990, the average coefficient for the agriculture sector is –0.01, which is statistically significant.
5. The average coefficient for the industrial sector is 0.08, controlling for the initial share of the sector, which is statistically significant.
6. The average coefficient for the services sector – statistically significant – is 0.11, also in this case controlling for the initial share of the sector.
7. This trend was mainly the result of increases in labour shares in Western European OECD countries (Guscina, 2006).
8. Calculations of labour shares of income in developing and emerging countries are always dependent on the treatment of self-employed income (because National Accounts treat income from unincorporated enterprises as accruing to capital). However, even when the data is adjusted, a strong negative trend remains (Rodriguez and Jayadev, 2010; Harrison *et al*., 2002).
9. However, the empirical evidence on the relevance of this mechanism is in fact weak. See OECD (2011).
10. OECD (2010b) for Latin America; OECD (2011) for major emerging economies.
11. In South Asia and sub-Saharan Africa, more than 60% of employed women work in agriculture.
12. Kucera and Xenogiani (2009) found that women earn 32% to 36% less than men in Ethiopia, Morocco and Tunisia.
13. MDG Target 7D aims for significant improvement in the lives of at least 100 million slum-dwellers by 2020. Progress has so far been good: between the years 2000 and 2010, a total of 227 million people in the developing world moved out of slum conditions. Across the developing world, the proportion of city dwellers living in slums fell to 33% in 2010 from 46% in 1990 (UN HABITAT, 2010).
14. The data used for this analysis originate from a joint venture between the University of Sussex and the World Bank to build a bilateral migration matrix with estimates of the stock of migrants by country of origin and destination [for more details see Ratha and Shaw (2007)]. Based on census data, these estimates are subject to the inherent limits of counting migrants (Dumont and Lemaitre, 2005; Dumont *et al.,* 2010). The number of undocumented migrants and the differences from one country to another in the definition itself of "immigrant" make the exercise more difficult. Estimating South-South flows is even trickier than in the case of developed countries as borders are generally more porous than in the North, and statistical systems subject to more deficiencies.
15. It is notable that most of the countries where food production per capita declined have been negatively impacted by conflict during the last two decades. For a summary of the evidence on the relationship between conflict and food security, see World Bank (2010a).
16. In Ethiopia only 25% of smallholders were net sellers of either *teff* (the local staple) or maize, and only 25% were net sellers of maize in Mozambique. Up to 72% of smallholders were net buyers of maize and *teff* in Ethiopia; in the other countries, the number of net buyers ranged from 30 to 67% (Staatz and Dembele, 2007). For a more formal analysis of the impacts of price changes on different countries, see OECD (2010f).
17. To cite one example, the Ethiopian/Saudi Arabian businessman Al-Amoudi has purchased over 1 000 hectares of land near Awassa, to the south of Addis Ababa, on a 99-year lease. His Saudi Star company plans to spend a further USD 2 billion acquiring and developing over 505 000 hectares of land in Ethiopia. The company is already growing wheat, rice, vegetables and flowers for the Saudi market and expects eventually to employ more than 10 000 people.
18. In a study of the legal contracts involving 12 different recent land deals, Cotula (2011) observes that: "Together with applicable national and international law, contracts define the terms of an investment project, and the way risks, costs and benefits are distributed […] Yet very little is known about the exact terms of the land deals. Negotiations usually happen behind closed doors.

Only rarely do local landholders have a say in those negotiations. Few contracts are publicly available […] As a result, there is a substantial risk that local people internalise costs without adequately participating in benefits, and major environmental issues are not properly factored in."

19. The Ethiopian government, for instance, claims that "Ethiopia has [over 75 million hectares] of fertile land, of which only 15% is currently in use – mainly by subsistence farmers […] Investors are never given land that belongs to Ethiopian farmers". A total of 3 million hectares of land in Ethiopia is expected to have been allotted by 2013 – one-fifth of the cultivated area. By way of example, Karuturi, a Bangalore-based Indian company, has acquired more than 300 000 hectares of land in Gambella, Ethiopia.

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Chapter 4

Inequality

An equitable distribution of living standards is a central pillar of cohesive societies. Although shifting wealth has brightened the prospects for global income distribution, the transformation of the global economy raises key distributional challenges for social cohesion. A cohesive society reduces inequality between groups and ensures that all citizens – the poor, the middle-earners, and the rich – are socially included. Building a common understanding of what constitutes an adequate standard of living – and how to help those members of society who do not reach it – is an integral part of building a cohesive society. Understanding the complex interactions between opportunities, endowments, and market outcomes underlying distributional change is necessary to the establishment of a development strategy that takes into full account the specific needs and characteristics of a country. Education can help by addressing inequality of both outcomes and opportunities – raising the minimum level of education can offset inequality-increasing pressures originating from the structural changes that shifting wealth has brought with it. Preferences for redistribution as a means of reducing inequality differ from country to country and change over time – understanding how is an additional challenge for policy makers trying to build social cohesion.

Introduction

Rising income inequality is a warning bell to policy makers that social cohesion is at risk. Inequality can hamper further growth, breed social resentment, and generate political instability by fuelling populist and protectionist sentiments. Work to promote social cohesion must therefore address inequality. Over the last decade, the importance of distributional issues has become apparent to governments, development agencies and ordinary citizens alike.[1]

Although the emergence of new poles of growth in the developing world holds enormous promise for levelling income differences globally, shifting wealth's reconfiguration of the world economy has thrown up a number of important distributional challenges. Rising inequality in some key large economies has excluded disadvantaged populations from the benefits of the growth process and increased top earners' share of incomes. Both poor and middle-class populations are increasingly alienated from the richest in many societies. Stark inequalities persist between groups defined by sex, working status and ethnic origin. Both rising inequalities and their persistently high levels can sow the seeds of future conflict and social unrest.

Inequality is a considerable threat to social cohesion. Rising inequality can limit social inclusion even as the number of extremely poor falls, if much of the population remains excluded from the customary living standard enjoyed by a socially relevant reference group. Where important inequalities persist between different groups, society will enjoy less social capital, less trust and less sense of belonging among its members. High levels of inequality, particularly in opportunities offered by education, for example, constitute steep barriers for social mobility. To promote social cohesion, policy makers must understand what drives rising inequality and how to address it.

This chapter seeks to identify the driving forces of inequality and, in particular, to disentangle the relative importance for inequality of human capital, labour market returns to education, and individuals' labour market behaviour. These factors can be influenced by policies in different areas, although the optimal policy mix ultimately depends on the critical characteristics of each country. Changes in labour market returns to education have been shaped by globalisation, technological change, and growing demand – and wages – for more highly skilled individuals – all of which generates inequality-producing pressures. Other major labour market changes, including greater educational attainment and higher numbers of women in the labour force, have generally raised average incomes, but affected inequality differently across countries.

Policies can affect inequality directly as transfers and taxes alter the market distribution of incomes and lead to less inequality in final disposable incomes. This chapter, however, focuses primarily on the distribution of welfare as determined by the market, since shifting wealth's main impacts on social cohesion have come from how it has altered the structure of global markets. Although policies that directly affect the distribution of market incomes are mentioned, particularly as they relate to changing

attitudes affecting social cohesion, the main redistributive role of fiscal policy is fully developed in Chapter 5.

Addressing the distributional challenges of social cohesion requires that particular attention be paid to equality of opportunity, in particular through education policies. Reducing the proportion of the population with little or no formal education is a crucial step towards ensuring social inclusion and buttressing the future middle classes. However, making the most of the opportunities afforded by shifting wealth also involves going beyond primary education. Due to the skills bias in wage distribution, wages for workers with post-primary education in a number of countries may not provide sufficient incentives for climbing the education ladder. Access to free – or at least affordable – secondary education and the prospect of further training are a necessity if individual incentives are to be aligned with the great benefits – which include reduced income inequality – that a better educated population can bring the economy.

This chapter is organised as follows. The first section outlines overall trends in income inequality between and within countries. It documents, first, how the convergence of large developing countries like China and India is altering the global income distribution, before going on to look at income inequality trends in a number of developing countries. Although shifting wealth has brightened prospects for narrowing the gap in living standards between countries, it has brought in its wake rising or high inequalities in some, though not all, countries. The following section looks at the challenges that specific parts of the income distribution pose to social cohesion. The key distributional challenges include: reducing the number of relatively poor, buttressing the middle classes, dealing with increases in top incomes, and overcoming persistent inter-group inequalities. The next section examines the underlying forces by which both policy and the market influence change along the entire income distribution. Using the example of educational attainment, returns to education and female labour force participation, the income distribution is shown to depend on household endowment, the remuneration of those endowments, and labour force participation behaviour. Then, the next section uses subjective data to show that societies have strong and changing views about inequality, which can influence how redistributive policy addresses inequality in the income distribution. The last section concludes.

Trends in inequality between and within countries

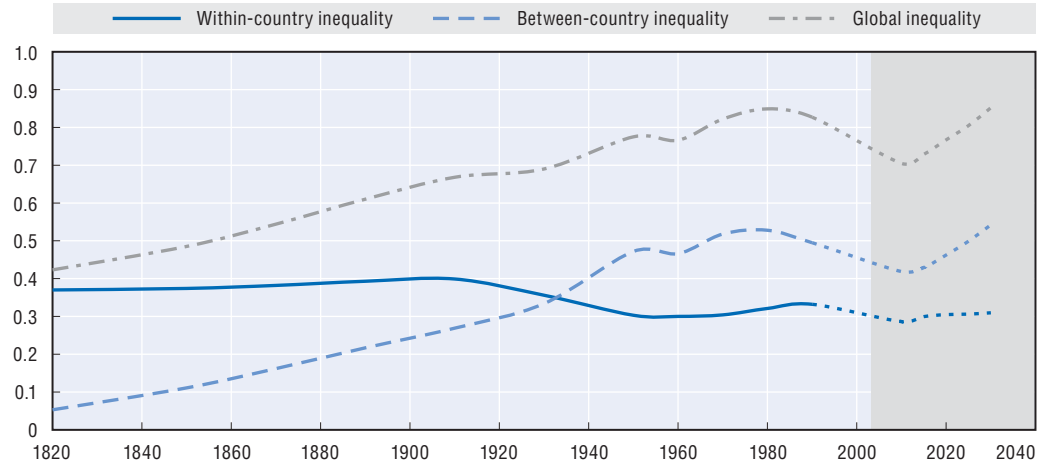
Shifting wealth ushered in the beginnings of a reversal in long-term trends of inequality **between** countries. That reversal will be short-lived, however, if sustained growth is not extended to the broader developing world. At the same time, inequality has grown **within** some developing countries, and particularly in a number of large economies, as shifting wealth has reconfigured the global economy.

Despite the rising number of converging countries, most global inequality is still due to inequalities **between** countries. Shifting wealth offers the possibility of reducing such inequality through convergence in per capita income. Indeed, improved growth performance in Africa and Latin America in the past decade will, if sustained, go some way towards that end. However, because of their sheer size, China and India dominate the global distribution of income.

Long-term trends in rising inter-country inequality began to reverse with the rise of China and India in the 1980s (Figure 4.1).[2] Until that time, widening differences **between** countries had been the principal explanation for rising global inequality since the Industrial

Figure 4.1. **Composition of global inequality**

Mean log deviation



Note: Shaded area indicates projections. Projected trends in the Gini and Theil indices differ, as shown by Morrisson and Murtin (2011a; 2011b). Mean log deviation is used here to emphasize changes in the lower end of the global distribution.

Source: Bourguignon and Morrisson (2002) for 1820-1992. Authors' elaboration based on Maddison (2007, 2010), UN DESA (2008) and PovcalNet for 2000-30.

StatLink http://dx.doi.org/10.1787/888932518123

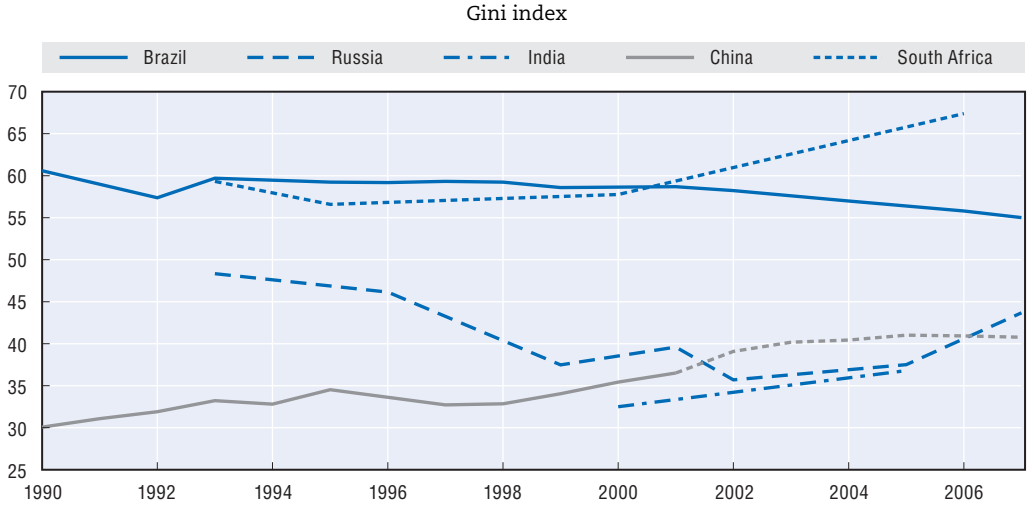
Revolution. At the dawn of the 19th century most countries had similar average living standards, even though the gap between the rich and the poor **within** each country was pronounced. Industrialisation and economic take-off in Europe and North America in the early 19th century triggered a surge in average living standards in the industrialised world, which steadily accentuated global inequality to the middle of the 20th century. Thus, the period 1820-1950 showed a clear trend where inequality **between** countries increased, while falling **within** many countries thanks in large part to the expansion of social safety nets and redistribution. During the 1950s, the differences between countries declined slightly as Europe began to converge to the income levels of the United States. However, once average living standards in European countries exceeded the global average income per capita, the divergent trend between countries re-asserted itself and, with it, the great divide between rich and poor countries.

The convergence of China and India towards OECD average living standards is again raising the prospect of levelling the world's inequalities through the reversal of the long-term trend in widening gaps between countries. However, if sustained Chinese and Indian growth is not matched by poor countries, the reversal will be as short-lived as it was during Europe's convergence in the 1950s and 1960s. As demonstrated by the projections shown in Figure 4.1, once Chinese and Indian average incomes exceed the world average, inequality between countries will resume its upward trend, as measured by mean logarithmic deviation.

Inequality has increased **within** some important converging countries in recent years. The BRICS countries furnish an instructive example. Figure 4.2 shows change in inequality as measured by the Gini index over the period 1990-2007: while inequality increased dramatically in China, India and South Africa, it declined markedly in Brazil – albeit from very high levels. Over the past decade, inequality has increased in Russia, as well.

The developed economies in the OECD area also experienced a rise in the Gini coefficient – 10% on average – from the mid-1980s to the late 2000s. The increase – from 0.28 to 0.31 – was due to widening income inequalities in 17 of the 22 countries for which data

Figure 4.2. **Changes in the Gini index in the BRICS, 1990-2007**



Note: Expenditure data used for India, Russia and South Africa; income data for Brazil and China. The dotted line in the China series post-2002 indicates a change in the income indicator.

Source: World Bank (2010) for Brazil, Russia, India's 2005 data and South Africa. OECD (2010) for China. World Bank (2004) for India's 2000 data.

StatLink http://dx.doi.org/10.1787/888932518142

over the period was available (OECD, forthcoming). The OECD experience is, however, not representative of the world as a whole.

Inequality is not rising everywhere in all developing countries, as the findings from a broader survey shown in Table 4.1 clearly confirm. The table charts the changes in Gini coefficient for a sample of developing countries for which income or consumption distributional data are available from the World Bank's PovcalNet database. Thirty-seven surveys saw inequality grow in the 2000s, while 39 experienced drops. Clearly inequality is not on the rise all over the world.

Inequality trends are also often obscured by measurement differences between countries and different types of surveys. The choice of welfare measure (*e.g.* income, wage earnings, consumption expenditure, wealth) and the unit of analysis (*e.g.* individual or household, per capita, or adult equivalent) impact greatly on any conclusions drawn from the data. Measures therefore must be chosen carefully, in particular for comparisons across time and space.[3]

Magnitudes and even the direction of trends in inequality may differ according to whether the distribution of market incomes, disposable incomes (after taxes and transfers), or consumption expenditure (after savings) is taken as the yardstick.[4] For example, recent work (OECD, forthcoming) has shown that during the past two decades the market income Gini coefficient grew at twice the rate of the increase in the Gini for disposable income in the OECD on average. Inequality in market incomes in the OECD also varies between countries more widely than inequality in disposable income, due to differences in the magnitudes of taxes and transfers (both cash and in-kind). Savings rates differ markedly across countries, as well. Thus trends in market incomes, disposable incomes, and consumption expenditure are not strictly comparable.

So, while inequality **within** countries has not risen across the board, it has risen to the top of the agenda in both developed and developing countries. How shifting wealth

Table 4.1. **Changes in the Gini coefficient, early 2000s**

Most recent points per annum

Consumption expenditure					
Country	Gini change	End year	Country	Gini change	End year
Zambia	5.77	2004.3	Ethiopia	–0.05	2004.5
Azerbaijan	5.63	2008	Madagascar	–0.06	2005
Bulgaria	4.03	2007	Vietnam	–0.10	2008
Seychelles	3.29	2006.5	Indonesia (urban)	–0.11	2009
Central African Republic	2.55	2008	Romania	–0.12	2008
South Africa	1.69	2005.7	Egypt, Arab Rep.	–0.13	2004.5
Russian Federation	1.59	2008	Philippines	–0.15	2006
Pakistan	1.56	2005.5	Sri Lanka	–0.18	2006.5
Rwanda	1.28	2005	Mali	–0.20	2006
Croatia	1.17	2008	Belarus	–0.23	2008
Macedonia, FYR	1.05	2008	Ukraine	–0.23	2008
Cambodia	0.84	2007	Poland	–0.24	2008
Lao PDR	0.71	2008	Mozambique	–0.29	2007.5
Kenya	0.62	2005.4	Indonesia (rural)	–0.32	2009
Moldova, Rep.	0.61	2008	Jordan	–0.33	2006
Yemen, Rep.	0.61	2005	Senegal	–0.52	2005
Albania	0.49	2008	Armenia	–0.59	2008
Tanzania	0.45	2007	China (rural)	–0.72	2005
China (urban)	0.45	2005	Kazakhstan	–0.74	2007
Lithuania	0.44	2008	Iran, Islamic Rep.	–0.83	2005
Uganda	0.42	2009.5	Cameroon	–0.94	2007
Hungary	0.38	2007	Guinea	–1.00	2007
India (urban)	0.30	2004.5	Burundi	–1.14	2006
Ghana	0.28	2005.5	Côte d'Ivoire	–1.15	2008
Georgia	0.19	2008	Timor-Leste[1]	–1.27	2007
India (rural)	0.17	2004.5	Malawi	–1.66	2004.3
Kyrgyz Republic	0.17	2007	Niger	–4.93	2007
Bosnia and Herzegovina	0.14	2007			
Mongolia	0.06	2005			
Bangladesh	0.06	2005			
Morocco	0.04	2007			
Income					
Country	Gini change	End year	Country	Gini change	End year
Malaysia	1.66	2009	Colombia	–0.11	2006
Mexico	0.84	2008	Bolivia	–0.47	2007
Costa Rica[1]	0.77	2009	Peru	–0.53	2009
Nicaragua[1]	0.51	2005	Brazil	–0.62	2009
Honduras[1]	0.50	2007	Panama[1]	–0.86	2009
Chile	0.11	2009	Argentina (urban)	–0.98	2009
			El Salvador[1]	–1.04	2008
			Uruguay	–1.27	2009
			Paraguay	–1.39	2008
			Ecuador	–2.69	2009
			Dominican Republic	–3.47	2007
			Venezuela, RB	–4.11	2006

1. Based on an estimated PPP.

Source: Authors' elaboration based on *PovcalNet Database*.

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contributes to aggregate inequality is hotly debated[5] and further complicated by its different effects across countries. However, it is apparent that shifting wealth has changed the distributional challenges facing the global economy today. The next section looks beyond Gini coefficients and other scalar inequality measures to understand how the distributional challenges to social cohesion differ across each part of the entire income distribution.

Understanding the distributional challenges of social cohesion

Understanding the distributional challenges of social cohesion means going beyond scalar measures of inequality and examining how living standards and opportunities are distributed across the entire population. Box 4.1 discusses in some detail how inequality changes are related to differences in the growth of living standards between different parts of the distribution. Social cohesion involves the inclusion of citizens and groups across the entire distribution of living standards – all need to share understanding of, responsibility towards, and a sense of belonging to their society. What, then, are the different social cohesion challenges facing each part of the income distribution?

The social cohesion lens changes perceptions of distributional challenges. First, it considers disadvantaged groups in a different light: in countries where growth has lifted large numbers of people out of extreme poverty as defined by common international standards, many still remain disadvantaged by socially relevant standards, such as relative poverty lines. Second, social cohesion concerns also involve creating opportunities for the middle strata of the income distribution. Although many in those strata have enjoyed rising living standards in recent decades, they do not yet constitute what can be considered a "middle class" in the traditional sense. Third, social cohesion concerns require paying particular attention to trends in rising top incomes, and the challenges they present for social cohesion through the alienation of other sections of society. Finally, inequalities defined in terms of group membership and characteristics, which often persist over time and space, must also be addressed since they galvanise differences and can lead to conflict.

Reducing the number of relatively poor

Eliminating extreme poverty remains an important and unfulfilled goal internationally. However, in those countries that have succeeded in reducing absolute poverty over the last decade, policy makers need to remember that helping the poor and disadvantaged does not end with the eradication of extreme poverty.

In addition to eliminating absolute poverty, reducing relative poverty is particularly important for social cohesion at the bottom of the income distribution. The reconfiguration of the global economy in favour of converging countries is changing and broadening the nature of poverty in the developing world. The decline of more than half-a-billion global poor over the past two decades (OECD, 2010a) only takes into account the absolute dollar-a-day poverty line, while ignoring poverty as a relative phenomenon. Considered against a relative definition, poverty may have actually increased over this period.

Poverty in developing countries has been traditionally measured in absolute terms, often because the poverty line is equated with survival. Most national poverty thresholds in poor countries are defined through quantifying either the cost of basic needs in a given society or the cost of the minimum caloric intake needed to survive there (Haughton and Khandker, 2009). Poverty comparisons between developing countries typically focus on absolute poverty lines that use an international yardstick, such as the World Bank's dollar-a-day (USD 1.25 PPP per day), to represent this minimum survival requirement.[6]

Box 4.1. **Measuring inequality – Looking beyond the Gini coefficient**

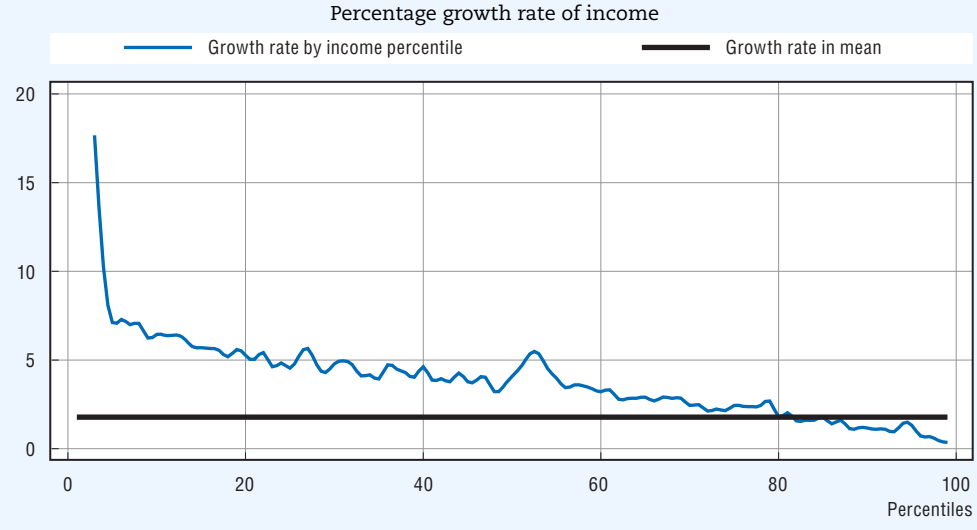
Scalar inequality measures, such as the popular Gini coefficient, summarise inequality in a single number and are widely used to talk about inequality changes and levels. The so-called "generalised entropy" class of indicators, such as the mean log deviation and Theil indices, are other widely used scalar measures that can be broken down by population group. Additional measures like the decile ratio (share of the 90th percentile/share of the 10th percentile) and the coefficient of variation are also popular ways of measuring dispersion in the distribution.

Despite the appeal of single scalar measure like the Gini coefficient, analysis increasingly focuses on the entire distribution of whichever welfare indicator is selected. Analysing the entire distribution has a number of advantages and allows the analyst to identify whether changes in inequality are due to changes in the welfare of individuals at the top or the bottom of the income distribution. Additionally, looking at the entire distribution makes it easier to relate growth, inequality and poverty to each other.

Growth incidence curves unpack the changes in income distribution more comprehensively than scalar measures like the Gini coefficient. A growth incidence curve presents the growth in income of each percentile over a given period. The shape of the curve indicates the nature of pro-poor growth: a downward-sloping curve indicates that the poor benefit disproportionally more from growth, which is therefore pro-poor, while an upward curve indicates that the better-off do.

By way of example, Figure 4.3 shows the growth incidence curve of Brazilian adult-equivalent household income between 2001 and 2006, revealing that over this time, during which inequality decreased, the incomes of the poorest percentiles improved at a much higher rate than those of the richest. As Gini coefficients merely quantify the rise or fall in inequality using a scalar measure, they thus tell the policy maker much less than a growth incidence curve about which part of the income distribution changed and affected inequality.

Figure 4.3. **Growth incidence curve showing reduction in Brazilian inequality due to pro-poor growth, 2001-06**



Source: Authors' elaboration based on Pesquisa Nacional por Amostra de Domicílios (PNAD), 2001 and 2006.

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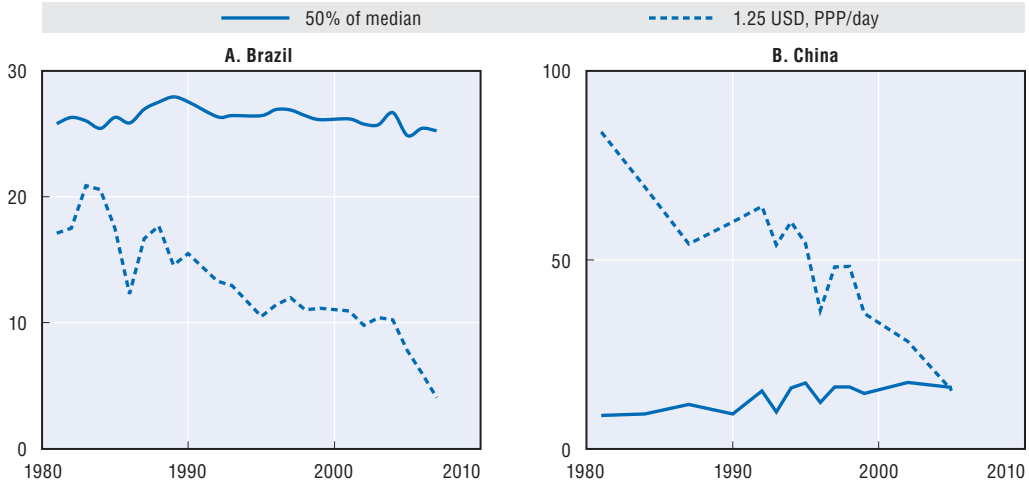
In contrast, the relative poverty measures used in industrialised countries, such as those undertaken by Eurostat or by OECD, do not fix the poverty standard at a set basket of goods or level of income. Instead they define that basket or income level as a proportion of a given society's mean or median standard of living (consumption or income). As an example, the poverty line in a number of European countries is set at 50% of the median of adult-equivalent household income.

A relative poverty measure complements the absolute poverty headcount, because it takes into account the cost of social inclusion needed to achieve society's customary living standard (Atkinson, 1995). Relative poverty lines are therefore explicitly socially relevant and are thus an important element in measuring the degree of social cohesion. A crucial difference between absolute and relative poverty is that growth alone can reduce absolute poverty, while reducing relative poverty involves reducing inequality in the lower part of the distribution.

While absolute poverty has fallen in many emerging countries in recent decades, the number of the relatively poor has stagnated or increased. Figure 4.4 contrasts relative and absolute poverty headcounts for Brazil and China in the last few decades. Contrary to the popular conception that poverty has declined in both countries in that time, relative poverty headcounts show that a steady share of Brazilians and a growing share of Chinese are significantly below the median living standard enjoyed in those countries. Thus, while the absolute living standards of the poor may have improved thanks largely to shifting wealth, the number of people who are socially excluded through some form of relative poverty has in fact grown over the last two decades.

Figure 4.4. **Absolute *versus* relative poverty in China and Brazil, 1981-2007**

Incidence of poverty as a percentage of the population below the given poverty line



Source: Garroway and de Laiglesia (forthcoming) based on PovcalNet.

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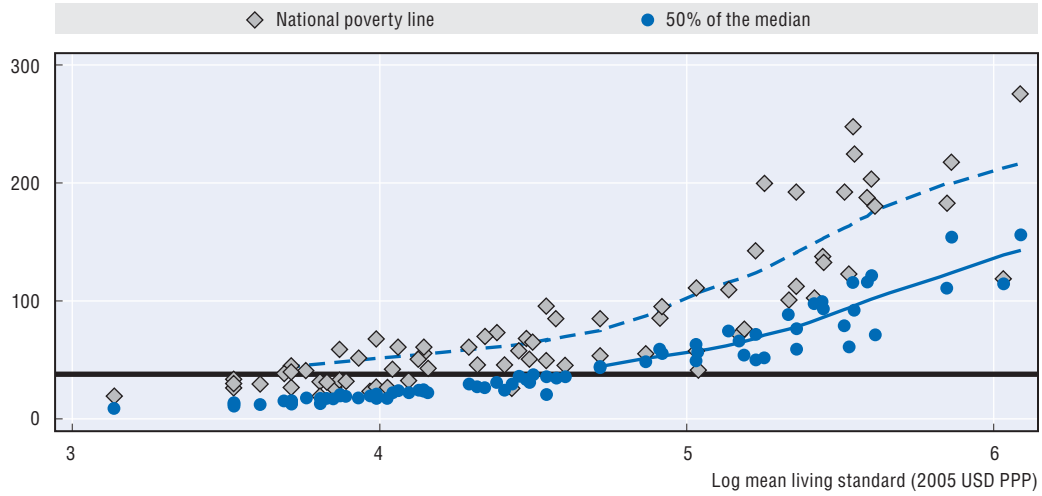
The increase in relative poverty finds additional support in recent work on global poverty counts which applies relative poverty standards to countries with sufficiently high average incomes. Ravallion and Chen (2011) show that while 25% of the world population, some 1.4 billion people, lived below the dollar-a-day poverty line in 2005, 53% of the world population could be considered poor using a "weakly" relative standard.[7] The number of poor, defined in this way, has actually increased from just over 2.3 billion relatively poor in 1990 to almost 2.6 billion in 2005.

An additional appealing feature of relative poverty lines in converging countries is that national poverty lines rise with mean living standards. Figure 4.5 demonstrates how relative poverty lines mimic the economic gradients of national poverty lines across a sample of 73 countries. The figure shows not only that poverty lines tend to rise with average incomes, but that their dispersion among countries at similar income levels increases as well. The inference is that poverty may have a different social significance in countries of similar income levels and that richer countries may have greater scope for engaging in a national debate about what poverty is and who should be classified as poor. Setting a poverty threshold is therefore a technical exercise of an extremely political nature, which can serve an increasingly important social cohesion goal, as countries' average living standards improve and grow.

Figure 4.5. **The economic gradient of national and relative poverty lines for 73 countries**

Monthly living standard associated with given poverty lines (in 2005 USD PPP)



Note: The horizontal line indicates the USD 1.25/day absolute poverty line (*i.e.* approximately USD 38/month). Locally weighted regression lines approximate the economic gradients of both sets of poverty lines, above USD 1.25/day.

Source: Garroway and de Laiglesia (forthcoming) based on PovcalNet and Ravallion, Chen and Sangraula (2009).

StatLink http://dx.doi.org/10.1787/888932518199

That national poverty lines should increase with mean living standards shows that, as countries become richer, they tend to adopt more demanding standards of social inclusion (Figure 4.5). This higher standard demands greater effort in social and economic policies. In those countries where extreme, "dollar-a-day" poverty persists alongside rising relative poverty, it is not a question of choosing to address the latter at the expense of the former. Both are complementary objectives of social and economic policy.

Addressing absolute poverty and rising relative poverty may require separate policy initiatives to be developed in parallel. Action that addresses extreme poverty should address the multiple deprivations that extreme poverty causes in food security, health, basic education, access to water and sanitation, etc. Poverty reduction programmes addressing these problems should aim to move people out of poverty (with the ultimate goal of eliminating extreme poverty) and require focused efforts with significant transfer components, be they cash or in-kind. Eliminating relative poverty is not possible because by definition relative poverty persists even in very high income societies. Action to reduce

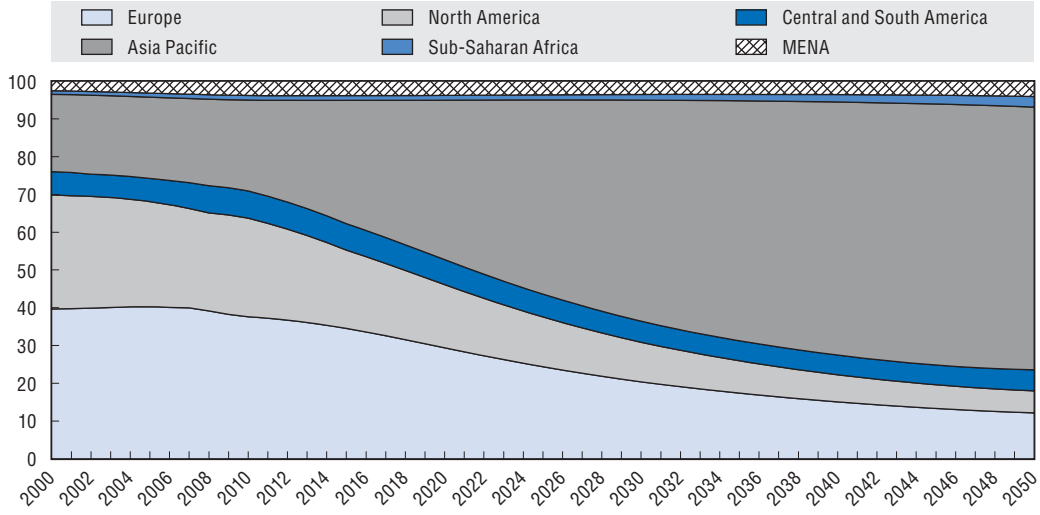
relative poverty should thus strive to bring down the barriers to social inclusion faced by the relatively poor. In this way, programmes that target relative poverty are closely associated with the long-term goal of building a sustainable social safety net and providing adequate risk management instruments to reduce vulnerability and exclusion.

Buttressing the emerging middle classes

The increase in average incomes and the fall in levels of absolute poverty in converging countries suggest that an increasing proportion of the world's population is neither rich nor poor by national standards and finds itself in the middle of the income distribution. Kharas (2010) estimates that the size of the "global middle class" will increase from 1.8 billion people in 2009 to 3.2 billion by 2020 and 4.9 billion by 2030. The bulk of this growth will come from Asia – by 2030, Asia will represent 66% of the global middle-class population and 59% of middle-class consumption, compared to 28 and 23%, respectively in 2009 (Figure 4.6).

Figure 4.6. **Global middle class consumption, 2000-50**

Percentage of global total



Note: Global middle class consumption is defined here as household consumption between USD 10 and USD 100 PPP/day. This absolute definition of the global middle class can be contrasted with relative definitions, such as between 50 and 150% of median income, used by OECD (2011), which may be more appropriate for individual country analysis. Projections hold most recent distribution constant (from PovcalNet database) and assume consumption equals income growth (projected by a Cobb-Douglas production function, a model of RER convergence based on the Balassa-Samuelson model, and UN population projections).

Source: Kharas (2010).

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Many view the developing world's "emerging middle class" as a critical economic and social actor because of its potential as an engine of growth, particularly in the largest developing countries such as China and India, but also in sub-Saharan Africa (OECD, 2011; AfDB, 2011). People in the middle – who are neither poor nor rich – make an important contribution to economic development, particularly in cohesive societies. This growing population of individuals in the middle offers hope as a new consumer class that could, if integrated into a cohesive society, stimulate domestic demand. To underline this point, Kharas (2010) contrasts the experience of South Korea with that of Brazil. In the 1960s, both countries had similar income levels and similar rates of growth. By

the 1980s, however, due to high inequality in Brazil, the middle class made up only 29% of the population, in contrast to South Korea's 53%. South Korea's larger middle class enabled it to shift away from export-driven growth towards domestic consumption, a transition that did not occur in Brazil.

These middle strata – or "middle sectors" (OECD, 2011) – remain vulnerable, despite incomes that are above international or even national poverty lines. They do not constitute a developmental "middle class" and their employment, education and consumption behaviours do not coincide with perceptions of a middle class that drives domestic consumption and growth.[8] In Latin America, for example, the middle sectors are still economically vulnerable: average schooling is only 8.3 years and few of its members have university degrees. Similarly, many of them work informally – there are more informal than formal workers in the middle sectors in every Latin American country, except Chile. This is a "middle class" that is dissimilar to the one which drove development in many OECD countries. In most Latin American countries, for example, middle-sector working people are also more unlikely than the affluent to be public-sector employees like teachers or civil servants. Nor is the middle sector the cradle of entrepreneurship: the affluent in Latin American countries boast the most entrepreneurs (OECD, 2011).

The vulnerability of emerging non-poor populations in Africa appears even more striking. AfDB (2011) points out that in African countries where the "middle class" may be growing, ownership of durable goods such as passenger cars remains largely a rarity, even if it is on an upward trend. Even in economies like Mauritius or South Africa where durable goods ownership has grown considerably, less than one-fifth of households have passenger cars.

Action targeted at the distribution of incomes can play a role in buttressing the middle classes, especially as part of social protection. Social transfers that kick in when individuals are faced with life risks (unemployment, old age, disability, parenthood) help reduce the vulnerability of the middle strata (see Chapter 6). While the poor should be the main target of direct cash transfers, direct provision of public services can also limit the scope for downward mobility among the non-poor. Moreover, middle class workers have the capacity to participate in contribution-based systems which are flexible enough to accommodate their characteristics, particularly the fact that many of them switch between formality and informality several times over their working lives.

For middle classes to play a role in fostering social cohesion, ensuring that they and their children have opportunities for upward mobility is crucial. A level playing field and the prospect of upward mobility ensure that middle classes are not alienated from higher-earning elites. If the middle strata of the distribution have stable employment and reasonably robust incomes, then, arguably, they will provide a solid foundation for economic progress. Moreover, they might also support moderate but progressive political platforms, serving as a cornerstone for democracy itself – a political role often attributed to middle classes by historians and sociologists. Conversely, if those in the middle have precarious incomes and unstable employment, their consumption cannot be counted upon to drive national development nor their growth taken as a sign of social progress. What's more, their political preferences may veer toward populist platforms not necessarily conducive to good economic management (OECD, 2011).

Governments need to look carefully at the economic and socio-demographic characteristics of those who make up the middle strata in the welfare distribution. Those characteristics include their income levels, the kind of jobs they perform and, more

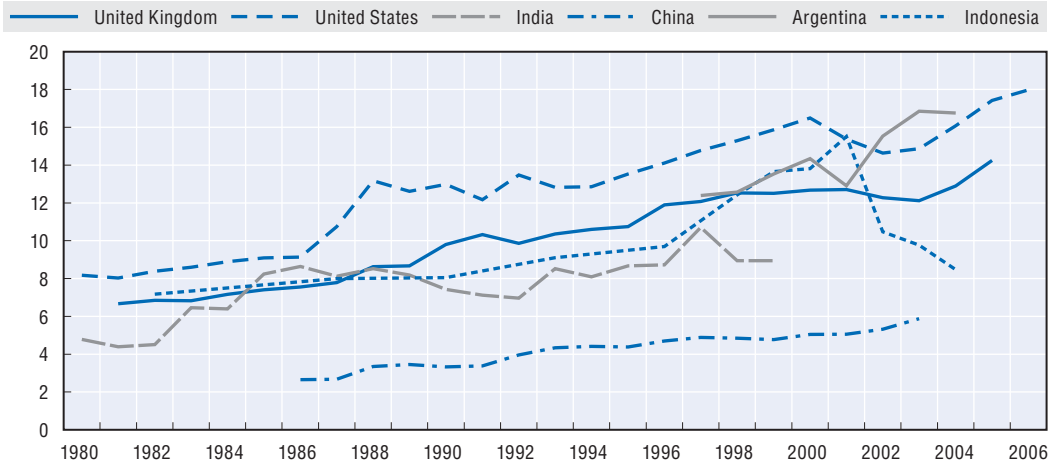
generally, attitudes and values regarding inequality, economic policy and democratic politics. OECD (2011) finds that the middle sectors in Latin America are often quite economically vulnerable, prone to the risk of slipping down the economic ladder. Their precariousness has to do with high levels of economic inequality, as well as economic institutions and incentives that have too often rewarded rent seeking over formal-sector entrepreneurship, for example. Accordingly, public policies need to protect the livelihoods of middle-sector households, with policies such as social protection and public education generally geared to promoting greater upward mobility.

Dealing with increasing top incomes

Inequality is rising in a number of rich and poor countries due to increases in top incomes. Fiscal administrative data sources for the last century indicate that the widely observed rise in top incomes in the rich countries (OECD, forthcoming) is also true of China, India, Indonesia, Argentina and South Africa (Alvaredo *et al.*, 2011). Figure 4.7 shows that the richest 1%'s share of national income has grown significantly in those countries over the last two decades.

Figure 4.7. **Rising incomes at the top in both rich and emerging countries**

Income of the richest 1% of the population as a percentage of national income



Source: Alvaredo *et al.* (2011).

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Rising top incomes challenge social cohesion because they risk polarising the population. On the one hand, there are those who perceive high earnings as the right reward for talent or hard work and who see the possibility of high earnings as an opportunity. On the other hand, there are those who think high earnings are unfair. A particularly vexed consideration is that part of the rise in top incomes is linked to increasing capital shares in total income (see Chapter 6), coupled with the unequal distribution of capital and land holdings, which are transmitted from one generation to the next.

The rise in top incomes is also a reflection of enhanced opportunities to the extent that it represents increases in returns to talent and effort. It has resulted, in part, from structural changes that have helped drive many of the observed increases in inequality over the past 20 years. During this time, highly skilled workers have reaped disproportionately higher benefits from shifts in labour demand due to both greater financial and trade integration and technological progress. The distribution of earnings has

changed accordingly. Top incomes have responded to the "more global market for talent and a growing use of performance-related pay benefitting top executives and finance professionals in particular." (OECD, forthcoming).

Changes in tax schedules also impact on top incomes. Policy changes that reduced marginal tax rates in many OECD countries in the 1980s, for example, directly increased inequality by increasing the amount of disposable income available to the upper percentiles of the distribution. At the same time, reductions in marginal tax rates may also have indirectly encouraged behavioural increases in labour supply, further increasing the earnings of high-income individuals (OECD, forthcoming).

Rising top incomes also present a uniquely daunting challenge to social cohesion: given the increasingly globalised market for the highest skill levels, individuals who possess them may feel more social cohesion with one another than with members of their respective societies. The emergence of a global elite that is isolated from less fortunate echelons of the societies from which its members originate is an important risk that policy makers must be aware of. Elites may thus breed resentment, misunderstanding, and sow the seeds of divisive populism, including both radical and reactionary political movements. This risk is a strong argument for the creation of shared spaces, socio-economically diverse educational institutions, and other opportunities for the diverse strata of society to meet and interact.

Rising top incomes can be an important source of revenue through tax collection, since an increase in top incomes under a given tax schedule will, by definition, produce increased tax receipts. Given the high share of tax revenue that higher incomes contribute, the stability and long-term evolution of higher incomes should be borne in mind in planning redistribution policies. Indeed, OECD (forthcoming) shows that existing tax provisions may no longer be optimal in the light of equity considerations and revenue requirements. This is especially true where the share of overall tax burdens borne by high-income groups has declined in recent years (*e.g.* through non-compliance or because tax expenditure chiefly benefits high-income groups).

Overcoming persistent inter-group inequalities

Inequality can be a particularly important sticking point when it separates identifiable groups, be they ethnic, linguistic, or geographic. Inequalities between groups have also been called "horizontal inequalities" (Stewart, 2009), because they result from group identities – as opposed to vertical inequalities that can be traced back to inequalities in incomes.

Inequality between groups threatens social cohesion because it creates fault lines in common identities. It can have a polarising effect on society, isolating, alienating and increasing the likelihood of conflict. Civil conflicts resulting from an unequal distribution of resources do not spring from economic interpersonal inequality as measured by the Gini coefficient of income or consumption, but rather from a lack of social cohesion caused by inter-group inequality (Sambanis, 2005). Inter-group inequalities produce strong grievances which may be used to mobilise people politically, especially when a socio-economically deprived group is also without political power (Stewart, 2009).

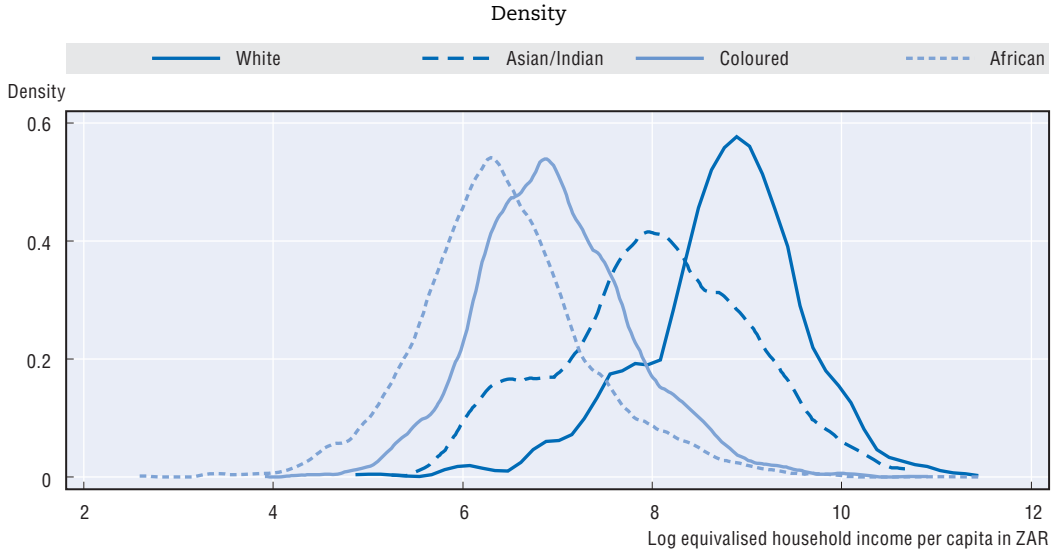
Group polarisation, rather than inequality itself, is often seen as the principal explanation for inter-group inequalities eventually leading to conflict (Ostby, 2008). The 2011 *World Development Report* on conflict, security and violence looks at strategies governments may undertake to bring vulnerable and marginalised groups back into the fold and build and transform peaceful institutions (World Bank, 2011; Stewart, 2010).

However, it should be noted that, long before horizontal inequalities have degenerated into conflict, unravelling social cohesion can be spotted in an income distribution that is polarised by some type of group characteristic. In this way, it is possible to address intergroup inequalities before they lead to conflict.

One indicator of a highly polarised income or wage distribution is bimodality in the distribution. The literature has associated bimodality with a "missing middle" (Wolfson; 1994, 1997). It may, however, produce inequality measures that do not tell the whole story. For example, in a bimodal distribution it is conceivable that polarisation increases – indicating further deterioration in social cohesion – while the overall level of inequality remains unchanged. Thus polarisation measures have properties that are notably different from inequality measures, like the Gini coefficient (Jayadev and Reddy, 2011).

Evidence of polarisation in the income distribution can be found either in the bimodality of the frequency distribution of a given welfare indicator or the lack of overlap between the distributions of different groups. A well-known example of this type of fractionalisation is South African income distribution, which is highly polarised by race (Figure 4.8). Equivalised African and Coloured incomes overlap very little with those of Whites. Only the Asian/Indian distribution, which is numerically very small and heterogeneous, overlaps widely with the other three races' distribution.

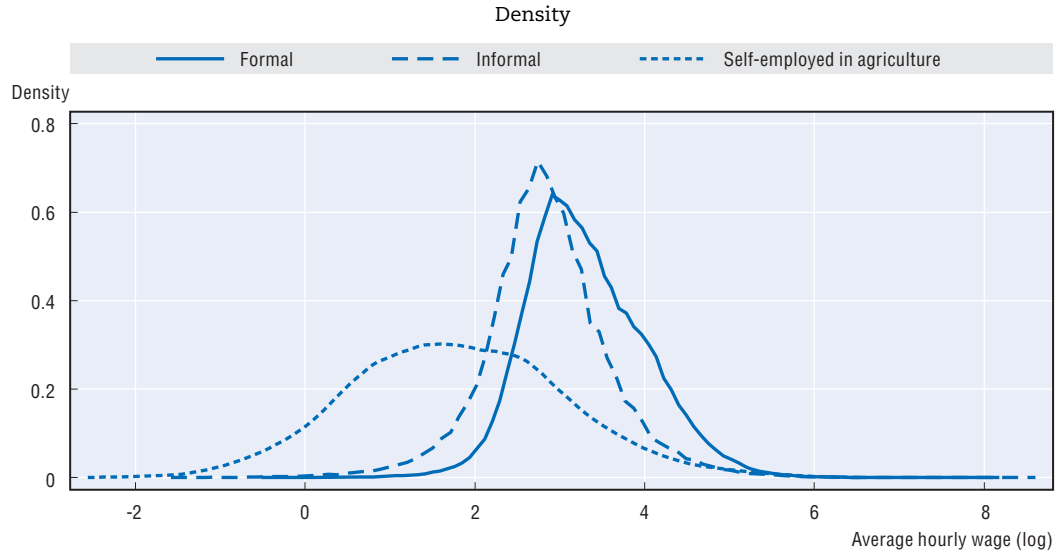
Figure 4.8. **Distribution of equivalised incomes is polarised by race in South Africa, 2008**



Source: Authors' elaboration based on SALDRU (2009).

Inter-group inequality often affects labour market outcomes. In other words, labour markets in many countries reinforce inequalities that are based on spatial distinctions between rural and urban workers or on sector-related differences, such as between agricultural and manufacturing sectors or informal and formal workers. Wages in Mexico, for example, are highly polarised between agricultural and non-agricultural workers, as shown in Figure 4.9. Informal non-agricultural workers have slightly lower wages than the formally employed, yet the two distributions overlap to a large extent. Agricultural earnings, however, are far below either formal or informal wage employment and constitute a second poorer mode of the wage distribution.

Figure 4.9. **Distribution of wages is polarised by employment status in Mexico, 2007Q2**



Source: de Laiglesia *et al.* (2008).

Depending on the country context, persistent inequalities between groups are also often associated with other distributional challenges, including growing relative poverty, vulnerable middle classes and rising top incomes. Thus, while it is convenient to examine different parts of the income distribution to understand how inequality affects social cohesion, it is also important to look at how exogenous forces and policies shape the distribution as a whole. The following section looks in greater depth at the determinants of inequality across the entire income distribution to address how structural transformation, market forces and policy interventions combine in unique ways within each country to drive distributional change.

Disentangling patterns of distributional change: The example of education

Policies to address income inequality need to be tailored to the determinants of inequality in each country. Changes both in policy and markets – such as the structural transformation of many countries over the last twenty years due to shifting wealth – affect the income distribution through different channels. The evolution of inequality within countries is the result of policy changes as well as of changes in individual and household endowments and resources, returns to those resources, labour market participation behaviour, and demographic characteristics.

Policy makers control tax rates, benefits, and eligibility far more easily than they can control earnings, labour force participation, and family structures. Differences between market incomes and disposable incomes are sizable in many OECD countries, which points to the important redistributive role of the state. The role of taxes, cash, and in-kind transfers is markedly less important in many developing countries. Transfers that equalise disposable incomes tend to be smaller in developing countries and to take the form of in-kind services rather than cash transfers, such as pensions. Policy makers in these countries thus may have more room for further equalising disposable incomes, particularly given the increased fiscal space that shifting wealth has afforded them. The use of more active fiscal policies to increase and improve the provision of services, redistributive transfers, and the

effectiveness of taxation is clearly an important way of reducing inequality over the short and medium term. It is a topic that is examined further in Chapter 5.

Although redistributive policies can directly influence the market incomes and population characteristics that affect inequality, household behavioural patterns like labour-market participation also change and may prove to impact more strongly on the long-term dynamics of market income inequality than policy changes. Changes in market income inequality are the composite result of many different forces, some of which act in opposing directions. Nonetheless, it is necessary to understand how these factors interact with one another, and how they fit into longer-term trends – such as education, fertility and employment patterns – in order to draw up a development strategy that takes into full account the specific needs and characteristics of a country.

Decomposing distributional change: Endowments, returns and behaviour

It is important to bear in mind that individual country experiences are unique precisely because they combine various forces in different ways. Net changes in the distribution mask a host of individual and sometimes opposing changes taking place in the underlying determinants of income. For example, as this section explains, although rising educational attainment may generally reduce inequality, it may actually push it up in the context of an increase in returns to education. Moreover, similar phenomena can have opposite effects on inequality, depending on the unit of analysis. For example, increased women's labour force participation can lower individual wage inequality among the working age population, but widen household income inequality if the new women workers tend to be from higher income households. Extracting information about the nature and magnitude of these interactions from observed distributional change can be an important step towards understanding which channels provide the most efficient options for policy intervention.[9]

A number of studies of the determinants of distributional change have broken down changes in inequality into changes in individuals' endowments (such as their human or physical capital), changes in the prices or returns paid to these endowments on the market, changes in household members' labour market participation, and changes in the demographic composition of the household (Bourguignon, Ferreira and Lustig, 2005):[10]

- endowment effects: changes in educational attainment, experience, land ownership, capital ownership, and gender differences in educational attainment;
- price effects: changes in returns to education and experience, changes in the gender wage gap, and in the urban/rural wage gap;
- participation or labour supply effects: changes in self-employment, informality, wage work, women's labour force participation, and child work;
- demographic effects: changes in household size, fertility rates, and the age structure of the population.

Overall inequality change is the compound result of equalising and unequalising effects. Summarising a number of detailed studies on the issue, Table 4.2 sets out interactions between some of the above-mentioned forces which have driven the net changes in inequality over the observed periods and shows their effects in selected countries. Importantly, the table includes a number of high-growth economies that have been more fully integrated into the world economy over recent years. Thus, while it does not feature a representative sample of countries, it does shed light on distributional changes in a number of important emerging economies that have experienced increases in

Table 4.2. **Countervailing forces affecting dynamics of household income and wage inequality in selected countries, late 1970s-mid 2000s**

Economy	Period	Net change in Gini	Inequality concept	Equalising effects	Unequalising effects	Source
Argentina (urban)	1986-98	+5.5 points	Wage earnings	Narrowing of gender wage gap – wage inequality is narrowed but not household income inequality. Expansion of education.	Rise in returns to education, experience and unobserved characteristics among wage earners. Declines in hours worked among poorest quintile.	Gasparini, Marchionni, and Escudero (2005)
		+7.8 points	Household equivalised income			
Bolivia	1999-2005	+3 points	Household per capita income	Narrowing of wage gap between sectors.	Higher unemployment. Changes in returns to unobservables.	Gutierrez (2008)
Brazil (urban)	1976-96	–0.4 points	Household per capita income	Returns to education and experience fell. Narrowing of gender wage gap.	Higher unemployment and informal employment. Fewer hours worked by less educated informal workers.	Ferreira and Paes de Barros (2005)
Colombia (urban)	1988-95	+4.2 points	Household per capita income	Increased labour force participation by poor women. Expansion of education in rural areas.	Educational expansion in urban areas given convexity of returns to schooling.	Velez *et al.* (2005)
Côte d'Ivoire	1992-98	–0.5 points	Household equivalised income	Increased labour force participation. Declines in returns to schooling. Narrowing of native/immigrant wage gap.	Rise in returns to unobserved characteristics.	Grimm (2001)
Indonesia	1980-96	+1.6 points	Household per capita income	Decline in regional disparities. Narrowing of gender wage gap. Declines in relative returns to land size. Rural-urban migration.	Rise in returns to education, experience, and urban residence. Increase in self-employment. Educational expansion given convexity of returns to schooling.	Alatas and Bourguignon (2005)
Malaysia	1989-97	+3.8 points	Household per capita income		Expansion of education given convexity of returns to schooling. Increased returns to education. Shift away from agriculture.	Fields and Soares (2005)
Chinese Taipei	1979-94	–2.4 points	Wage earnings	Increased labour force participation by women had equalising effect in the earnings distribution.	Increased returns to education. Increased labour force participation by women had unequalising effect in the household income distribution because these women were from the upper half of income distribution.	Bourguignon, Fournier, Gurgand (2005)
		+1.9 points	Household equivalised income			
Paraguay	1992-2005	–9.9 points	Wage earnings	Average real wages fell more for higher wage individuals. Decreased returns to education. Narrowing of gender wage gap.		Otter (2009)
		–7.8 points	Household equivalised income			

inequality over the last quarter of a century. Some common patterns emerge from detailed studies of the underlying determinants of inequality that can be seen to apply to a number of different countries.

More equal opportunities through education policy and female labour force participation

Education is an important resource which illustrates the complex interactions underlying changes in the income distribution. Education is human capital acquired over an individual's life cycle and serves as an investment that pays returns in the form of wages. It is commonly measured by years of formal schooling. Both the amount of education and the return that schooling is paid on the labour market in the form of higher wages determine labour market earnings. Household income additionally depends on whether individuals in the household participate in the labour market at all. These three variables – an individual's educational endowment, the return paid to that endowment, and whether the individual participates in the labour market – all contribute to the income of the household and thus determine its place in the income distribution. How these variables have responded to shifting wealth over the past 20-30 years illustrates the sheer complexity of forces underlying inequality in individual countries.

Reducing the proportion of the population with little or no education is an important stepping stone towards higher income and reduced inequality. Higher educational attainment does not necessarily reduce inequality, however, because returns to education are higher for skilled individuals and greater attainment among the highly skilled can, in some cases, lead to increased inequality. Therefore, in moving up the education ladder to exploit more fully the opportunities afforded by shifting wealth, there may be trade-offs between short-term inequality reduction and building an economy that is more competitive in the long run. However, it is when increases in inequality stem from unequal access to education that decisive action to boost educational attainment and reduce inequality in outcomes is necessary.

Shifting wealth makes it more important for converging countries to upgrade skills in order to seize the new opportunities afforded by the world economy. Higher average education levels help attract more FDI while technical education brings in manufacturing FDI (Te Velde, 2005). Moreover, scientific advance is no longer the sole preserve of high-income countries. Although research and development (R&D) expenditure remains highly concentrated in a few countries, converging countries such as China and the Russian Federation are now among the ten highest R&D spenders. Higher education opportunities nurture and sustain such activity.

Developing countries have made substantial progress in access to primary education, but challenges remain. Between 2000 and 2008, net primary enrolment rates in sub-Saharan Africa – the region with the lowest average education achievement – increased from 54 to 84%. At the same time, East Asia and the Middle East and North Africa further narrowed their secondary education deficits. However, average enrolment rates in secondary education in South Asia and sub-Saharan Africa remain low (Table 4.3). Moreover, recent increases in enrolment have not yet translated into large increases in average educational attainment in all regions. In Latin America, the increase in numbers of secondary education graduates is recent, so that the rise in average education in the workforce has lagged behind gains in other regions. Similarly, average educational

Table 4.3. **Educational enrolment and attainment in the 2000s**

	Gross enrolment rates								Net enrolment rate		Average years of education (population aged 15-64)	
	Pre-primary		Primary		Secondary		Tertiary		Primary			
	2000	2008	2000	2008	2000	2008	2000	2007	2000	2008	2000	2010
OECD	68	78	103	104	95	98	50	65	97	96	11.4	11.8
East Asia and Pacific	37	45	106	113	59	75	10	22	94	94	6.3	7.1
Europe and Central Asia	49	65	103	98	88	90	42	59	91	90	10.2	11.1
Latin America and the Caribbean	55	61	125	117	88	92	23	37	95	93	7.4	8.0
Middle East and North Africa	15	31	92	102	66	83	17	26	85	86	5.9	6.9
South Asia	25	54	89	110	46	55	9	11	79	87	4.3	5.3
Sub-Saharan Africa	11	18	83	102	26	37	3	4	58	84	3.9	4.4

Note: Regional averages weighted by population of the relevant age. Regional averages exclude OECD countries in the region.
Source: Authors' elaboration based on UNESCO Institute for Statistics, *World Development Indicators*, and Cohen and Soto (2007).
StatLink http://dx.doi.org/10.1787/888932519035

attainment in sub-Saharan Africa remains very low and exhibits the slowest absolute increase of all developing regions over the past decade.

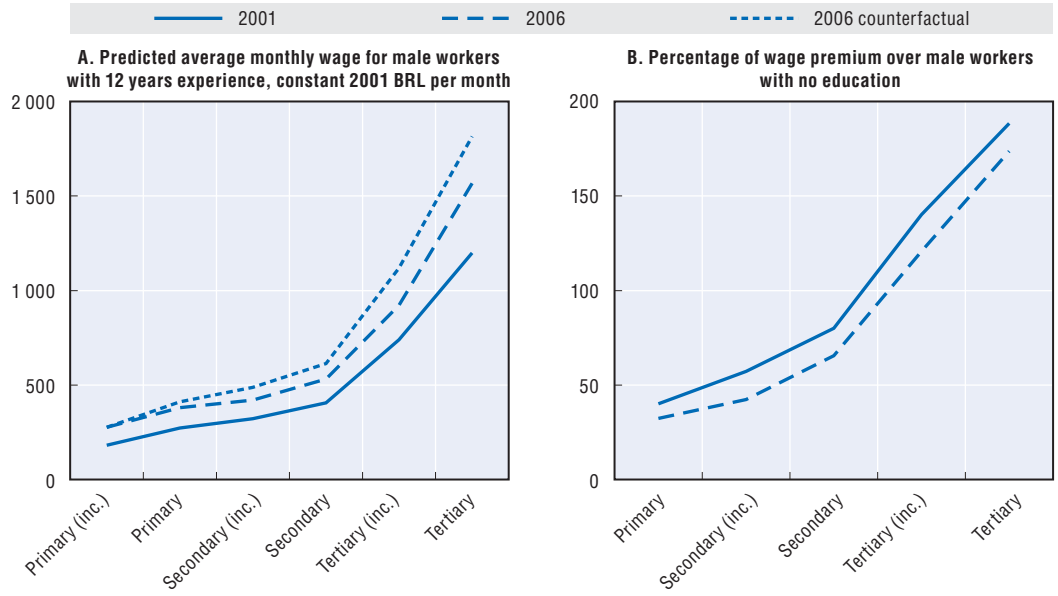
Shifting wealth also increases the demand for skills and, therefore, returns to education, especially secondary and higher education. Educational expansion that increases the supply of more educated workers at the same time as returns to education rise hints at large swings in demand for higher skills on the global labour market. Rises in returns to education tend to increase inequality. Indeed, the United States' experience illustrates the inequality-generating effect of changes in returns to education (Juhn *et al.*, 1993; Katz and Murphy, 1992), which is a key part of the argument that skills-biased technological change widens inequality.

The way in which the interaction between increased education and increased returns to education affects inequality is not pinned down by theory. Rather, it constitutes, as Tinbergen (1975) has called it, a "race between education and globalisation/technology", whose end result depends on the circumstances of individual countries. Overall increases in the return to human capital assets like education and experience have increased inequality in the last 20-30 years in a number of developing countries in East Asia and Latin America.[11] In some cases, expansions in education can actually lead to increases in inequality in the context of increasing returns to schooling.

Developing countries studied during the past 30 years typically saw both an increase in average educational attainment and a higher valuation of education and potential labour-market experience. The increase in returns to education is more important than many other factors in accounting for the rise in inequality in a number of countries over the 1980s and 1990s (Bourguignon, Ferreira and Lustig, 2005). Conversely, a fall in the returns to tertiary education may also help explain falling inequality. Figure 4.10 Panel A shows how between 2001 and 2006 in Brazil, wages did not rise as much for the more educated as they would have done if returns to education had not fallen. This substantially impacted on the inequality of the wage distribution in Brazil. Box 4.2 describes in greater detail how falling returns to education and policies, such as cash transfers, helped lower inequality in Brazil.

In a number of countries a "convexification" of returns to schooling was also observed as a strong determinant of inequality increases. Convexification occurs when marginal returns to an extra year of schooling decline at low levels of education, but increase at

Figure 4.10. **Returns to education in Brazil, 2001-06**



Note: Experience proxied by age less 18 years. Counterfactual 2006 wage distribution was simulated using returns to education from a Mincerian wage equation estimated for the 2001 distribution; 2006 wages were deflated using Brazilian CPI data drawn from IMF International Financial Statistics.

Source: Authors' elaboration based on Pesquisa Nacional por Amostra de Domicílios (PNAD).

StatLink http://dx.doi.org/10.1787/888932518256

higher levels (Bourguignon, Ferreira and Lustig, 2005). This is particularly worrying because it increases incentives for early school-leaving.

The shape of the curves in Figure 4.10 show that despite the across-the-board decline in returns to education in Brazil between 2001 and 2006, students still faced little incentive to complete secondary school. The data for 2006 indicates that while primary school completion offers a premium of approximately BRL 106 per month over non-completion, and secondary school completion offers a further premium of approximately BRL 149, failing to complete secondary school offers only an additional BRL 40 per month on average beyond primary school. Students may therefore face a dilemma in choosing between staying on at secondary school or dropping out to take employment. More needs to be done to help students stay in school until they can begin to truly enjoy the higher returns of secondary and tertiary education, as shown by the sharp "kink" at secondary school completion in Figure 4.10.

Box 4.2. **Transfers and falling returns to education have reduced inequality in Brazil**

Brazil is often cited as the emerging economy which has had the most success reducing income inequality. Brazil's inequality levels were stable over most of the 1990s after a rise in the late 1980s and early 1990s. In the 2000s, they shrank impressively. How much and to what extent has policy been a part of Brazil's success?

Brazil also produces a rich supply of household income data that can help better understand its success. Ferreira *et al.* (2008) look at the period 1981-2004 and find that increases in inequality stem from falls in the returns to education, rural-urban convergence, lower racial inequalities, and bigger, better targeted government social assistance

Box 4.2. **Transfers and falling returns to education have reduced inequality in Brazil** *(cont.)*

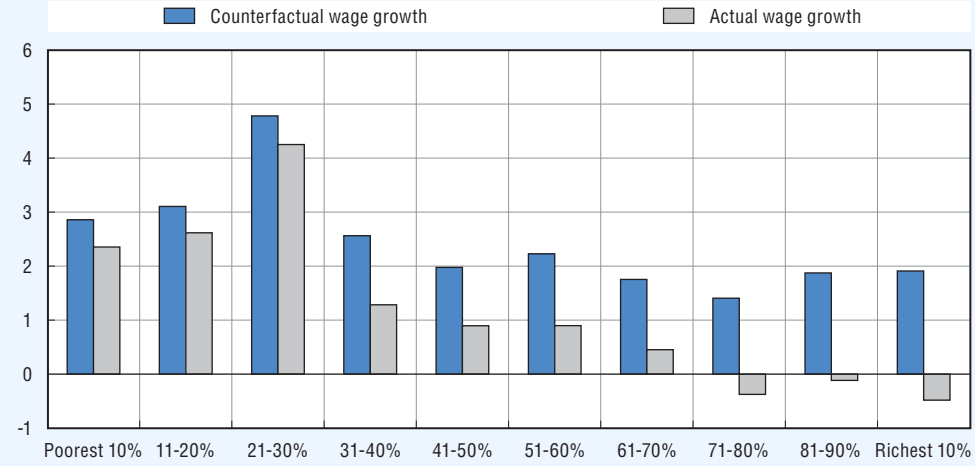
transfers. While social assistance transfers – such as "Bolsa Família" the well-known conditional cash transfer scheme – influence inequality of incomes, particularly over the short to medium term, the falling returns to education also played an important role, accounting for more than one-third of all changes in inequality over the period.

Lopez-Calva and Lustig (2010) consider two principal explanations for the fall in inequality observed more broadly across Argentina, Brazil, Mexico and Peru. These are the narrowing of the earnings gap between high-skilled and low-skilled workers and an increase in government transfers to the poor. Key educational changes were falls in the number of people with less than secondary education, combined with curtailment of the skills-biased technological change of the 1990s, which reduced returns to the best educated.

A simple breakdown of changes in the Brazilian wage distribution between 2001 and 2006 reveals the strong impact of falling returns to education through lowered growth in higher wages. Figure 4.11 shows the distribution of wage growth across earnings deciles between 2001 and 2006, a period when returns to education fell. Comparison of actual distribution with a simulated counterfactual distribution, which holds returns to education constant over the period, demonstrates that the fall in returns to education was greater in the higher earnings deciles. Wage inequality over this period declined, with the Gini coefficient falling from 0.57 to 0.54. If returns to education had not been kept constant it would have declined only to 0.56, all other things being equal.

Figure 4.11. **Changes in returns to education disproportionately affected growth in wages of the upper deciles in Brazil, 2001-06**

Percentage annualised change in real wages by deciles



Note: Counterfactual 2006 wage distribution was simulated using returns to education from a Mincerian wage equation estimated for the 2001 distribution. 2006 wages were deflated using Brazilian CPI from the IMF's International Financial Statistics Database.

Source: Author's elaboration based on PNAD.

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Reducing the disparity in educational attainment between the least and best educated should be a chief priority of governments seeking to mitigate growing inequality. Investment in the human capital base of the lower income quintiles in particular can help attenuate large increases in inequality due to structural changes in demand for skills. There is a need to combine both long-term human capital investment with short-term

income support. Bourguignon, Ferreira and Lustig (2005) point out that educational expansion takes time to reduce inequality. Complementary policies are needed to protect the lower parts of the income distribution over the short and medium terms. These include both cash and in-kind transfers to help the disadvantaged afford schooling, health and nutrition for their children.

Increases in educational attainment can also interact with increases in women's labour force participation in ways that depend on country-specific labour market circumstances. The direction of the impact can differ according to where, along the income distribution, women are joining the labour force. For example, in Chinese Taipei educated women's entry into the labour force in the middle of the wage distribution narrowed the gender wage gap but increased inequality in the household income distribution (Bourguignon, Fournier and Gurgand, 2005). As poorer households have fewer wage earners and rely more on subsistence agriculture or informal employment, the gains from increased female labour force participation went largely to the middle classes. Almost the opposite occurred in Mexico: women entered at the bottom and the top of the wage distribution, increasing wage inequality but reducing household income inequality (Velez *et al*., 2005).

The interactions highlighted above (and further detailed in Table 4.2) only hint at the possible combinations of endowments, prices and participation behaviour that determine inequality. For example, women's increased labour force participation also goes hand in hand with increased female educational attainment and declines in fertility. Throughout the developing and industrialised world, declining fertility rates have accompanied women's entry into the labour force together with related declines in inequality. Fertility changes further affect household income because they influence the labour market choices of other household members and impact on the dependency ratio. Where these behaviours occur along the income distribution in a particular country will ultimately determine whether the net effect is an increase in inequality or not. On the other hand, many studies reveal that greater gender equality in labour market remuneration is one of the few labour market developments that consistently seem to reduce inequality (Bourguignon, Fournier and Gurgan, 2005).

Thus, while general patterns can be seen to develop through multiple channels from global phenomena like shifting wealth, understanding the country-specific interaction of these general patterns is crucial to determining why inequality rises and falls and how best to address it. The next section examines some subjective data in order to demonstrate how demand for redistribution can also differ between countries.

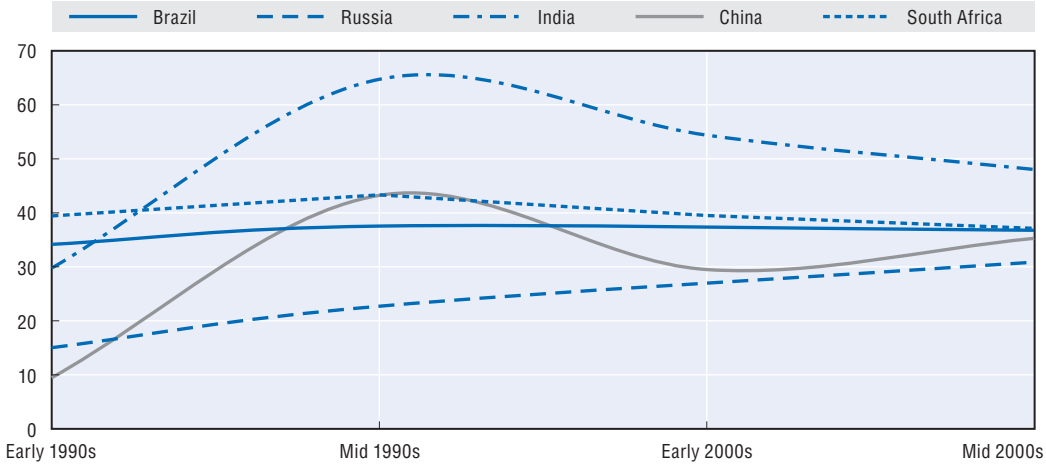
Social cohesion and preferences for redistribution

Political consensus and public perceptions reveal that concerns about inequality are more widespread than they were 20 years ago. Much of such sentiment is fuelled by the sense that productivity gains in the past two decades have been to the main – and, in some cases, exclusive – benefit of highly skilled, educated workers, and have left others behind (OECD, forthcoming). But there are also deep, underlying differences between countries in their preferences for redistribution, in what policy is best to help the disadvantaged, and in prospects for upward mobility. Moreover, preferences for redistribution also change over time, and may react to increases or changes in inequality more than to high levels of inequality. How do changes in perceptions of inequality affect the political economy of redistribution and alter the way in which policies rise to the distributional challenges of social cohesion?

In both non-OECD and OECD countries, the last 20 years have seen an increase in concerns about the unequal distribution of living standards, prompting greater demands for redistributive policies in many cases. Attitudes towards redistribution are difficult to measure directly, but subjective, attitudinal surveys can capture respondents' stated preferences. Demand for redistribution has increased in some of the same countries which have experienced growth in inequality. Figure 4.12 shows that in China and India the percentage of individuals who feel that there should be action to equalise incomes has increased since the early 1990s. The Russian Federation, a country which has undergone dramatic structural transformation in the last two decades, has seen inequality both rise and fall and a growing number of people feel that incomes should be made more equal. At the same time, highly unequal countries, like South Africa and Brazil, have relatively stable proportions of the population that believe incomes should be made more equal.

Figure 4.12. **Preferences for redistribution, early 1990s to mid-2000s**

Share of respondents stating a preference for more equal incomes



Note: Preference is determined by the share of respondents who agree more with the statement, "incomes should be made more equal" than with "we need larger income differences as incentives".

Source: *World Values Survey*, Waves 2-5.

StatLink http://dx.doi.org/10.1787/888932518294

Preferences for redistribution evolve over time. The shift in preferences towards redistribution in the BRICS shown in Figure 4.12 is in line with similar findings for OECD countries (OECD, forthcoming). Only in a few OECD countries has no change been found since the late 1980s. Of course, the view that "incomes should be made more (or less) equal" says little about the preferred method for achieving such a change.

Forming collective beliefs about inequality is a defining characteristic of the political economy of redistribution in most societies (Robinson, 2010). How these attitudes towards inequality translate into concrete government policy, such as tax and transfer schemes or public service provision, is an important part of the social contract in every country. Aggregating different individual preferences about how to deal with inequality into a national political consensus on the redistributive role of government is a big step towards building a cohesive society.

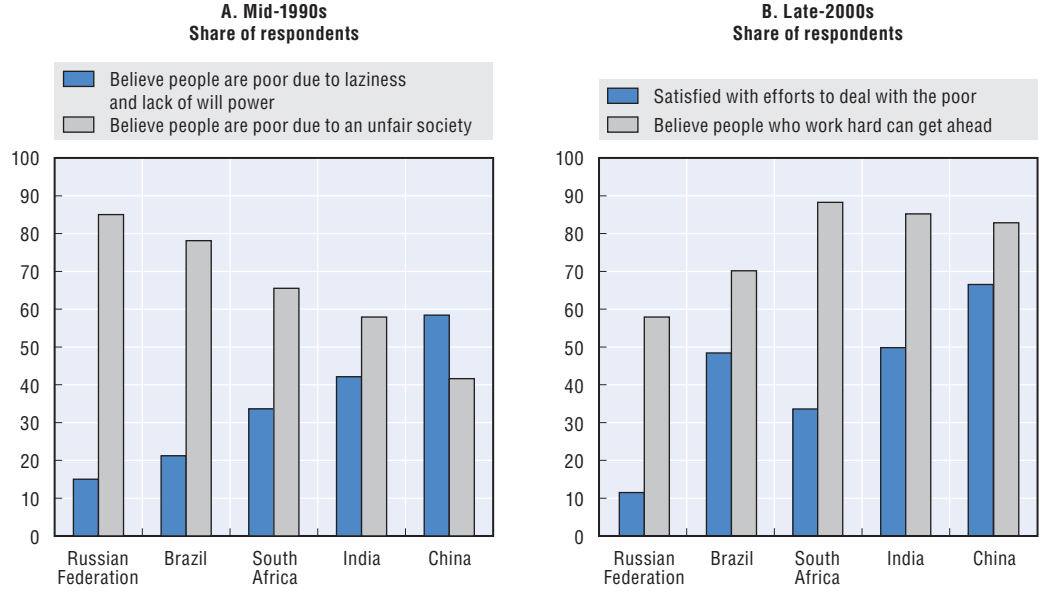
Preferences for redistribution in different societies may prompt calls for very different sets of policies. Some may have in mind government redistribution, while others advocate

regulatory measures to reduce the inequality or volatility of market incomes. Views of social justice influence views of inequality and shape policy approaches towards redistribution. In particular, a distinction may be made between those who believe there should be fairness in the *ex ante* distribution of opportunities and those who advocate fairness in the *ex post* distribution of outcomes (Roemer, 1998). Policies to directly reduce the inequality of outcomes *ex post* correct differences between individuals' material circumstances. The priority in measures to achieve equality of opportunity *ex ante* is to grant all citizens a fair chance of making the most of their skills, talents and efforts.

Policies can reduce both inequality of outcomes and inequality of opportunity. Inequality of outcomes can be reduced through progressive taxes, service provision, and by targeted income support policies, such as minimum wages, which aim to empower the relative poor to participate more fully in society. Greater equality of opportunity can be fostered by addressing education inequalities and gender discrimination and by providing a level playing field for marginalised groups like rural inhabitants, ethnic and racial minorities, and informal workers. Policies that address outcomes and opportunities can complement each other and work in a virtuous cycle over time to achieve lower inequality and greater social cohesion. Conditional cash transfers, for example, aim to reduce inequality in outcomes while ensuring more equal opportunities for future generations (through incentives for investment in the human capital of children).

Whether a society prefers to rely principally on policies that equalise either outcomes or opportunities underpins societal preferences for redistribution. Preferences can be measured by subjective attitudes towards redistribution and inequality and by beliefs about the origin and desirability of inequality and about social mobility. Tolerance for inequality is often equated with belief in the possibilities of upward social mobility (Piketty, 1995; Alesina and Giuliano, 2009). Data from the BRICS countries in Figure 4.13 show how preferences vary across emerging countries. Commonly held beliefs about why people are

Figure 4.13. **Beliefs about determinants of poverty, satisfaction with redistributive policy and perceived prospects for upward mobility in the BRICS**



Source: Panel A: *World Values Survey*, Wave 3; Panel B: Gallup World Poll (2010).

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poor, what determines improved life chances, and whether society is doing a good job dealing with the poor vary widely.

Preferences do not translate into policy directly. Rather, they inform the political process (OECD, forthcoming). The degree to which income therefore influences the political process can determine support for different approaches to redistribution. While increases in inequality may lead to increased demands for redistribution, increased incomes in the upper half of the distribution can also increase resources that might seek to politically reduce the burden of the rich in the redistributive system.

Conclusion

This chapter has argued that the structural transformation of the global economy has changed the nature of the distributional challenges standing in the way of social cohesion. Shifting wealth offers enormous promise for reducing inequality on a global scale but, while continued convergence may go on narrowing inequality between countries, it is inequality within them that is the main concern for social cohesion. Such inequality poses a tough challenge for social cohesion by excluding many from ordinary social life, reducing trust and the sense of belonging felt by different groups, and by restricting the prospects for advancement through social mobility. Fiscal policy, employment with social protection, and civic participation can all contribute to better social cohesion across the entire income distribution.

Policy makers must consider the welfare of citizens at the bottom, middle and top of the welfare distribution within each country in order to ensure social inclusion. Each part of the distribution contributes to social cohesion and development in a different way. Disadvantaged households at the bottom need to maintain adequate economic proximity to median living standards so as not to threaten social cohesion. Households in the middle need to be able to continue to improve their living standards and grow into a viable middle class. Top incomes must not rise so much and so fast that they alienate the rest of society.

Social cohesion also requires policy makers to address persistent inequalities between groups perpetuated by deep-seated inequalities of opportunity. Inequalities between ethnic groups, the sexes, and segments of the labour market are exceedingly difficult to reduce without long-term investment and political will.

Although separate challenges to social cohesion can be pinpointed in different parts of the income distribution, understanding how exogenous forces like shifting wealth affect the entire distribution as a whole is a critical task for practitioners looking to implement coherent policies that address inequality and foster social cohesion. Generally, household resources, the returns earned on those resources, labour market participation behaviour, and demographic characteristics all contribute to the make-up of the income distribution. However, it is necessary to identify how these factors interact in a particular country context and are affected by exogenous forces before forming sound policy recommendations.

Upgrading skills through education provides an excellent example of how countries can both invest in promoting long-term equity while reducing unequal outcomes today through both cash and in-kind transfers. The problems many countries face in addressing the upward pressures on skilled wages from shifting wealth and associated increases in returns to education also provide convincing evidence that, rather than focus on increasing average education attainment by any means, governments should specifically try to raise the minimum level of education in their countries. This is a powerful argument for

subsidising secondary education, in addition to primary education, in order to ensure that students overcome conflicting incentives to leave school after primary school and join the informal labour market.

Finally, the political economy of redistribution can itself be seen as a vehicle for building social cohesion. The political processes in which societies come together to address and aggregate individual preferences about the nature of the income distribution can build national identity, establish a shared sense of community, and promote greater social harmony.

Notes

1. Over the last decade, international agencies have released a proliferation of reports on distributional issues and their impact on development goals. UNDESA's (2005) *Report on the World Social Situation* argued that rising inequality has produced a growing segmentation of societies requiring the attention of development policy. UNDP's *Human Development Report* (2005) on aid, trade and security in an unequal world argued that extreme inequality stands as a significant barrier to human development and hinders progress towards achievement of the Millennium Development Goals (MDGs). The World Bank's *World Development Report* (2006) argued that policy makers need to address equity issues and provide equality of opportunity for poor and marginalised populations to ensure continued economic growth and development. The International Labour Organization's *World of Work Report* (2008) pleaded the need to address widening inequality of incomes in the labour market. OECD (2008) has also highlighted growing income inequalities in the industrialised world in its *Growing Unequal?* report. Most recently, the second *European Report on Development* (2010) argues that social protection plays an important role in reducing inequality even in the poorest countries of sub-Saharan Africa.
2. Bourguignon and Morrison (2002) reconstruct historical income distributional data going back to 1820 using Angus Maddison's historical statistics. They show that at the dawn of the Industrial Revolution the bulk of global inequality was due to differences among citizens within countries.
3. Inequality discussions often focus on "household income inequality" or "wage inequality". However, because of the way survey data is collected around the world, many of the inequality measures for Africa and Asia utilise consumption data. In contrast, inequality measures for Europe and the Americas tend to use income data. These different data types are not strictly comparable, since according to the permanent income hypothesis, consumption smoothing through saving and borrowing ensures that the distribution of consumption is less unequal than the distribution of income. Similarly, a country's level of development influences the availability of consumption data *versus* income data: richer countries prefer income data as they are easier to collect, poorer countries tend to use consumption data, as they are a more reliable measure of well-being than income, particularly given the dearth of non-subsistence activity employment in poor countries. Another measurement issue of great importance is the unit of analysis. Individual wage inequality focuses narrowly on the remuneration individuals receive for their activities on the labour market. Household income inequality can refer to a broader concept, which includes remuneration received both from wages and from returns to assets owned by the household members. Household level data can also raise issues about whether data are in a per capita form or use an equivalence scale. An additional complication arises when the differences between stocks and flows in money metrics are considered. The distribution of wealth, for example, is certainly much more unequal than the distribution of wages or income or consumption. Nonetheless, in some countries wealth itself is the focus of redistributive policies in some form or another through taxes on the value of property or other assets. The nature of data sources differs greatly as well, with representative household survey data generally being preferred to grouped distributional data (Atkinson and Brandolini, 2001).
4. Market incomes include income from wages and salaries, self-employment income, capital income and private pensions received by household members and tend to be the most unequally distributed of these three household living standard concepts. Disposable incomes are often less unequally distributed than market incomes because they take into account cash transfers, public pensions and other benefits paid to the household, less the taxes paid by the household. Consumption expenditure may be even more equally distributed, since it generally reflects disposable income less household savings to account for consumption smoothing.

5. There has been widespread debate as to whether observed increases in inequality are due to the increased globalisation of the world economy. IMF (2007) argues that trade globalisation has lowered inequality, while financial globalisation has increased it, although it is difficult to disentangle the effects of financial globalisation from the effects of increased technological progress. OECD (forthcoming) has taken this line of reasoning further, concluding that increased trade integration has had little impact on both wage inequality and employment trends within OECD countries, despite import penetration from low-wage countries that might have been expected to drive down the wages of workers in domestic manufacturing or services. Significantly, however, both increased financial flows associated with growing outward FDI as well as technological progress have been found to be associated with wage inequality increases – in particular in the upper half of the wage distribution.

6. Typically this fixed, absolute standard only varies according to price differences across time and between countries. At its simplest it can be thought of as a minimum-subsistence living standard, below which individuals are unable to survive. For hundreds of millions of people around the world, exclusion at this level of basic subsistence is a reality. The most widely used measure of international poverty, the World Bank's dollar-a-day poverty line, attempts to quantify this subsistence level in purchasing power parity (PPP) terms based on the average of the national poverty lines used in the poorest countries of the world (Ravallion, Chen and Sangraula, 2009).

7. "Weakly" relative poverty provides a measure of poverty that unites absolute with relative views of income poverty in order to calculate global poverty in a way that is more relevant for middle-income countries. For more information see Ravallion and Chen (2011).

8. A number of different definitions for the emerging middle class in developing countries have been used. However, irrespective of the definition, it is clear that in the vast majority of developing countries these middle strata do not yet constitute a middle class that can serve as a powerful engine of growth and development. There are absolute definitions, such as the African Development Bank (2011), which labels household per capita living standards between USD 2 and USD 20 per day as middle class; Ravallion (2009), who uses between USD 2 and USD 13 per day; and Kharas (2010), who labels per capita subsistence between USD 10 and USD 100 per day as middle class in an attempt to make the definition universally comparable between both developing and developed countries. There are also relative definitions of the middle "sector", such as OECD (2011), that look at individuals with living standards between 50 and 150% of the median. Relative definitions of the middle strata can be used to avoid including those who could be considered relatively poor as is done by OECD (2011). In either case, as pointedly suggested by reference to a middle "sector" rather than a "class" (OECD, 2011), these non-poor middle strata of the income distribution do not have the same type of resources and socio-political role as the traditional "middle class" of industrialised countries.

9. Better understanding of which channel drives an observed distributional change and how the underlying forces interact, can also inform *ex ante* evaluations of policy reforms or exogenous shocks. This can help target which groups are most vulnerable given a change in government policy or external macroeconomic event. Some examples can be found in Bourguignon and Pereira da Silva (2003), which focuses on simple microeconomic tools for policy evaluation and Bourguignon *et al.* (2008), which looks specifically at related macro-micro evaluation techniques and tools integrating general equilibrium effects into policy analysis.

10. As Bourguignon, Ferreira and Lustig (2005) point out, this may include "changes in the distribution of factor endowments and socio-demographic characteristics among economic agents [changes in] the returns these endowments command in the economy, and [changes in] agents' behaviour such as labour supply, consumption patterns, or fertility choices. Of course, those forces are not independent of one another. In some cases, they tend to offset one another, whereas in others they could reinforce one another. They are also likely to be affected by exogenous economic shocks as well as by government policies and development strategies."

11. See Gasparini, Marchionni and Escudero (2005) for Argentina; Ferreira and Paes de Barros (2005) for Brazil, Grimm (2001) for Côte d'Ivoire, Alatas and Bourguignon (2005) for Indonesia, Fields and Soares (2005) for Malaysia and Bourguignon, Fournier and Gurgand (2005) for Chinese Taipei as well as the general discussion by Bourguignon, Ferreira and Lustig (2005).

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PART II

Building a Policy Agenda for Social Cohesion in Times of Shifting Wealth

As Part I demonstrated, the transformation process associated with Shifting Wealth poses new challenges for developing countries. Strong growth can bring with it a number of social costs, such as rising inequality and high food prices that affect land markets and threaten food security. In this context, social cohesion becomes an important policy consideration. As Chapter 2 argued, social cohesion is both a desirable end in itself and a means to achieve development outcomes.

Fortunately, there is ample evidence that public policies can make a difference. Tax and transfer policies to reduce poverty and income inequalities are one powerful example that can produce significant changes in the distribution of income without requiring long-term changes in the structure of the economy. The levels of inequality in disposable incomes between the average OECD country and a number of Latin American countries differ by 15 to 25 points in their Gini coefficients. However, most of this difference does not stem from much greater inequality in market incomes – the incomes derived from returns to factors of production, mostly through wages and capital income. Rather, in OECD countries, the tax and transfer system manages to effect substantial redistribution (Chapter 5). On average, disposable income in OECD countries is 10 points below market income, due principally, for those of working age, to benefits, and in particular out-of-work transfers – including unemployment benefits and income support measures for those unable to work. Progressivity in income tax also plays a role in reduction of income inequality in OECD countries, albeit a more limited one. Building the necessary consensus for more redistributive tax and transfer systems will require substantial time and effort in some countries. In the short run, increasing the targeting efficiency of public expenditure by reforming untargeted spending in food and fuel subsidies can increase the redistributive effect of public expenditure (Chapter 5).

While such redistributive reforms and policy interventions can generate results relatively quickly, others will not bear fruit for some time. Consequently, strengthening social cohesion requires a long-term vision and commitment. Building a more inclusive education system, for example, which increases the education levels of the disadvantaged and the average level of education takes a number of years to translate into increased inter-generational social mobility. This kind of long-term vision and commitment to policies also requires a stable macroeconomic environment.

A key element in the social cohesion agenda is equalising opportunities across the population to ensure the social integration of those from disadvantaged backgrounds and to help all identify with common social values. The public provision or financing of health, education and other social services contributes to lowering inequalities in both OECD and non-OECD countries. Indeed, among countries where social transfers only play a minor role in shaping the income distribution, the in-kind provision of healthcare and education is one of the factors that most contributes to the reduction of inequalities. Moreover, provision of health and education services reduces inequalities in human development attainment. Not only is this desirable in itself, it also offers the prospect of future

reductions in inequality by increasing the earning potential of those from disadvantaged backgrounds, thereby increasing prospects for inter-generational social mobility. Such policies require sustained and predictable financial backing.

Although there is no single recipe for a social cohesion policy agenda, a number of policy areas are key in responding to the challenges outlined in Part I:

- Taking advantage of the opportunity offered by the increased flows linked to shifting wealth (Chapter 1) requires economic and fiscal institutions that de-link expenditure from current revenues. This de-linking stabilises the macro-economic environment and opens up the fiscal space to finance priorities linked to a social cohesion agenda. While there is no single path to achieving this goal, Chapter 5 discusses how fiscal rules, stabilisation funds, sovereign wealth funds, and budgetary transparency can all contribute to this aim.
- In the long run, more cohesive societies and greater fiscal legitimacy reinforce each other in a virtuous cycle. Establishing greater fiscal legitimacy requires both better and more effective public expenditure and taxation that is fairer and more transparent. Tax administration reform is a promising starting point in this agenda (Chapter 5).
- Income policies such as minimum wages and expanding the coverage of social protection systems can reduce income inequality in the short run (Chapter 6). But these are not enough. In the long run, labour market institutions should be reformed with the aim of not only being more efficient price-setters in labour markets, but also reducing segmentation between formal and informal labour markets (Chapter 6). Moreover, access to quality education is vital for increasing aggregate human capital and social mobility. Building a high-quality, inclusive education system is a substantial task of great importance. In the short run, schools can be made more socially inclusive, while curricular reform can help raise political awareness and improve civic participation in the next generation (Chapter 8).
- Social protection affects both current incomes and future prospects, in particular by creating better conditions for human capital accumulation, especially for disadvantaged groups. Experiences from both low- and middle-income countries show that it is possible to make substantial progress towards universal coverage in healthcare in less than a decade. Innovative instruments can help fill the gaps in coverage of pension and income support systems, even among middle-income informal workers (Chapter 6). Ultimately, reforms to social protection can foster social cohesion by progressing towards a systemic view of the social protection system that takes into account the interactions between social protection and labour market outcomes.
- Dealing with increased food prices (Chapter 3) presents a particularly difficult challenge, especially in the short run. In-kind assistance is expensive in times of increased food prices, especially if it is not well targeted, while cash transfers risk falling short of the needs of the poor as prices increase. In the medium to long run, ensuring food security, in particular by paying more attention to agricultural productivity and by building a wider safety net, can help avoid this conundrum in the future (Chapter 8).
- In order to build a cohesive society, it is imperative to address inequalities motivated by group identity, including those between different ethnic groups and between men and women. Increased female labour force participation on an equal footing with men is unequivocally one of the most positive ways to reduce income inequality (Chapter 4). The inclusion of minorities and women in public life and political participation is just as important as their participation in economic life. Quotas have been shown to be effective (Chapter 8), although a deeper change in social institutions, attitudes and norms, is necessary in the longer run.

- Policy processes that help build common identities and a sense of belonging by involving citizens in the decision-making process are critical in turning the sense of belonging into concrete policy interventions. Allowing space for citizens to voice their preferences and dissent therefore helps create a cohesive society (Chapter 7). Modes of civic participation are being altered by the Internet revolution and virtual social networks. More traditional modes of civic participation, through civil society organisations or local political processes, can also be fostered to help build social cohesion while contributing to better public service delivery by giving voice to stakeholders.

Implementing a social cohesion policy agenda requires co-ordinated action across policy domains. Co-ordination is particularly important between taxation and efficient public expenditure and service delivery (Chapter 5), between social protection and labour market policies (Chapter 6), between fiscal incomes and food policies (Chapter 8). Moreover, implementation of a more ambitious development agenda requires strengthening administrative capacity in many countries. Decentralisation and civic participation can help increase the relevance and scrutiny of public action and thereby improve the quality of public service delivery, but also call for co-ordination at the local level (Chapter 7).

A social cohesion policy agenda is best served by being fully integrated into a coherent development strategy with a broad support base. The scale and scope of the policy interventions suggested require not only co-ordination, but also careful sequencing which takes into account the priorities and specific challenges faced by each country. The chapters in this second part of the report highlight areas where reform or capacity-building can fruitfully be used as a stepping stone to a more ambitious reform agenda. For example, tax administration reform enhances trust in the fair and efficient use of public funds and improves governance (Chapter 5) and unbundled social insurance, including unemployment savings accounts, can be used first among formal workers to build a financially sound system and can then be opened to other categories of workers (Chapter 6). Successful experiences in social protection such as Rwanda's Vision 2020 Umurenge Programme, Ethiopia's Productive Safety Net Programme or Brazil's *Bolsa Família*, underline the effectiveness of co-ordinated action that is embedded in a national development strategy.

This second part of the report is organised as follows. Chapter 5 examines fiscal policy, and suggests ways in which developing countries can create a stable source of financing by increasing fiscal legitimacy. Chapter 6 turns to the issue of employment and social protection, and in particular makes recommendations for reforms in labour market institutions and social protection systems which can foster social cohesion. Chapter 7 looks at ways to boost civic participation and political feedback mechanisms which can improve service delivery as well as being valuable in their own right. Chapter 8 looks at the policy areas of education, gender equality, food and the integration of migrants – all important cross-cutting areas which need to be incorporated into a social cohesion agenda. Finally, Chapter 9 discusses how to frame social cohesion policies and suggests ways that the international donor community can promote social cohesion in developing countries.

Chapter 5

Sustainable Fiscal Policies for Stronger Social Contracts

Shifting wealth increases the availability of resources in many converging countries, creating a window of opportunity to foster social cohesion. Fast economic growth and structural change are producing more development finance flows in converging countries where tax revenues have outpaced those of other developing countries. However, for opportunities to materialise, converging economies must take determined steps to create a stable source of financing by increasing fiscal legitimacy. The current situation in many converging economies is characterised by the state's low legitimacy as an honest broker between different interest groups, limiting public sector effectiveness in delivering essential services for reducing inequalities and fostering social cohesion. Public policies to increase social cohesion require stable financing and time to mature. Fiscal policies and institutions that loosen the link between current levels of revenue and expenditure – e.g. *rainy-day funds that save a share of windfall revenues to maintain social expenditures during bad times – are effective tools for dealing with this challenge. Financing inter-generational redistribution like social pensions out of such funds can foster social cohesion and create a constituency for stable fiscal policy.*

Introduction

The way taxes and expenditure are allocated in a society is at the heart of the social contract between citizens and the state. In this sense, taxation levels – as well as tax structure, evasion, and enforcement – reflect a society's political equilibrium and its preferences for redistribution through fiscal policy. These issues are particularly relevant in converging economies, as rapid changes in income levels and distribution throw up opportunities and challenges for social cohesion and fiscal policy. Traditionally, taxation and transfers of wealth have been important instruments in reducing income inequalities. In developing countries, however, they often have a much more limited role, as tax levels are low, systems not very progressive, and evasion widespread. This chapter analyses how taxation and expenditure interact with social cohesion in converging economies.

While shifting wealth creates opportunities for converging economies to improve social cohesion through fiscal policies and higher social expenditure, such opportunities do not necessarily translate into better social outcomes. The shift in wealth to converging countries is freeing up more resources which frequently include fiscal revenue. The way governments manage these resources is key to the sustainability of policies over time. Although they may be tempted to accelerate expenditure in response to pressing social needs, it is important that they create stable flows of funding for social expenditure so as to get the most out of the opportunities that shifting wealth is currently creating for many of them.

First, this chapter discusses the main links between social cohesion and fiscal policies, while the following section analyses the tax effort and composition of tax revenue and their link to tax morale in developing and converging countries. *Second*, it explores the tie-in between tax morale and social cohesion, with emphasis on two types of policy reform that could help foster greater social cohesion: fiscal decentralisation and tax administration reform. *Third*, the chapter stresses the importance of fiscal frameworks in stabilising revenue fluctuations and easing public expenditure funding uncertainty. *Finally*, it presents some key questions for reforming fiscal policies with the aim of increasing social cohesion in developing economies.

How social cohesion and fiscal policy are linked

Social cohesion and fiscal policy interact in multiple dimensions and directions. When a certain level of social cohesion exists, degrees and perceptions of social mobility, inclusion and trust shape citizens' preferences for certain kinds of expenditure and favour high or low levels of taxes and transfers. Conversely, transfers and public expenditure can, in turn, increase opportunities for upward social mobility, provide social safety nets, and build a more inclusive social infrastructure. Fiscal legitimacy is especially relevant for the effectiveness of public policies in countries where citizens can influence policies through voting or other forms of civic participation. If ignored, low or no fiscal legitimacy can ultimately lead to outbreaks of violent social unrest.[1]

OECD countries with initially high income inequalities redistribute more through taxes and transfers. This evidence is in line with traditional political economy arguments, as in high-inequality societies the relatively poor majority ("the median voter") show a preference for the redistribution of income and resources from rich to poor. If each person could vote directly for their preferred net transfer, economies with higher income inequalities would see larger *ex post* redistribution.[2] Thus, in principle, significant redistribution of income can occur in market-oriented democracies through taxes and public expenditures. Of course, in-kind public service provisions such as health or education programmes also redistribute income, even though it is difficult to assign a monetary value to them.

However, in many developing countries (*e.g.* in Latin America) tax and transfer systems have a much more limited impact on income distribution (Figure 5.1). In seeking to understand why this should be so, it is important to understand how tax and transfer systems function in developing economies. A number of social factors impact significantly on low state legitimacy, particularly as regards fiscal policy, which translates into lower revenues and fiscal policies that are generally less effective at addressing inequalities and creating opportunities for upward social mobility. In addition, even when formal democratic institutions do exist, fiscal policy tends to reflect the interests of elites and powerful lobbies if large swathes of the population are excluded from the political process or have limited access to collective instruments for influencing policies. An interesting example is the post-apartheid period in South Africa, which highlights the importance of democratisation on the composition and volume of social expenditure (Box 5.1).

Figure 5.1. **Gini coefficients before and after taxes and transfers in developing countries**

Source: OECD (2008a and 2008b).

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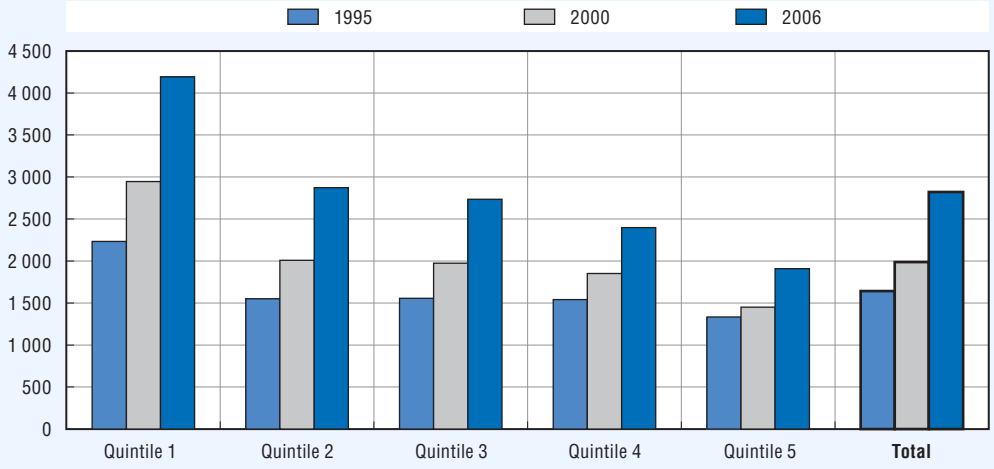
Why is redistribution in developing countries lower?

While necessary, citizens' participation in the political process may not be a sufficient condition for effective redistribution.[3] As a rule, voters can only choose between political platforms (and the multiple policies they advocate) rather than directly voting for a desired level of redistribution. Furthermore, preferences for redistribution stem from numerous sources, such as individual histories of social mobility, the political system, family organisation, nationwide and regionally-based cultural and social values, and even race.[4]

Box 5.1. **Fiscal policy and redistribution in South Africa's transition towards democracy**

The fiscal system – especially on the expenditure side – changed dramatically after the apartheid regime was abolished and democracy established in 1994. Social expenditure increased significantly for the poorest two quintiles between 1995 and 2006 (around 86% for both quintiles in real terms) and significantly less for the better-off segments of society (Figure 5.2). Social expenditure thus became more redistributive, yet the effectiveness of fiscal policy in reducing inequality remains limited.

Figure 5.2. **Per capita real public social expenditure in South Africa by income quintile (ZAR, year 2000)**



Source: Van der Berg (2009).

StatLink http://dx.doi.org/10.1787/888932518351

Prior to democracy (in 1993-94) the Gini coefficient of pre-tax and pre-transfer income was around 0.7, while once taxes and transfers had been incorporated, it changed to around 0.6 (McGrath *et al.*, 1997). This Gini coefficient included not only cash transfers (like those in Figure 5.1), but such in-kind transfers as public education and healthcare, making it safe to say that public policy interventions had very little effect on South Africa's extremely high levels of inequality. In contrast, although the pre-tax and pre-transfer Gini coefficient was still a very high 0.71 in 2000, it dropped to 0.53 after taxes and transfers had been factored in (Van der Berg, 2009).* Three qualifications regarding these figures for South Africa are important. First, they are not comparable to those presented in Figure 5.1, as they include in-kind transfers. Second, post-tax and post-transfer inequalities are still very high in South Africa. Third, a simple back-of-the-envelope calculation based on the relationship between OECD countries' pre-tax and post-tax inequalities would indicate that South Africa's post-tax and cash transfer Gini should be 0.37 (and that is without even considering in-kind transfers).

* There is also evidence that during the apartheid regime, whites and richer households benefitted proportionally more from government expenditures (van der Berg, 2006).

Social beliefs about degrees of fairness in society also play an important part in determining preferences for redistribution. If most people think that they live in a "meritocracy" – in which individual effort primarily determines income and all have the same rights and opportunities to enjoy the fruits of their efforts – they will choose low levels of taxation and redistribution. However, if they think that luck, birth, connections, or

corruption determine wealth, they will call for high taxes and social beliefs will be self-fulfilling.[5] Furthermore, if citizens do not trust the government or the political system to allocate tax revenues to socially valuable programmes, they might not consider paying taxes a legitimate obligation. Trust can have particularly important effects on the willingness to pay taxes and support transfers. Tax morale is lower in countries where most people perceive that other members of society cannot be trusted. Thus, if people think that everybody else evades taxes when possible, they might consider that individual compliance puts an unfairly high burden on them.

Similarly, the societies where people opt for low levels of redistribution are those with high social mobility or, to be precise, where people believe there is high social mobility. Even the poor may vote for low levels of redistribution if they think that, in the future, they or their offspring have a good chance of bettering themselves and becoming net payers who will not benefit from higher tax rates and redistribution. This is the so-called "prospect of upward mobility" (POUM) hypothesis. Conversely, in societies where mobility is perceived to be low, the median voter theorem will prevail and the poor will vote for more redistribution (Benabou and Ok, 2001).[6]

Social segregation can also work against a functioning fiscal policy. This is particularly true of communities (whether ethnic, religious or geographical) that are very cohesive but do not trust other communities. They are likely to be reluctant to fund transfers between groups or public programmes that have benefits beyond their local community. The empirical cross-country evidence is consistent with this argument: it shows that countries with high levels of social polarisation have weaker government finances, *e.g.* higher budget deficits and more procyclical fiscal policies (Woo, 2003; 2009). However, the case of South Africa is again an interesting example of the complexities involved. The apartheid regime was able to raise significant resources from direct taxation (mainly personal and corporate income tax), as high-income whites considered that expenditure would mainly benefit poor whites rather than other social groups. It has also been argued that the centralised organisation of white-based unions and parties facilitated negotiations between interest groups. Indeed, the reliance on income tax and the high level of consultation have remained a useful legacy for the democratic period (Di John, 2006; Lieberman, 2001).

Even if the socially excluded account for the vast majority of a population, they may be either unwilling or unable to use their political rights to further equality of property, income, and even opportunity. This might be due to ideological domination (the media are owned by the elite) or to the difficulties experienced by the poor in co-ordinating political action when they show mixed preferences in other aspects of life not directly related to the economy (Przeworski, 2007).[7] Furthermore, in societies where the rich can influence politics so that they do not pay taxes, the "median voter" could prefer low levels of taxation to reduce incentives for rent seeking (Rodriguez, 2004).[8] Perception-based evidence also shows that people have less tendency to justify tax evasion or to think that taxes are too high when they are satisfied that democracy works, that corruption is low, and that public services are of good quality (Daude and Melguizo, 2010). Yet even in situations where governments are elected with the support of the poor to equalise income and actually try to do so, they may fail. Modern redistribution policies aim chiefly at equalising human capital by investing in health and education (in contrast to earlier emphasis on the redistribution of land or industrial capital). Such redistribution might not yield equal outcomes, as the same education system may produce different results depending on the

socioeconomic background of pupils.[9] In other words, the equalisation of opportunities may not be enough to reduce inequalities.

In summary, while fiscal policies to reduce social exclusion and increase opportunities are far from impossible to implement in converging countries, the initial institutional and political challenges are often significantly greater than in affluent economies. It is therefore important to consider these challenges in addition to the technical considerations when reforming fiscal policies in converging and developing economies.

Taxation in developing countries

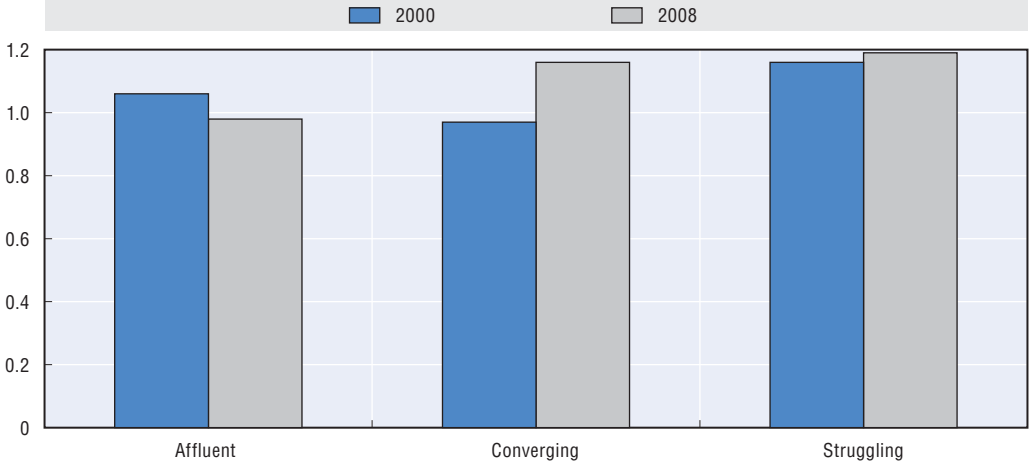
This section considers the stylised facts of the tax effort and the tax structure in converging and developing countries, and their links to tax morale, *i.e.* the willingness of the public to finance the state.

Tax effort in developing countries

Relative tax performance across countries is reflected more accurately by tax effort measures than the ratio of taxation to GDP. The level of taxation depends on structural variables such as a country's overall degree of development, its openness, and the structural composition of economic activity.[10] Thus, when economists seek to assess whether a country's tax performance makes the most of its opportunities and limitations, they usually compute tax effort indicators that compare the observed tax revenues (as a ratio of GDP) with a counterfactual based on the expected tax revenues, while controlling for the economy's development and openness and how its activity is structured.[11]

On average, converging countries strengthened their tax effort[12] more than affluent or struggling economies between 2000 and 2008 (Figure 5.3).[13] However, a number of converging countries are natural-resource-intensive economies whose revenues should be considered special cases, as the "effort" to raise them is considerably less. For example, a tax performance assessment of African countries shows that the estimated tax effort is significantly smaller in oil-producing economies (such as Algeria, Angola, Chad, the

Figure 5.3. **Average tax effort in 2000 and 2008**



Source: Authors' elaboration based on *World Development Indicators*.

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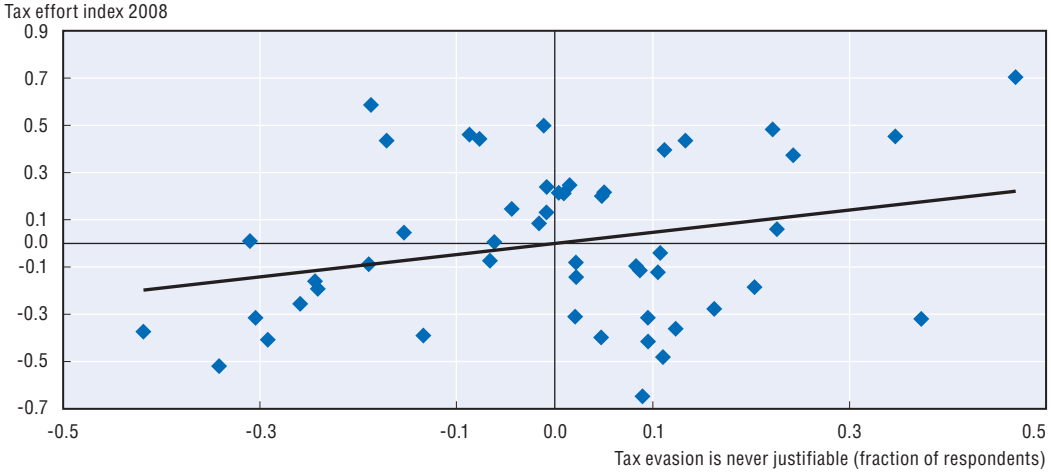
Republic of the Congo, Nigeria and Sudan), than in mining-intensive ones (*e.g.* Botswana and Namibia), where it actually increases when resource rents are excluded (OECD, 2010b).

Countries with higher average tax morale – where citizens consider that tax fraud is never justifiable – exhibit higher levels of tax effort. This is effectively the case, as Figure 5.4 illustrates. To make tax systems more effective in converging countries, it is thus important to better understand the links between tax morale and social cohesion.

Figure 5.4. **Partial correlation between tax morale and tax effort in 2008**

Controlling for GDP per capita



Note: Data are residuals from regressing both measures on GDP per capita (in logs).

Source: Authors' elaboration based on *World Development Indicators* and World Values Surveys.

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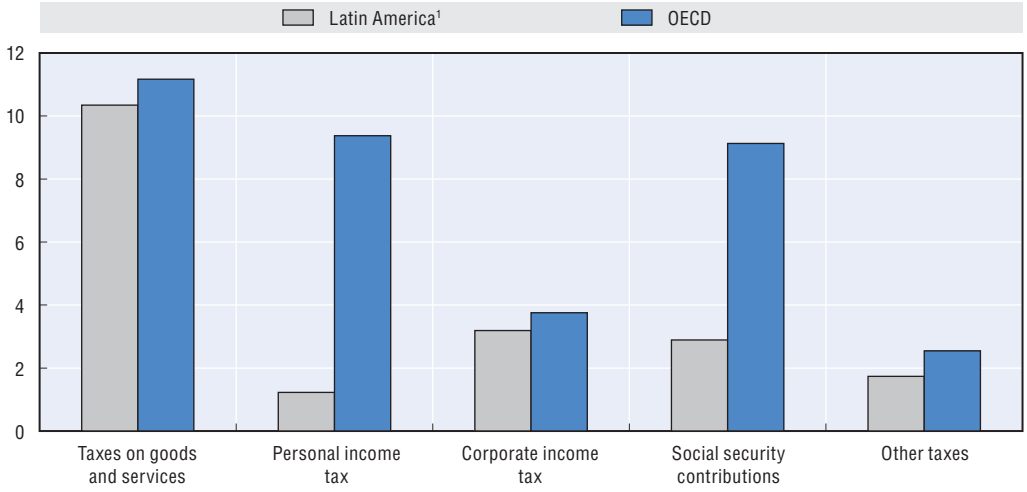
The composition of tax revenues in developing countries

Developing countries are not only characterised by low tax revenues (as a share of GDP) compared to OECD economies, but by a very different revenue structure. Much state funding comes from international aid (in the case of LDCs) and commodity-linked tax and non-tax revenues (like income tax on oil companies, royalties, and state-owned enterprises active in the relevant commodity sector). Both sources of income, highly volatile and unpredictable, pose considerable fiscal risks for countries. Furthermore, resource-related revenues can reduce the incentives for governments to raise revenue from forms of taxation that are politically more challenging, but have better economic and social implications. For example, in Latin America, while indirect taxation and corporate income tax (CIT) raise, on average, similar amounts of revenue (as a share of GDP), revenues from personal income tax (PIT) and social security contributions are significantly lower than the OECD average (Figure 5.5). Social security contributions are lower mainly because of high levels of labour informality, while the low PIT revenues are a combination of the region's highly concentrated income profile, a tendency to under-report income, and tax codes that teem with credits and exemptions (OECD, 2008b; OECD 2010a; and Daude *et al.*, 2011).

Although there are economic reasons for redistributing chiefly through expenditure and the delivery of public services, in many converging and developing countries tax systems could redistribute more. For example, in Latin America tax structures lead to systems that redistribute very little compared not only to developed countries, but to other middle-income economies (Prasad, 2008). East Asian and Eastern European economies – with similar GDP per capita levels to Latin America – respectively raise four and seven

Figure 5.5. **Main tax revenues in Latin America and OECD countries (percentage of GDP, 2006)**



1. The Latin American countries covered are Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Guatemala, Mexico, Peru and Venezuela.

Source: OECD (2008).

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times more revenue from PIT and property taxes (Di John, 2006). In this respect, the experience of large converging countries is also illuminating. While, in China, the population that pays income tax increased from 0.1% in 1986 to almost 20% in 2008, Indian PIT essentially remains a tax on the very rich (the richest 2.8% in 2008). The difference in the Chinese and Indian performances is reflected by the fact that PIT revenue accounted for 2.5% of GDP in China in 2008, while in India it has oscillated around 0.5% for the last 20 years (Piketty and Qian, 2009).

Heavy reliance on revenues linked to natural resources is another characteristic of many developing countries. Resource-related revenues present a special challenge for many converging countries in that they have little incentive to broaden their tax bases and increase fiscal legitimacy. In fact, for many resource-rich economies in Africa non-commodity-related taxes have stagnated or even declined in the last decade. While, on average, tax revenues as a share of GDP climbed from 22% in 1990 to 27% in 2007, most of the increase is due to a surge in taxes on resource extraction in oil-producing countries: they rose from 5% of GDP in 1996 to around 15% in 2006-07 (OECD, 2010b). Many resource-rich countries, including those which have recently discovered oil or minerals, tend to substitute resource-related tax revenue for revenue from other taxes (direct and indirect) or from trade.[14]

Resource-based revenue diminishes the role of tax revenue in financing the state and often lowers incentives for building a social contract between the state and its citizens. This dims the perception of a fair exchange between citizens who fund the state and demand, in return, public services and the right to participate in the political process (Bräutigam *et al.*, 2008). In recent times, several approaches to tackling this problem have been advocated. For example, the Extractive Industries Transparency Initiative (EITI) aims to improve governance of natural-resource revenues and reduce corruption.[15] Other proposals include setting up specially ring-fenced funds to manage revenue re-investment and distribute non-renewable resource rents across generations. An additional idea is to distribute a share of natural-resource revenues directly to citizens and to tax such transfers

as a way of creating stronger social demand for public goods and services and incentives for transparency (Moss, 2011; Gillies, 2010).

Another challenge – especially in LDCs – is the continuing heavy dependence on aid. For example, out of 51 countries covered in the OECD's *African Economic Outlook* (2010b), 13 received more aid than revenues earned, while around 50% registered tax revenues that were half the amount of their aid inflows. Of course, aid and domestic tax revenue efforts have to go hand-in-hand in Africa, but for many African governments the challenge is to break the vicious cycle of aid dependence, as it compels them to be accountable to their donors rather than to their citizens. Donors could help in this regard by devoting significantly more resources to technical co-operation for improving tax collection and administration with an emphasis on transparency. As of 2008, only 2% of all technical co-operation aid funds in Africa were allocated to activities related to public-sector financial management (OECD, 2010b).[16]

To summarise, converging economies are increasing their tax effort and opportunities by using fiscal policy to address social inequalities more effectively. Challenges nevertheless remain. Tax morale tends to be lower in converging countries, prompting many people to slip out of the social contract by evading taxes. As a result, fiscal policies are less effective in addressing social cohesion issues like income distribution. However, such challenges are amenable to policy action. The next section discusses some alternative fiscal policies that could bolster social cohesion by strengthening the social contract and the effectiveness of fiscal policies.

Social cohesion and fiscal legitimacy: Evidence and policies

This section looks first at some of the principal links between social cohesion and fiscal policy. It then considers fiscal policy options and institutional reforms that could improve social cohesion and instruments for strengthening social cohesion that could, in turn, make policies more effective. It focuses on three issues: fiscal decentralisation, institutional reform of tax administration, and the connection between expenditure policy effectiveness and social cohesion.

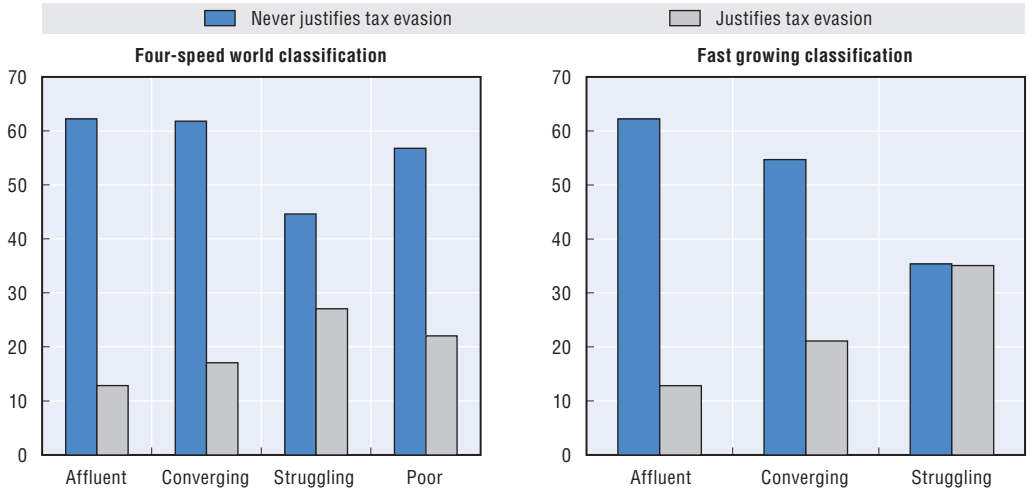
Tax morale and social cohesion

On average, affluent economies exhibit higher tax morale than converging countries and a much higher one than struggling economies. For example, while around 62% of people in affluent economies do not justify tax evasion under any circumstances, only 55% feel the same way in converging countries, with less than 35% sharing that view in struggling economies (Figure 5.6). Furthermore, the proportion of respondents that justify tax evasion is below 13% in affluent economies, around 21% in converging economies, and 35% within the struggling group. Interestingly, however, tax morale in poor countries tends to be higher than in struggling economies.

Countries where people feel safe and trust each other present significantly higher levels of tax morale. There is a positive, statistically significant correlation between tax morale and the index of interpersonal safety and trust compiled by the Institute of Social Studies (Figure 5.7).[17] Alternative ways to measure social capital – *e.g.* participation in social and political organisations, volunteer social work, and the degree to which people express concern about neighbours from a different faith or race – all show similar results at the micro level. They point to a greater willingness to finance the state in societies whose members share a common sense of belonging.[18]

Figure 5.6. **Tax morale in the four-speed world**

Percentage



Source: Authors' elaboration based on World Values Surveys.

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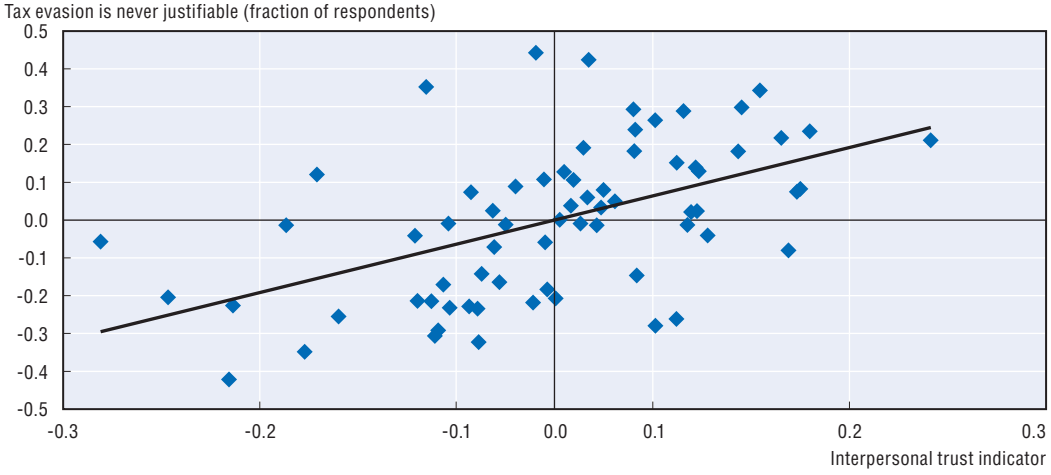
Figure 5.7. **Tax morale and interpersonal safety and trust**

Controlling for GDP per capita



Note: Data are residuals from regressing both measures on GDP per capita (in logs).

Source: Authors' elaboration based on World Values Surveys and Indices of Social Development (2011).

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Similarly, societies where there is greater civic participation and perceived mobility (when people think that hard work, not connections or luck, is the main determinant of success in the long run) also exhibit higher levels of tax morale. Evidence of mobility from Latin America shows that people who expect their children to move up to a higher income level, or who have experienced upward mobility, are less likely to justify tax evasion (Daude and Melguizo, 2011). They are also less likely to consider that taxes are too high. As there is no evidence of the desired level of redistribution, however, such observations are not conclusive proof against the POUM hypothesis. Nevertheless, they indicate that people who entertain prospects of climbing the social ladder are willing to finance the state and have a higher tax morale, which opens a window of opportunity for financing productive public investment that could result in a strong, positive impact on growth, job creation, and poverty reduction.

In countries where people do not trust their government[19] tax evasion is considered more justifiable. While people often justify tax evasion because it is the prevailing view among their fellow citizens, it could be the lack of vertical trust that makes them truly suspicious that their taxes will not be used to meet society's needs. If elites within the government carry out self-serving policies, the common citizen might think there is no legitimate obligation to finance government expenditure. Cross-country evidence is consistent with this hypothesis. It also holds good at the micro level after it has been controlled for country-specific differences and socio-economic characteristics. Similarly, evidence is in line with studies that make direct use of micro-data from opinion surveys for different time periods and regions.[20]

Given the strong links between fiscal legitimacy and social cohesion, reform efforts to increase revenue for financing social expenditure or productive investment should take into account that in many developing countries citizens do not feel part of the social contract and are consequently disinclined to support funding for the state. The result is a vicious cycle, as public policies with inadequate funding are less effective in involving citizens or delivering public services of the required quantity and quality.

Fiscal decentralisation: fostering social cohesion and increasing policy effectiveness?

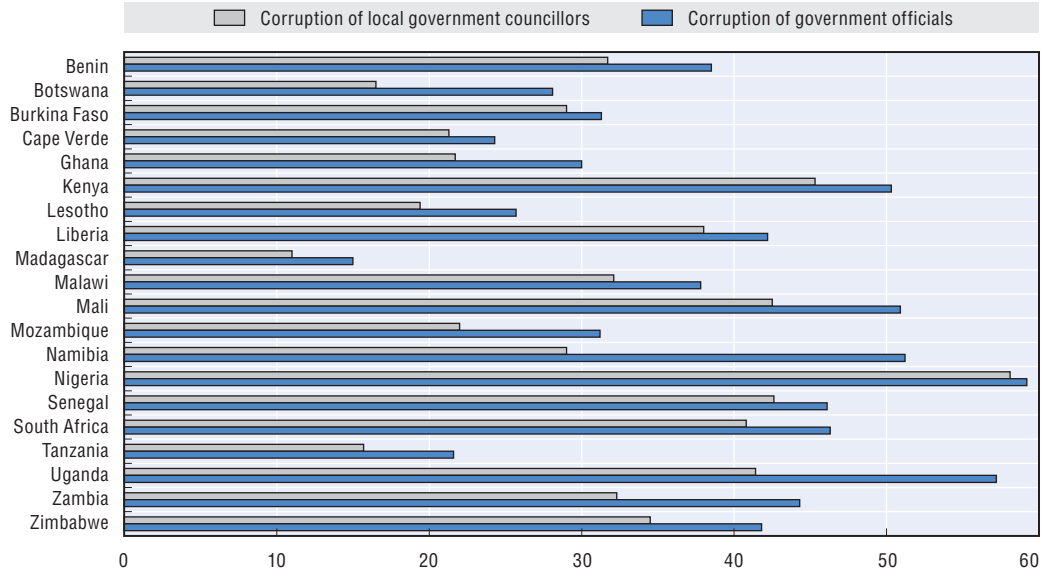
Fiscal decentralisation can be instrumental in strengthening social cohesion. Its potential benefits hinge on the notion of "fiscal correspondence" or "subsidiarity", which emphasises the efficiency gains of a public goods and services provision at local level that takes into account locally specific demands and priorities. Although it is costly to gather such information, local authorities can do so more cheaply than central government. Furthermore, decentralising the actual funding of publicly provided goods and services enables a better match between those who pay for them and those who receive them. It could also lead to greater internalisation of social costs and benefits (Olson, 1969; Oates, 1972).

In principle, fiscal decentralisation improves accountability and responsiveness as decisions match public needs more closely and results are easier to monitor. The empirical evidence also reveals a causal link between fiscal decentralisation and social capital indicators similar to those used in this report (De Mello, 2004). For example, Afrobarometer surveys indicate that most people in most countries perceive local officials as significantly less corrupt than those in central government. While an average of 40% of respondents thinks that most, if not all, central government officials are corrupt, only 32% take the same view of local councillors (Figure 5.8). Although this figure remains extremely high, it is significantly below the general perception of corruption and probably due to the fact citizens have more trust in local authorities because they are more responsive to their needs. This greater responsiveness can help make the delivery of public services more effective, as citizens take part in monitoring and even designing local programmes.

In the long run, greater local civic participation can have beneficial spillover effects at the national level, reinforcing the social contract between citizens and the government. However, the evidence is mixed. A study of the relationship between social capital and fiscal decentralisation across countries, with special emphasis on Brazil and Indonesia, shows that fiscal decentralisation strengthens people's pro-voice attitudes (De Mello, 2010). The institutional structure of the fiscal system within a country can, therefore, significantly increase citizens' involvement in government decisions: although stronger pro-voice attitudes have a positive impact on social capital in Brazil, they harm it in Indonesia. A possible explanation for the difference is that, because of Indonesia's

Figure 5.8. **Perceptions of corruption among local and central government officials in Africa**

Proportion of respondents that consider most or all officials corrupt (%)



Source: Authors' elaboration based on Afrobarometer's Value Surveys Databank (2008, 2009).

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relatively recent transition to democracy (and decentralisation), the positive effects of social capital may take longer to make themselves felt. Nevertheless, it is true that fiscal decentralisation can genuinely have adverse effects on social capital, *e.g.* making it easier for local officials to capture transfer resources. Case studies show both positive and negative results with decentralisation bolstering social capital and policy effectiveness in some cases (*e.g.* in Bolivia) and weakening them in others (De Mello, 2010).[21]

While fiscal decentralisation might increase the responsiveness of local government, involve citizens, and increase the quality and effectiveness of public policies, there are also potential limitations that have to be considered by policy makers when deciding how to implement it. For example, if local governments fail to internalise the effects of their policies on neighbouring regions or to co-ordinate their actions with them, inefficiencies and duplications may ensue. More fundamentally, demand for decentralisation can sometimes be the result of wide social and regional fragmentation, weakening national social cohesion and further worsening the situation.

On balance, a pro-cohesive decentralisation process hinges upon the capacity and willingness of political leadership and central government to truly devolve power and resources to the local level and to put in place systems for ensuring accountability (Jütting *et al.*, 2005).

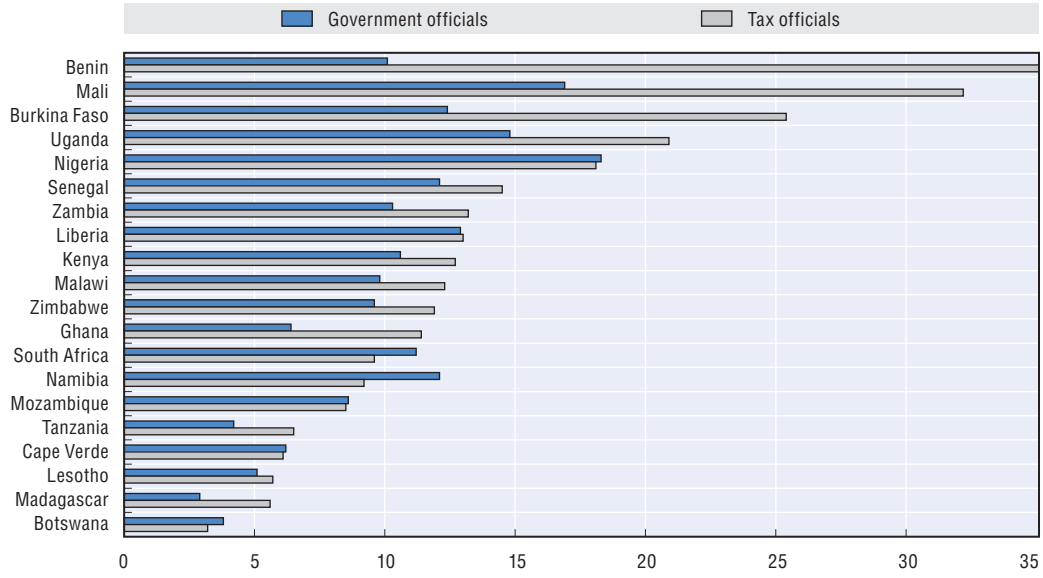
Institutional capacity-building in tax administration

Strengthening tax administration and collection – in particular its transparency and accountability – is another area of policy reform that has received attention in developing countries and international organisations, particularly as regards setting up semi-autonomous tax collection agencies. Proponents of this approach emphasise that "tax administration **is** tax policy" (Fjeldstad and Moore, 2008). The creation of semi-

autonomous tax collection agencies has been a common institutional reform in many developing countries over the last two decades. Most of them have budgetary autonomy and can make their own human resource and organisational decisions. In principle, the agencies are an attractive prospect as they deliver greater efficiency and transparency in a critical area of economic policy. If, as argued in Chapter 4, however, citizens and firms believe that the revenue they pay will be appropriated by corrupt tax agents instead of financing public expenditure and investment, they will not feel obliged to pay taxes. To increase fiscal legitimacy, therefore, it makes sense to increase transparency and make tax collection agencies less prone to corruption. Evidence for Africa seems to support this claim, as citizens in most countries perceive tax officials as significantly more corrupt than other government officials (Figure 5.9).

Figure 5.9. **Perceptions of corruption by tax and government officials in Africa**

Percentage of respondents that consider all to be corrupt



Source: Authors' elaboration based on Afrobarometer's Value Surveys Databank (2008, 2009).

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A number of initiatives have been undertaken in developing countries to increase transparency and trust and so enhance voluntary tax compliance. They include the recent tax education campaigns in El Salvador, South Africa and Zambia and the use of information technologies to reduce compliance costs (like the "pay as you earn" withholding tax in Uganda). Box 5.2 describes how Malawi used these elements to reform its tax administration.

Tax administration reform is more effective when combined with expenditure policy reform. As discussed above, better and more transparent tax collection must be linked to better public services. This fiscal exchange, which emphasises the link between services received in return for taxes paid, is essential to setting in motion a virtuous cycle of social cohesion and fiscal policy. If citizens perceive that they are not receiving adequate social protection, infrastructure, or public goods (*e.g.* public safety) in return for their taxes, or that the quality of the provision is low, they are less willing to pay taxes. The empirical evidence for Latin America confirms this hypothesis for education, health and public safety, but reveals less of a link in the case of pensions (Daude and Melguizo, 2010).[22] As for

Box 5.2. **Building fiscal legitimacy**

Taxation provides one of the principal lenses through which to measure state capacity, legitimacy, and power relations in a society. Joseph Schumpeter noted: "The fiscal history of a people is above all an essential part of its general history." Tax systems are also instrumental in building effective states because taxation is a core manifestation of the social contract between citizens and the state. How taxes are raised (and spent) shapes government legitimacy by promoting the accountability of governments to tax-paying citizens, and by stimulating effective state administration and good public financial management.

In 2004, the Malawi Revenue Authority decided to reward tax-compliant, tax-paying businesses. If, at the end of their annual accounting period, they met legal requirements and liabilities, businesses would receive tax compliance certificates. They would also be assigned revenue officers in charge of all issues affecting taxpayers, including reminders, tax information, and notices of audits to be carried out. Of broader significance, local banks unilaterally started using the certificates as an index of overall credit worthiness for businesses seeking loan finance.

The government of Malawi reports that this initiative has led to an increase in tax compliance for large and medium taxpayers and that there has been a motivational effect on smaller taxpayers keen to qualify for the certificates. Overall, incentives on both sides have resulted in a climate of improved relationships between the Malawi Revenue Authority and businesses, based on the principle of reciprocity. The way in which banks have used this initiative has considerably reinforced its impact.

Rwanda, too, undertook tax administration reform backed by the UK's Department for International Development (DfID). DfID's support for the Rwanda Revenue Authority (RRA), established in 1997, resulted in a dramatic increase in domestic revenue as a percentage of GDP – from 9% in 1998 to 14.7% in 2005. Costs of collection were also reduced. This success is attributed both to the strengthening of the RRA's internal organisational structures and processes, and the building of accountable relationships with external partners such as central and local government, a newly growing tax consultancy profession and taxpayers themselves. The RRA now plays an important role in strengthening relationships between citizens and the state, building a "social contract" based on trust and co-operation.

Source: *African Economic Outlook 2010*, based on Di John (2009), OECD and DfID.

Africa, access to health and education has a positive impact on tax morale, while the evidence is weaker regarding the actual quality of these services (D'Arcy, 2011).

Peru's sub-national semi-autonomous tax collection agencies (SATs) are an interesting case for understanding the strengths and weaknesses of institutional reform. There is evidence that these new agencies are more effective at tax collection than traditional government-controlled agencies, although not that they are more cost-efficient. The SAT scheme clearly shows some of the advantages of the tax administration approach for fiscal legitimacy, but also some of its limitations. There is a consensus that SATs, being more customer-oriented and transparent, have significantly reduced corruption in tax collection. However, as they operate separately from the rest of the public sector, improvements in compliance and transparency on the revenue side do not translate automatically into more or better public services. Citizens might feel that they are paying more for the same services, eroding fiscal legitimacy and ultimately undermining efforts to strengthen the social contract (Von Haldenwang, 2010).

To sum up: although tax administration reform is a useful tool for improving fairness, transparency and tax morale in developing countries, policy makers should bear in mind the limitations of institutional reforms when carried out in isolation. Because co-ordination between all branches of the civil service and government is essential, the autonomy of tax collection agencies can pose problems. Co-ordination with the ministry of finance, for example, is crucial: if tax collection agencies are set up in competition with other branches of government, the whole system is undermined and tax collection outcomes are rendered ineffective.[23] More fundamentally, tax administration reforms are no substitute for the broader reform agenda that addresses the legitimacy-related issues of fiscal policy. While such fundamental changes are not easy to implement, they are key if fiscal policy is to be a tool for social cohesion and development.

Sustainable fiscal policies

Stable, predictable financial resources are vital for the effectiveness of social policies. Many public policy interventions for increasing social cohesion are, by nature, long-term investments with benefits that accrue after several years. For example, education and health programmes require an important cumulative maturing process and disruptions due to lack of adequate funding during downturns can be costly (in human capital, for example). Furthermore, for social safety nets to be effective, the state must be able to step in during bad times, which means that fiscal space has to be constantly available. If this is not the case, citizens in developing countries assign low value to entitlements, perceiving them as not "real". The effectiveness of fiscal policies in delivering public services is thus jeopardised and its legitimacy undermined.

Public expenditure and investment in many developing countries are often volatile and procyclical. In other words, social expenditure can be limited, fragmented, and subject to sharp changes in size, as the Latin American example has shown (OECD, 2008b). The international evidence shows that such volatility in government expenditure often translates into a higher level of macroeconomic volatility and harms economic growth.[24] Although the pattern is more marked in developing countries than in OECD economies, even they are significantly affected by volatile expenditure. Reforms that help to ease expenditure volatility not only help policies to yield more effective results, but may also contribute to easing macroeconomic fluctuations and associated economic and social uncertainties.

Economic and fiscal institutions that de-link expenditure from current revenues are essential. An important role of macroeconomic fiscal policy is to create the conditions for sufficient, predictable fiscal space in order to finance development expenditure priorities linked to social cohesion – be they social pensions, unemployment compensation, education, or youth employment programmes. In this sense, many developing countries conduct fiscal policies which are of limited effectiveness in stabilising overall macroeconomic fluctuations. A less ambitious objective is to stabilise public expenditure over the revenue cycle. What are the types of institutions, rules, or frameworks that would be conducive to this aim and could be implemented in converging and developing countries? There is no single path. The experience of some developing and OECD economies, however, could be useful pointers as to what works best in different circumstances with different institutional, political, and economic constraints.

While the accumulation of international reserves has acted as an *ad hoc* stabilisation fund in several economies, separating fiscal savings from monetary reserves with greater

transparency and more effective rules would enhance the stabilising power of such savings. For example, one useful stabilisation tool could be rainy-day funds, where excess revenue is set aside for financing countercyclical fiscal policies in downturns. These funds would not, in general, accumulate assets in the long run, but smooth out short-term fluctuations in revenue. In principle, perfect access to international capital markets or multilateral lending would lessen the need for rainy-day funds, but most converging and developing countries cannot take such access to credit for granted. Revenue-smoothing self-insurance mechanisms could, therefore, be a useful complement to other international risk sharing arrangements. Naturally, it is important to maintain funds in instruments with high liquidity and low risk. These types of revenue stabilisation funds have been used in several OECD economies at national and sub-national levels and have been highly effective in calming volatility in public funding.[25]

In natural-resource-intensive economies, the surge in commodity prices linked to shifting wealth has created considerable opportunities but also challenges for fiscal policy and social cohesion. Beyond the economic problems of diversification and job creation, the main challenge from a fiscal viewpoint is complacency over abundant resources and lower incentives for raising revenues from other sources, particularly taxation. The result is a particularly weak social contract. However, well managed resource rents can help countries increase social cohesion by creating social programmes and ensuring their long-term sustainability. Persistently low coverage of its private pension schemes, for example, prompted Chile's government to create a non-contributory social pension in 2008. Good administration of copper revenues was an important tool for freeing up the necessary fiscal space for the reform. Furthermore, the creation of a special fund for financing the pension has ensured its sustainability beyond short-term fluctuations in public revenue. This option seems superior to funding social pensions directly through revenue from taxes on natural resources (how Bolivia currently funds its so-called "renta dignidad"), given that fluctuations in commodity prices can be very large and jeopardise the viability of pensions (UNRISD, 2010).

Although non-renewable commodity exporters may use sovereign wealth funds (SWFs) as an advantageous way of smoothing resource-linked revenues over time and across generations, they still have to address the funds' institutional and technical aspects to get the most out of them. SWFs are often set up to channel public savings towards more diversified portfolios than US Treasury bonds and to avoid excessive exchange rate appreciation by investing a large part of the funds abroad (Reisen, 2008). When creating an SWF, it is important to set a clear time horizon and expenditure priorities so that it has a coherent, properly defined investment strategy and portfolio. SWFs set up to finance countercyclical short-term expenditure (*e.g.* additional unemployment benefits) differ from those intended to finance social pension schemes. It is important, therefore, to manage resources separately. SWFs should also meet the same transparency and governance standards as other institutional investors. Mutual and pension funds, for example, generally have higher standards of transparency, which may include making public their portfolio benchmarks, communicating their investment strategy, and meeting some minimum credit rating requirements. Such practices reduce opacity and can help build public consensus as to the usefulness of the funds.

Numerical and procedural fiscal rules, as well as budgetary rules and transparency, can also help to make tax policy more sustainable and expenditure less volatile**.** Fiscal rules restrict governments' room for discretionary action by creating incentives to reduce procyclicality in fiscal policy: in principle, they reduce flexibility but deliver better fiscal

outcomes. Some countries, *e.g.* Chile, have introduced numerical targets for their cyclically adjusted budget balances, while other resource-intensive economies (like Norway) set fiscal targets for their non-oil fiscal accounts and use SWFs to manage their oil revenues. Other options – less intensive in their institutional and technical requirements – involve reporting structural balances in order to analyse performance and set objectives, budgeting over multi-year periods, and determining sustainability conditions. Clearly, there is no single institutional architecture that delivers the best outcomes for all countries. But certain combinations of rules and budgetary procedures can deliver more stable revenue management and so reduce funding uncertainties. When tax-related institutions are combined with explicit social expenditure objectives, the general public comes to value them more highly. A constituency for responsible fiscal policies may thus develop, bringing additional benefits beyond stable social expenditure funding, while contributing indirectly to a more cohesive society.

Key principles of fiscal reform

Political leadership and wide-reaching negotiation among stakeholders (parties, civil society, unions, business associations, etc.) are extremely important as tax reform in developing countries is most effective and sustainable when part of a broader development agenda. While reforming the tax and benefit system is always a complex issue anywhere, reform efforts in developing countries must take the fiscal legitimacy issue especially seriously. This chapter has documented the complex interaction between fiscal policy issues and social cohesion in a context where the legitimacy of the state is not taken for granted – which is the case in many developing and fast-growing, or converging, countries. Even the best and most technically sound reform might turn out to be unfeasible in a context of no or low fiscal legitimacy. This section sets out some guidelines for policy reform that can help bridge the confidence and funding gaps in developing countries and break the vicious cycle of low legitimacy and ineffective public policies.

Transparency, accountability, and an inclusive, citizen-based process are key elements in reforms to make tax and expenditure policies more effective tools for increasing opportunity, reducing inequality, and improving social cohesion. When citizens feel that tax officials treat them in an arbitrary manner, that they have no say in the type and quality of public services, and that they are excluded from the social contract, they just opt out (by joining the informal economy or evading taxes). It becomes more difficult, therefore, to put in place effective social safety nets or fair tax systems. In many developing countries governance is weak in all areas of the public domain. However, the central role of tax administration makes it a good place to start implementing greater transparency and the fight against corruption. International evidence shows that creating strong, professional, transparent tax administration helps improve enforcement and compliance, so increasing tax revenue significantly. New information technologies are also valuable aids, as they significantly lower administration and monitoring costs. Although low levels of revenue might suggest that tax reform is the first step in most developing countries, it might actually be easier and more effective to start by reforming the way public services are delivered. Again, transparency and civic engagement are key factors in building confidence in places where fear of corruption and arbitrariness is widespread. Administrative reform to increase the quality of services may also help in this regard. However, policy makers should consider embedding such reforms within a broader

strategy to modernise social relationships and steer the coercive nature of the state's dealings with taxpayers towards more balanced, reciprocal negotiation.

Fast growth and structural transformation in converging economies has not yet translated into solid fiscal positions or greater fiscal space for financing more ambitious social expenditure programmes or increasing productive investment in social and economic development. Furthermore, booming commodity revenues might tempt a number of governments to scale back the types of taxes they levy on citizens, so weakening links between taxation, civic participation, and public services. The shifting wealth context compels policy makers, therefore, to make trade-offs, but also offers them opportunities. For example, tax expenditures such as fuel and food exemptions are ill-targeted solutions to the surge in commodity prices and often undermine tax revenue. As the rich tend to spend more than the poor on fuel (particularly petrol), downsizing or eliminating fuel subsidies would eliminate substantial leakage, freeing up sufficient resources for other social spending and more than compensating losses incurred by the poor (Coady *et al.*, 2006).

Bundling aspects of expenditure and revenue reform might help to build in compensation for different veto players. It is often argued that the whole fiscal system, rather than just individual instruments, should be progressive so as to improve equality in income distribution. From this perspective, taxation should essentially raise revenues without creating too many distortions in labour and capital allocations, while social expenditure should redistribute. Clearly, balance has to be achieved between distribution and efficiency to make reform viable. For example, the elimination of VAT exemptions might be difficult to pass in isolation, given its regressive impact on income distribution, even though it might be justifiable from an efficiency point of view. However, if such reforms were offset by compensation on the expenditure side, they might also become acceptable from a distributive viewpoint. Another approach might be to introduce measures that add to conflicts of interest between different groups opposed to reform, so diluting their influence and improving the political feasibility of reform. However, such action needs to be handled with care because reform might prove unfeasible if everybody feels they have something to lose. Alternatively, revenue earmarking might, in some cases, help to signal a clear commitment to certain areas of social expenditure, but would have to be balanced against the risks of creating further budget rigidities and inefficiencies.

While expenditure is clearly a better instrument for transferring income to the poor (as the poor are often exempt from income taxes and also pay few indirect taxes), taxation also has a redistributive role to play among the emerging middle class in converging countries. In some countries (*e.g.* China and South Africa), personal income tax is becoming an important source of revenue and redistribution, while in others (notably in Latin America) it remains a marginal source. While highly progressive tax rates can – in principle – have efficiency costs, income tax clearly plays a central role in building fiscal legitimacy. In that light, the experience of Eastern European countries which combine an almost flat personal income with exemptions for the poor might be an interesting middle way for middle-income countries currently unable to raise substantial revenue from income tax. The evidence shows that personal income tax reforms based on the Eastern European example yield large increases in revenue through higher tax compliance – because taxation becomes easier to understand, is more transparent, and is also considered fairer (Gorodnichenko *et al.*, 2008).

Conclusion

What is needed to increase the likelihood of successful change in converging economies in the future is a better understanding of how tax morale and preferences for redistribution are affected by the institutional and economic fiscal reforms discussed in this chapter. To build such an understanding a research agenda needs to be drawn up. It would study issues of tax morale, preferences, and fiscal reform in a cross-country setting, while also drawing on the subjective surveys available. Alternatively, it could focus its work within individual countries where relevant reforms have taken place. Furthermore, "details" often neglected in academic research might prove to be essential to successful reform. Such information could become available to converging countries through policy dialogue based on peer-learning with other converging economies as well as OECD economies.

Notes

1. A classic example is the American Revolution which started as a conflict between the colonies and Great Britain on the issue of "taxation without representation".
2. See Milanovic (2000). For example, the correlation in OECD economies between pre-tax and transfer Gini coefficients and the resulting reductions in inequality after taxes and transfers is 0.73, statistically significant at conventional levels.
3. See Daude and Melguizo (2011) for an analysis on the relationship between taxation and democracy in Latin America. Part of the discussion presented here is also based on Daude and Melguizo (2010).
4. For discussion of each of these issues, respectively: Piketty (1995); Benabou and Tirole (2006) and Roemer (1998); and Alesina and Glaeser (2004). Alesina and Giuliano (2009); Alt *et al.* (2010) and Robinson (2010) also provide recent surveys of these matters.
5. Alesina and Angeletos (2005). Some evidence seems to support these views, *e.g.* the degree of self-interest (*i.e.* the expectation of being net beneficiary or net payer) and meritocracy respectively reduce the demand for redistribution between and within countries (Isaksson and Lindskog, 2009). Regarding unfairness and corruption, there is evidence that taxpayers perceive their relationship with the state not only as a relationship of coercion, but also as one of exchange. When they feel they are treated fairly, they are more willing to pay taxes (Torgler, 2005).
6. It is important to note that for the POUM to hold true, some – rather stringent – conditions have to be met. First, policies should be expected to persist. This condition rules out time-inconsistent fiscal policies and oft-observed strategies by politicians (*e.g.* promising redistributive fiscal policies during campaigns, but not delivering once they are in office). Furthermore, risk aversion should be limited because, under extreme risk aversion, everybody wishes to be insured against potentially bad shocks and so votes for a large welfare state. Finally, income distribution has to be such that the poorer-than-average should expect to become richer-than-average. Otherwise, concerns about downward mobility would also dominate.
7. Chong and Olivera (2008) show that countries with compulsory voting exhibit less income inequality. Therefore, since poorer countries also have relatively more unequal distributions of income, the authors support the promotion of such voting schemes in developing countries.
8. Social incentives might also play a role. For instance, even if middle-class households benefit from extensive redistribution, the fear of losing social status to the poor may prompt them to embrace a more conservative fiscal policy (Corneo and Grüner, 2000; 2002). Some authors also argue that demand for redistribution results from a balance between the aspirations of the middle and poor classes and the economy-wide disincentives they expect from a higher level of taxation. In particular, if poor and middle-income voters (potential beneficiaries of redistribution) take into account the effects of taxation on the labour-leisure decisions of their rich fellow citizens when voting, they will limit the size of government – tax revenues – and consequently the degree of redistribution (Meltzer and Richards, 1981).
9. See Daude (2011) for empirical evidence of the Latin American case.
10. See Aguirre *et al.* (1981), Bird *et al.* (2004), and Piancastelli (2001). Von Haldenwang and Ivanya (2010) analyse the institutional determinants of low tax performance in developing countries.

11. An econometric model was studied: it included GDP per capita, the share of services in GDP, the share of the primary in GDP and trade openness, as well as a set of year dummies for the period 2000-08. Tax effort was then computed as the difference between the observed tax-to-GDP ratio and that predicted by the econometric model.
12. The tax effort index is computed by regressing tax-to-GDP ratios on GDP per capita, the share of services in GDP, the share of the primary sector (agriculture and mining) in GDP, trade openness and year dummies for the period 2000-08 with all variables in logs. The index was then computed as the ratio between the observed tax-to-GDP ratio and that predicted by the econometric model.
13. Poor countries are not reported, as data availability severely restricts the number of countries in that group.
14. This is the case for Algeria, Angola, Botswana, Congo, Chad, Equatorial Guinea, Gabon, Libya and Nigeria.
15. For a critical assessment of the EITI, see Ölcer (2009).
16. Although they are private flows, remittances pose similar problems. In addition to potentially generating an appreciated exchange rate and therefore reducing profitability in the trade sector, remittances can also reduce the state's incentives to increase domestic resource mobilisation. Furthermore, they also generate important horizontal equity problems. Some programs like the "Tres por uno" in Mexico try to create benefits for the community from remittances.
17. The partial correlation coefficient (controlling for GDP per capita) is 0.52 and significant at a 1% level. The partial correlation with the alternative tax morale indicator (percentage of people that justify evasion) is negative at –0.55 and also significant at standard levels.
18. Survey-based evidence for 17 European countries from the European Social Survey also shows that ethnic-linguistic fragmentation has a negative and statistically significant impact on tax morale (Lago-Peñas and Lago-Peñas, 2010).
19. Trust in the government is measured as the proportion of people who reply that they trust the government either "completely" or "somewhat", as opposed to "not very much" or "not at all".
20. See Torgler (2005) for Latin America, Torgler (2003) for Central and Eastern Europe, and Torgler (2004) for Asian economies.
21. See also von Haldenwang (2008) for a discussion on social cohesion and fiscal decentralisation in Latin America.
22. This latter result might be due to the importance of private pension schemes in the region.
23. Fjeldsted and Moore (2008) argue that this has been a problem in several African countries (*e.g.* Uganda).
24. See Afonso and Furceri (2010) for evidence across OECD and EU of the effects on economic growth of expenditure levels and volatility, as well as Furceri (2007) on the negative impact of government expenditure volatility on economic growth beyond macroeconomic volatility and other controls that affect GDP growth.
25. See Fatas and Mihov (2006) for the case of US states.

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Perspectives on Global Development 2012
Social Cohesion in a Shifting World

Chapter 6

Employment and Social Protection Policies for Social Cohesion

Labour market outcomes and social protection are important determinants of social cohesion. Shifting wealth has altered the challenges for employment and social protection. Although it has created opportunities, it has also led to disruption in the form of changing functional distributions of income, tense labour relations, and changes in the risks faced by citizens. Looking at labour market and social protection challenges from the point of view of social cohesion calls for examining labour market institutions and social protection systems not only in terms of efficiency, but also their ability to prevent or mitigate duality and segmentation. Labour market institutions need to evolve to better accommodate the transformation in labour markets if they are to fulfil their price-setting and allocative roles and so produce fair outcomes that are achieved with minimal strife. Social protection systems that are segmented into social assistance for the poor and social insurance for formal workers risk leaving a missing middle among vulnerable but non-poor informal workers. A holistic approach that considers social protection systems in their entirety as well as their interactions with labour market outcomes helps identify such gaps and leads to different choices in programme design.

Introduction

Labour market outcomes are critical determinants of social cohesion. *First*, because they determine the level and distribution of labour earnings, which are the most important source of income for the great majority of people in the world. *Second*, because – beyond earnings – jobs are critical loci of social interaction. Having a job is positively linked to life satisfaction as measured in surveys across countries. This is especially true when it is a "good quality job", in which tenure and possibly earnings are predictable, secure, and provide social protection. *Third*, because social protection is a key policy tool for limiting degrees of inequality and preventing social exclusion. However, different regimes of social protection are accessible to citizens depending on job status, especially in the case of contribution-based programmes, which are often only accessible to formal salaried workers.

Shifting wealth has led to a dramatic fall in extreme poverty worldwide: the poverty reduction rate accelerated in 2000 to the extent that, by 2005, there were 320 million fewer people under the international USD 1.25 poverty line (Chen and Ravallion, 2010; OECD, 2010a). By some estimates, there are fewer than 1 billion poor in the world today.[1] This success has been achieved by creating productive jobs and generating fiscal resources that have allowed a number of countries to scale up their poverty reduction strategies (Chapter 1).

Fostering social cohesion requires more than reducing absolute poverty: first, because social inclusion requires a broader view of poverty and, second, because preventing the alienation of social groups calls for a holistic approach to social protection and labour policy. As pointed out in Chapter 4, ensuring social inclusion also requires that attention be paid to vulnerable groups who, though their survival is not at stake, require assistance to afford the costs of social inclusion. Preventing alienation between groups is best served by labour market and social protection policies that strive to avoid duality and segmentation.

Not only has shifting wealth created great opportunity, it has shaken up global labour markets, driving global labour shares of income down and underlining the challenge of distributing the proceeds of growth fairly among workers (Chapter 3) and all citizens (Chapter 4). The "great doubling" of the global labour force in the early 1990s, when approximately 1.5 billion workers were integrated into the global labour market in the wake of economic reforms and the collapse of the Soviet Union (Freeman, 2005; OECD, 2010a), is still having major repercussions. The rapid growth in converging countries since 2000 has been accompanied by faster growth in labour productivity. However, throughout this period, the share of labour in total value added has followed a downward trend in most regions of the world (Chapter 3).

The employment crisis that the economic and financial crisis of the late 2000s has left in its wake has put certain labour policies, particularly minimum wages, firmly on the political agenda. The growth in inequality in a number of countries has compounded the effect of the crisis, worsening the social climate (ILO, 2010a). However, changes in returns to labour and demands for greater redistribution in a number of countries, as this chapter

documents with reference to China, predate the crisis. They have disrupted labour relations and led to calls for changes in labour market institutions.

This chapter examines the role of labour market and social protection policies in cushioning the effects of rising inequality and segmentation that are linked to ongoing trends in the functional distribution of income and the persistence of informal work (see Chapter 3). The chapter highlights the fact that, contrary to the orthodoxy of the 1990s, labour market policies and institutions seem to be very much on the policy agenda, in both OECD and emerging countries and across the international community.[2] However, the transformation of labour market institutions requires that they be co-ordinated with other areas of policy and, in particular, with social protection. Some forms of social protection – particularly income support – can help ensure social inclusion and prevent downward mobility when labour outcomes are adverse. Because social protection and labour outcomes combine to generate the bulk of incomes, both social protection and labour market policies should consider their respective effects on labour market behaviour and outcomes as well as on incomes and their variability.

A holistic approach to social protection can help identify policies that foster social cohesion. Coverage is particularly important for at least two reasons: first, providing effective support to those most in need so as to ensure their social inclusion remains a challenge in many countries; second, access to social protection is also a matter of horizontal equality especially among workers (Chapter 4). Social protection is a form of institutionalised solidarity. Excluding certain categories from social protection systems, whether by neglect or by design, deprives them of risk management and risk-sharing tools and runs the risk of alienating segments of society. While the focus on the neediest is part of any development agenda that aims to reduce or alleviate poverty, a social cohesion agenda requires that attention also be paid to other forms of exclusion. In this respect, the chapter draws on recent evidence to show that combining contribution-based social security with targeted social assistance is not always sufficient and leaves a "missing middle" in the coverage of informal middle-income groups. Strategies to extend coverage while providing adequate labour market incentives exist. Ultimately, social cohesion will be fostered by holistic social protection systems that avoid reinforcing the dual nature of labour markets.

The remainder of this chapter is structured as follows: The next section examines the links between employment and social cohesion. This link is manifold, as employment affects both personal well-being and the sense of belonging. The chapter then re-examines the role of labour market institutions in the light of the evolution of labour relations, drawing on the Chinese example and the mounting body of country-specific empirical evidence. Finally, it goes on to analyse the interface between informality and social protection and to present strategies for covering the uncovered.

Employment and social cohesion

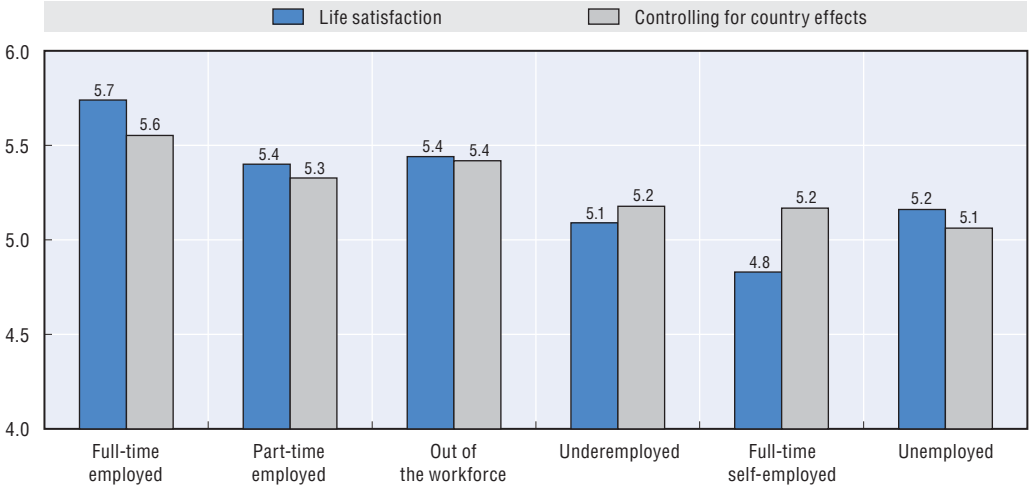
Productive employment matters for individual happiness. Employment does not only provide income, but also a sense of self and a focal point for social interaction, while involuntary unemployment is associated with a variety of adverse social and health outcomes (Stiglitz, 2002). Unemployment is an important determinant of the distribution of income. Beyond income, though, spells of unemployment have also been shown to diminish well-being. Even when the jobless do find work, the periods of unemployment they endure reduce life satisfaction (Clark *et al.*, 2001). Not only do their earnings fall, the

knock-on effects on their health and the education outcomes of their children can be permanent (ILO/IMF, 2010).

The quality and status of employment also matter. Self-employment is often a poor substitute for salaried employment when the economy fails to generate enough jobs. The average life satisfaction levels (Figure 6.1) of full-time employees are remarkably higher than those of other categories. For the self-employed, life satisfaction is substantially lower, closer to that of the unemployed. Although entrepreneurs value the independence that self-employment affords them, many self-employed would prefer salaried work.[3] The differences are smaller once country fixed effects are controlled for. National income is positively related to average life satisfaction and negatively to self-employment and vulnerable forms of work, but the unemployed are much more likely to receive support in more developed countries. Controlling for national averages therefore brings the differences down, although all remain statistically significant.

Figure 6.1. **Average life satisfaction by employment status, latest wave**

Cantril ladder, mean value



Note: Averages of individual responses to the Cantril ladder question "On which step of the ladder would you say you personally feel you stand at this time, assuming that the higher the step the better you feel about your life, and the lower the step the worse you feel about it? Which step comes closest to the way you feel with steps numbered from zero at the bottom to ten at the top?" weighted by sample weights multiplied by country population. The light grey bars correspond to an average country and are calculated as fitted values from a regression with country fixed effects. Differences between full-time employees and all other categories are statistically significant.

Source: Author's elaboration based on Gallup World Poll data (Gallup, 2010).

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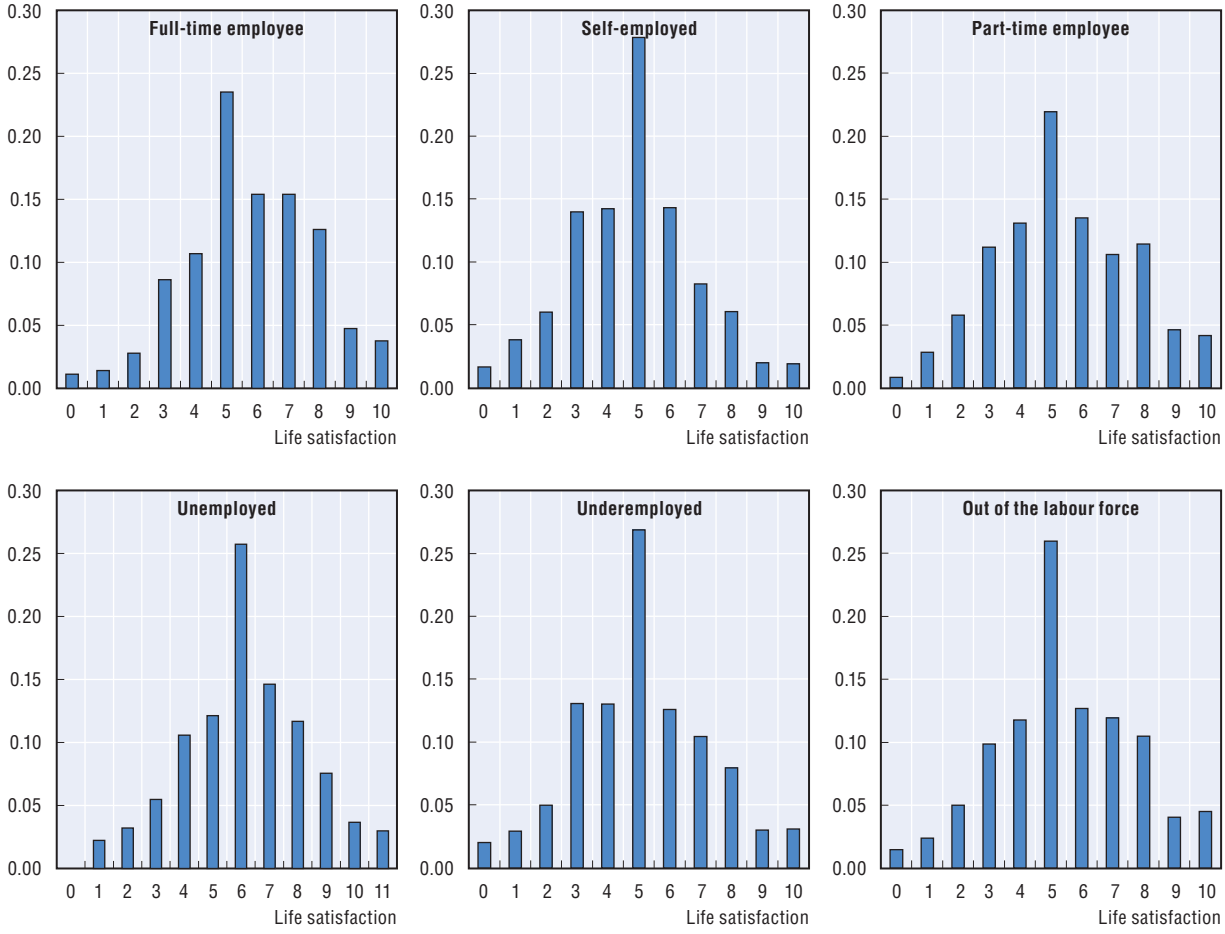
Observing the full distribution of life satisfaction across all job-status groups (Figure 6.2) shows that the results are led mostly by the number of people who declare themselves to be happy (answers higher than "8" on the life satisfaction scale in Figure 6.2). Such people are numerous among employees, whether part-time or full-time, but much less so among the unemployed, the self-employed, and the underemployed (those working part-time despite wanting full-time work). Correspondingly, a ranking can be established in terms of work status for life satisfaction outcomes, with full-time employment followed by chosen inactivity or part-time work, followed by underemployment and unemployment and finally, self-employment.[4]

Figure 6.2. **Distribution of life satisfaction by employment status, 2010 or latest wave**

Proportion by category and by Cantril ladder value



Note: Data weighted by sample weights and country population. People who work part-time but want full-time work are considered to be underemployed. Life satisfaction is measured by the answers to the Cantril ladder question "On which step of the ladder would you say you personally feel you stand at this time, assuming that the higher the step the better you feel about your life, and the lower the step the worse you feel about it? Which step comes closest to the way you feel with steps numbered from zero at the bottom to ten at the top?"

Source: Authors' elaboration based on Gallup World Poll data (Gallup, 2010).

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Aggregate employment outcomes also matter for social cohesion. Both income inequality and unemployment are associated with heightened risks of social unrest (ILO, 2010a). In practice, two different mechanisms, not easily distinguished in cross-country analysis, may be at play. Income inequality moves relatively slowly over time and may lead to feelings that income is distributed unjustly – in particular when average incomes are growing rapidly, as was the case during the 2000s in a number of emerging economies. Unemployment may also increase the risk of social unrest if it accentuates disaffection.

Labour market institutions and wage determination

The determination of wages and job conditions is key to the distribution of the benefits from growth. While labour market institutions were out of favour in international policy circles under the Washington Consensus, the pendulum seems to be swinging the other way, pushed both by successes and failures. The need for institutions capable of

peacefully and efficiently managing the transition in China's evolving labour market, on the one hand, and the necessary responses to the employment crisis on the other hand call for better, possibly new, labour market institutions. Certain traditional instruments of labour policy, such as minimum wages, have become particularly prominent in the discourse of recent times, but they remain partial solutions. Labour institutions and labour market regulations should be better integrated with social protection and other policies to help mitigate the effects of unequal income distributions, both between individuals and from a functional perspective.

The demand for labour market institutions in China[5]

The evolution of the Chinese labour market apparently matches traditional dual-economy development models closely. According to classic dual-economy models based on the "surplus labour" model (Lewis, 1954; Ranis and Fei, 1961), wages in the modern sector are kept low as long as there is sufficient surplus labour in the agricultural sector. They begin to increase only once the expansion in labour supplied to the modern sector falls behind labour demand.[6] Viewing the evolution of labour markets in emerging economies from this angle, the rises in inequality associated with structural transformation processes seem benign. Indeed, in the context of a dual economy, the increase in inequality is both desirable and temporary. Ultimately, once surplus labour has been exhausted, workers are paid their marginal productivity, so that remaining inequality in incomes reflects differences in ability.

The transition is not always smooth, however, and the exhaustion of surplus labour in China has coincided with a considerable increase in labour disputes. According to Cai and Wang (2011), the rate of increase in labour demand – as measured by urban workers plus migrant workers – has outpaced the increase in the working age population since 2003.[7] The increase in migrant worker wages outpaced that of urban workers in manufacturing and construction, suggesting labour shortages at prevailing wage rates (Cai and Wang, 2011). During the 2000s, labour disputes have become increasingly commonplace in China: there were 169 000 in 1999 and 870 000 in 2009. The number of disputes almost doubled in 2008 following the enactment and implementation of several pro-labour laws,[8] but has followed a steady upward trend since 1999.

The increase in labour disputes reflects a need for smoother wage-setting mechanisms. Wage demands were the reasons for almost half the disputes initiated by workers, both urban (43%) and migrant (49%) (Cai and Wang, 2011).[9] Most disputes, however, are low-intensity, with only a small minority coming to courts and the majority being resolved through mediation within enterprises.[10] Moreover, disputes are more likely on the richer eastern coast and among better educated employees, suggesting that they are indeed a means of bargaining over the proceeds from increased productivity.

The Chinese authorities have advocated developing collective bargaining as a means of maintaining social cohesion while the labour market transitions. Collective bargaining mechanisms were first piloted in the mid-1990s and have been evolving ever since. The 2008 landmark Labour Contract Law sets out regulations governing collective contracts. At the same time, tripartite co-ordination bodies have been set up at provincial level (in 2002) as well as at city and prefecture levels.

Although collective bargaining remains weak in China, unionisation and the coverage of collective agreements are on the increase. Only 94 million workers – or about 12% of the

labour force – were covered by collective contracts in 2009, up from 50 million in 1998. Union membership has also expanded, coinciding with an increasingly tight labour market. While it remained stable at about 100 million throughout the 1990s, union membership has more than doubled during the 2000s to reach 226 million – over a quarter of the labour force – in 2009 (Cai and Wang, 2011).

The demand for labour market institutions that has emerged in the Chinese case contrasts markedly with the view that labour market policies and institutions (minimum wages, job protection legislation, etc.) increase formal sector wages at the expense of labour incomes in rural informal sectors, where most of the poor work (*e.g.* World Bank, 1990).

The role and relevance of minimum wages

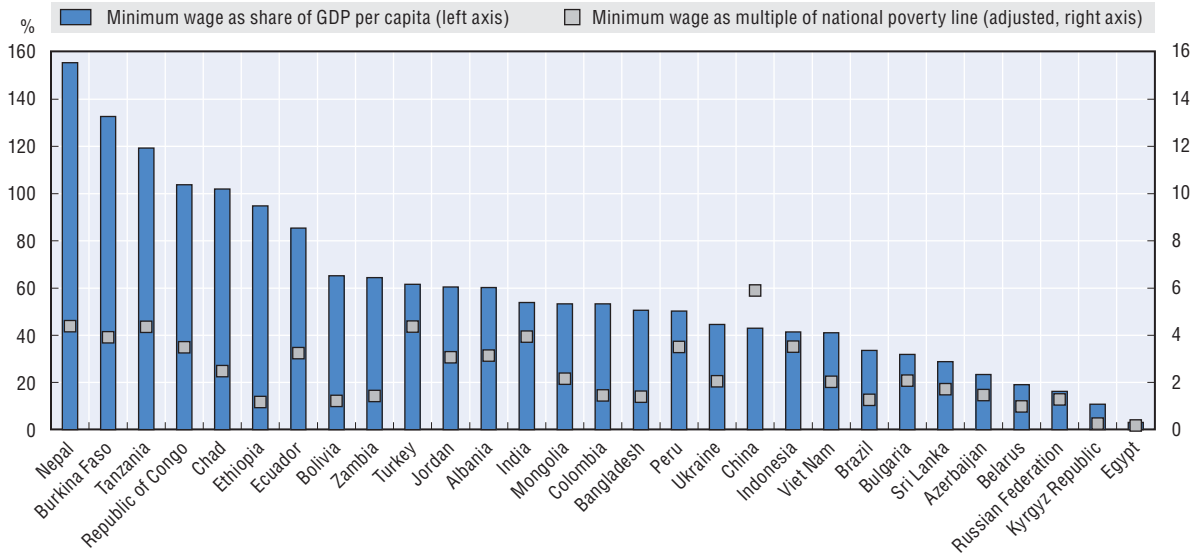
The issue of a minimum wage in developing countries has gained political salience in recent years. A significant number of countries increased minimum wages in the years before the financial crisis of 2007-08 (ILO, 2009), while others made changes in response to the crisis. Egypt is a case in point of just how the minimum wage has returned to the forefront of politics after years of neglect. Set at EGP 35 (about USD 6.5) per month since 1984, minimum wages eventually lost all relevance (Abdelhamid and El Baradei, 2009). As they remained fixed in nominal terms, they were eroded, dropping below 1% of GDP per capita by 2007. In 2007, average wages were over 30 times the statutory minimum wage. With the onset of the crisis, the Egyptian administration raised minimum wages by 30% in 2008 and then again in October 2010, setting them at EGP 400. Although the raises put the minimum wage back on the political agenda, the labour movement deemed them insufficient and the minimum wage became one of the demands of the social movement that ultimately ousted President Hosni Mubarak.[11]

Minimum wage hikes are often a plank in election manifestos in emerging and developing countries. The 2011 election in Thailand saw both main contenders enter into a bidding war, with the Democrat Party promising a 25% increase in minimum wages over two years and Puea Thai (who eventually won the election) promised a 40% increase. The elected president of Peru, Ollanta Humala, also ran on a platform that included a substantial 25% increase in minimum wages. Political debates on minimum wages seem more likely when, as in the Peruvian case, minimum wages have stagnated in real or even nominal terms for a number of years while the economy has grown.

Even when statutory minimum wages do exist, there are substantial variations between countries in their levels relative to national living standards (Figure 6.3). In the Russian Federation and Belarus, for example, minimum wages are not just low relative to national income; they are insufficient to sustain a family – as indicated by national poverty thresholds. At the other extreme, minimum wages in Nepal appear high relative to both GDP per capita and the poverty line. Indeed, average wages are estimated to be around 110% of the nominal minimum wage (ILO, 2010c).

Evidence shows that, in many developing countries, partial compliance with minimum wage legislation is sufficient for there to be a significant effect on the wages of low paid formal workers. In a number of countries, in Latin America,[12] but also in Indonesia (Harrison and Scorse, 2003) and elsewhere, the wage distribution has a spike at the minimum wage: a sizeable share of the workforce earns exactly the minimum wage. Often, however, a non-negligible share of the workforce earns less. Although compliance may be less than perfect – with minimum wage levels acting as a soft constraint –

Figure 6.3. **Minimum wages in selected converging countries relative to living standards, 2009 or latest available data**



Note: Minimum wages as a share of GDP per capita are annualised minimum wages for 2009 or the latest available year; minimum wages as per the ILO Global Wage database in some cases refer to certain occupations only. Minimum wages as shares of national poverty lines are 2009 minimum wages expressed in 2005 PPP USD and compared to national poverty lines collected by Ravallion *et al.* (2009). Poverty lines are adjusted using the country-specific CPI and may not correspond to actual poverty lines in force at the time of writing.

Source: Authors' elaboration based on the *ILO Global Wage Database* (ILO, 2010c), ICP 2005 (World Bank, 2008), World Development Indicators (World Bank, 2011a), and Ravallion *et al.* (2009).

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minimum wage legislation often acts as a guideline for wage setting both in formal and informal employment.

Minimum wages can impact negatively on total employment or increase levels of informality, but in most cases the effects are modest – an observation consistent with the debate sparked by contentious literature on the minimum wage in the United States. It is not because the minimum wages may have had negligible effects on employment that they cannot potentially harm employment levels. It is rather that, in the past, minimum wage levels were set bearing in mind the risks they implied (Freeman, 2009). The Colombian case, where the minimum wage was raised in the midst of the deep recession of the late 1990s, when the unemployment rate more than doubled to a historical high of 20%, tells a cautionary tale (Kucera and Xenogiani, 2009). Similarly, the rapid increase in minimum wages in Indonesia during the 1990s, where the statutory minimum wage doubled in real terms between 1990 and 1996, had sizeable negative effects on manufacturing employment, reducing employment growth at plant level by an estimated 6% (Harrison and Scorse, 2010). But such large changes in minimum wages are the exception rather than the rule.

A minimum wage often has positive effects on informal workers. Evidence, arising especially from Latin America, shows that increases in minimum wages raise rather than depress wages in the informal sector.[13] In Brazil, this is known as the *efeito farol* or "lighthouse effect". The mechanisms underlying the lighthouse effect are not well known and there are many possible explanations. If there is mobility between the formal and informal sector and some informal workers choose to be informal, then the minimum

wage, possibly discounted by the cost of payroll taxes and other contributions, serves as their reservation wage. A minimum wage can also serve as a guideline for determining compensation in the informal economy: if wage dispersion is high, then workers use the established minimum level as guidance to what they might expect. The standard-setting role of minimum wages is particularly important in countries with a history of hyperinflation, in which indexation – whether explicit or implicit – of remuneration to minimum wages was common. It is however possible for the anchoring role of minimum wages to change over time, as it did in Brazil after the introduction of inflation targeting (Messina and Sanz-de-Galdeano, 2011).

In cases where the minimum wage has modest effects on the amount of formal employment and positive spillovers that lead to increases in both formal and informal workers' income, they are a potentially useful tool against poverty. To the extent that it affects the earnings of low-paid employees, the minimum wage can increase incomes at the bottom rungs of distribution. The increase in the minimum wage in Brazil, which led to gains of 50% in real terms between 2003 and 2009, certainly played a part, together with social programmes, in the historic reduction in inequality.

Although a minimum wage has particularly strong impacts when other transfers are tied to it, as in the Brazilian case, the impacts are less well targeted. There are two consequences: *first*, it becomes difficult to estimate the effect of minimum wage policy on overall inequality, since other transfers to the same household (old age or invalidity pensions for example) increase simultaneously; *second*, indexing social transfers on the minimum wage makes increasing the minimum wage costly for public finances.

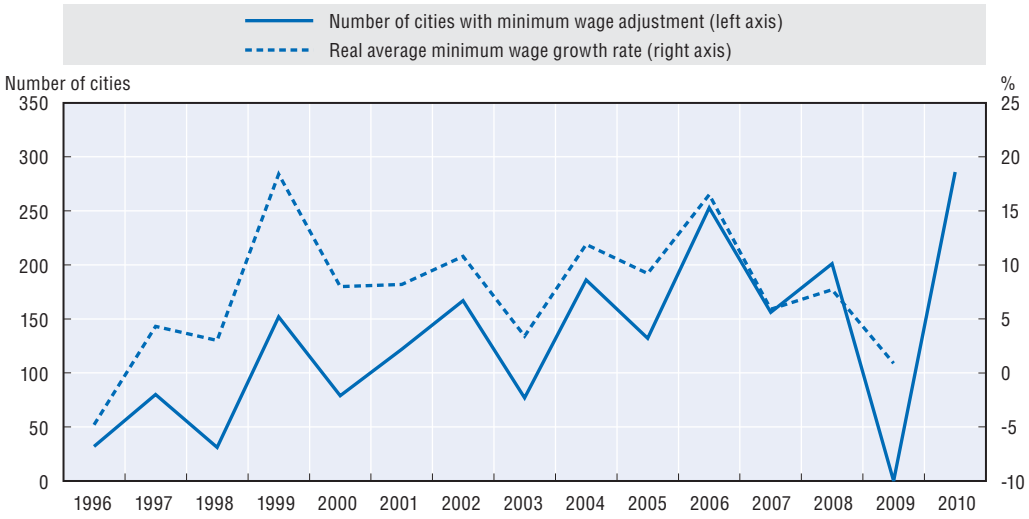
The multiple effects of the minimum wage instrument across labour market and social policy can lead to setting it at levels which are either too high or too low to be relevant. When it is too low, or allowed to be eroded by inflation, as in Egypt prior to 2008, it ceases to be binding or effective. Indexing social benefits or public sector remuneration to the minimum wage is one cause of extremely low minimum wages.[14] When it is too high, compliance becomes impossible for a substantial share of employers and it becomes, at best, a guideline for bargaining. In Indonesia, 50% of full-time casual workers receive less than the minimum wage and there are multiple exemptions, too.[15]

The re-emergence of the minimum wage as a salient issue is a mixed blessing for workers: although it can lead to higher incomes in the short run, it is also indicative of the weakness of collective bargaining. In Thailand, for example, union density is barely above 1% in the private sector (Saget, 2008). Minimum wage rises in China (Figure 6.4) accelerating after industrial relations have become more tense in the past years[16] can be viewed as a response to the weakness of collective bargaining, despite recent increases in union density.

Employment regulation

Employment protection legislation (EPL) affects social cohesion in several ways: it lengthens the duration of employment, so increasing security and well-being for protected workers. However, it also introduces differences between the protected and unprotected segments of the labour force. Moreover, it can affect levels of employment, at least in the protected sector. EPL refers to legislation that protects jobs by requiring severance pay or authorisation for layoffs. As remarked by Freeman (2009), employment protection laws essentially deal with property rights at work – whether the worker or the firm owns the job. The protection afforded by EPL does not necessarily overlap with formal employment.

Figure 6.4. **Increases in minimum wages in Chinese cities, 1996-2010**



Note: Minimum wages as a share of GDP per capita are annualised minimum wages for 2009 or the latest available year; minimum wages as per the *ILO Global Wage Database* in some cases refer to certain occupations only. Minimum wages as shares of national poverty lines are 2009 minimum wages expressed in 2005 PPP USD and compared to national poverty lines collected by Ravallion *et al.* (2009). Poverty lines are adjusted using the country-specific CPI and may not correspond to actual poverty lines in force at the time of writing.

Source: Institute of Population and Labour Economics of the Chinese Academy of Social Sciences, and Du and Pan (2009).

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Indeed, formal employees who work on non-standard contracts may be covered only by limited provisions or uncovered, and occasional or piece workers often have no coverage at all, irrespective of contractual status. Importantly, EPL does not only tilt the balance between capital (employers) and labour (employees), but also between insiders or experienced workers and new entrants.

Mandated employment protection is higher in many emerging and developing countries than in OECD countries. Indemnities paid on dismissal are estimated to be three times more costly in the average Latin American country than in the average OECD country (Heckman and Pagès, 2004). Severance pay in emerging countries tends to be significantly greater than for workers with similar characteristics and tenure in OECD countries (OECD, 2011). However, the total cost of complying with labour regulations is larger in OECD countries once payroll taxes are included, as they are higher on average in OECD countries than in emerging economies. Moreover, actual employment protection is much lower in emerging and developing countries due to non-compliance leading most workers to receive discounted amounts or no severance pay at all (OECD, 2011).

Fears that EPL might significantly lower aggregate employment have not materialised according to the available evidence, although there are notable differences from country to country. The assessment of evidence for OECD countries (OECD, 2006) concludes that the effect of EPL on overall unemployment is probably small. Studies of its impact on total employment find negative effects in some countries and none at all in others. Much of the evidence comes from Latin America, which tends to have both more costly job security provisions (Heckman and Pagès, 2000) and more available data. Even within Latin American economies, the evidence is mixed (Freeman, 2009): there are sizeable effects on unemployment in Colombia, but not in Chile, while findings from cross-country analysis do not always coincide with those from time-series or panel studies (see Kucera and

Xenogiani, 2009). This suggests that measures of job protection legislation and its cost taken across countries tend to hide important differences in implementation.

On the other hand, there are also cautionary tales of employment protection that is overly restrictive or increases costs while offering only limited benefits. The inference is that the quality and details of employment protection legislation matter. In stark contrast with the modest aggregate effects observed in Latin American studies, research into India not only finds that pro-worker employment legislation shifts workers and output from the formal to informal sector (Besley and Burgess, 2003), but that pro-worker legislation brings workers no gains. Similarly, Kucera and Xenogiani (2009) interpret findings that link the regulatory burden to the size of the informal economy as representing how labour is regulated (especially through firm entry) rather than how much it is regulated. The effects of labour regulation on employment outcomes also depend on enforcement, which is typically imperfect. Increased enforcement efforts in the case of Brazil led to lower rates of informality but also to more unemployment and smaller firms (Almeida and Carneiro, 2009). In Indonesia during the 1990s, increased compliance with minimum wages was the key avenue to increased wages in the textile, footwear and apparel industry (Harrison and Scorse, 2010).

EPL may have a larger effect on social cohesion through another channel insofar as it limits turnover in the labour market and therefore creates barriers for new entrants. Studies of changes in EPL for Chile and Colombia do find that weaker EPL is associated with declines in job tenure, higher separation rates, and increased hiring in the formal sector (Freeman, 2009). Using a firm-level dataset for a set of 16 industrialised and developing countries, Haltiwanger, Scarpetta and Schweiger (2008) find that, although industry and firm size account for a large share of gross job flows, labour regulations are associated with lower job flows. If labour legislation reduces the ability of firms to adjust their workforce accordingly, particularly in downturns, it may have effects on aggregate performance.

With regard to social cohesion, one of the potential problems raised by lower gross flows is that it may raise youth unemployment by increasing the time new entrants need to find a job. This may only be a transitional difficulty for many young people, but those who remain unemployed for long periods may develop disadvantages that will affect them permanently throughout their careers. One answer to such challenges is the creation of specific non-standard employment contracts (with limited protection) for the young. However, experience suggests that such fixes, albeit effective, can create a trap by which those eligible remain trapped in fixed-term contracts with relatively little prospect of upgrading human capital. From a general standpoint, this leads to dual labour markets – although in quite a different form from the divide between formal and informal employment – which can seriously harm social cohesion.

If labour regulations generate two-speed labour markets, they may increase the threat to social cohesion. Indeed, in dual labour markets, the brunt of adjustment is felt mostly in the more flexible part of the market, usually the most unprotected one. Informal workers, and those with little job security, therefore feel all the more insecure. According to the Economic Commission for Latin America and the Caribbean (ECLAC), perceptions magnify precariousness, so that fear of unemployment is up to five times greater than actual unemployment rates (ECLAC, 2007).

The concept of "flexicurity" provides one answer to the dilemma facing policy makers in determining the right level of employment protection legislation. The principle is to lower job protection, while increasing protection for workers when they are unemployed.

In practice, this involves first reducing job protection for formal workers who are incorporated into the social security system, while offering them viable unemployment insurance or income support. Such an approach requires careful co-ordination of EPL and other policies, especially unemployment benefits, income support, and active labour market policies (OECD, 2006). However, since the objective is to narrow the disparities in social protection and labour market outcomes between formal and informal workers, what needs to be found are viable social protection instruments for incorporating informal workers into the social security system without creating adverse incentives for their labour market behaviour, whether participation or formality. Informality compounds the challenge of flexicurity in developing countries given the difficulties in promoting social protection instruments that can adequately incorporate informal workers.

Solving collective action problems in labour markets

Beyond specific regulations, what is needed to ensure that workers get not only a fair share of the proceeds from growth but enjoy decent working conditions, are modes of social dialogue that can peacefully resolve individual and collective disputes. Trade unions have an important role to play, but it must be recognised that they differ markedly from country to country in the way they function, their objectives, and the outcomes they achieve.

When frameworks for the smooth resolution of differences fail, disputes can take a toll on the attractiveness of an economy, especially to foreign investors. Analysis of international labour allocation decisions by US firms (Box 6.1) shows that increased strikes are associated with a reallocation of labour away from a country. The effects are, however, very slight (the elasticity of employment to strikes is only 0.6%).

Box 6.1. **Social conflict and the allocation of labour – An econometric analysis of decisions by US firms**

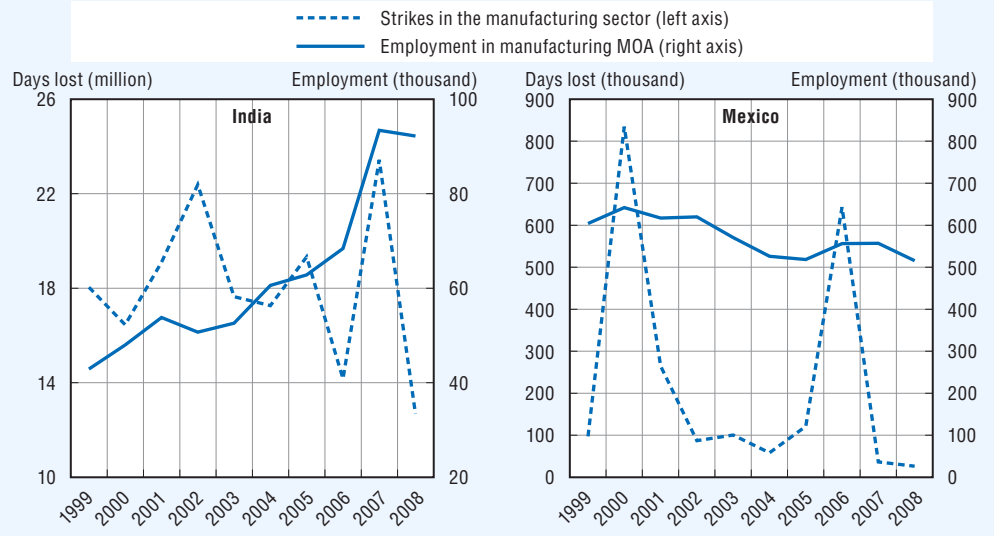
Multinational companies (MNCs) can reallocate labour between different locations and may thus be considered particularly sensitive to labour unrest. Yet there is little empirical evidence on the impact of industrial relations on labour allocation by MNCs. Mold (2011) looks at the empirical evidence using the case of US majority-owned multinational firms in the manufacturing sector.

The last decade has seen a significant reallocation of labour within US manufacturing firms, which closely reflects the shifting balance of economic power in the global economy. China has gained most in absolute terms, with an increase of over 200 000 employees in US manufacturing affiliates. Other BRIC countries are also well represented, while the losers have been the more traditional recipients of US FDI such as the United Kingdom, Canada and Mexico. The data show that at least for some countries, major changes in employment in MNCs were punctuated by spikes in strikes.

To quantify the effect of strikes on the allocation of labour, augmented labour demand for the manufacturing sector is estimated using a Cobb-Douglas production function, including labour unrest (measured by days lost in strikes data from the ILO), and controlling for local GDP per capita and firms' market orientation. The dependent variable is the number of employees in each affiliate. The market orientation variable (the share of local market sales in total production) measures whether firms' foreign operations are predominantly export-oriented **efficiency seeking** or **market seeking** (Dunning, 2000). Data availability limits to 24 the number of countries where there is comprehensive strike data over the whole period (1999-2008).

Box 6.1. **Social conflict and the allocation of labour – An econometric analysis of decisions by US firms** *(cont.)*

Figure 6.5. **Strikes in the manufacturing sector and employment in US manufacturing majority-owned affiliates in India and Mexico, 1999-2008**



* MOA means Majority-Owned Affiliates.

Source: Authors' elaboration based on BEA (2010) and ILO (2010d) data.

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Table 6.1. **Employment allocation and the incidence of strikes in US MOFAs, 1999-2008**

Regression results in first differences of logarithmic transformation of the model

Variable	DLOG (employment)
Constant	–0.010
DLOG (plant, property, equipment)	0.031
DLOG (value added)	0.079*
DLOG (strikes)	–0.006**
DLOG (GDP per capita)	0.455
DLOG (share of local market)	–0.301***
Observations	192
Adjusted R-squared	0.255

Note: ***, ** and * indicate significance on the 0.10, 0.05 and 0.01 levels respectively. DLOG stands for the first log difference and "1" is added to the number of strikes in order to allow for log transformation. The dependent variable is the first log difference of employment.

Source: Authors' elaboration based on BEA (2010) and ILO (2010d) data.

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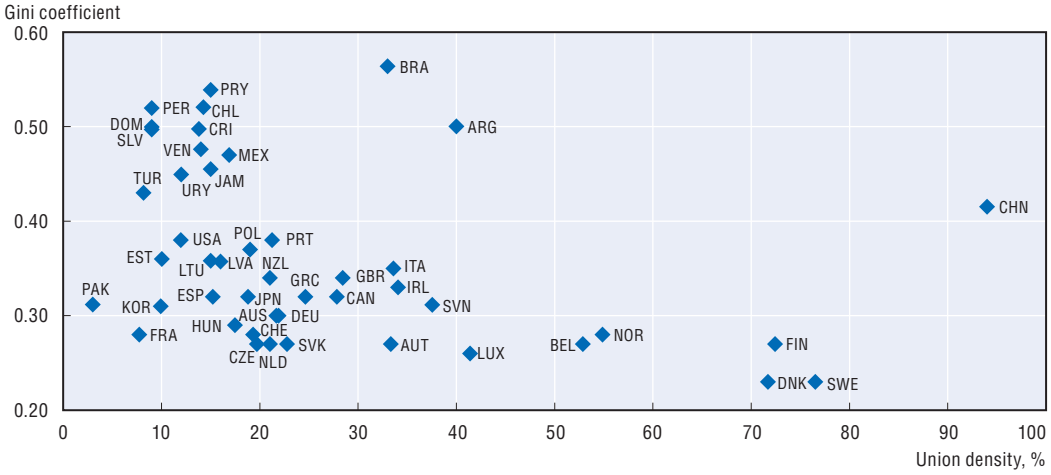
Strikes are found to be significantly and negatively related to employment, but the coefficient is extremely small – the elasticity of employment to strikes is 0.6%. Even if there were a doubling of strikes in a country, the result would still only be a 0.6% change in employment. However, the standard deviation of strikes is large, so that there is much variability around the mean. This high variability means that, year-on-year, there is wide variation in the number of strikes. Strikes might therefore have some noticeable effect on employment when their number escalates rapidly. On aggregate, however, the impact of strikes on employment in US manufacturing MNCs is at best modest. On balance, in determining the allocation of labour within the company, US firms seem to be priming locations for export markets (efficiency-seeking motives).

The available evidence from country-specific quantitative analyses of the economic effects of unions (Freeman, 2009) shows that unions generally obtain higher wages for union firms or union members. In some cases, the union-related wage benefit is larger for traditionally disadvantaged groups such as women (in Korea) or blacks in South Africa.

Unions also tend to narrow wage dispersion, which has two implications. The first is to reduce wage inequality, something which holds true across all countries (Figure 6.6). By altering the composition of inequality, there is also an effect on social cohesion, as the composition of the distribution of wages within and across groups changes. If unions reduce inequalities within groups but cause inequalities across groups – *e.g.* between urban and rural workers, formal and informal workers, or across skill categories – then the potential for social disorder may actually increase.

Figure 6.6. **Union density and inequality across countries**



Note: Gini coefficients are for disposable income (after taxes and benefits) for OECD countries. Trade union densities expressed as wage and salaried employee union members as a share of total salaried and wage employees when available [see data sources' methodological notes for details: *www.oecd.org/dataoecd/37/2/35695665.pdf* for OECD data and Baccaro (2008) for IILS data].

Source: OECD Income Distribution Database, *OECD Trade Union Density Database*, World Bank (2011a) and *International Institute for Labour Studies Trade Union Density Database*.

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A key difference in how unions function across countries – and possibly across industries – lies in whether, on top of incomes and work conditions, they also (or alternatively) bargain over employment. Maloney and Ribeiro (1999) find that unions in Mexico increase employment and, correspondingly, Menezes-Filho *et al.* (2005) find that unionised firms have lower profitability and productivity. While the effect on profitability is to be expected, the effect on productivity is by no means general. Indeed, unions may be more likely to organise in plants where rents and profitability are relatively high – see Cassoni *et al.* (2002) on the Uruguayan example. In such firms, capital investment may be sufficient to offset the increase in employment so that a negative relationship between employment and productivity across firms may not be observed.

Whether unions bargain for employment as well as work conditions and whether collective agreements are in place makes a big difference. In the Korean case, analyses of union effects find that workers on non-standard contracts who are excluded from

enterprise unions actually receive a wage discount in unionised establishments. Moreover, results suggest that unionism is associated with greater employment of workers under non-standard contracts, as firms substitute them for more expensive union labour.

When unions move away from being workers' representatives in well-established negotiation processes, the effects of unionisation on labour outcomes can be very different. Freeman (2009) discusses Zimbabwe, Cameroon and Senegal, where studies have found that union membership can mean wage discounts rather than premiums when – as has happened at various times in these countries – unions have entered into conflict with governments. (Conversely, the governing political party may also use them as appendages.) Clashes between unions and governments can have dramatic, long-lasting consequences on the capacity of organised labour to play a role in determining wages and working conditions. The union movement in Chile was persecuted during the military dictatorship and never regained its influence after the return to democracy in 1990: unionisation levels are currently below 10% (Solimano, 2011).

The contribution of unions and collective bargaining processes to enhanced social cohesion stems from the capacity of social dialogue (tri- and bipartite) to respond to tensions before they generate conflict and to adapt terms of negotiation to the economic environment. It is recognition of that fact that is behind the current attempts to establish a working collective bargaining process in China and tripartite committees for social dialogue in Korea.

In sum, the recognition of employment and quality of employment as key policy objectives, especially in the wake of the economic and financial crisis of the late 2000s, has made labour market policy a prime issue. Moreover, the mounting body of evidence from labour institutions has generally toned down the view (based on perfectly competitive labour market models) that labour regulations were the source of many woes, from informality to rigidity. Well designed regulations embedded in a recognised institutional framework can help labour markets adjust while protecting workers. However, especially if they reduce job protection, reforms to labour institutions need to be co-ordinated with reforms in other areas of policy. Indeed, in that case, it becomes necessary to increase the protection of workers, both in and out of a job. In countries with high levels of informality, this presents a formidable challenge, but one towards which much progress has been made in the past 20 years.

Implications for social protection

Social protection systems composed of sets of means-tested social assistance instruments and a social insurance system that chiefly serves formal salaried workers, leave a "missing middle" in their coverage. In middle-income Latin American and transition economies, social insurance systems which are mature, albeit limited in coverage, ensure coverage at the top of income distribution. In other regions, coverage for the better off is achieved mostly through private expenditure and self-insurance in the form of savings.

The emergence of large means-tested social assistance programmes holds promise as a way of closing the coverage gap at the bottom of the income distribution. Indeed, impact assessments and the evolution of the poverty gaps in countries where they have been implemented show that such instruments as conditional cash transfers, public works, and

employment guarantees increase income security. These innovative instruments need to be complemented by more traditional transfers and support for those of working age who are unable to work and for the elderly, for whom employment generation and conditions aiming at improving human capital make less sense. In fact, a number of countries, including low-income ones, have put in place social pensions (Barrientos, 2009; Barrientos *et al.*, 2010). They help to fill the gaps left when key social assistance interventions have implicit or explicit age limits or focus on building human capital and therefore do not directly support the incomes of the elderly.

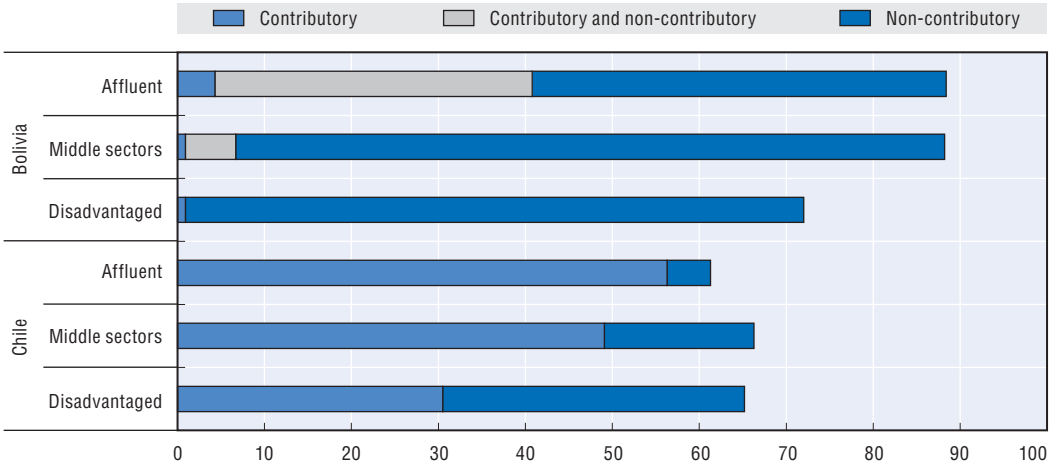
Can social assistance fill the coverage gaps in social protection?

Against certain risks, such as old age poverty, social assistance can fill the gap in coverage. Thanks to social pensions, 90% or more of the elderly receive regular pension payments in countries such as Cape Verde, Lesotho, Mauritius or Kyrgyzstan. This is despite active contributors to pension systems accounting for less than 30% of the working age population and, in Lesotho, a mere 3.6% (ILO, 2010b; Barrientos, 2009). Moreover, social pensions help narrow the coverage gap that exists between rich and poor. Figure 6.7 shows the share of over 65s in Bolivia and Chile who receive pensions, broken down by income group.[17] There are dramatic differences in those entitled to pensions from contribution-based systems: in Bolivia 40% of the elderly in affluent households receive such a pension, but less than 10% of those in middle income segments. Once social pensions are taken into account, the differences in coverage are much smaller.

For pensions at least, the dual model – contribution-based pensions paired with social pensions – seems to work, albeit with room for improvement. *First*, transfers can be relatively small, *e.g.* USD 2.3 per month for Bangladesh. *Second*, although social pensions are progressive, coverage among the poor still falls short, as in Bolivia (Figure 6.7). In Bangladesh, where targeting imposes quotas by ward, social pensions only reach 16% of the elderly (Barrientos, 2009).

Figure 6.7. **Old age pension coverage in Chile and Bolivia**

Percentage of over-65s receiving pensions in 2006 (Chile) and 2004 (Bolivia)



Source: OECD (2010b) based on National Household Surveys.

StatLink http://dx.doi.org/10.1787/888932518617

However, such dual systems can undermine social cohesion as well as the financial health of the contribution-based system, the social assistance mechanism, or both. Increasing coverage by generating dual systems throws up a number of challenges. The first is financing. Many people without coverage, especially if they are of working age, have the capacity to contribute, yet their income streams are less verifiable and often more variable than those of formal salaried workers. Fragmentation also leads to lower risk pooling and increased administrative costs. If sources of finance differ and non-contributory programmes are financed out of general taxation while contributory programmes are financed out of payroll taxes, formal salaried workers effectively contribute to the system twice. This can erode the support for certain anti-poverty programmes despite their relatively low cost.

A greater danger of fragmented systems is that they add to the duality of the economy and, in particular, of the labour market: if benefits are not fully portable, job changes that require workers to switch to another system become more costly for them. This is particularly true when systems are split along formal or informal lines, which can reinforce barriers to moving between formal and informal jobs. When schemes for informal workers are comparable to those for formal workers but subsidised rather than contribution-based, informality is effectively being subsidised (Levy, 2008). The degree to which this has an effect on the prevalence of informality depends on how easily workers can move between formal and informal jobs and on how much they value other aspects of formal work (including the protection of labour rights other than social security). However, to the extent that markets are competitive, such subsidies can alter the marginal returns of **capital**, thereby slowing down capital accumulation in more productive parts of the economy. Not only are dual systems that combine job-linked contribution-based social security with a social safety net less desirable from the point of view of social cohesion, they also leave a gap in coverage of middle-income sectors, which enjoy – at best – limited services and – at worst – are excluded, *de facto*, from both systems by the prevalence of informality.

The missing middle in social protection coverage

For the working-age population, the prevalence of informality places a further limitation on the dual model. The combination of means-tested transfers and contributory social security would only suffice if informal workers were poor and therefore among the target population of social transfers. This is not, however, the case. That poverty and informality do not perfectly overlap is obvious in countries where informality rates are substantially higher than poverty rates, *e.g.* Guinea, Mali and India. In these three countries informality in non-agricultural employment exceeds 80% (Jütting and de Laiglesia, 2009), while dollar-a-day poverty headcounts are respectively 70, 51, and around 40%.[18]

Moreover, means-tested cash transfers may not be adapted to the risk profiles of informal workers, which is also clear in income support, for example. For those who have no access to unemployment insurance, only social assistance can play the role of insurance against temporary falls in income. However, many social assistance transfers, such as conditional cash transfers, are aimed at alleviating permanent poverty – and rightly so, given constraints on the social budget. Moreover, these are often means-targeted and, in the absence of income verifiability, proxy means-tested. In practice, if no other instruments are available, proxy means-tested cash transfers will be systematically too little, too late. Indeed, ownership of productive assets is often a factor in eligibility calculation. Faced with major income or liquidity shock, such as illness or death, households will therefore need to resort

to selling their productive assets before they can access income support. By that time, if the assets are lumpy (such as, say, a truck or a mobile kitchen) and the transfers relatively small, the household will have fallen into a poverty trap.[19]

But poverty and informality do not necessarily overlap in countries with both lower poverty and lower informality, either. In a study of four Latin American countries based on nationally representative household surveys, da Costa *et al.* (2011) find that 44 million of the 72 million workers in households with adult equivalent income between 50 and 150% of median earnings are informal. Figure 6.8 illustrates this point. In the four countries covered, the lower bracket of 50% of median household earnings lies above the USD 1.25 (PPP) a day poverty line. They would not therefore be considered as belonging to the core targets for means-tested benefits.

Figure 6.8. **Informality and occupational status in the middle sectors**

Percentage of middle sectors by status

Note: Data for 2006 (Brazil, Chile and Mexico) and for 2002 (Bolivia).

Source: Da Costa *et al.* (2011) based on national household surveys.

StatLink http://dx.doi.org/10.1787/888932518636

The data show that, with the exception of Chile, most workers in the middle of the income distribution are informal. Rather than merely dividing workers into formal and informal categories, they are spread across six occupational groups – formal salaried workers, self-employed professionals, self-employed agriculturalists, self-employed outside of agriculture, informal salaried agriculturalists and informal salaried workers outside of agriculture. Self-employed professionals are identified as those who have completed higher education. The figure also shows that, although self-employment plays an important role, about 20% of workers in the middle income bracket are informal employees in each of the countries.

The self-employed are an example of workers outside of formal employment who contribute to pension systems, albeit to a limited extent. Self-employed workers usually have the option of voluntarily accessing the social security system under a special regime. Da Costa *et al.* (2011) find that a substantial number of them take up that option. In Brazil, where enrolment is compulsory, the self-employed contribution rate is about 38% among

affluent households and just over 10% in middle-income segments. The proportion of informal employees who contribute is much lower, however. Employees in informal employment would have to contribute under the self-employed regime, effectively subsidising their employers' social security contributions.

Filling the gaps: three strategies for innovations in social insurance

Incorporating informal workers into the social protection system is a necessity, a challenge, and an opportunity. Although they are not poor, many workers in the "middle sectors" are vulnerable and can slip into poverty in times of crisis. At the same time, although their income streams may be more volatile than those of formal salaried workers, many workers in the missing middle have saving capacity. Moreover, despite low average contribution rates, the positive relationship between contributions to the pension system and income among informal workers shows that there is latent demand for social protection. Coverage of middle-income households is also a way, therefore, of raising money to pay for the social protection system.

Three different general strategies can help cover the missing middle. The first consists of generalising unbundled contributory instruments, in particular if they have limited risk pooling. Limiting the amount of risk pooling brings entitlements into line with contributions, which helps limit adverse incentives for informality. The second is to subsidise the contributions of certain categories of workers to contribution-based social insurance, and the third universal entitlement to a subset of public services and assistance.

Unbundled individualised instruments

The clearest examples of unbundled individualised instruments are defined-contribution pensions. In their simplest form, they act as retirement savings accounts. They may also grant entitlements for topping up pensions and redistributive components based on contribution (rather than working) histories, thus allowing informal workers to remain affiliated and contribute even when working informally. It is now well established that, over a lifetime, workers in countries with a high prevalence of informality tend to move back and forth between informal and formal jobs. The minimum number of annuities, say 24 years of contributions,[20] is therefore unattainable for many workers, especially those already half-way through the active phase of their lives.

In Mexico, pension reform is one of the explanations for the relatively high contribution rates among informal workers. They are 11 and 19% for the middle sector and affluent workers, respectively, despite the relatively low coverage rates for formal workers (80 and 87%, respectively, compared to 99% for both categories in Brazil and 95% in Chile).

The same strategy underpins one of the most popular recent innovations in social insurance from Latin America – unemployment insurance savings accounts (UISAs). UISAs are mandatory individual accounts to which workers (and their employers) contribute in periods of employment and from which withdrawals can be made, at a specified rate, in periods of unemployment.

UISAs are widespread in Latin America, where they are used as an alternative or complement to social security unemployment insurance and severance pay. Brazil's *Fundo de Garantía de Tempo de Serviço* (Severance Indemnity Fund), which was established in 1967, works on this principle. With the exception of Chile, where 22% of the employed population has an active account (Ferrer and Riddell, 2009), most Latin American UISAs are relatively

small. Although they are generally open to and compulsory for formal employees only – in part because employers contribute to them as well – the system, much like defined-contribution pensions, could be opened to informal workers on a voluntary basis, at least.

UISAs differ from unemployment insurance in that they constitute a mechanism for self-insurance by compelling workers to accumulate savings during periods of employment. Conversely, unemployment insurance pools risk across workers and firms, and therefore has a redistributive role. The objective of unemployment benefits – whether in the form of UISAs or traditional unemployment insurance – is more akin to consumption smoothing than poverty reduction. However, it has an important role to play in limiting downward mobility among the middle class. Evidence from Central and Eastern Europe suggests that unemployment insurance reduced poverty among the unemployed by more than 50% in Hungary and 45% in Poland. Such an effect on poverty stems from the extensive coverage of unemployment in the region – 78% of Hungarian households with unemployed members received the benefit and 65% of Polish households (Vodopivec *et al*., 2005).

The main advantage of UISAs is that they circumvent the issues of verifiability associated with informality. Given large informal sectors with low entry costs, it is very difficult to monitor claimants to ensure they meet the conditions required by OECD countries' unemployment insurance systems, *i.e.* being unemployed and available to work. The "moral hazard" problem, whereby incentives to seek work are diminished by the receipt of benefits, is compounded by the possibility of "double dipping", *i.e.* claiming benefits while in fact working informally[21] (OECD, 2010b). Severance pay packages can help cover workers during spells of unemployment, but they are subject to the solvency of their last employer: in times of crisis, when they are most needed, severance packages may not be forthcoming. To counter this eventuality, many countries in the Latin American region have introduced self-insurance in the form of individual unemployment savings accounts. Argentina, Brazil, Chile, Colombia, Ecuador, Panama, Peru, and Venezuela have all introduced such schemes, especially for dependent workers.[22]

A typical UISA plan does not pool risk across workers and may actually deliver insufficient insurance, especially to young and vulnerable workers. The recent Chilean experience (established in 2002) offers a model with limited risk pooling. Employers and employees contribute both to an individual savings account and to a solidarity fund which provides top-up benefits where individual accumulated savings are low. Employees who have formal written contracts and have contributed to the scheme for at least 12 months are entitled to access their savings accounts and withdraw funds. Those who have accumulated less than two months' salary in their accounts are covered by the solidarity fund, unless there were fair grounds for their dismissal (misconduct, for example). Since workers own the balance on their individual accounts, the scheme incentivises job seeking.

Such individualised instruments make it possible to keep tight control over costs, since public funds are needed only to manage the system and, if necessary, to top up the capital in the solidarity fund. They are more a vehicle for self-insurance than insurance *per se*. In fact, the insurance element may very well be too small and the coverage too limited. In the case of unemployment insurance savings accounts, mobility between formal and informal jobs limits coverage. Even in Chile, where informality is the lowest in Latin America, unemployed workers are, on average, much less likely to have been in formal jobs with written contracts – around one-third report having had an atypical contract in their last job, and around 30% no contract at all. What is more, about 60% of the

unemployed had been in their last job for less than 12 months (Sehnbruch, 2006) and such workers are precisely those most likely to be affected by unemployment.

In policy design, unbundling has a very important role to play. While it is the individualisation of risk management that helps keep costs down in these schemes, it is the unbundling that enables them to capture the latent demand for unemployment or health insurance (including when it emanates from some informal workers). In fact, one of the ways in which social protection can contribute not only to social cohesion but to growth is by allowing households to overcome the market failures that prevent them from insuring against both life risks and certain covariant risks (Dercon, 2011).

Subsidised contributions

A second strategy consists of drawing workers into contributory systems by subsidising their contributions. An example is matched defined contributions in pension finance. These plans supplement mandatory social security pension plans and operate like retirement pension accounts. However, transfers are made by the state to these plans and are conditioned by the contributions of workers, much as employers match contributions for formal sector employees. Such plans have been introduced in Colombia, Mexico and Peru, for example. They are more promising approaches to the subsidising of contribution-based systems for informal workers than standard tools (tax deductions or tax credits) because the latter do not reach most informal workers. However, the available evidence from Mexico indicates that take-up rates have so far been low (Ferreira and Robalino, 2010). A similar scheme, the West Bengal Provident Fund, operates in the state of West Bengal in India. What distinguishes it from the Latin American experience is that it was designed to cover workers in the informal ("unorganised") sector and is means-tested. Although not, as yet, integrated into India's New Pension Scheme (NPS), the fund's defined-contribution character makes portability and integration much easier than in defined-benefit schemes.

Similar approaches are possible in health financing – with coverage of the uninsured (usually on a means-tested basis) financed from a providence fund – in systems where private care providers play an important role. For example, in Chile, the unemployed, inactive, and low-income workers are covered by the national health fund (FONASA), which ensures that they have access to care in the public system and partial coverage for private healthcare.

Towards universal entitlement

The third and final strategy to fill the missing middle in social protection coverage is to universalise entitlement to one or more social security functions, often by creating a parallel delivery or financing structure. Universal social pensions (which, like Bolivia's *Renta Dignidad* retirement pension, are not means-tested) are one example of this approach, but the most striking progress has been made in health. A number of countries have established national health services with the explicit aim of achieving universal health coverage, although coverage is often limited to a pre-established list of conditions.

Although the development of such programmes has often been gradual, it has also been remarkably fast. Thailand introduced a universal coverage (UC) scheme in 2001 to take in all hitherto uncovered citizens – workers in the public sector and private enterprises with more than 20 employees were already covered by occupational schemes. This compulsory UC scheme[23] helped Thailand achieve 98% coverage by 2007 (ILO, 2010b). Similarly, Mexico's *Seguro Popular* (*Sistema de Protección Social en Salud,* or social protection

system for health) offers basic healthcare coverage for a degressive, income-based, annual premium (and is free for the bottom income deciles). It was established in the year 2001 and covered 36.8 million people, or 75% of the universal coverage objective, by mid-2010 (Government of Mexico, 2010). Unlike Thailand's UC, the Mexican scheme relies on voluntary affiliation and a network of providers that was originally totally independent from the country's social security institute (IMSS) which provides medical services for formal workers. Advances in unifying delivery have been made since 2006, although the dual nature of the health coverage system remains.

Pluralistic approaches have also been used in poorer countries to increase coverage, combining national health systems with subsidised insurance schemes. In Ghana, as in other Central and West African countries, community-based health insurance (CBHI) schemes emerged in the 1980s and 1990s as a response to user fees in healthcare. Especially active in rural areas, the schemes are small-scale, voluntary health insurance programmes, organised and managed in a participatory manner, often at the behest of NGOs, community organisations, and even commercial companies. Compared to the traditional informal mutual help networks, CBHI offers well defined *ex ante* protection with reliable premiums (Tabor, 2005). Such insurance allows members to cover low-frequency, high-cost events – especially hospitalisation – when health service supply is available (Jütting, 2003). Despite these advantages, most CBHI schemes remain small: from a subset of 44 schemes Carrin, Waelkens and Criel (2005) found the median value of coverage among the eligible population to be 24.9%; 13 schemes had a coverage rate below 15%, and only 12 had a coverage rate above 50%. These schemes only covered 1% of the population in Ghana by 2002.

On establishing its national health insurance scheme (NHIS) in 2003, the Ghanaian authorities recognised CBHI and private commercial schemes as two of three forms of insurance, while establishing community-based district mutual health insurance as the vehicle for subsidised access to healthcare. These community-based units identify and categorise beneficiaries, including those who are exempt from payment (the core poor, those aged 70 and over, and retired contributors to the social security system). By 2008, some 12.5 million Ghanaians or 61% of the population were registered with the NHIS (ILO, 2010b).

Establishing universal rights to healthcare has proven to be quick and relatively affordable, even in lower middle-income countries. By the mid-2000s, a number of Latin American countries – Chile, Uruguay and, to a lesser degree, Peru and Colombia – had managed to significantly reduce or eliminate gaps in health coverage (Ribe *et al.*, 2010). Even in countries with fragmented systems, the coverage gap was greatly reduced by the establishment of national health insurance systems, universal coverage plans, or subsidised access to the contribution-financed system.

The need for greater coherence across social and economic policies

Labour market effects of social protection

A common concern in designing, and especially scaling up, social protection instruments is that they should not have adverse effects on labour market behaviour and undermine growth prospects. Transfers, whether unconditional or contingent, may reduce labour supply through an income effect. If they are contingent on certain labour market statuses, such as unemployment, which is typically difficult to observe, they may lure job-seekers to informality or tempt them to ease up on the job-hunting efforts. As highlighted

in the previous section, informal workers are vulnerable, which can pose difficult trade-offs between social and employment policy objectives.

A growing body of evidence suggests that such trade-offs take different forms in emerging and advanced countries (OECD, 2009; 2011; DfID, 2011). The differences are due to the prevalence of informality, to the relatively small income effects that can be expected when transfers are relatively less generous, and to the existence of other market distortions (particularly access to capital) which transfers can alleviate and thereby increase returns to labour and incentives to work.

In some cases, effects do follow the same patterns as in advanced countries. Unemployment compensation in Brazil makes it more unlikely that a job-seeker will start a new job, while in South Africa, where social assistance is fairly generous, the old age pension scheme reduces the labour supply from other household members in recipient households (OECD, 2011). Indeed, in the South African case, an additional factor is that when unemployed working-age members of the family rejoin the household, the social pension acts, in part, as a substitute for unemployment assistance (Klasen and Woolard, 2009). This effect demonstrates that the size of the grant is sufficient to cause changes in labour market behaviour.

In many other cases, however, effects differ because positive impacts on labour market participation or productivity dominate. Empirical studies of the effect of non-contributory healthcare – including evidence from the expansion of Mexico's *Seguro Popular* – find either no relationship with, or only small effects on, the rate of informality (OECD, 2011). Similarly, cash transfer programmes have no adverse effects on labour market participation (DfID, 2011; Alzúa *et al*., 2010). On the contrary, they may impact positively by relaxing constraints on entrepreneurship. Moreover, cash transfers have also been found to have positive wage effects on beneficiaries in Mexico (Alzúa *et al*., 2010) and to boost the wages of the lowest paid workers on the Employment Guarantee Scheme in Maharashtra – the precursor of the National Rural Employment Guarantee Scheme in India (DfID, 2011).

Programme design also helps to avert adverse labour market effects from social protection mechanisms. Conditionalities by which the delivery of benefits is tied to certain behaviours (especially schooling and health monitoring) ensure that human capital effects are extensive and improve outcomes in the long run. Withdrawal or "graduation" mechanisms from social assistance programmes also matter. Smoother withdrawal rates – by which benefits are only reduced rather than eliminated as households become less poor (*e.g.* the South African old age pension and Mexico's *Seguro Popular*) – and the looser application of means tests allow vulnerable households to receive a greater share of the marginal returns from working, which in turn eases any loss of incentive to look for employment. Looser eligibility criteria also ensure greater coverage among vulnerable households near the poverty line, but come at a cost to targeting efficiency, thereby increasing total programme costs. The strictness and frequency of means tests should match the poverty profiles targeted so as to protect the chronic poor even when they step out of poverty.

Building social protection systems for social cohesion

The strategies outlined above have succeeded in widening social insurance coverage in some social security functions, at least. A deep rethink of social protection systems is nevertheless necessary. Indeed, the success of the strategies in generating contributions from those outside social security systems has been, at best, modest. Incorporating

informal workers into contributive social security systems or the taxpayers' base requires a change to the terms and methods of contribution. Greater flexibility in the amounts and regularity of contributions, for example, can help incentivise voluntary contributions (Hu and Stewart, 2009).

Moreover, although this chapter has focused on coverage gaps, fragmented systems still exhibit differences in the depth and breadth of coverage between those covered by contribution-based and social assistance systems. This same observation has already been made in the case of social pensions and has also emerged clearly from a number of national health service systems.[24] The issue is not exclusively one of public provision of insurance, but of missing insurance markets. Informal workers who cannot access social security systems unless they subsidise their employers by contributing as self-employed – something that very few of them do – have no option but a private health insurance that rarely caters to their needs.

Being part of the same social protection system – whether through social security or paying the taxes that finance social services and transfers – is an important element in building social cohesion. Social protection systems provide the means for societies to eliminate certain forms of social exclusion and to limit downward social mobility. They are also – along with progressive taxation and public service provision – an important determinant in the distribution of living standards in the population (Chapters 4 and 5).

Conclusion

Employment outcomes are key determinants of the distribution of income and of personal and societal well-being. Having a job – but not just any job – increases personal well-being and can help sustain and foster a sense of belonging that enhances social cohesion. Because they jointly determine a large share of household income, labour markets and social protection systems are crucial to fostering social inclusion by ensuring adequate living standards. Moreover, the balance between assistance and responsibility is a key ingredient of the social contract that enhances a feeling of community among citizens.

Despite rapid growth and growing labour productivity, workers have not received a fair share of the proceeds from growth during the period of shifting wealth, as the downward trend in labour shares of income testifies. Moreover, these patterns are also unfolding within industries, showing that they are not merely caused by structural transformation or by increases in the capital intensity of production through industrialisation.

The profound changes that shifting wealth has ushered into countries require that labour markets are able to adjust prices and work conditions to the evolving social and economic realities. Unregulated markets in China have not been effective in adapting to the changes: they have generated unrest and a dramatic increase in labour disputes. In other countries, fears that international competition could lead to a race to the bottom in labour standards and calls for policies that provide workers with greater protection press the case for more labour regulation. Labour market institutions should be able to set fair prices and adapt to changes in social and economic circumstances. However, the provision of protection to workers through labour regulation rather than effective social protection systems can be costly and lead to uncertain outcomes.

A re-examination of labour institutions in the light of recent evidence suggests that there is scope for labour institutions – minimum wages, collective bargaining, unionisation – to help protect workers with limited or no negative effects on labour market

efficiency. However, the experience of a number of countries shows that institutions need to be carefully designed in order to avoid unintended negative consequences. Labour institutions that severely limit turnover and create obstacles for new entrants into the formal sector – whether they come from the informal sector or are young people trying to break into the job market – can accentuate the duality of labour markets. Duality hinders their effectiveness and can damage social cohesion and labour relations.

The search for appropriate forms of labour institutions, including those based on new visions of labour markets and social protection, of which flexicurity is an example, must contend with the problem of social protection provision for informal workers. Recent innovations in social protection (the expansion of cash transfers, conditional or not, social pensions, and new forms of health coverage) have helped narrow the coverage gap. However, they often create dual systems, where the bottom is covered by social assistance and the top by contribution-based social security, private insurance, or self-insurance.

Dual social protection systems leave a "missing middle" in coverage among the large informal middle-income strata of the population. In response to the missing-middle challenge, a number of instruments have been put in place. This chapter divides them into three strategies: unbundled contributory instruments with limited risk pooling, subsidised access to contributory social security systems, and universal entitlements.

Of these, universal entitlements offer the best prospects for coverage and incentive structures for the labour market. However, financing them can be challenging if they are to afford a reasonable level of coverage. The need for a source of finance that can ensure the long-term sustainability of funding and accommodate the counter-cyclical nature of expenditure is a particularly difficult challenge, which shifting wealth can help an increasing number of countries meet (Chapter 9).

Reforms in labour market institutions and social protection systems can foster social cohesion by curbing inequalities in outcomes and opportunities. But they need to be part of a holistic agenda which should consider the mutual relationships between the functioning of labour markets and social protection: the work incentives created by social protection and how social protection can be adapted to informal workers, including those who have the capacity and willingness to pay. However, a holistic agenda needs to go further and consider how employment and social cohesion outcomes are linked to the structure of the economy so as to move towards the creation of more and better jobs which are accessible to all.

Notes

1. The global dollar-a-day poverty rate is believed by analysts of world poverty to have continued its downward trend to this day. Estimates vary substantially between authors and methods. Chandy and Gertz (2011) estimate a global poverty rate of 15.8% for 2010, down from 25.2% in 2005, while the World Bank (2010) forecasts that level to be reached in 2015.
2. As demonstrated, in particular, by the International Labour Conference's adoption of the Global Jobs Pact in June 2009.
3. According to Perry *et al.* (2007), the proportion of the informal self-employed who would rather be employees is 40% in Argentina, 25% in Bolivia and the Dominican Republic, and 59% in Colombia.
4. A plot of the cumulative distributions shows that the distribution of life satisfaction for full-time employees exhibits first-order stochastic dominance of the other distributions, except at the maximum level of satisfaction, while the distribution of life satisfaction of the self-employed is dominated by that of other groups. The other statuses lie in the middle, with part-time employees

and those out of the labour force dominating the underemployed and the unemployed. Because the distribution is discrete, a simultaneous plot of all distributions is very difficult to read and is therefore omitted.

5. This section is largely based on a background paper prepared for this report (Cai and Wang, 2011).
6. Or, equivalently, once the labour supply curve is no longer perfectly elastic at the subsistence wage received in the traditional sector. This is referred to as the "Lewis turning point".
7. There is some debate about when upward pressures on wages from labour supply began and about whether surplus labour still exists in some areas (Knight *et al*., 2011).
8. The Employment Contract Law, the Employment Promotion Law, and the Labour Disputes Mediation and Arbitration Law were all implemented from 2008.
9. The main causes of dispute in the remainder of cases differ between migrant workers for whom wage arrears account for 34% and urban workers, where separations (18%) and working time (17%) are the causes of most disputes.
10. The Labour Disputes Mediation and Arbitration Law of 2008 put in place a system of arbitration that is free of charge, which covers about 30% of disputes.
11. The minimum wage was raised again to EGP 700 per month in June 2011.
12. See Bell (1997) for Colombia, Maloney and Nuñez (2004) for eight Latin American countries, Lemos (2004) for Brazil, and Saget (2001) for further references.
13. See Lemos (2004) for the Brazilian case and Saget (2008) for the Indian state of Punjab, Indonesia and South Africa.
14. In the Uruguayan case, the minimum wage was de-linked from social security benefits in 2004. While it was non-binding prior to that – only 3% of workers benefitted – it was subsequently increased by 70% in real terms in 2005 (Saget, 2008).
15. The situation is similar in the Philippines or Thailand, where minimum wages represent high shares of average wages yet apply only to a fraction of the workforce.
16. The adjustment of minimum wages to increases in the CPI was frozen in 2009 due to the crisis.
17. The threshold lines between the three income groups are set at 50% and 150% of the median of adult-equivalent total household income (OECD, 2010b).
18. Latest available USD 1.25 PPP a day poverty headcount rates from PovcalNet (World Bank, 2011b).
19. For evidence of the importance of distress sales in poverty traps, see for example Dercon (1998) or Zimmerman and Carter (2003).
20. Twenty-four years is the minimum number of contribution annuities in Mexico to qualify for a pension.
21. OECD (2011) provides evidence based on worker-level data that job losers eligible for unemployment insurance in Brazil have a tendency to move into informal work during the period of benefit receipt.
22. See the overview by Ferrer and Riddell (2009). Argentina's system covers only construction workers.
23. The scheme was originally called the "30-baht" scheme for the sum of the small co-payment requested from beneficiaries. This co-payment was abolished after the change in government in 2006.
24. Although Mexico's *Seguro Popular* has recently increased the number of medical acts that it covers, some national health services have limited coverage, even for catastrophic health expenditures – that is expenditure so large that they risk durably undermining livelihoods. The case of anti-retroviral drugs for HIV-positive patients in the Ghanaian national health insurance scheme is a case in point.

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Perspectives on Global Development 2012
Social Cohesion in a Shifting World

Chapter 7

Social Cohesion and Policies for Enhancing Civic Participation

Governments in many parts of the world are currently confronted by some major governance challenges. They need, as a matter of priority, to defuse social tensions which arise from phenomena such as rising food prices, increases (real or perceived) in inequality, and political exclusion. To complicate matters further, and partly because of new technologies (particularly the Internet), states no longer exercise the same degree of control over their territories as they once did and increasingly have to take into account a myriad of external influences. In such a context, giving space to dissenting voices is fundamental to the creation of a sustainable, socially cohesive society. The harnessing of civic participation and political feedback mechanisms is essential if growth processes are not to be derailed. This is particularly true in the context of shifting wealth, where faster economic growth and more social dislocation require innovative responses. Promoting civic participation and decentralisation could prove to be a powerful tool for improving service delivery as well as something to be valued in its own right. Similarly, women are important agents of change, and facilitating their full participation in democratic life is an important policy objective.

Introduction

Despite the up-beat prospects for growth in most developing countries (see Chapter 1), governments in many parts of the world are currently confronted by some major governance challenges. They must, as a matter of priority, defuse the social tensions which arise from phenomena such as rising food prices (Chapter 3), real or perceived increases in inequality (Chapter 4), and political exclusion. Civil unrest has been most perceptible recently in North Africa and the Middle East, but there are also signs that it is spreading to other regions of the world. In sub-Saharan Africa, for instance, a number of countries that were previously considered stable have recently seen major demonstrations against their governments.[1] To complicate matters further, and partly because of new technologies (particularly the Internet), states no longer exercise the same degree of control over their territories as they once did, and are increasingly having to take into account a myriad of external influences.

This chapter argues that, regardless of the kind of political system in place, the harnessing of civic participation and feedback is essential if growth processes are not to be derailed. Giving space to dissenting voices is fundamental to the creation of a sustainable, socially cohesive society. Any government which aggressively attempts to repress dissent runs a high risk not only of undermining its own legitimacy, but also of committing major policy mistakes. Repression of popular opinion may sometimes work – perhaps for considerable periods of time, even decades. Eventually, however, the dam will burst, with unpredictable consequences for social stability and posing grave risks for developmental gains.[2]

This chapter begins with a discussion of the new governance challenges in the period of shifting wealth and goes on to look at why civic participation matters for development outcomes. The following section considers ways in which government can be brought closer to the people through the promotion of participation and decentralisation – not only as ways of improving service delivery but in their own right and in order to enhance democracy. The chapter then proceeds to explore the fundamental role of women as protagonists and agents of change through civic participation, before examining some of the obstacles that still prevent their full participation in democratic life. It then analyses the rapid spread of ICTs and virtual communities, and follows on with a discussion of how they impact, both positively and negatively, on civic participation and, more broadly, on political governance.

New governance challenges in the period of shifting wealth

In the period of shifting wealth, governance has become more and more complex for many states. Though there have been earlier manifestations of the changing nature of governance (Mann, 1997), the roles and functions of states have changed considerably as a result of globalisation (Held and McGrew, 2002; Todd and Taylor, 2004). Nation states no longer exercise the same degree of control over their territories as they once did and increasingly have to take into account a myriad of external influences. Political power is

becoming more diffuse, with international and supranational organisations (like the international financial institutions (IFIs), multinational corporations, and the United Nations) all having considerable influence.

An additional complexity is that electronic communications are changing the nature of social interaction, making geographical location much less important. This opens up the possibility of new political and social relations that cross national boundaries (Baylis *et al.*, 2005) but also make it a more complicated matter for governments to control the flow of information and set the domestic political agenda. Technological advances have enabled many social movements to become global rather than confined to local or national arenas (Cohen and Rai, 2000), again precipitating a challenge to the Westphalian sovereignty of the nation state. At the same time, the jury is very much out as to whether new communications enhance or undermine social cohesion at the level of the individual. It is sometimes argued that electronic forms of communication can result in "cyberbalkanisation", breaking down the social solidarity between traditional groups and leading to a more individualistic society (Putnam, 2000).

At the confluence of these trends, politics is becoming more complex and multilayered. While some citizens are able to participate in new ways, others risk being left behind and marginalised from the political sphere. Some feel increasingly impotent to influence events, a sentiment which often provokes anger and feelings of frustration – particularly among the young and in countries where the job market has remained sluggish and unable to meet aspirations. In developed and developing countries alike, youth unemployment rates are frequently many times higher than those that affect older members of the workforce. All this, combined with a feeling of disenfranchisement, lays the ground for social disturbances and conflict.

These developments certainly create new challenges for social cohesion across the world. Democracy is based upon the assumption that a group of people can exercise control over their own affairs and decision-making processes. But as it becomes more difficult to confine issues within national boundaries, it also becomes harder to operate democracy within them. As well as bringing people together, globalisation can create fragmentation and disintegrative trends. There are, thus, opposing, contradictory forces at play: closer global ties can bring people of different cultures and national identities together, but they can also increase the chances of conflict between them. What new spaces open up for greater civic participation, how states choose to manage democratic processes, and the quality of the institutions that they have at their disposal all influence the degree to which people are empowered and able to exercise a "voice" (Hirschman, 1970).

An amazing variety of institutions have proven to be compatible with human progress (UNDP, 2010). The fast-growing converging countries identified in this report have many different kinds of political systems and institutional structures. Over the past 30 years, the parliamentary democratic model has spread (Diamond, 1996; 2002), but there is a temptation among Westerners to see this positive development only through the lens of their own experience and culture. The history of citizenship and the way in which civil society and governments interact has often depended excessively on the experiences of Western Europe and North America (Green, 2010).[3]

Moreover, political participation has a meaning that runs wider and deeper than the institutions of a democratic regime – *e.g.* voting and the checks and balances on the control of power (Ocampo, 2008). This is a lesson that many incipient democracies are learning the

hard way. That wider meaning is rooted in the qualitative aspects of democracy and governance, in the broad sense of civil, political and social participation. There is a wide recognition (and growing concern) across the world that the qualitative side of democracy and governance is crucial (Tilly, 2007; Hutton, 2010; Stiglitz, 2011) and that no country in the world can afford to rest on its laurels when it comes to improving its democratic system and political accountability. Moreover, in countries where there is low or no progress in economic, social and cultural rights, civil and political rights tend to lose significance for the poor segments of society. Support for the political system can become dangerously shallow and fragile, and democracy loses all real meaning (Mahbubani, 2004). In addition, despite the remarkable vibrancy of indigenous NGOs in countries like Bangladesh, democracy still accommodates high levels of poverty. It would seem, in other words, that there is still a long way to go before the developing world achieves a new "Great Transformation" which empowers the poor (Stewart, 2007).

This message has been driven home, in a very dramatic fashion, by the developments in late 2010 and early 2011 in the Middle East and North Africa (Box 7.1). One of the major ironies of events in that region is that a number of countries there had earned praise for their human development achievements, particularly Tunisia. In order to understand the linkages between civic participation, social cohesion, and sustainable development, this chapter considers why civic participation is important, who takes part, and the tools that they are using. There are, as the chapter documents, many manifestations of "voice". Moreover, because of the rapid expansion of new technologies and ICTs, the manner in which voice is exercised is changing radically. Increasingly, that voice transcends national boundaries.

Box 7.1. **Lessons to be learned from Tunisia**

By most measures, Tunisia was considered a success story prior to the civil unrest which broke out in December 2010. In numerous aspects of human development, it was seen to outperform many other – faster-growing – developing countries (Rodriguez and Samma, 2010). This impression was widespread and shared by peers across Africa who saw in Tunisia the example of a well-run, pro-development government. Over the last three decades, the country had expanded its infrastructure well, boasted good governance indicators, and claimed an extremely strong record in human development (improving educational opportunities and health provision). In gender, too, it performed well, ranking number 25 out of the 102 countries in the OECD Development Centre's Social Institutions and Gender Index (SIGI).*

Yet, with the benefit of hindsight, it is clear that the model had an Achilles' heel – combined with a poor record in job creation, the model clearly lacked political legitimacy. The lessons are hard but clear. There is a need to acknowledge the importance of looking beyond traditional measures of progress and development. The positive developments in Tunisia's economy and governance structures were eventually overshadowed by the immense challenge of a high number of unemployed people (particularly the young) living in an unequal society with little space for political participation. However, even providing good education may not suffice (Stiglitz, 2011): countries across the world are struggling to create enough jobs for new labour market entrants. High unemployment and pervasive corruption create a combustible combination. Contemporary events at the time of writing this report therefore present a compelling case for the importance of civic participation.

* For more information on SIGI, please see *www.genderindex.org*.

Why civic participation matters for social cohesion

People are more willing to contribute to society when they feel that they are treated as full citizens. However, not all groups are equally able to participate in civic and political life and pockets of exclusion and marginalisation may emerge. New technologies and the creation of new identities that transcend national boundaries also challenge citizens' active engagement in their societies. Hirschman's typology of "voice, exit and loyalty" (Hirschman, 1970) helps to understand some of the challenges and illustrates the mechanisms at the heart of social cohesion.

Hirschman stressed that whereas economic transactions in the marketplace are characterised by a "take-it-or-leave-it" mechanism (*e.g.* a buyer or seller simply chooses to enter or exit a particular market, but exercises no other influence on outcomes), much human progress is, in actual fact, due to both the "loyalty" and "voice" facets of human interaction. So, for instance, while disgruntled parents may be able to remove their child from an unsatisfactory school (the "exit" option), the "voice" option would entail them becoming actively involved in the governance of the school through the parents' association, in an effort to improve the school's performance.

Hirschman's incisive contribution was to highlight ways of improving social outcomes that transcend straightforward market transactions. In this sense, social progress and development rely on much more than the market – they rely on members of society being given a full expression of "voice" and on stimulating sentiments of "loyalty".

One of the founders of the pluralistic perspective on power relationships and the state was the 19th-century French historian and thinker, Alexis de Tocqueville. He argued in 1835 that a democratic political system would become unworkable if any one group in society came to dominate all others. Such a situation could lead to a tyranny of the majority whereby the wishes and interests of the minority would be totally disregarded. Groups that are socially excluded – both from material equality and equalities of power (Byrne, 1999; Madanipour, 1998) – may then become a destabilising force, undermining social cohesion and leading to increased conflict in society. The gains from globalisation are unequally shared: benefits are often reaped along ethnic lines, with certain groups in society managing to gain from new opportunities and others becoming marginalised (Chua, 2003). The result has been resentment, damaged social cohesion and even violence aimed at groups such as the ethnic Indian populations in East Africa in the 1970s, or the Chinese in Indonesia in the 1990s. As Box 7.2 shows, the risks of endemic exclusion are pronounced, especially when based upon ethnic or religious grounds.

Examples like those in Box 7.2 lead some observers back to the idea that in poor, fractious societies the developmental state must enjoy a strong degree of "autonomy" from popular opinion in its actions (Khan, 2008). According to this view, development is by nature a difficult, conflictual process. A degree of authoritarianism and a purposeful state are thus considered necessary evils. Governments that are unable to take difficult decisions which may offend important, well-established groups or vested interests in society will ultimately be unable to reach their development goals.[4] A number of contemporary African leaders have used this argument to defend the lack of plurality in their political systems.[5] Gray and Kahn (2010) uphold that arguments about "good governance" are misplaced. The term was popularised in the 1990s to explain the poor record of economic reform in many Latin American and African countries. Yet

Box 7.2. **Exclusion from civic participation as a cause of conflict: Some examples**

The root causes of violent conflict are rarely simple. While there is a large body of research which emphasises the role socio-economic and political inequalities between groups can play in causing tensions and violence, less research has been done on the part played by different forms of cultural exclusion (such as the non-recognition of languages or religious practices). These are issues that can lead to civil unrest and protest and may also be important root causes or triggers of conflict. To cite some examples:

- Severe rioting against the Chinese in Malaysia in the late 1960s has been attributed largely to the animosity felt by the politically dominant but economically sidelined Bumiputera majority towards the economically dominant Chinese minority.
- The civil war which afflicted Sri Lanka between 1983 and 2009 was linked to tensions resulting from inequalities between the Tamil minority and Sinhalese majority. Colonial administrators had favoured the Tamil minority economically, but this advantage was sharply reversed once the Sinhalese gained power and increasingly sidelined the Tamil minority in such areas as educational opportunity, civil service recruitment and language policy.
- In Uganda the Bantu-speaking people (largely in the centre and south of the country) have been economically dominant but are politically sidelined by the non-Bantu-speaking people (largely in the north). These economic and political inequities have played a role in major conflicts, including the violence initiated by Idi Amin in the 1970s and the second Obote regime in 1983-85. They are also a factor in the ongoing conflict between government forces and the Lord's Resistance Army.
- In South Africa, before 1994 the black majority was severely disadvantaged politically and socio-economically. This led to many uprisings between 1976 and the transfer of power in 1993.
- Increasing tensions between Muslims and Christians in Poso, Central Sulawesi, Indonesia, began surfacing in the mid-1990s as the Muslim community increasingly gained more than indigenous Christians from new economic policies.
- The Maoist insurgency launched in Nepal in 1996 may be attributed to deep grievances stemming from the systematic marginalisation and exclusion of certain ethnic groups, castes and women.

Source: Based on UNDP (2004).

according to Kahn, truly democratic systems have never been able to exist below a certain threshold of development. From this perspective, good governance is more a consequence than a source of development.

It might also be expected that democratic regimes perform best when it comes to poverty reduction and pro-poor growth. The evidence, however, does not speak with such clarity: democratisation has a mixed record on poverty (Leftwich, 2005; Donaldson, 2008). Many studies have assessed the link, but all have concluded that there is no consistent connection between pro-poorness and democracy.[6] While the very worst performers in terms of poverty reduction tend not to be democracies – democracy does provide some kind of safety net – there are also non-democracies among the best performers. Over relatively long stretches of time, some authoritarian regimes, like the one which ruled

Indonesia for over 35 years, have reduced poverty faster than states which have enjoyed long periods of democracy. One example is the Philippines, where the rate of poverty reduction has been much more modest.

Yet there are serious problems with the view that democracy is an expensive luxury that most developing countries can ill afford. Without adequate feedback mechanisms, checks and balances, and in the absence of a vibrant civil society, the political stability of such governments or regimes is balanced on a knife-edge. From this perspective, a degree of contestability in a political system is fundamental to the viability of its long-term development strategies. Striking the balance between participation and the ability of governments to act decisively is the key. In other words, and as argued in Chapter 2, governments require "room for manoeuvre" (Ritzen *et al.*, 2000). Stiglitz (2011) has stated the case in these terms:

> "There are many balancing acts to be mastered: a government that is too powerful might violate citizens' rights, but a government that is too weak would be unable to undertake the collective action needed to create a prosperous and inclusive society – or to prevent powerful private actors from preying on the weak and defenceless."

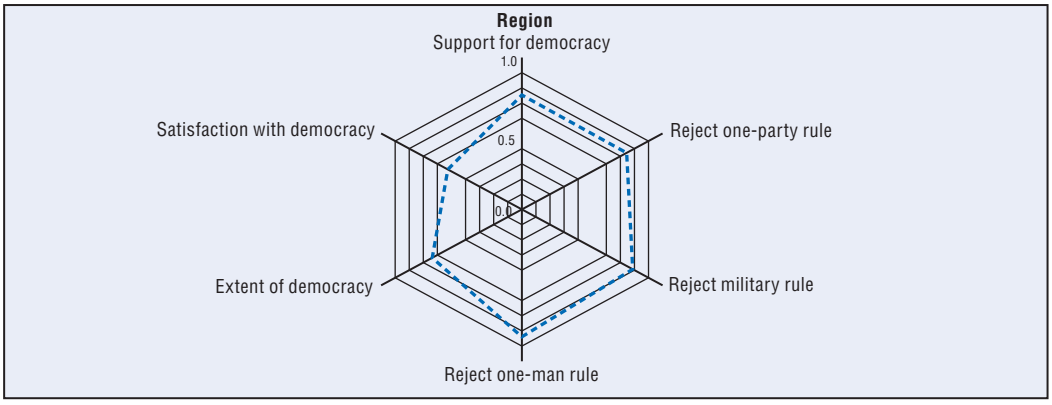
The importance of democracy, civic participation and governance is now widely acknowledged among developing countries themselves, as reflected, for example, by the adoption in 2007 of the African Charter on Democracy, Elections and Governance. The charter compels African Union member states to respond to unconstitutional actions within member states and secure the gains made in democracy and governance. By the end of 2010, 36 countries had signed and eight had ratified the charter (UNECA and OECD, 2011).

Tensions, however, have always existed between the participatory and procedural aspects of democracy (Bardhan, 2010) and there are many different ways of classifying states according to how much voice their citizens are allowed to exercise.[7] An important distinction is to be drawn between liberal democracies, with extensive provision for political and civic pluralism as well as individual and group freedoms, and mere electoral democracies or "hybrid" states. Hybrid states boast many of democracy's electoral trappings, but lack internal checks and balances, transparency and accountability in budgetary processes, reliable enforcement of legally stated rights and privileges, and effective control by elected officials (Diamond, 1996; Heller, 2006). They do not prize civil freedoms highly and minority rights are less secure. It is indeed worrying that among many of the newer democracies, there are signs of democratic erosion or "hollowing out", where regimes assume the form but not necessarily the substance of electoral democracy (Burnell, 2005).

One way of viewing progress in democratisation and civic participation is through subjective data relating to the supply of and demand for democracy (Mattes and Bratton, 2009). For Africa, Afrobarometer[8] provides a number of questions which can be used to gauge how much popular support there is for democracy. Questions include support for democracy and the rejection of one-party rule, military rule, and "one-man" rule. There are also questions that can be reasonably interpreted as proxies for the extent to which democracy has been delivered. They relate to satisfaction with democracy and the extent to which it is perceived to exist. Taken together, these questions offer an interesting perspective on how far aspirations for democratic

participation have been met. In Figures 7.1 and 7.3, the wider the hexagon is on the right, the greater those aspirations are; the wider it is on the left, the greater the perception that aspirations are being met. Figure 7.1 shows the regional average, where it is clear from the lop-sided hexagon that aspirations for democratic practice far exceed perceived "democratic delivery".

Figure 7.1. **African regional average – questions relating to demand and supply of democracy, 2008**

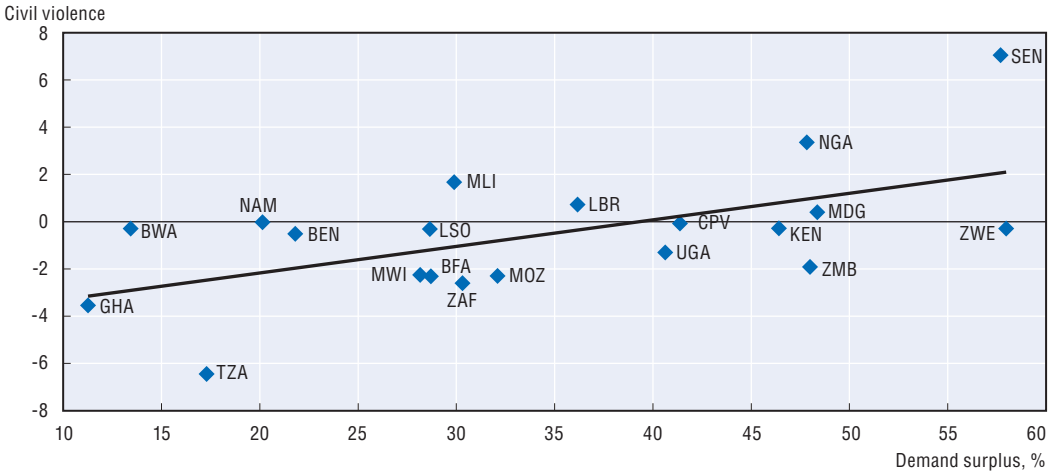


Source: Authors' elaboration based on Afrobarometer (2010) data.

StatLink http://dx.doi.org/10.1787/888932518674

It seems reasonable to hypothesise that in countries where the perceived demand for democracy is much higher than the perceived supply, frustrations are likely to grow. It is revealing to use the African Economic Outlook (AEO) index (AfDB *et al.*, 2011) to correlate civil violence with the "demand surplus" (*i.e.* unmet desires for democratisation – the difference between demand and supply measures): countries with larger democratic deficits generally show higher levels of civil violence (Figure 7.2). Demand for democracy is

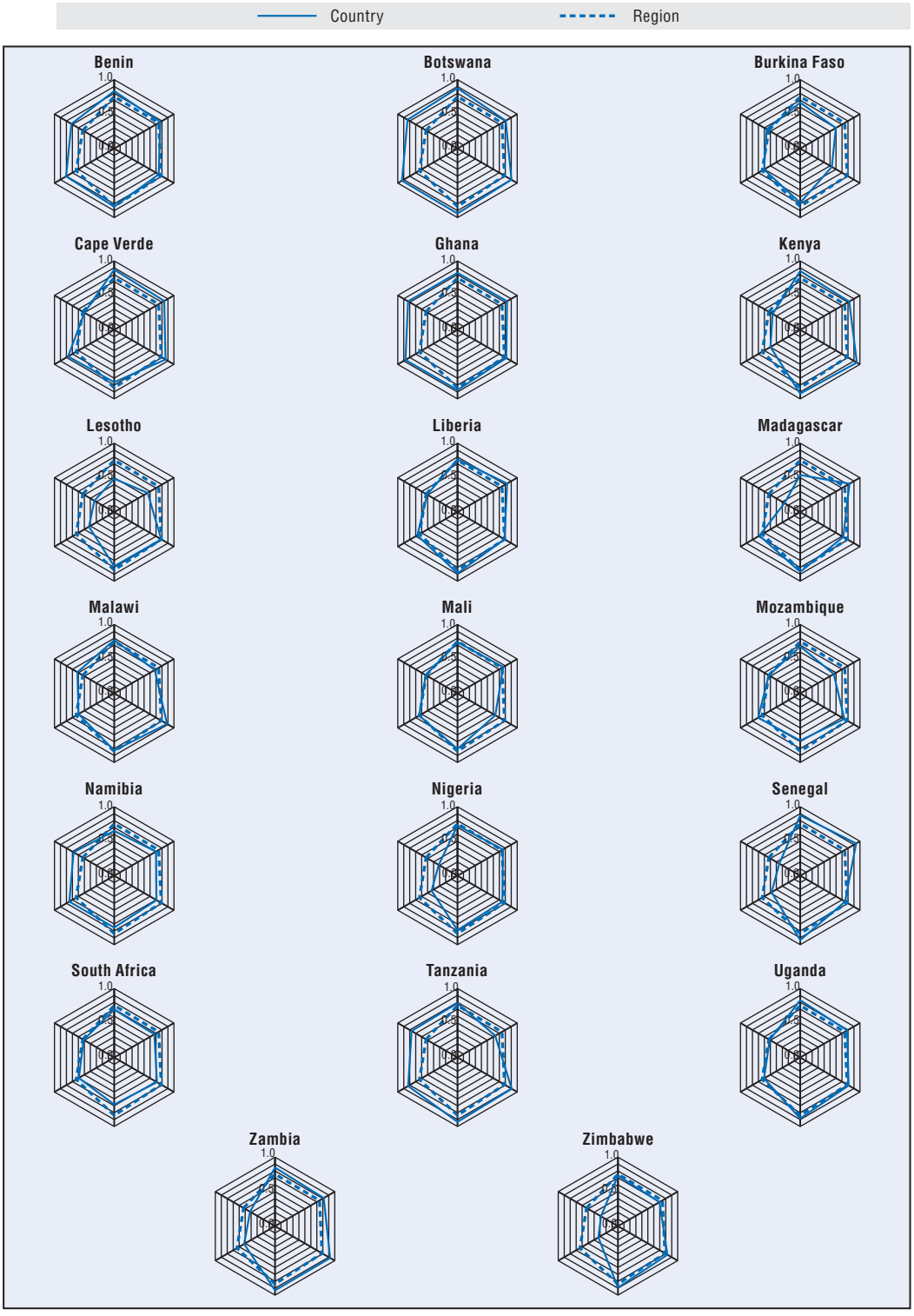
Figure 7.2. **Civil violence and the democratic demand surplus, corrected for population, 2008**



Source: Authors' elaboration based on AfDB *et al.* (2011), Afrobarometer (2010) and World Bank (2011a).

StatLink http://dx.doi.org/10.1787/888932518693

Figure 7.3. **Regional benchmarking of the supply of and demand for democracy in sub-Saharan Africa, 2008**



Source: Authors' elaboration based on Afrobarometer (2010) data.

StatLink http://dx.doi.org/10.1787/888932518712

relatively high in countries like Kenya, Zambia, Nigeria and Zimbabwe, but delivery generally falls short of people's expectations (Figure 7.3). The best performers are clearly countries like Botswana and Ghana, with levels of democratic supply and demand that are significantly higher than the regional average.

One way in which governments seek to control the yearning for democracy is to dampen expectation: in a number of African countries (*e.g.* Lesotho, Burkina Faso) aspirations for democratic forms of government are much lower than the regional averages. This is, of course, partly the product of different historical trajectories and governance structures. Yet, it can also be attributed to a political culture that discourages civic participation in democratic governance by, for instance, stifling internal debate and censoring newspapers and other media outlets.

Ultimately, however, in the era of the Internet, mobile phones, and satellite dishes – as argued later in this chapter and borne out by Arabic countries in 2010-11 – it is more and more difficult for governments to control aspirations. They are increasingly universal and, regardless of the exact form participatory government takes, non-democratic governments struggle increasingly to repress such demands. A much more legitimate policy is to give people greater democratic voice by improving governance and providing space for civic participation.

Bringing government closer to the people: Service delivery, accountability and decentralisation

As stated in the preceding section, development has proved compatible with a remarkable variety of political arrangements. From an instrumentalist point of view, it is difficult to resolve arguments about which form of government is most successful in producing the best development outcomes. However, there are many compelling examples of how civic participation can enhance social cohesion by promoting inclusion and building social capital – the focus of this section. For instance, where collective actors are less engaged in social accountability, there may be little impetus for reform and the delivery of public services often remains poor. Devereux and Lund (2010) use this argument to explain the poor quality of public services in Africa: "There is a perplexing dormancy of civil society in much of Africa, with regard to mass mobilisation and participation around welfare rights."

The rights, freedoms and mechanisms needed to create domestic pressure for accountable, contractual social protection include the holding of regular elections; freedom of association and the mobilisation of civil society; transparent budgetary procedures; and parliamentary advocacy, with members of parliament able to pose questions and receive clear answers about the efficacy and equity outcomes of public spending (Devereux and Lund, 2010).

Yet even with all these requirements in place, participation of the poorer, more marginalised members of society remains a vexed question (Cornwall and Coelho, 2007). An instructive illustration comes from India. There, to the surprise of many observers, the large proportion of poor people in an assertive electorate has not always succeeded in focusing the attention of politicians on the sustained implementation of programmes to alleviate mass poverty or to deliver basic services such as education and health care. As Bardhan (2010) puts it with reference to India: "[A] heterogeneous society, riddled with social and economic inequality and conflict, makes collective action for lasting change difficult."

Valuable lessons can be learned from unusual cases, however. One notable exception within India has long been the southern state of Kerala, which has among the best human

Box 7.3. **Social innovation and civic participation in Thailand**

Politics in Thailand has been marked by strife and protests since the 2006 coup that deposed former prime minister Thaksin Shinawatra. The violence peaked between March and May 2010 as anti-government protesters opposed security forces in Bangkok. They were led by the red-shirted supporters of former leader Shinawatra, who demanded the current prime minister's resignation and pressed for new elections. This political crisis exposed the aspirations of Thai society for increased participation in the political debate and greater transparency. The country's deep social divisions also aggravated the tensions and fuelled the conflict. Inequality in Thailand is relatively high, scoring 42.5 on the Gini index compared to other countries in the region such as Viet Nam or Indonesia which score 37.6 and 36.8 respectively (World Bank, 2011a). It is also high relative to inequality in disposable income in OECD countries, being on a par with the most unequal OECD countries.

In response to the political crisis, the government established a process to elicit proposals for reform to improve social equality and justice, promote dialogue and bring peace and reconciliation. A National Reform Committee made up of eminent Thai figures was commissioned to provide guidance for reform. However, the government acknowledged the need for a more participatory approach in tackling issues to ensure that any solutions had political legitimacy and buy-in from citizens. A National Reform Assembly was therefore created alongside the NRC, with the mandate of opening up political space for citizens to participate actively in crafting the country's reforms.

The National Reform Assembly follows the tradition of civic participation in Thailand institutionalised for example in the health sector with the creation of the National Health Assembly (NHA). The Thai NHA is the first case of translating the approach and format of the annual World Health Assembly of the World Health Organisation to a country context. The NHA is organised once a year and participants need to belong to a "constituency". These constituencies correspond to country delegations at the World Health Assembly and are defined so as to be inclusive: a number of them are area-based constituencies from each of the provinces, while the rest represent the private sector and civil society, professional associations and academia and political and government agencies. In 2008, 1 500 people from 178 constituencies attended the first NHA. The consultation is done at the national, provincial and district levels through a series of civic forums, workshops and conventions. The constituencies are entitled to submit proposals for agenda items to be discussed during the Assembly. A steering committee reviews and selects the proposals according to their importance for public health, public interest and potential for implementation. For each selected agenda, a technical report is commissioned and a draft resolution submitted to the NHA for endorsement.

The issues tackled are diverse in theme and scope. They range from issues related to the statute of the national healthcare system or the role of local administrations in the management of health to more specific and targeted issues such as the regulation of food marketing to prevent obesity, problems of sexual violence, healthcare for the elderly, etc. The Assembly also addresses issues at the local level. For example, it looked at ways to ensure the sustainable development of the Southern provinces. The Assembly typically intervenes on issues that require collective buy-in and action. For example, in 2009, it looked at issues related to the management of hazardous waste from communities.

Though it is difficult to separate the impact of the NHA resolutions from other potential contributing factors, the wording adopted in NHA resolutions has been echoed in the text of recent reforms and decisions made by government at national or local level such as the Health Charter of Songkhla Province. Following the crisis, the NHA urged the government

Box 7.3. **Social innovation and civic participation in Thailand** *(cont.)*

"to implement social protection measures, to provide in particular increased budgetary support sufficient for the management of the universal health coverage" (National Health Assembly, 2008). The government did so, increasing the 2010 Universal Coverage budget by 10% even as overall public spending was reduced by 13%. This enabled 700 000 laid-off workers formerly covered by Social Health Insurance to retain access to healthcare. Another key achievement of the NHA lies in the process itself. The NHA has proved successful in bringing together various actors and sectors that have a stake in the health sector, including groups often marginalised in policy making such as ethnic and religious minorities and young people (Rasanathan *et al.*, 2011).

Source: Discussions at the experts' meeting on Social Cohesion in Southeast Asia organised by the OECD and the Ministry of Foreign Affairs of Thailand, in Bangkok, on 21 July 2011; National Health Assembly (2008); Rasanathan *et al.* (2011); World Bank (2011a).

development indicators in the whole country, despite its low per capita income. It is also probably no coincidence that Kerala is a state with fewer excluded social groups (*e.g. dalits*, the former "untouchables") than states like Bihar and Orissa, which do much more poorly in human development outcomes. Fortunately, Kerala is becoming less exceptional as other South Indian states begin to emulate its practice of mobilising the lower class/caste groups around stable political parties that, once in government, redistribute resources to the poor in ways that lead to permanent reductions in poverty (Moore and Putzel, 1999; Harriss, 1999).

At the micro level, the arguments in favour of popular participation in efficient service delivery are also compelling. Research in Delhi (IDS, 2010) highlights the role of social accountability measures from local collective actors in helping to improve services. For example, in recent years the significant mobilisation of poor people has taken as its focal point the Public Distribution System (PDS), which provides subsidised basic food grain. By general consensus, corruption is endemic within the PDS, with much subsidised food being stolen. According to one account, the country's top investigative agency has had to process 50 000 separate charges of corruption involving the PDS (*The Economist*, 2011). However, PDS operations through a single point of provision – fair price shops run by licensed private owners – provide a clear focus for collective action. Since 2001, civil society groups in Delhi, organised under the aegis of the Right to Food movement, have actively campaigned for PDS reform, so helping to reduce levels of corruption and institutionalise some transparency in the system at the local level. IDS (2010) contrasts this situation with the one prevailing in India's health sector, where there has been an emphasis on top-down approaches to reform in recent decades, with little civic participation and poorer results.

In China, one of the major challenges has been to develop the right kind of feedback mechanisms in the context of a state without an historic tradition of political pluralism. Although no open elections are held at national level, there is much discussion in academic circles about the possibility of "democratisation" from below: China has a million village councils for which elections are held, though the jury is out on the extent to which the councils provide space for citizens to exercise their voice (Greig *et al.*, 2007). According to Pei (2005), ordinary Chinese citizens often have little recourse for redressing grievances. The official petition system, which enables aggrieved individuals to seek intervention from higher officials, is, again according to Pei, under stress: only two in 1 000 petitions actually lead to some kind of resolution. Chinese courts see only about 90 000 lawsuits a year

against local authorities and rule against the government in less than 25% of the cases. On occasion, however, the Chinese media do publicise particularly egregious instances of official abuse of power, and subsequent public outrage forces the central government to act (Pei, 2005). As noted in Chapter 6, a growing number of labour disputes in China are going to litigation, with a surprisingly high proportion of cases finding in favour of workers.

Decentralisation is an important mechanism through which governments of developing countries can enhance accountability and monitor government officials and decision makers. Purported benefits of decentralisation include political education in the meaning and practice of democracy, training in leadership, political stability through the trust generated in democratic structures and processes, local accountability (which fosters officials' legitimacy), the bolstering of citizens' involvement and interest in politics, and enhanced responsiveness to people's demands. Local government may also show greater allocative efficiency as decisions on public expenditure made by a branch of government close to the people is more likely to reflect their real needs and demands (Jütting *et al.*, 2005; Greig *et al.*, 2007).

The gains from decentralisation are far from automatic, however, and, as even supporters of decentralisation concede, a number of obstacles need to be overcome if it is to work efficiently (Jütting, 1999; World Bank, 2005). Examples of the problems and obstacles facing decentralisation include the risk of encouraging parochialism; central government giving in to the temptation to shed functions without providing the necessary local funding; the control that central government keeps over regulation and funding; the capture of political office by self-interested local elites; an inadequate capacity to undertake decentralisation efficiently and effectively; and the continued exclusion of the poor and disadvantaged from decisions which affect their welfare (Greig *et al.*, 2007). Decentralisation has certainly proved to be no poverty reduction magic bullet.

In a paper summarising a number of major studies, Robinson (2007) concludes that improved equity outcomes have generally not been achieved and that the quality of public service has not improved as a result of transferring power and resources to local governments. Many decentralisation processes in Africa, for example, have retained top-down control: in Tanzania, for example, the local government system was seen in the past by many citizens as a means of securing compliance to the wishes of the ruling party. In Nigeria local government was used by military rule to install political bosses and agencies for the distribution of patronage (Langer and Stewart, 2010). China's decentralised governance structure played an important role in promoting rural industrialisation, but at the same time has limited the powers of central government to rein in local officials who abuse their power in alliance with local commercial interests. The result has been environmental damage, land seizures, violations of consumer product safety standards, and the acceleration of economic inequality (Bardhan, 2010).

Decentralisation is also clearly not enough in environments with high inequalities grounded in traditional social institutions such as gender or caste. It is often the case that traditional patterns of power are replicated and become entrenched in both local and central government. Research on India suggests that granting power to local tiers of government has not necessarily increased the civic participation of marginalised groups, particularly women (Narayana, 2005). In Uganda, judicial reform has favoured local councils that often discriminate against women. To have a pro-poor impact, then, decentralisation should be accompanied by complementary measures such as investment

in education or the promotion of land reform, as well as the strengthening of the legal framework (Jütting *et al.*, 2005).

Rwanda is an example of a country which has used decentralisation as a tool for underpinning social protection programmes. It already has in place a well-developed set of social protection programmes, including universal health insurance (covering 91% of the population), free education, social transfers (*e.g.* a pension scheme), the Vision 2020 Umurenge Programme (VUP), support for survivors of the genocide, and the "one cow per family" programme. But central to this extensive social provision is administrative decentralisation, driven by the Ministry of Local Government, Good Governance, Community Development and Social Affairs. As part of decentralisation, the Ubudehe programme enables local people to identify area-specific programmes and vulnerable individuals or households within their communities (ERD, 2010).

Women's role in political participation

Throughout history, but particularly from the 20th century onwards, women have been indispensable agents of change in many societies. In Kenya in the 1990s, for example, Nobel Peace Prize laureate, Wangari Maathai, mobilised popular opposition to the country's corrupt leadership. In Burma, the pro-democracy leader Aung San Suu Kyi has, since 1990, spearheaded opposition to the military junta which has held power since 1962. Whilst women do not always campaign on feminist agendas or as specific women's groups, they have at times secured political voice by drawing on their identities as wives or mothers – like the *Asociación Madres de Plaza de Mayo* in Argentina. Paradoxically, emphasis on their traditional roles can actually make it difficult for women to be seen as legitimate political actors, particularly in patriarchal societies. Political and social mobilisation can also come at a heavy social cost for women, exposing them to increased levels of violence or causing them to be stigmatised by their communities' male leaders.

Despite restrictions on their civic participation, women have still been effective agents of change in many contexts. They have, for example, played active roles in campaigning for an end to conflict across ethnic, religious and socio-economic divides in countries such as Liberia, Bosnia and Nepal. In Sierra Leone, it was the action of a group of elderly women protesters that galvanised broader public support for protests against the leader of the Revolutionary United Front, Foday Sankoh, in 2000 (Mazurana and Carlson, 2004). However, once violence has ended and their uniting influence subsides, women's organisations may become fragmented and their voices lose impact, as happened in Sierra Leone.

High levels of discrimination against women generally leave them little opportunity to engage politically or be active politicians. This may be reflected in lower numbers of female parliamentarians, although women's participation in national politics had in fact been rising slowly before accelerating in the late 1990s and 2000s, with the proportion of women in national assemblies climbing from 11.6% in 1995 to 18.4% in 2008 (UNIFEM, 2008). Similarly, the number of women in ministerial positions is also on the increase, although numbers remain low in regions such as the Middle East and North Africa, and South Asia. There is clearly still a long way to go before parity is reached.

One particularly noteworthy trend has been the wider use of quotas to speed up the representation of women in parliament in countries such as Nepal and Mozambique. Although they are no panacea, quotas do help to break down some of the structural barriers to women's involvement in politics. However, challenges remain – combating traditional

stereotypes and ensuring that women are not just represented but that they participate meaningfully. In Rwanda, women now account for 56% of all parliamentarians, the highest proportion in the world. However, in an increasingly restrictive political climate, it can still be difficult for women to have their voices heard, which highlights the importance of continuing to build their parliamentary skills so that they may effectively promote a more inclusive political agenda. Furthermore, while leaders such as Ellen Johnson-Sirleaf in Liberia and Michelle Bachelet in Chile have done much to advance women's rights in their countries, women who are politically active do not automatically represent women as a constituency, and do not necessarily adopt a gender perspective in their work.

In developing countries, women are particularly active at community level. They fill gaps in service provision, they care for families and vulnerable members of their communities, they are often active in grassroots and community-based networks and associations, and they can play important roles in shaping attitudes and values within households and society as a whole. However, such work does not necessarily translate into women's voices being heard at national level or in formal governance structures. Their civic participation may therefore be confined to the community level and informal channels and networks. An additional drawback is that women's roles are not necessarily perceived as valuable. However, failing to capitalise on or to further develop women's civic participation at both the community and national levels carries a significant cost for broader social cohesion and equality.

Beyond direct political participation, women may have to contend with gender-specific barriers to their civic participation. Violence is one such barrier. It is a significant risk run by women who seek to play a role in their communities and governments. Even where they do not face overt violence, backlashes may occur if they are perceived to be crossing accepted gender roles and they may have to endure increased domestic violence behind closed doors.

Another barrier is that women may neither possess the skills that enable them to engage politically nor enjoy access to the patronage networks and power brokers who moderate which voices are heard (Goetz, 2009). Restrictions on women's freedom of movement can further prevent them from being able to attend public meetings or follow the training courses and information sessions that would allow them to gain the skills necessary to participate.

One of the most significant obstacles to women's civic participation is time poverty. The sheer amount of time they spend working in the home or community may prevent them from exercising their voice in public spheres (Beall, 1996). They may have neither the time nor the resources to travel to local council meetings or vote – in other words, their responsibilities as carers may compromise their chances of civic participation. These factors are all further compounded by the discriminatory social institutions that limit women's decision-making power, with negative consequences across all dimensions of their lives.

New tools for civic participation: The role of ICTs and virtual communities

One of the most controversial aspects of the civil disturbances in North Africa and the Middle East which began in December 2010 has been the role of the Internet, and especially of new social networking tools such as Facebook and Twitter. In reality, however, a sea change in the way social networks evolve has been perceptible now for several decades, as communications costs have come down. The idea that communications technologies

spontaneously drive revolution is too simplistic – but they certainly can be a catalyst. And examples are not restricted to Internet-based tools. The Iranian Revolution of 1979, for example, illustrates the shift from broadcast media (radio and television) to another set of communications tools – cassette tapes with recordings of speeches against the Shah by Ayatollah Khomeini (then based in Paris), which were widely distributed across Iran. They helped mobilise many millions of Iranians against the Shah's rule.

Mobile phones were the next innovation to act as catalysts of social rebellion. In January 2001, during the impeachment trial of the Philippine President Joseph Estrada, thousands of angry Filipinos demonstrated in the centre of Manila against a veto by the country's Senate to ignore important evidence linking Estrada with corruption. The protest was arranged, in part, by forwarding text messages with over 1 million people flocking to downtown Manila and bringing the traffic system close to collapse. Close to 7 million text messages were sent that week. The Philippine legislators backed down in the face of the public protests and by 20 January Estrada was obliged to resign. Estrada himself reputedly blamed his downfall on the "text messaging generation" (Shirky, 2011).

New forms of communication clearly provide a major challenge to authority and existing structures of power. Governments (particularly undemocratic ones) are understandably nervous about the evolution of spontaneous social networks over which they have little control or influence and which cross previously impermeable boundaries. Some – like Ethiopia, Iran and Ukraine – have sought to restrict access. But it is also clear that the issue is a major one for developed countries, too, as the controversies sparked in 2010 by the WikiLeaks case testifies.[9] Innovations in modern communications may help the erosion of authoritarian power over time. But, for the moment, their impact on international politics is not so easy to predict (Bremmer, 2010).

More than 50% of the world's population has access to some combination of cell phones (5 billion users) and the Internet (2 billion). These people communicate within and across borders, forming virtual communities that can empower citizens at the expense of governments (Schmidt and Cohen, 2010). Patterns of Internet usage are changing rapidly, alongside the deeper shifts in the global economy. While it was the preserve of a select band of high-income countries led by the United States in its infancy in the 1990s, the Internet has undergone a sharp increase in usage in the developing world over the past decade. China now leads the world, with over 420 million users who account for 21.4% of the world total. Over 30% of the population connect to the Internet, most of them in cities. In 2009, a Gallup poll found that 42% of urban Chinese reported having Internet access at home – a leap of 14% since just 2008. In absolute terms, more people are wired in China than anywhere else in the world (Economy, 2010).[10] India is in third place with 81 million users who account for 4.1% of the world total (Internet World Stats, 2010). This increased connectivity has been coupled with a production boom in the ICT related software and hardware industries in both countries. China's software industry is growing by 29% year on year. As well as fuelling the domestic economy, a growth rate of 23% per annum in software exports signals a dominant world position in the future.

In developing countries, the Internet boom has built on the mobile phone platform, making its emergence quite unlike that in the West. The mobile phone phenomenon in developing countries has enjoyed exponential growth. In the world's two most populous countries, India and China, mobile technology provides basic telephone services to over 90% of villages. In the last decade, the Asia and Pacific region has experienced continuous

Box 7.4. **Music as a force for forging collective identities or a lightning rod of civil unrest?**

Just as there is a debate on the role of the Internet as facilitator of social cohesion or catalyst of social unrest, there has been a long-standing debate on the social role of music. An affinity for music first shows itself in infancy and is manifest and central in every culture – it probably has been since the very beginnings of the human species. This innate character of music is puzzling, especially since, as Sachs (2007) notes, it has no obvious practical purpose. Although music is present in all cultures in some shape or form, it is perhaps something of a *cliché* to affirm that "music is a universal language". It is also a statement that is not necessarily true – a lot of music still tends to be culturally specific, and not necessarily easily accessible for people from other cultures, *e.g.* flamenco music in Spain, Brazilian batucada, or African souk.

That said, it has an enormous capacity for crossing traditional and geographic boundaries. In this sense, music is very much a creator of social cohesion and common social identities. The power of black music, for example, is self-evident in the rhythms of the Latin American music of Brazil, which fuses Portuguese sense of melody and saudade (nostalgia) with African rhythms (principally from Yorubaland in present-day Nigeria). It is also patently present, in a different manifestation, in the roots of Cuban and Central American salsa music, and in the blues and jazz which sprung up in the early 1900s in the southern states of the US. These latter styles took root and were later perceivable in the music of Western artists such as Elvis Presley or The Beatles. It is no exaggeration to say that, without the influence of black jazz and blues musicians, rock'n'roll would probably never have appeared.

But what about music's important political connotations? In a very real sense, music often works best when it represents a challenge to the *status quo*. It creates social dynamism by challenging existing norms and traditions. Musical movements are certainly not always an expression of harmonious cultural empathy – they can also be extremely reactionary and counter-cultural. In the turbid years of the mid-1970s the punk movement was very much a rebellion against authority. It was also, pointedly, a rebellion against music itself – against the grandiose pretentions of the punks' musical peers at the time, stadium rock bands such as Pink Floyd and Led Zeppelin.

Another example of a challenge to existing authority in the 1970s was Fela Kuti in Nigeria. His song, ITT (International Thief Thief), denounced the corruption of Nigerian politicians. He was increasingly hounded by authorities with his mother infamously being pushed out of the window in a police raid on his house. Similarly, the Brazilian popular music movement (MPB) was active in articulating opposition to the military government in power in Brazil from 1964-73. In Chile, in 1973, the popular singer-songwriter Victor Jara was cruelly assassinated on the instructions of the military junta, who first cut his hands in a symbolic attempt to silence his musical talents forever.

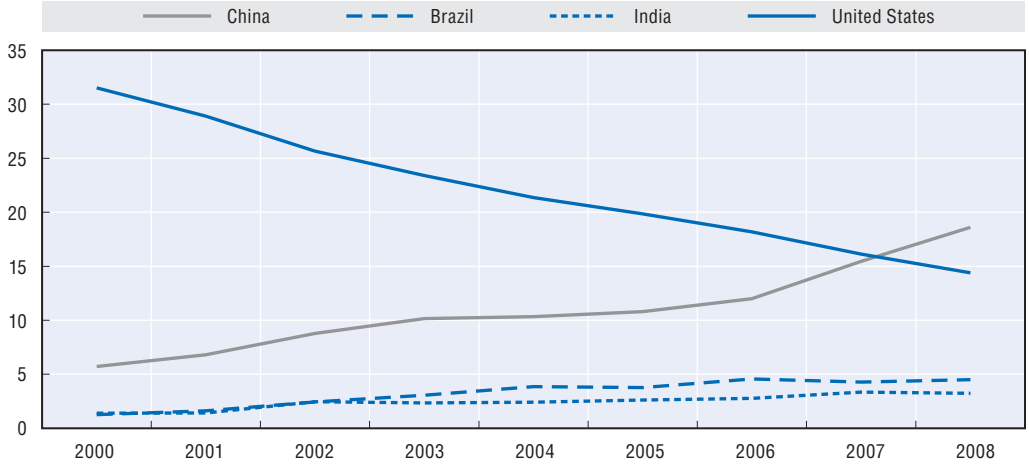
Clearly, then, authorities may sometimes harbour a "fear of music". Nevertheless, the political power of music is perhaps more muted than many people think. For instance, at the time of the Viet Nam War, many artists united against US involvement. Yet the war went on for more than a decade until 1974. Musicians themselves are usually less sanguine than their followers about their ability to exert a real influence on events. It is a moot point whether musicians pre-empt popular moods, or simply reflect them (a question which is also relevant to other art forms). As Bono, the singer of rock band U2, once wrote: "I can't change the world, but I can change the world in me." Pointedly, musicians only seldom become directly involved in politics, two notable exceptions being Gilberto Gil, who became Minister of Culture in Brazil in Lula de Silva's administration, and Ruben Blades, who took up the tourism portfolio in Panama.

Box 7.4. **Music as a force for forging collective identities or a lightning rod of civil unrest?** *(cont.)*

More broadly, however, it is widely recognised by most policy makers that music confers huge social, cognitive, emotional and therapeutic benefits, especially on those who take an active part in it. This has been made explicit policy by some governments, which have adopted policies to promote social cohesion through musical activities. Important examples of this are Venezuela, with its famous El Sistema programme, as well as Cuba and Finland (Norman, 2010).

Figure 7.4. **Internet usage, 2000-08**

Share of global internet user population (%)



Source: ITU (2010a, 2010b).

StatLink http://dx.doi.org/10.1787/888932518731

ICT infrastructure development and service uptake, making the region a world leader in ICT (ITU, 2009). In addition, there is a general upward trend in mobile telephone subscriptions which is particularly pronounced in the emerging economies of Brazil, China, and India. In China, for example, over 73 million people (29% of all Internet users in the country) use mobile phones to get online.

One of the most striking developments in new communications technologies has been the explosion of social networking sites: over 200 such sites are active worldwide in various languages and countries.[11] A social network might take the form of a chat room, a discussion forum, or an e-shopping site with embedded functions for rating, recommending, and commenting on specific products. The power of a social network grows with the number and nature of relationships and interactions, as individual members share information, ideas and influence. Social networking services use computer software to build online communities of people who share similar interests and activities, or who are interested in exploring the interests and activities of others. Web 2.0 initiatives – web-based applications intended to facilitate participatory information sharing, inter-operability, user-centred design and collaboration on the World Wide Web – thus contribute to the creation of new "imagined communities" (Anderson, 1983), in the sense that technology connects people beyond borders and geographical boundaries, allowing societies to move towards a more globalised collective identity (Hariche *et al.*, 2011).

The world now spends around 110 billion minutes a month on social networking and blog sites. This equates to 22% of all time spent online (Nielsenwire, 2010). The Internet is ideally designed "for many-to-many communication, which represents a form of networked interaction that is significantly different from the one-to-many communication used by centralised hierarchies" (Castells, 2001). Today, with the advent of improved technology, the rise in the use of social networking services, knowledge sharing and creation, online communications are changing the broadcasting model and moving towards multi-dimensional conversations. Potentially, social networking tools allow everyone from citizens in the street to those in positions of power to create and share content, adding value to political and social debates.

Due to the nature and the complexity of global relations, and because societies are dynamic and diverse, governments will need to keep close track of e-innovations if they are to remain relevant. Nye (2008) argues: "[I]n information-based societies, networks are replacing hierarchies – modern leaders need an ability to use networks, to collaborate, and to encourage participation. *They need to be able to make decisions within rapidly changing contexts*."

Furthermore, Web 2.0 technologies have the capacity to foster social cohesion by building networks of opportunity for diverse societal groups. By following models of "openness, transparency and interconnectivity" (Williams, 2010), governments could pave the way for more participative, innovative democracies. In the same way, online networks such as Facebook and Twitter (and many more) share this sense of commonality and belonging that is a characteristic of social cohesion. The Internet promises to create a global village consisting of sparsely knit communities by removing space constraints (Quan-Haase and Wellman, 2004), where global, not national, citizens connect and work collaboratively in online communities.

Social networking sites can be a low-cost way of identifying the communities where supporters and activists can communicate together. The Indian Pink Chaddi Campaign, for example, has shown how individuals (as well as organisations) can quickly generate enormous amounts of attention and engagement that feed into the mainstream media (Cranston and Davies, 2009). The Pink Chaddi Campaign was launched in February 2009 as a collective, pacifist response to a violent attack on women in Mangalore by right-wing activists. The objective was to send as many items of pink underwear (*chaddi* in Hindi) to the leader of the fundamentalist vigilante movement that was behind the violence and had issued threats. Four women began the peaceful campaign on Facebook, which was met with huge success (over 13 000 *chaddis* were sent). There followed widespread media coverage and an exponential growth in the related Facebook group's membership to over 57 000 (Banerji, 2010).

What the new ICT tools mean for political governance and social cohesion

Despite their promise as innovative tools for increasing participation and cohesion, however, there are two arguments against the idea that social media will make a major difference in enhancing civic participation and changing the nature of national politics (Shirky, 2011). The first is that the tools themselves are ineffective, and the second is that they do as much harm as good to civic participation, because repressive governments are becoming better at using them to suppress dissent.

The ineffectiveness critique (Gladwell, 2010) concentrates on examples of what has been termed "slacktivism", whereby casual participants seek social change through low-

cost activities, such as joining Facebook's "Save Darfur" group, which are "long on bumper sticker sentiment and short on any useful action" (Shirky, 2011). The critique may be correct but is not necessarily central to the question of social media's power: the fact that barely committed actors cannot click their way to a better world does not mean that committed actors cannot also use social media effectively. Recent protest movements – *e.g.* against education laws in Chile in 2006, against US beef imports in South Korea in 2008, and the Pink Chaddi Campaign in 2009 – have used social media not as a replacement for real-world action but as a way to co-ordinate it (Shirky, 2011).

The second argument – that repressive governments actually use social media to undermine civic participation – has more resonance. It is true that authoritarian states have grown more adept at shutting down communications networks to block the free flow of unwelcome ideas. Increasingly, they are also exploiting modern media and technology to go on the offensive, gain access to all kinds of information on their own citizens and disseminate pro-government propaganda. As Bremmer (2010) points out: "[These technologies] are a megaphone, and have a multiplier effect, but they serve both those who want to speed up the cross-border flow of information and those who want to divert or manipulate it."

Having seen what has happened in other countries, authoritarian states now shut down mobile phone networks or texting services at the first hint of civil disturbance. In an attempt to prevent access to new social networks, they also disrupt Internet services – much as the authorities did in Egypt during that country's revolution in 2011. Yet such shutdowns become problematic for governments if they last. When protesters occupied the centre of Bangkok in the summer of 2010, their physical presence disrupted banks and the shopping district. But the government's reaction – cutting off significant parts of the telecommunications infrastructure – hit the whole economy hard and affected people far from the capital. The repressive response of closing down services creates an additional dilemma for the state – there can be no modern economy without working phones – and limits its ability to take such action over large areas or long periods (Shirky, 2011). For instance, the OECD (2011) estimates that Egypt sustained large-scale losses, equivalent to 3-4% of GDP per annum, when it shut down its communication system in 2011.

There is also a vibrant debate, from a sociological point of view, about whether new Web-based tools are socially enabling, or whether their negative impacts outweigh the positives because they contribute to the break-down of traditional forms of human relationships and the rise of a "virtual", individualistic (and presumably superficial) existence. Advocates of social networks argue that by promoting interaction they can positively affect citizens' well-being:

> "People with more social connections report higher life evaluations, as many of the most pleasurable personal activities involve socialising. The benefits of social connections extend to people's health and to the probability of finding a job, as well as to several characteristics of the neighbourhood where people live (*e.g.* the prevalence of crime and the performance of local schools)" (Stiglitz *et al.*, 2009).

But does Web 2.0 truly facilitate social interaction, or does it lead to a situation which Durkheim (1893) described as "*anomie*", where norms no longer direct behaviour, and deviance is encouraged? The role that the Internet has played in several infamous crimes (including murders) suggests that the "dark side" of the rapid expansion of social networks cannot be ignored. Other authors have raised the question as to whether, in developing economies, the aspirations of the Facebook generation are more influenced by their peers

in affluent countries than by their fellow citizens (Glennie, 2011). The disintegration of privileged classes' sense of solidarity with their fellow citizens could lead to the emergence of a ruling class or elite with little or no concern for a national, broadly based, pro-poor development model that offers opportunities for everyone. The idea that elites in developing countries are increasingly identifying with elites abroad is, of course, far from new – Frantz Fanon (1952) made the point very forcefully in the early years of post-colonialism. But it is possible that new technologies may lend greater impetus to such socially disintegrative forces.

In summary, the most positive way to view social media is as long-term tools that can strengthen civil society and social cohesion in the public sphere. The Internet is thus more a facilitator than a catalyst (Shirky, 2011). The World Bank (2011b) has recently proposed a number of strategies for Africa intended to strengthen the voice of citizens using instruments of social accountability and harnessing the immense potential of ICT to devise innovative ways of enabling citizen-centred governance. These include the External Implementation Status and Results Reports Plus Initiative (E-ISR Plus), designed to systematically engage non-state actors (civil society organisations, professional associations, media, etc.) and maximise the impact of their feedback on project performance for better project implementation (E-ISR is currently being carried out in 40 projects). Leveraging enhanced mobile penetration, the Bank is also proposing to use geo-referenced data – like the Ushahidi Platform developed in Kenya – to amplify social accountability. As a general assessment, the World Bank (2011b) observes:

> "There is immense potential to use ICT to enable citizen-centred governance. The new generation of Africans has adopted mobile technology rapidly and is therefore well prepared to use this potential to engage on governance and provide feedback to government."

This is perhaps a good example of how international institutions are beginning to acknowledge the paradigm shift in government accountability and collective action that this chapter has sought to describe. Now that the technological genie is out of the bottle, it is going to be difficult to put it back.

Conclusion

The framework for governance is changing rapidly and governments need to adapt to new circumstances. In this chapter it has been argued that, regardless of the denomination of the political system in place, any developmental state that does not give adequate space to citizens to exercise their voice and strengthen mechanisms of loyalty is ultimately unsustainable. Governments must therefore adopt a more permissive attitude towards plurality, and particularly towards minorities and women. Responsible governments actually need to nurture dissenting voices and opposition – not crush them. As Stiglitz (2011) has put it:

> "A sense of fair play requires voice, which can be achieved only through public dialogue. Everyone stresses the rule of law, but it matters a great deal what kind of rule of law is established. For laws can be used to ensure equality of opportunity and tolerance, or they can be used to maintain inequalities and the power of elites."

This chapter has argued that more participative forms of development yield additional payoffs in the shape of potential improvements in the efficiency of public service delivery. ICTs can act as an important facilitator of both social cohesion and improved governance.

Finally, the events in North Africa and the Middle East, as well as elsewhere, may also require the donor community to reconsider the way in which it interacts with governments in the developing world and to look again at the ways in which it supports civic participation and democratisation. There are no simple one-size-fits-all answers to such complex questions, which require an important margin of subjective judgement as befits particular cases. But there are nevertheless strong arguments that donors, too, have a responsibility to promote a social cohesion agenda, central to which is a re-examination of the way in which aid is delivered. This issue is further discussed in Chapter 9 of this report.

Notes

1. The 2011 edition of *African Economic Outlook* contains an index of civil unrest in Africa.
2. Anyone doubting such a proposition need only look at Eastern Europe in the wake of the collapse of the Soviet Union. After nearly 70 years of varying degrees of despotic leadership, President Mikhail Gorbachev introduced *glasnost* (transparency) on the grounds that it was needed to facilitate *perestroika* (economic reform). He unleashed so much repressed discontent that it brought down the Soviet Union and with it the subsequent catastrophic implosion in many human indicators (see Ellman, 2003).
3. Sen argues forcefully that the idea that democracy is a Western idea is misleading – almost all societies have possessed mechanisms, however imperfect, for conflict resolution and voicing popular opinion.
4. Note that this argument has also been used to explain decelerating performance in high income countries. Olson (1982) postulates that over time the coalescence of interest and pressure groups undermines the ability of governments to take decisive action.
5. Three leaders in East Africa come to mind: – Meles Zenawi, the Ethiopian Prime Minister, who has been in power since 1991; the Ugandan President Yoweri Museveni (since 1986), and the Rwandan President Paul Kagame (since 2000). Kagame has frequently alluded to the Singaporean model of development, meaning a highly autocratic, technocratic and pro-developmental state. For discussions on the viability of such models, see Heller (2006).
6. Easterly (2010) has noted that the variance around the mean is enormous between democratic and non-democratic regimes – in other words, non-democratic regimes show both the best and worst economic performance. Varshney (1999) examined countries' records of reducing the numbers of people below the poverty line, defined in terms of income or consumption. Niles (1999) measured the effort governments put into protecting the poor against the adverse effects of economic adjustment. Moore and Putzel (1999) explored the extent to which national political and economic systems converted national income into longevity, literacy, and education for the mass of citizens.
7. See, for example, North *et al.* (2009), who distinguish between three types of states according to the degree to which "voice" was allowed expression. The three types are natural states, mature natural states, and open-access orders.
8. The focus here is on analysis of Africa in part because the data is available. But the analysis may be extended to any region or country with the right comparable subjective dataset.
9. WikiLeaks, the whistle-blowing website, published 250 000 pages of classified communications between the United States' State Department and its embassies worldwide.
10. Already, the Internet is evolving into a virtual political system in China: Chinese people inform themselves and each other, organise and protest online. In July 2010, bloggers provided first-hand accounts of a large-scale pollution disaster in Jilin Province, contradicting official reports. Thousands of people ignored government officials and rushed to buy bottled water (Economy, 2010:145).
11. Brazil has the highest percentage (86%) of Internet users visiting social networks. The popularity of social networking in Brazil is due to Orkut, which appeared there in 2004; one year later, half of the Brazilian Internet population visited the site to promote events or learn about them (UNCTAD, 2010).

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Chapter 8

Cross-cutting Policy Issues

A social cohesion policy agenda requires co-ordinating actions across policy areas, in particular to ensure the integration of vulnerable and traditionally excluded groups. The challenges posed by shifting wealth to social cohesion through structural transformation and swings in factor prices also call for coherent action across policy domains. Quality education accessible for all, equal chances for women and men, food security and the integration of migrants are important cross-cutting areas which need to be incorporated into any social cohesion agenda. The current changes in the global economy offer the opportunity to address some long existing inequalities in these areas. This opportunity should not be wasted. A better integration of women into the economy, improved access to land, schools offering shared spaces and a better deal for immigrants in the fast-growing host countries will not only support a cohesive society but also contribute to sustained growth in the long run.

Introduction

Fostering social cohesion in a shifting world requires bringing several different policy strands together. While the last chapters examined in detail policy challenges and options in the area of fiscal management, employment, social and civic participation to foster social cohesion, this chapter addresses cross-cutting issues. Education, gender equality, food security and the transforming of institutions are crucially important in developing cohesive societies.

The role of education and educational systems for promoting social mobility has been widely documented. The first section of this chapter deals with two aspects: *i)* the importance of the how-to-supply citizens with education to strengthen social cohesion and *ii)* equal access, particularly to secondary and tertiary education. Subsequently, the chapter addresses the cross-cutting topic of gender equality. As Part I of this report argues, shifting wealth throws up many opportunities, but men and women do not always share in them equally. On the contrary, women in some converging countries tend to lose out. This chapter discusses why and what can be done about it. It goes on to focus on the topic of food security in times of increased price volatility for basic food commodities. Next, it looks at food price spikes which particularly affect the most vulnerable and can lead to social unrest. The growing importance of South-South migration and its ramifications for the integration of migrants in the South is then elaborated on. The chapter concludes by addressing institutional bottlenecks, in particular those that are invisible but shape social cohesion outcomes such as social institutions.

Education

Higher educational attainment is a necessity if countries are to take advantage of the opportunities afforded by shifting wealth (Chapter 1) and reduce long-term inequality in market incomes (Chapter 4). But beyond the sheer accumulation of human capital, education policy is critical to fostering social cohesion – both because it helps provide equal opportunities and because schooling itself can contribute in multiple ways to social cohesion.

Education policy is key to any social cohesion agenda, as education outcomes affect social inclusion, capital, and mobility. As Chapter 4 argued, the distribution of educational attainment in the population is a decisive determinant of inequality in market incomes. Its importance has been reinforced by the changes in returns to education brought about by shifting wealth. School shapes and transmits the common values that underpin social capital and, when opportunities for quality education are afforded across the population, it can be a great leveller of opportunity, bringing prospects for upward mobility even to disadvantaged groups.

Schooling offers the opportunity to create shared spaces

Creating shared spaces is critical to the building of social cohesion. The spaces that different social groups share include, of course, physical, public spaces, but also the social

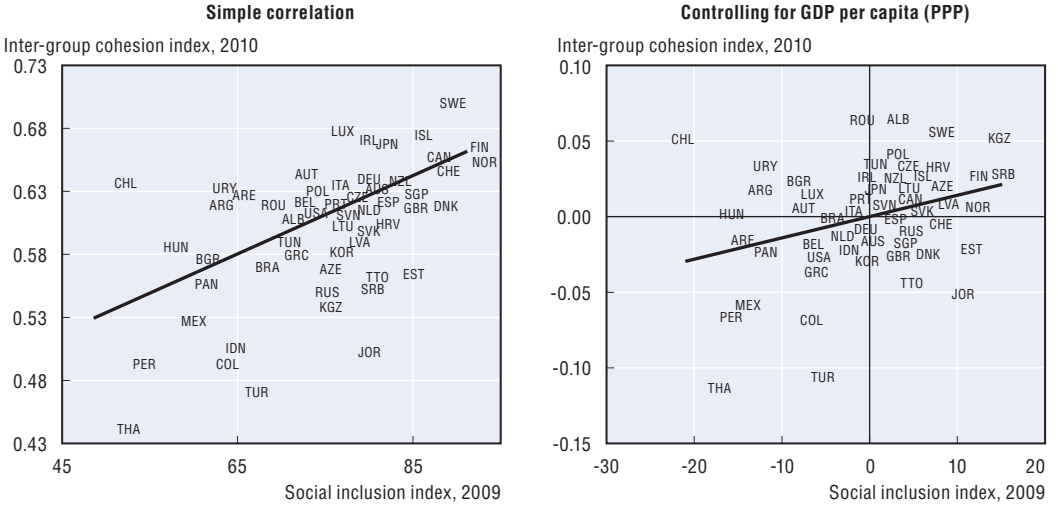
spaces where critical life events shape values, *e.g.* public service institutions like schools, whose quality is also determined by the demands that different social groups put on them.

How children are schooled is important for building their sense of belonging to society even though the emphasis is often placed on average levels of education (Chapter 4). The way in which schools are organised can help increase the participation of children from disadvantaged groups, thereby enhancing the inclusive character of education. Many countries have sought to increase inclusiveness by shaping schools and schooling. Laos actively recruited local villagers for teacher training to ensure familiarity and presence. In order to narrow the gender schooling gap as part of its Girls' Education Initiative, Egypt's "girl-friendly" schools programme not only built schools in rural areas to limit travel time, but also ensured that school buildings had bathrooms and were generally safe for girls to access and be in (Grynspan, 2011; UNICEF, 2008).

In cohesive societies children learn in environments that are more faithful reflections of society at large. In more fragmented communities, the education system tends to segment pupils according to their socio-economic origins. The Programme for International Student Assessment (PISA) measures the inclusiveness of education systems by the share of variance in socio-economic background that is present within schools. There is great variation in the degree to which education systems produce more or less uniform education outcomes relative to the student population: the inclusiveness index, which is a number between zero and 100[1] ranges from 49 in Chile and Thailand to 91 in Norway.

Inclusive education systems mirror cohesive societies. Countries where inclusion at school is greater are those where inter-group trust is greater (Figure 8.1).[2] The most inclusive school systems are found in higher-income, relatively homogenous OECD countries: pupils in Norway show the third lowest socio-economic dispersion of all the countries participating in PISA. Nevertheless, even when the effect of income is accounted for, there remains a strong positive relationship between trust in society and the inclusiveness of education systems.

Figure 8.1. **Inter-group cohesion is positively related to inclusive school systems**



Note: See endnotes 1 and 2 for variable descriptions. The right-hand side panel shows residuals after controlling for GDP per capita (in PPP).

Source: Authors' elaboration based on OECD (2011a) and Indices of Social Development (2011).

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Inclusiveness in schools can also be achieved by developing a system, teaching techniques, and curricula that foster diversity and enhance the positive perception of others in an environment of critical thought. Indeed, in certain cases, what is required is deep-reaching reform over and above material incentives in order to foster the integration of minorities. Traditionally disadvantaged groups, such as the Roma in Eastern Europe, were often educated in segregated schools, both because they are concentrated in certain neighbourhoods and because of outright discrimination. The Czech Republic has a large Roma community, estimated at between 250 000 and 300 000 people (Lavicka, 1998).[3] Of the Roma parents interviewed about their children's schooling in the Czech Republic, 76% reported that their children attended special schools with reduced curricula and low prospects (Andruszkiewicz, 2006).[4] Only a few attended mainstream schools and their failure or drop-out rate was about six times higher than non-Roma pupils, leading to an unemployment rate of between 50 and 80% in some regions (Roma Education Fund, 2004).

Desegregation requires not only incentives for schooling, but also models of education that incorporate and acknowledge Roma culture (Andruszkiewicz, 2006). Since the mid-1990s, institutions such as the European Union, Council of Europe, and the Organisation for Security and Co-operation in Europe's Office for Democratic Institutions and Human Rights (ODIHR/OSCE), have sought to narrow the social and cultural gap by encouraging the adoption of a new legislative framework[5] and promoting Roma culture through books and curricula. A successful initiative of the Roma NGO Amalipe has been an optional class designed to foster inter-ethnic tolerance as part of the state curriculum. A growing number of students attend the class (currently 5 500, of whom 40% are not Roma) and the Roma drop-out rate has dwindled. A similar initiative has been to add the issue of Roma segregation to the teacher training syllabus. Such approaches to teaching are designed for all children and have helped foster a sense of solidarity among those who learn about themselves and each other.

Education can also itself furnish tools for civic participation. The classroom develops cognitive and emotional skills, may prompt debate on social issues, and raises civil and social engagement (CSE) through "learning-by-doing" (Borgonovi and Miyamoto, 2010). In turn, family attitudes and cultural goods can enhance learning outcomes linked to civic participation. Finally, by providing information, experience, and such general emotional skills as conviction and confidence, education also stimulates pupils' interest in politics and, by the same token, in civic participation.

Inclusive schooling systems tend to perform better than segmented ones. In fact, every OECD country with social and academic inclusion indices above the OECD average,[6] except Spain, boasts mean performances in PISA tests above the OECD average (OECD, 2011a). More socially inclusive education systems are also more academically inclusive, which means that diversity in ability does not run counter to average performance. The correlation between country rankings on social inclusion and academic inclusion (discrepancies in school results) is 0.47 for reading and 0.38 for mathematics and science.

The levelling of opportunity is a characteristic of school systems, not a consequence of social inequalities. PISA measures the degree to which school systems equalise opportunity by the strength of the correlation between socio-economic background and performance in normalised tests. While students with higher scores in the socio-economic background index perform better overall, the correlation varies markedly across countries. And variation is only marginally accounted for by income inequality as measured by the Gini coefficient. Educational equality can therefore be achieved in diverse socio-economic contexts.

Overcoming barriers to educational attainment

Ensuring that children have equal opportunity to accumulate human capital irrespective of their socio-economic background is a key challenge to increasing both average educational attainment and social mobility. Inter-generational social mobility depends on educational mobility to bring about changes in the income distribution. However, in many developing countries, parental education remains a key determinant of individuals' own educational attainment. In a number of Latin American countries, the correlation is particularly high – greater than 0.6. In Guatemala, where the figure is the region's highest, four years of parental education translate into a difference of 3.4 years between children and, considered in terms of average returns on education, into 40% in potential labour income (OECD, 2010a).

The gap in educational attainment is particularly wide at secondary level and above, where returns to education are greatest (Chapter 4). And because they rise dramatically for post-secondary education, increasing educational attainment among the disadvantaged is a key challenge. The example of Brazil discussed in Chapter 4 shows that merely beginning and not completing secondary education brings minimal gains. Graduating from high school, on the other hand, boosts earnings, while the possibility of higher education affords extra incentive.

Although school performance typically depends on socio-economic background, there are measures that can help lessen the importance of background and encourage students from all walks of life, even the most deprived, to acquire more education. Programmes which aim to bridge the capacity gaps between the disadvantaged and the others should factor in the role of early-life nutrition, pre-school programmes, and the development of cognitive, social, and emotional skills through formal schooling. As early childhood development (ECD) determines potential and, to some extent, actual success in school, students from disadvantaged backgrounds tend to perform less well than those from better-off families, which in part reflects non-schooling inputs to education (Behrman, 2011).

A first objective is therefore to narrow the difference in the ability to benefit from formal schooling. With this in mind, the role of early-life nutrition is crucial. More than 200 million children are estimated to fail to reach their development potential due to stunted growth as well as iron and iodine deficiency (Grantham-McGregor *et al.*, 2007). A study conducted by the Institute of Nutrition in Central America and Panama (INCAP) revealed how better nutritional supplements in ECD improved school attainment: they raised female achievement by 0.36 standard deviations of the attainment distribution and cognitive and non-verbal skills by 0.28 and 0.24 standard deviations for men and women, respectively (Maluccio *et al.*, 2009).

Attainment is often cut short by lack of incentive. If returns to secondary education are relatively low, private incentives may not be enough even for able students from disadvantaged backgrounds. Indeed, if secondary education is not compulsory (it often is not) and costly, students who think they might not complete secondary school do not even begin it. The result is a vicious circle as high-school leavers become more numerous and so face even lower returns in the labour market. Increasing the expected labour market returns for secondary school graduates is difficult given the context of increasing rewards to higher education. Lowering the cost of secondary schooling is therefore an important first step in encouraging the completion of secondary school and higher education enrolment rates. Easing the transition from secondary school to higher education for

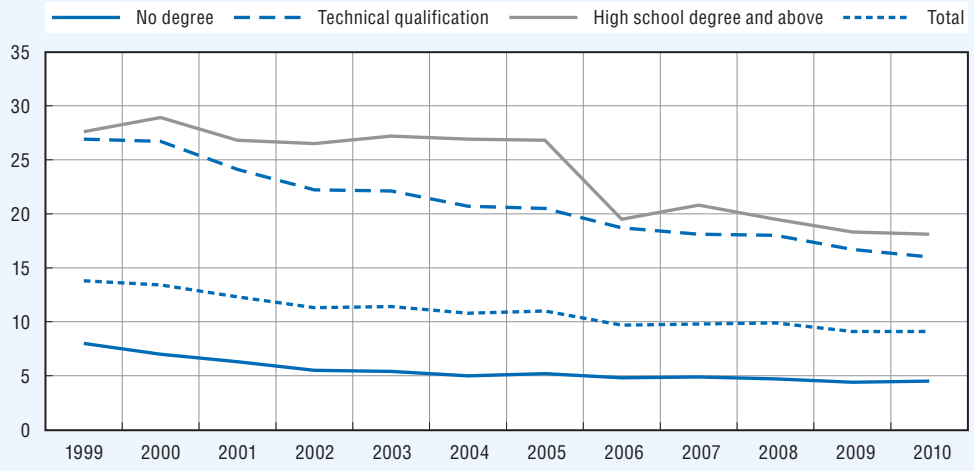
Box 8.1. **Youth employment and social cohesion in Africa**

The reasons that prevent young Africans from entering the job market or finding decent jobs are diverse. They range from the size of the informal sector in African economies to mismatches in skills and between supply and demand on the job market, low access to financial, physical and social capital, and the general sluggishness of the job markets.

Another issue is that of educated youth unemployment. Figure 8.2 shows how the unemployment rate of educated young people in Morocco was higher than the overall level between 1999 and 2008.

Figure 8.2. **Unemployment rates and educational qualifications in Morocco**

Percentage



Source: Haut-Commissariat au Plan of Morocco.

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Responses to these challenges need to be integrated, coherent, and co-ordinated in all areas of government policy (employment, education, taxation, etc.). Interventions in Africa are mainly of two types: measures to promote self-employment and entrepreneurship in a context of growth with low employment on the one hand, and reforms of the education and training system on the other hand.

The obstacles to starting up a business are multiple, especially for young people who often lack the experience and skills to become entrepreneurs. In addition, they face difficulties in accessing credit since they usually have no collateral or banking history. Governments can play a key role in creating an environment conducive to business creation through tax incentives, the provision of additional training, measures to facilitate tax registration and access to credit. In this regard, a number of African countries have put in place programmes and funds to support youth entrepreneurship (UNECA, 2009).

The Umsobomvu Youth Fund, for example, a South African government initiative started in 2001, offers young entrepreneurs services that range from training and mentorship programmes, to microloans, advice, information databases, and business development services in accounting and marketing. International organisations are also very active in advocating and supporting initiatives for youth entrepreneurship. The Youth Employment Network (YEN) – created in 2001 by the United Nations, the International Labour Organization, and the World Bank – is an example of initiatives to support governments in formulating employment policies for the youth while involving key

Box 8.1. **Youth employment and social cohesion in Africa** *(cont.)*

stakeholders such as youth-led organisations. YEN has notably created a Youth-to-Youth Fund that provides youth-led organisations with both funding and capacity building, enabling them to provide training and services and to fund young entrepreneurs.

Reform also emphasises education and training. Despite significant improvement in access to primary education in Africa, major problems persist in accessing post-primary schooling, the quality of education, and skills matches. The focus of reform should be widened to include the transition from primary to secondary schooling and from school to work. At the beginning of the 2000s, Morocco undertook major reforms to improve the education system and facilitate access to first-time employment. In its National Charter for Education and Training adopted in 1999, Morocco laid down the fundamentals that would underpin reform. The goals were to expand access to higher levels of education, improve the quality of teaching through incentives, revise recruitment criteria for teachers, and run regular evaluation exercises. The charter also reasserted the objective of matching the education and training system to the economic environment more closely. To that end greater flexibility in the choice of curricula was introduced. Through a system of modules and credits professional experience was incorporated into the curriculum in order to ensure greater adaptability to the needs of the labour market. Partnerships between universities and the private sector have been encouraged to ease the school-to-work transition and measures are in place to match skills with job market demand.

Yet, despite significant financial efforts and political will, the reforms have not yet produced the expected outcomes. This is partly due to a lack of co-ordination between the different ministries and agencies implementing the reforms and between youth employment policies and other macroeconomic and sector-related policies. Progress has also been hindered by the inability to adjust policy – a consequence of the lack of information on youth employment (unemployment, underemployment, working conditions, etc.) and the absence of systematic monitoring and evaluation (El Aoufi and Bensaid, 2006).

Source: Discussions at the experts' meeting between OECD and the Morocco's Haut Commissariat au Plan on Social Cohesion in Africa in Rabat, 13 April 2011; El Aoufi and Bensaid (2006); UNECA (2009) and World Bank (2009a).

students from disadvantaged backgrounds will help provide them with further incentives to complete secondary education.

Conditional cash transfers (CCTs) and food for education (FFE) are known to be efficient incentives for higher attainment, while performance-based incentives and vouchers seem more promising ways of improving results in learning and cognitive tests (Behrman, 2011). These incentives play an important role in lowering the opportunity cost of education, however, as they focus on primary education where enrolment is compulsory, we do not know their impact on higher education.

Efforts to increase educational attainment need to be coherent with interventions in the labour market so that the young can look forward to the productive employment that rewards investment in human capital. Young people are disproportionally affected by unemployment, particularly in Africa where they make up 37% of the working age population, but 60% of the total unemployed. Even this statistic does not reflect, however, the levels of underemployment and working poverty typically faced by young Africans, 72% of whom live on less than USD 2 per day (World Bank, 2009a). Reducing youth unemployment requires education and vocational and technical training that are adapted to labour market needs. Further important measures are interventions to ease the

transition from education to the workplace, which is closely linked to turnover in the labour market (Chapter 6).

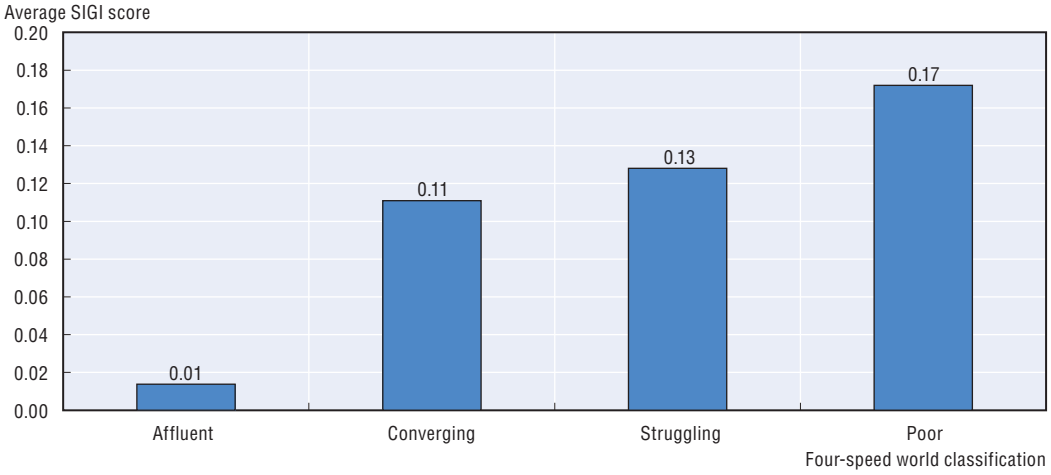
Gender equality

Economies lose out on women's productive capacity if it is not coupled with access to employment. Similarly, if women are unable to participate in community and public life their contribution to society is compromised. Greater gender equality would not just lead to better outcomes for women, it would also enhance social cohesion. Discrimination against women should be fought to enable them to undertake higher-value economic activity and to increase their social and labour market mobility, their civic participation and inclusion and, ultimately, their sense of belonging to a wider group within the population.

While countries with higher incomes and faster growth generally discriminate less against women than those with the lowest incomes and less growth (Figure 8.3), the relationship between growth and gender equality is not as clear-cut as it might appear. In fact, there are many countries which, despite high growth in the last 20 years, have not made any real headway in improving gender equality. One important reason is the persistence of informal social institutions that discriminate against women and block progress. Discriminatory social norms, values and traditions, such as those captured in the OECD's Social Institutions and Gender Index (SIGI), restrict women's access to resources and decision-making positions. They drive violence, too, and can lead to persistently poor human development outcomes in areas such as health, employment, and political participation – even in countries where overall poverty rates are falling.

Figure 8.3. **Gender inequality in the four-speed world**

Average SIGI score[1]



1. Social Institutions and Gender Index (SIGI) scores range from 0 (low discrimination) to 1 (high discrimination).

Source: OECD (2009a).

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Cultural dynamics and the fact that social institutions lie at the root of existing power relations make challenging discriminatory social institutions a daunting task. Providing incentive for change is therefore crucial. There follows an overview of some entry points through which to initiate change in the areas of employment, education and entrepreneurship.

Secure women's property and inheritance rights

A critical starting point for addressing institutional bottlenecks in the area of gender equality is to enhance women's productive activities by guaranteeing them property and inheritance rights. Limited access to resources reduces the ability of women and girls to generate a sustainable income, and can lead them to take up more poorly paid or insecure employment. Furthermore, the lack of access to and control over land can have a negative impact on the food security of the household, increase women's vulnerability to poverty or violence, prevent them from accessing bank loans or financial services, and reduce their decision-making power.

Policy reforms such as land titling or changes in inheritance legislation that secure women's property rights and incorporate monitoring mechanisms to guarantee their implementation can play a significant role in ensuring that women enjoy greater employment opportunities and may choose not to take up informal activities. For example, in Ethiopia, the World Bank initiated a joint land-titling programme granting equal rights to both men and women in accessing and controlling land. The impact of such an initiative on social cohesion is significant as it has not only helped reduce conflict over land in the region, but more importantly it has increased women's confidence and sense of belonging. Results show that when women have control over their property and have access to a sustainable livelihood they feel more secure, equal and can be productive members of the household and of the community (OECD, 2010b).

Conditional cash transfers for gender-sensitive social protection

Conditional cash transfers can be used as mechanisms to improve girls' retention rates in primary and secondary school and to improve their health outcomes. For example, programmes such as *Oportunidades* in Mexico, *Bolsa Familia* in Brazil, and *Juntos* in Peru have provided cash transfers to mothers on condition that their daughters continue to attend school.

Cash transfers can also be used to specifically target and transform discriminatory social institutions such as early marriage. In India, a conditional cash transfer scheme, "Dhan Laxmi", provides financial incentives to families (usually the mother) on the fulfilment of specific conditions such as birth registration, immunisation, school enrolment, and insurance coverage – but only if the girl remains unmarried until the age of 18. In Malawi, conditional cash transfer schemes with conditions linked to girls' education and health have also been proven to reduce the likelihood of girls marrying while in school, becoming pregnant, and (probably) being infected by HIV/AIDS. Fee waivers, scholarships, and school feeding programmes are other policy measures that can be used to keep girls in school in developing countries and to help them benefit from the same education opportunities as boys.

Change gender stereotyping

Gender-related stereotyping is present in all walks of life, including education and families. It robs boys and girls of opportunities to follow less traditional learning and vocational training paths. It is possible, however, to transform some of the stereotypes that are perpetuated by textbooks, other teaching material, and the media. UNESCO has developed a training manual[7] for educators on how to integrate a gender perspective that combats stereotypes in curriculum development for use in Zimbabwe, Mali and Zambia.[8]

Increase women's access to credit and flexible bank loans

The lack of access to credit is one of the most significant barriers facing women entrepreneurs in developing countries. It is a barrier that could be eased by making bank loans more flexible through, for example, fewer conditions for collateral and no requirement for the signature of a male family member. The Global Entrepreneurship Monitor Report on Women and Entrepreneurship finds that there is a gender gap in venture creation and ownership activity. Overall, the report reveals that men are more likely to be involved in entrepreneurial activity than women, who face obstacles such as the lack of education, greater child care responsibilities, and limited assets. In some parts of the world women are denied access to financial support and tools to build their own businesses by deep-rooted discriminatory practices and stereotypical attitudes, like being refused business loans without their husband's or father's co-signature. Although microcredit can help women obtain financial services that would otherwise be difficult to access, it may not enable them to scale up their businesses and go on to create and manage financially sustainable enterprises. Encouraging women's entrepreneurship supports women's overall economic empowerment in developing countries – and contributes to business diversification and economic growth in general.

Improve women's access to new technologies

In addition to restricting women's mobility, discriminatory social institutions can also affect their access to credit, education, and information. One way of addressing their limited entrepreneurship opportunities would be to enhance their knowledge of and access to new technologies. Initiatives led by the NGO, GenarDis, with women farmers' associations in sub-Saharan Africa use computers and mobiles phones to enable them to start up and strengthen their small-scale businesses. The projects have been very successful in both empowering the women and enabling them to thrive in a male-dominated sector. In Burkina Faso, women farmers were trained to use computers to better manage their revenue generating activities and tools, such as presentations and digital photography that could help them to train other women. In Togo, a women's union was trained to use mobile phones to monitor market prices and decide which supplies to buy in real time. In this way women were able to manage their own fishmonger businesses, generate income, and contribute financially to their families.

Food policy

Dealing with food price spikes

One of the most pressing problems in many developing countries is currently dealing with food price inflation and the concomitant social tensions. The World Bank (2009b) estimates that the poor urban population of the developing world spends nearly two-thirds of total income on food. Sharp increases in food prices can also exacerbate inflation (food weighting in the consumer price index basket is 10-20% in high income countries, but one third in China, 46% in India, and over 50% in Nigeria, Viet Nam and Bangladesh). As a result monetary policies and macroeconomic stability are also affected (Nomura, 2010), living standards erode. Many low-income countries have faced the double shock of rising food and fuel import bills, hindering growth and pushing up inflation. At the same time efforts to protect the poor from rising food prices could mean heavy increases in the cost of social programmes.

Designing policy measures to tackle the pressing problem of food spikes in a way that does not undermine social cohesion is a daunting task for governments. For instance, transfers in the form of cash or vouchers to offset higher food prices need to reach those affected by under-nutrition. However, this means compensating the poor while leaving out the nearly-poor, who pay the same prices (ODI, 2008). Similarly, as noted in Chapter 3, research into the different effects on rural and urban areas (*e.g.* Filipski, 2010; Aksoy and Isik-Dikmelik, 2010) highlights the need for differentiated policy responses that meet the needs of rural and urban areas.

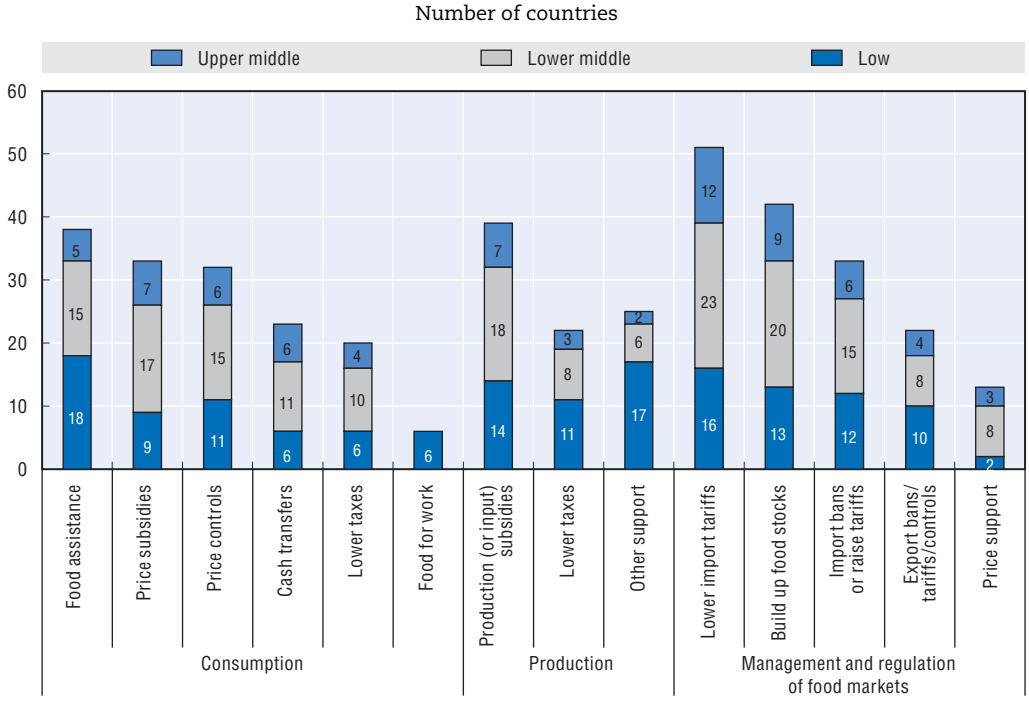
Governments certainly face dilemmas**.** Action to offset food price rises can cause sharp deterioration in fiscal balances. Indonesia, for example, spends the equivalent of 3% of government budget on consumer subsidies, while through its Public Distribution System (PDS) India paid out food subsidies to the poor in excess of USD 12 billion in 2010 (India's current subsidies for agricultural inputs are higher than its education spending).[9] In the wake of the food price rises in 2007-08, Malawi subsidised the Ministry of Agriculture's budget to the tune of 40%, more than 5% of the national budget (Dorwood and Chirwa, 2009). Subsidies to counterbalance the rises in fertiliser prices also constitute a significant threat to government fiscal balances (Mogues *et al.*, 2008).[10]

Almost all current food price subsidies are universal – in other words, they accrue to anyone buying the product. Some are implicitly targeted in that they apply to products that are disproportionately consumed by the poor. Although the practice may increase the share of benefits going to poor households, they will not receive larger absolute subsidies than wealthier households. An IMF study at the time of the food price crisis in 2008 found that 28 countries subsidised food. Six – Burundi, Egypt, Jordan, the Maldives, Morocco and Timor-Leste – had subsidies that were expected to exceed 1% of GDP in 2008 and had increased their universal subsidies since 2006. Sixteen other countries also reported increasing food subsidies, with rises ranging from near zero to 2.7% of GDP (for median of 0.2%).

Another way of compensating for higher food prices is through wage increases. In the aforementioned 2008 IMF study of 28 countries, ten countries had increased public sector wages and transfers to compensate workers and pensioners for higher prices. The fiscal cost ranged from near zero to 1.9% of GDP (with a median cost of 0.6%) and primarily reflected increases in public sector wages and pensions, except in Guyana, Kyrgyz Republic and Azerbaijan where they represented increases in minimum public-sector wages and pensions. As the IMF study noted, *ad hoc* adjustments to public sector wages in response to price increases are not well targeted, as public servants are rarely in the lower ranges of the income distribution.

In their study of the policy responses of ten major emerging economies, Jones and Kwiecinski (2010) note that eight emerging countries took some measure to directly affect the price or increase the supply of agricultural commodities to limit the rise in food prices. Only Chile and South Africa did not. Brazil, China, India, Indonesia, Russia and Viet Nam all reduced or removed tariffs on specific commodities. Argentina, China, India, Indonesia, Russia and Viet Nam introduced or increased export taxes or reduced export price incentives. A more recent study by Ortiz *et al.* (2011) documents the specific responses to rising commodity prices by 98 developing countries (Figure 8.4). Production subsidies and lower tariffs are the most widely used policies. On the demand side, about 40% of the sample ran some form of food assistance programme, while about one-third used price subsidies

Figure 8.4. **Specific policy responses to rising commodity prices in 98 countries, 2008-10**



Source: Ortiz *et al.* (2011).

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and price controls to support consumers. On the supply side, developing country governments prefer production and input subsidies for encouraging domestic production (about 40%), although a substantial 22% also reduced taxes on grain producers. As for the management and regulation of food markets, more than one-half reduced tariffs to encourage cheaper imports, while nearly one-quarter introduced export bans or other controls to discourage food exports. A large proportion also focused on stocking strategic food reserves to stabilise domestic market prices (43%).

Most of these policy responses have significant drawbacks:

- price controls can be hard to enforce and can remove incentives for farmers to produce more;
- food price subsidies can be wasteful as wealthier consumers also benefit;
- the subsidisation of inferior foods is less popular politically than subsidising well-liked items;
- limiting or taxing grain exports can exacerbate price spikes and disincentivise farmers to increase output;
- cash transfer schemes do not necessarily reach all the target population.

In poorer countries, there is often a need to provide more direct support through food transfers, but again this can entail a host of associated problems. Table 8.1 shows the advantages and disadvantages of trying to compensate consumers through food and/or cash transfers.

Table 8.1. **Advantages and disadvantages of food and cash transfers**

Food transfers	Cash transfers
Advantages	
Donor food surpluses are available	More cost-efficient than food
Immediately increases food availability	Allows more beneficiary choice
Directly addresses nutritional deficits	More fungible than food
Can be self-targeting	Encourages production
Usage favours women, children, older persons	Stimulates the market
Lower security risk	
Disadvantages	
High transport and storage costs	Limited donor resources are available
Losses from spoilage and theft	Losses from inflation
Less easily exchanged than cash	Can be used for non-food consumption
Disincentive effects on production	Usage favours men
Competes with local markets and trade	Heightened security risk

Source: Sabates-Wheeler and Devereux (2010).

Schemes to raise incomes through public works, with workers receiving wages rather than handouts, are more feasible. The provision of universal old-age pensions, such as those introduced in India and South Africa, can also help widen the safety net (ERD, 2010). Such measures need to be seen as part of a broader response to enhancing social cohesion and to more comprehensive social protection networks. They are ultimately the best way to meet the challenge of volatile and rising food prices.

Over the medium and long term, however, the challenge is clearly to improve food output and productivity, policies which focus explicitly on developing a more dynamic rural economy. Ensuring that small farmers can respond to higher prices is a familiar policy challenge that has now become even more pressing. Given small farmers' difficulty in accessing finance, inputs and information, public investment in infrastructure and agricultural research and institutional support would pay dividends. Poor farmers could benefit from rising prices by increasing production thanks to the greater political and economic support for agricultural development. For example, in the coastal cities of West Africa, the shift to the consumption of bread, rice and pasta made from imported grains at the expense of local yam, cocoyam, cassava, millet, and sorghum could be reversed, giving a boost to domestic farmers. In the short term, however, farmers may lack the credit and inputs needed to respond to rising demand, which is where government support steps in. Malawi is an example of a country which has achieved an impressive supply-side response, albeit with questions remaining over the sustainability of the policy of heavily subsidising farm inputs – estimated at around 9% of government spending, or 3.5% of GDP.[11]

The international community also has a major role to play. The FAO estimates that food import bills in developing countries rose by 25% in 2007 (Rosen and Shapouri, 2008). Some welcome changes to the World Food Programme (WFP) have been made since the 2007-08 crisis, giving it more flexibility to deal with crisis situations. In June 2011, the G20 Agriculture Ministers Meeting in Paris issued a *communiqué* expressly calling for the World Food Programme to develop hedging strategies to purchase food.[12] But the WFP is still substantially under-budgeted: during the 2007-08 food price rise, it found itself with a shortfall of USD 500 million for sustaining current operations. Donors need to provide adequate financial support for institutions like the WFP. There

are also strong arguments that emergency food aid would be much more effective if it were financed on a multi-year cash basis by rich countries, rather than on a year-by-year, reactive basis which exposes the WFP to dramatic commodity price uncertainty (Ramachandran, Leo, and McCarthy, 2010).

Land ownership and reform

The long-term challenge of increasing food production and agricultural productivity while fostering social cohesion will also require that particular attention is paid to land ownership. As global demand for agricultural products increases, shifting wealth has lead to an intensification of problems related to land ownership, a persistent source of conflict across the world. In countries such as Brazil, Bolivia, India and Paraguay, democracy has seen the emergence of powerful movements of landless would-be farmers. Even in Africa, where land rights are often portrayed as customary systems with relatively open, negotiable, and adaptable landholding and land use, there is a growing body of evidence to suggest this is only part of the story. The instances of intensifying competition and conflict over land, of deepening rifts between and within kin-based, ethnic and regional groups, and of expropriation of land by local and non-local elites beg for closer attention (Peters, 2004). Exclusionary patterns of land ownership clearly make the task of achieving social cohesion much more difficult.

In many Latin American countries, landholding is still very unequal. In Brazil, for example, 1% of rural landowners possess half of all farmland, although that figure includes large tracts of Amazonia that are unsuitable for agriculture (Reid, 2009). In rural India, the Gini coefficient of land distribution expressed in terms of land ownership was 0.74 in 2002 (Bardhan, 2010). A recent survey by Zezza *et al.* (2011), based on the Rural Income Generating Activities (RIGA) database for 15 developing countries across Asia, Africa and Latin America, provides some revealing information about the access of the rural poor to assets:

- Most rural households have no land at all, or only small plots of land. Landlessness is widespread in many countries.
- Landholdings in most countries are small. The vast majority of households own less than one hectare and less than 5% own ten or more hectares.
- Landholdings tend to be even more highly concentrated than incomes. For instance, between 70 and 90% of total land is held by the top quintile of landowners in Ecuador, Guatemala, Nicaragua, Indonesia and Panama.

Such high figures of concentration of land ownership are particularly worrying because small producers (whether peasants or labourers) constitute most of the world's poor people. Most farming households in the developing world still have minimal access to basic agrarian services and institutions, which may limit the potential of the rural poor to engage in an agriculturally-based pathway out of poverty (Zezza *et. al.*, 2011). Although the long-term policy stance has to be to seek ways of facilitating income-generating activities outside of agriculture, policy responses that ignore small-scale producers are unlikely to tackle hunger and poverty – nutritional trickle-down is far less likely to succeed when viewing the poor simply as consumers of food produced in large-scale capital intensive farms. Put simply, policy cannot afford to ignore the interests of small-scale farmers.

Land policy for social cohesion

Where land markets are very imperfect, skewed land distributions are not only unequal, but also inefficient. Land policy can do much to improve both productivity and social cohesion. However, redistributive land reform is usually socially disruptive and requires broad social consensus if it is to lead to better and more equitable outcomes. In some cases, the disruption may be viewed as necessary. In a clearly extreme example, the Somoza family was reputed to have owned as much as a quarter of arable land in Nicaragua when the regime was overthrown in 1979. The subsequent land reform redistributed or nationalised almost half of all arable land (Wheelock, 1990).

Whereas in the 1950s, 1960s and 1970s, land reform was high on the international agenda, the issue almost disappeared in the 1980s and 1990s. The consensus opinion shifted towards the idea that it was counterproductive and politically dangerous to pursue significant land reform: it was considered impracticable because of its disruptive impact on production and because it would lead to social unrest in the countryside. While there was a lot of support for land reform programmes when they entailed the privatisation of previously state-held land holdings (*e.g.* in China and Viet Nam), it became less wholehearted when related to private landholdings. The standard policy prescription thus stopped short of land reform to stress the importance of strengthening secure property rights, improving contract enforcement, and eliminating legal restrictions on the ability to freely buy or sell land (*e.g.* De Soto, 2000).

Clearly, however, where the underlying ownership structure is inequitable, enforcing existing property rights alone may not be enough. As the World Bank (2008) puts it:

> "Land reform can promote smallholder entry into the market, reduce inequalities in land distribution, increase efficiency and be organised in ways that recognise women's rights. Redistributing underutilised large estates to settle smallholders can work if complemented by reforms to secure the competitiveness of beneficiaries – something that has been difficult to achieve. Targeted subsidies to facilitate market based land reform are used in Brazil and South Africa, and lessons must be derived from these pioneering experiences for potential wider application."[13]

One of the most comprehensive recent land reforms was the one embarked upon by the Cardoso government in Brazil in response to the persistent conflicts between the Movimento Sem Terra (MST), the leading organisation representing the landless in Brazil, and landowners. Between 1995 and 2002, some 20 million hectares were redistributed to 635 000 families. The government created a land registry, introduced a tax on idle land and approved a summary procedure for expropriation. The programme was continued by the Lula administration. However, beneficiaries faced the familiar problems associated with small-scale family farming, such as lack of inputs or support services. Some beneficiaries were drawn from the ranks of the urban unemployed and had no background or experience in farming and new land holdings often failed to generate the expected incomes.[14] Land reform in such circumstances risks becoming a disguised welfare scheme – and an expensive one at that: the Cardoso administration reportedly spent USD 7 billion on land reform in its first term alone (Reid, 2009).

Land reform is not, therefore, a necessarily cheap policy option or one that should be carried out without considering the need for complementary policies to make farming economically viable. It needs to be accompanied by support measures that catalyse the creation of off-farm income sources by stimulating the emergence of a rural economy

which thus becomes progressively less dependent on farming *per se* and leads to a strategy of more diversified livelihoods (OECD, 2011b).

The success of redistributive land reform thus hinges upon the state's ability to reduce other market distortions to make the reformed farms viable, especially with regard to access to credit, markets and inputs. Where attempts to reduce other market failures have failed, as in much of Latin America's first wave of land reforms (Carter and Salgado, 2001), the result has been disappointing – negative or negligible effects on productivity and a gradual reconcentration of land holdings. Another key ingredient for successful land reform is selecting beneficiaries who will make farms prosper: the use of land grants as part of peace agreements, for example, or cases where land has been distributed to urban dwellers have often not succeeded because the new owners had little knowledge or interest in farming. Market-assisted land reforms which provide partial grants to land purchases (rather than redistributing expropriated land outright) are also more likely to lead to better allocations of land, but so far their scale and success have been modest (World Bank, 2003).

In conclusion, as shifting wealth increases the pressure on arable land – as exemplified by so-called "land grabs", especially in Africa – the ability of states to guarantee a stable but fair property regime for external investors and domestic farmers alike will be critical in ensuring agricultural growth that is equitably shared. In the face of growing interest in cross-border land purchases throughout the developing world, many relevant policy documents have been issued in recent years regarding how to progress in terms of providing the right institutional and legal framework. These include recommendations from the African Union (the July 2009 "Declaration on land issues and challenges in Africa"), the Japanese government, UNCTAD, FAO, the German Federal Ministry for Economic Co-operation and Development, the Inter-Parliamentary Union (IPU), and the Economic and Monetary Union of West Africa.[15] As pointed out by OECD (2010d), these initiatives promote a shared set of fundamental principles:

- **Land and resource rights:** existing rights to land and natural resources should be recognised and respected.
- **Food security:** investment should not jeopardise, but strengthen, food security.
- **Transparency, good governance and the enabling environment:** processes for accessing land and making associated investments need to be transparent, monitored and ensure accountability.
- **Consultation and participation:** those materially affected by land purchases should be consulted and agreements through consultations registered and enforced.
- **Economic viability and responsible agro-enterprise investment:** projects should be economically viable, respect the rule of law, reflect industry best practice, and deliver sustainable shared value.
- **Social sustainability:** investment must generate desirable social and distributional impacts and not increase vulnerability.
- **Environmental sustainability:** measures should be taken to encourage sustainable resource use, quantify its environmental effects, and minimise and mitigate any negative impacts.

Governments should make it their priority to translate these principles into binding legislation and so provide the right environment to catalyse agricultural development in times of shifting wealth.

Integration of immigrants

Shifting wealth in the world has intensified the channels of interaction between developing countries, especially with regards to South-South trade and factor mobility. Migration between developing countries has also significantly increased and diversified over the last two decades. South-South migration flows are currently greater than those between South and North (World Bank, 2010) and are likely to rise relatively faster in the future – not only because migration policies in developed economies are increasingly restrictive, but also because fast-growing economies in the South represent new magnets for potential migrants. The worldwide scale of anti-immigrant feeling reflects the fact that immigrant integration is a challenge not only in rich but also – and even more so – in poor countries. Locally born people face the same problems as immigrants and resent what they see as policies that favour certain groups. Moreover, many countries in the South have become immigration hosts, not because of rising economic opportunities, but because they lie on the way to richer countries. As restrictive migration policies are the trend in the North, immigrants are increasingly stopping en route rather than just stopping over. Yet such countries seldom have means to integrate new populations.

The experience of emerging economies is symptomatic of the challenges that integration presents for countries of immigration around the planet. It demonstrates, in particular, that the lack of specific measures to fight against social exclusion and promote integration may turn immigration into a threat to social cohesion. The primary victims are, first and foremost, the immigrants themselves: they suffer from human rights violations, discriminatory practices, and xenophobic pressures. But society as a whole is also affected, as social tensions between foreign and native-born populations surface.

Côte d'Ivoire is a good illustration of how the escalation of nationalism, in this case through the controversial concept of "ivoirité" ("Ivoriness"), can generate civil unrest and never-ending political crises. By contrast, a country like Ghana, whose economic success also relies on immigrants, has been spared serious migration-related social problems, at least in recent decades. But Ghana is not innocent of stigmatising and discriminating against immigrants. The rise in immigration in the last few years has sparked tension which could worsen if the authorities do not take action in time.

The experience of OECD countries might offer one important lesson in this respect: it is never too early to deal with integration issues. Social problems faced today by most immigration host countries are the result of a lack of long-term strategy. Migration-related social cohesion must indeed rely on a coherent policy framework that goes beyond anti-discrimination measures. A smooth integration process should incorporate a comprehensive set of social, employment, education and housing measures. Efforts also need to be made to improve native-born citizens' perceptions of immigrants. This implies – and this is the trickiest part – that politicians stop making immigrants the scapegoats for problems in society and, instead, highlight their contributions to the development of the host country.

Fostering social inclusion

A coherent integration policy should aim to prevent and reverse the social exclusion of immigrants, still the biggest single barrier to full integration. To maximise the potential of migration, immigrants should be free of discrimination on the labour market. In this respect, an important lesson from the experience of OECD countries is that the social exclusion of temporary immigrants actually leads to their settling (AIES, 2011). Temporary migration is no solution to the challenge of integration.

The core requirement of a successful integration policy is that it should have a human rights approach. Normative institutional structures may be on the rise,[16] but enforcement is low and many migrants are victims of trafficking and the worst forms of human rights violations. This can be minimised by enforcing protective measures for immigrants, above all unaccompanied children and women, through awareness-raising campaigns among local populations and immigration and police officers. Human rights violators must be punished.

Social security measures need to be adapted to informal workers and incorporate housing and health provision at the very least. Social security coverage and services are so weak in the South that laws mean little to either locals or immigrants: most immigrants are not even registered in the host country and are thus considered illegal.

Building social capital

Social capital involves generating social relations that can have productive benefits. Fostering positive bonding between immigrants and local people and bridging the gaps that may arise when diverse sets of norms intersect constitute key elements of integration. Policy makers need first to accept that culture and identity are not an obstruction to integration. The goodwill that social capital generates can then exert a positive effect on productivity and social cohesion.

Essential to building social capital are education and training. Education strengthens ties between the locally-born and immigrants as children learn elements of local culture and language at school. Specific skills and language training also improves interaction between immigrants and locals, both children and adults.

A second important thrust behind building social capital is allowing immigrants the freedom to practice and share aspects of their original culture. This involves a two-way interaction, whereby immigrants practice and share customs with local people, whose customs they learn in turn. Customs encompass elements of religion, food, and other practices related to culture and social norms. Education and training are effective vectors of cultural learning and understanding.

Building social capital also entails supporting and promoting the right to organise, assemble, and be represented. By forming groups, immigrants who are already settled in the host country can help new arrivals with red tape and teach them to make the cultural adjustment to their new environment. Immigrant groups can in fact form the natural bedrock of integration and act as go-betweens between new immigrants and the indigenous community.

Promoting social mobility

Immigrants often find themselves deliberately pushed to the bottom of the host country's social pile, principally because of their low material wealth, but also because their human capital is also perceived to be poor. The opportunity to climb the social ladder is an efficient incentive mechanism and increases productivity. However, immigrants' social mobility depends heavily on whether they are low or highly skilled, whether they intend to settle or stay temporarily, and whether they work in towns and cities or the countryside. Promoting social mobility for immigrants involves improving labour market mobility, facilitating entrepreneurship, better skills matching, and encouraging education.

As labour markets operate imperfectly in the South, policies should be drawn up to increase the benefits of working, ease mobility between the formal and informal sectors,

and remove barriers to better jobs. Such policies should include helping immigrants to organise into structures that perform informal activities by promoting entrepreneurship through the provision of loans and marketplaces. Policies should target groups that are susceptible to discrimination (*e.g.* low-skilled and women migrants) and provide job-matching mechanisms, particularly in areas where seasonal demand for labour is high.

Access to education and vocational skills training helps promote social mobility. Training can help workers secure not just better paid jobs but safer, better organised, and more productive ones. As education accelerates inter-generational social mobility, access to school for children of immigrants should be encouraged. Immigrants also tend to travel in families and child guardians are often over-burdened with work, providing food, and watching over the younger ones. By extending, subsidising and developing programmes to send immigrant children to school or to other types of social education establishment, host countries lessen the likelihood of their falling into forced labour.

Transforming and adapting institutions

Institutional change is key to harnessing the opportunities that shifting wealth affords for fostering social cohesion. Institutions are governed by formal written rules supplemented by typically unwritten codes of conduct. In many developing countries, the social order is predominantly shaped by informal agreements, norms and practices. As discussed in previous chapters, the building and strengthening of formal institutions and the design of a progressive tax system is critical to fostering social cohesion.

In many converging countries informal institutions – which often co-exist with formal ones – still have an important role to play in social cohesion, particularly in rural areas (Jütting *et al.*, 2007). For example, village associations based solely on trust and peer pressure provide access to credit and insurance, help in times of distress, and facilitate the construction of public roads and sewage systems. The rapid worldwide expansion of micro-finance and micro-insurance greatly relies on social cohesion among the participating members. Yet, while informal institutions can improve risk sharing and social protection at local levels, they can also be detrimental.

First, as research into participation patterns in micro-finance and insurance institutions has shown, the poorest are often excluded because they lack the financial and/or time resources to become active members (Weinberger and Jütting, 2000; Jütting, 2004). Second, institutions that are the very foundation of informal social security systems can have perverse effects. When solidarity with other members of the community is not a free choice but a social obligation, it soon becomes a "tax on success". An example would be a hard-working farmer who has built up wealth over the years and is compelled by social norms to share the fruit of his labour with his extended family, who may well include distant relatives. In economic terms, the informal institution of "sharing" can be a disincentive to invest and prompt opportunistic behaviour since there is no obligation to reciprocate (Platteau, 2000). Egalitarian norms for social cohesion can thus be a double-edged sword: while they help to reduce exposure to risk they may also constrain social mobility by limiting returns on investment and initiative (De Laiglesia, 2006).

The structural transformation of converging economies is an opportunity to transform and modernise informal institutions. The two examples below illustrate how, in the field of local self-governance, and social protection, pro-cohesive institutional change can benefit not only those immediately concerned, but the whole economy.

An interesting example of the difficulty in changing local governance structures to improve social cohesion at the local level are the mixed results of the Panchayati Raj Institutions (Box 8.2), democratic grassroots bodies in India. The government instituted them in the 1990s when it passed reforms to create a framework that would empower socially excluded groups. Outcomes have varied widely from one Indian state to the other and seem to be largely shaped by citizens' awareness, power relations, social capital and, most of all, by the vibrancy of political society and the type and extent of powers delegated to local governments (Narayan, 2005).

Box 8.2. **Local self governance and Panchayati Raj Institutions (PRIs)**

In 1992, a major constitutional amendment gave power to democratic grassroots bodies, the Panchayati Raj Institutions, operating at village level. The amendment's provisions also set aside seats for women, scheduled castes (SCs) and scheduled tribes (STs) in the Panchayats and made elections to the local bodies mandatory every five years. PRIs have great significance as agencies of decentralised government. The inclusion of representatives of disadvantaged groups such as SCs, STs and women has given the poor some voice. They enjoy the opportunity of participating in crucial decisions affecting their lives and livelihoods and those of other disadvantaged groups. This entitlement has helped them to acquire some social status as well (Viswanathan and Srivastava, 2007). Several micro-level studies carried out by the Hunger Project, Participatory Research in India (PRIA), and other organisations working to empower women Panchayat members show that there has been a slow but deliberate change in gender relations in rural areas. Today, there are more than 2 million women members of the Panchayats all over the country.

However, according to the Asian Development Bank (ADB), "Panchayat members discriminate against those who are not close to them. Only their party members get benefits from them. The case is the same with the block office." Implementation experiences point to key challenges to the exercise of villagers' roles in development projects. Their "sense of inclusion" is apparently not fully internalised and antagonism towards the project is expressed strongly and clearly at the slightest opportunity. The common alibis for their functional exclusion are: lack of education, inability to articulate, and improper manners in social interactions (which could be a euphemism for untouchability in some cases). Despite the constitutional safeguards, the dominant communities often use repressive and intimidating measures to silence the weaker groups (Viswanathan and Srivastava, 2007).

There is also a nexus between Panchayat leaders and political and administrative authorities that makes it difficult for disadvantaged people to raise their voices and be heard. Lack of information hampers people's participation and clouds aided schemes with lack of transparency. This gives the powerful Panchayat members the opportunities to identify as "beneficiaries" only those who are close to them (or their political party) rather than the needy. Throughout the PPA's rural sites, there are instances of local-level politics directly or indirectly affecting the well-being of either individuals or villages. Examples range from the "non-provision" of benefits to the location of infrastructure (Viswanathan and Srivastava, 2007).

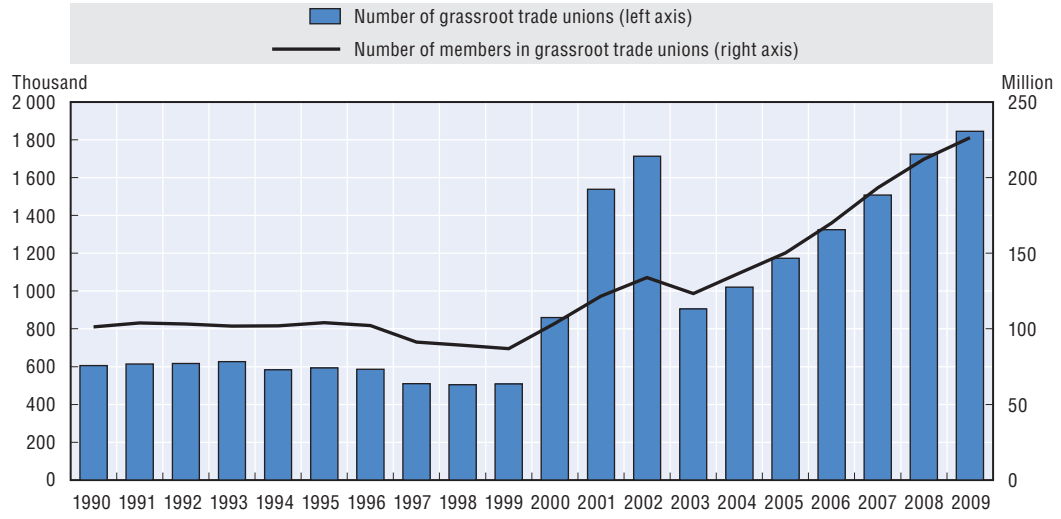
Source: Sinha *et al.* (2011).

The tremendous change of supply and demand in its domestic labour market led the Chinese government in 2008 to advocate the development of a wage bargaining system. It was the first time a government report had ever called for the development of labour market institutions bringing together wage employees and employers. The so-called

"Rainbow Project" stipulates that the coverage rates of collective contracts should be increased to 60% by 2010 and to 80% by 2011. The measure goes hand in hand with the creations of trade unions at enterprise level. The government's role would be to put in place a regulatory framework that defines the rules of this partnership.

According to Cai and Wang (2011), 83% of enterprises have established trade unions, 45% use a collective bargaining system for wages and 69% have a staff and workers congress system. Both collective contracts and grassroots trade unions in China have experienced a dramatic increase in number in the last decade. The number of unions and their memberships were more or less stable during the 1990s, before starting to grow in the 2000s to reach 1.8 million unions and 226 million members in 2009 (Figure 8.5).

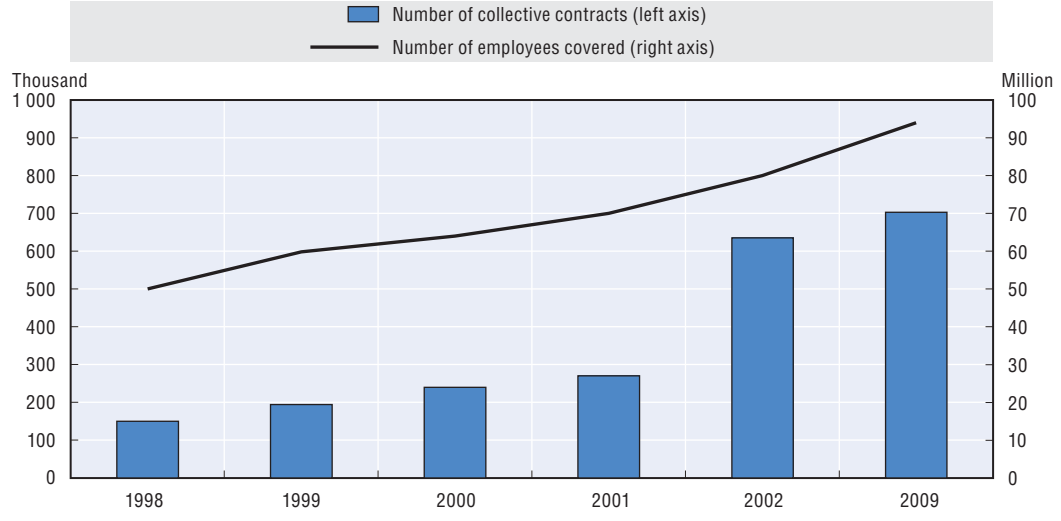
Figure 8.5. **Number of grassroots trade unions and their memberships**



Source: Cai and Wang (2011).

StatLink http://dx.doi.org/10.1787/888932518826

Figure 8.6. **Number of collective contracts and number of employees covered**



Source: Cai and Wang (2011).

StatLink http://dx.doi.org/10.1787/888932518845

With the development of a collective bargaining system for wages and a collective contract system, the number of collective contracts and the number of employees covered by these contracts rose from 150 000 and 50 million respectively in 1998 to 703 000 and more than 94 million in 2009 (Figure 8.6).

Both examples show how in the process of development and structural change, there is a demand for transforming institutions that have often served their purpose well at that particular point in time, but need to be either adapted or replaced by new institutions better suited to the increasing complexity of market interactions and their repercussions on households and individuals.

Conclusion

This chapter has highlighted key cross-cutting policy areas to be incorporated into a social cohesion agenda. The promotion of equal access to a good quality education, facilitating the participation of women in new economic opportunities, improving food security and the integration of immigrants are at the heart of promoting social inclusion, fostering trust and participation and laying the ground for upward social mobility. Many of the proposed policy interventions require a strong commitment and political will of the government to challenge existing power and clientele structures. Initiating a policy dialogue with different stakeholders of societies would be one important tool for assessing the priorities, imminent needs and expectations of citizens *vis-à-vis* the fostering of social cohesion.

Notes

1. The Social Inclusion Index is calculated as $100 * (1 - \rho)$ where ρ represents the intra-class correlation of socio-economic background, that is the variance in the PISA index of social, economic and cultural status of students between schools, divided by the sum of the variance in students' socio-economic status background between and within schools.
2. The measure of inter-group cohesion provided by the International Institute of Social Studies (ISS) emphasises the role of co-operation between ethnic, religious, and other identity groups as well as non-violence at local and national level (Foa, 2011).
3. Statistical information about Roma populations is limited because they are reluctant to declare themselves as such.
4. Graduates of those schools were ineligible for mainstream secondary schools until late 1999, when the Chamber of Deputies amended the School Act to permit such enrolment if applicants passed the entrance examination.
5. For instance, to conduct a desegregation process through the schools inspectorate as the Romanian Ministry of Education did in 2004 to eliminate all forms of segregated schooling for Roma children within three years (Andruszkiewicz, 2006).
6. The Academic Inclusion Index is constructed similarly to the social inclusion index but measures the degree of segmentation by academic performance rather than social background.
7. UNESCO training manual at *http://unesdoc.unesco.org/images/0013/001376/137604eo.pdf*.
8. Some other interesting examples can be found in this United Nations report on women: *www.un.org/womenwatch/daw/csw/csw55/Online-discussion-report-CSW55-Eng.pdf*.
9. The important caveat here is that such apparently large subsidies need to be put in the context of the large relative size of agriculture in the national economy. As a share of government expenditures or GDP, they seem large. But producer support measures for India are in fact broadly in line with the average when measured as a share of agricultural output (OECD, 2009b).
10. Some countries, like Nigeria, are of course much better off fiscally because of the oil boom (Headey and Fan, 2010).

11. In 2008-09, this increased dramatically to 16% of GDP due to the global spike in fertiliser prices, but has now fallen back to its previous level. See discussion of the issue in Lawson (2010) and Dorwood and Chirwa (2011).

12. At the G20 Agriculture Ministers' (2011) "Declaration and Action Plan on Food Price Volatility and Agriculture".

13. Even in the extremely controversial case of land reform in Zimbabwe, a recent DfID-funded study (Scoones *et al*., 2010) suggests that the reform has not been the unmitigated disaster commonly portrayed in the media. Since 2000, land reform has resulted in the transfer of around 8 million hectares of land across 4 500 farms to over 160 000 households, representing 20% of Zimbabwe's total land area, according to official figures.

14. For instance, at Pirituba, an MST settlement in upstate São Paulo, some farmers reported earnings of only USD 150 per month from their produce a dozen years after being awarded their plots (Reid, 2009).

15. See OECD (2010c) for a list of these declarations of principles.

16. In 2000, a set of three protocols on trafficking, the Palermo Protocols, were adopted by the United Nations (UN, 2000). Since they came into force in 2003, many countries have passed strong legislation against human trafficking.

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Perspectives on Global Development 2012
Social Cohesion in a Shifting World

Chapter 9

Fostering Social Cohesion in a Shifting World

The structural transformation of fast-growing economies offers various unprecedented possibilities for fostering social cohesion in society, among others the availability of greater fiscal resources that can be used to develop more inclusive social security systems. Implementing a social cohesion agenda at the national and sub-national levels requires sustainable financing, political leadership and, for some countries, external support. The mobilisation of domestic resources, monitoring and evaluating policies with respect to their impact on social cohesion, and a more active promotion of civic participation by donors are examples of how social inclusion, trust, participation and social mobility can be fostered.

Introduction

This report has shown that social cohesion in fast-growing societies presents opportunities and challenges in the context of shifting wealth. The preceding chapters in Part II have detailed various policy issues. This chapter looks at the "how", *i.e.* the conditions that need to be put in place in order to establish a social cohesion agenda at the national and sub-national levels. How can a social cohesion agenda be financed in the long term? What can governments do to ensure that this agenda is effectively implemented and has the buy-in of a large majority of key stakeholders? What role can international organisations and donors play in order to facilitate this process of transformation?

Since the late 1990s, developing countries have sought to bolster their commitment to social security and social protection (G20, 2011). Indonesia, for example, implemented programmes in the wake of the Asian crisis. It then reformed them in the mid-2000s by replacing highly regressive and increasingly costly fuel subsidies with conditional and unconditional cash transfer programmes (Sumarto and Bazzi, 2011). The introduction of unconditional cash transfers did not require extra funds, as they relied on savings from the gradual withdrawal of fuel subsidies.

Another example of how developing countries have been rethinking social protection comes from Latin America. Bolivia's pension reform law, passed on 29 November 1996, introduced a non-contributory annual pension system known as "*Bono Solidario*" or "Bonosol", for short, for resident citizens aged 65 years or older. The government's plan was to finance Bonosol from a capitalised fund built from the proceeds of its utility privatisation programme. In 2007, it replaced Bonosol with a monthly social pension scheme dubbed "*Renta Dignidad*", funded from Bolivia's direct tax on fuels, the *Impuesto Directo a los Hidrocarburos* (IDH). Because it was a genuine social entitlement, *Renta Dignidad* received much wider public support than Bonosol, which was associated with the privatisation process (Müller, 2009).

However, the Bolivian case also exemplifies the need to mobilise resources sustainably to finance priority expenditures for social cohesion. Financing *Renta Dignidad* out of current revenues from the IDH rather than a capitalised fund was questionable: in 2010, the IDH resources had to be supplemented to finance the transfer. Swaziland offers another illustration of how a social protection scheme has fared when a government comes under fiscal pressure. Its expansion of subsidies for energy and fuel coupled with the substantial loss of revenues from the Southern Africa Customs Union (SACU) forced it to cut its social protection expenditure (transfers to vulnerable groups including the aged and disabled). It shrank to an estimated 2.7% of the national budget in 2010-11, in contrast with 2009-10, when it reached 7.5% (AfDB *et al.*, 2011).

The remainder of this chapter examines key framework conditions for building a social cohesion agenda. It first looks at the fiscal effort needed to implement certain elements of a social cohesion agenda, in particular by extending social protection and

upscaling efforts in health and education. This effort requires increasing social expenditures and hence will require mobilising resources, but much can be achieved by reallocating existing expenditures which are particularly poorly targeted. The chapter then turns to key framework conditions, including leadership, and the process of policy making and monitoring. Finally, although a social cohesion agenda is eminently national, the supporting role of donors is examined.

Developing a fiscally sustainable social cohesion agenda

Fostering social cohesion by creating or expanding social services and social protection systems requires greater resources. This report argues that in the context of shifting wealth, many converging countries have increased their financial resources – greater budget surpluses, pension funds, and foreign exchange reserves, etc. – and invested them partly in developing comprehensive social protection systems. However, more resources are not enough: governments must make current public spending and service delivery more efficient and ensure long-term sustainability and affordability.

The cost of social protection and social services

Beyond basic health and education, the issue of a better social protection of citizens has been the focus of many reports recently giving strong evidence for the positive contribution of social protection programmes to poverty reduction and enhanced human development (Hagen-Zanker *et al.*, 2011).

First, both the scaling up of resources and the increase in the effectiveness of public expenditure are key to meeting the UN Millennium Development Goals (MDGs), whose 2015 target is fast approaching. Second, social protection programmes can help to mitigate the social risks and challenges associated with a changing global landscape and the general shifting wealth phenomenon. The greater openness of developing economies and the financial and economic crisis have further exposed them to changes in global markets. That exposure could turn into vulnerability to social and economic hazard if adequate defences are not put in place (Barrientos and Hulme, 2008). In this sense, social protection programmes are essential if social cohesion is to be fostered. A third argument in favour of social protection is that the bounce-back of food and fuel prices since mid-2009 (Chapter 3) has increased the cost of fuel and food subsidies, which are in principle regressive, distorting, poorly targeted, and could crowd out other items of social spending. Finally, social protection schemes have been a powerful vehicle of South-South peer-learning. They have spread from a mere smattering in the late 1990s to cover most of the developing world (OECD, 2010a).

As a first step, one needs to get an idea of how much the up-grading of social protection and public services in general would actually cost. The levels of social expenditure of OECD countries seem out of reach for many developing countries (Table 9.1). Indeed, they do not necessarily correspond to the social welfare model desired by emerging economies. However, a comparison of levels of expenditure also shows that there is ample room to increase expenditure, in particular through targeted social assistance programmes.

A number of individual programmes that have been shown to effectively reach the poor, are definitely affordable for most countries. From the estimates reviewed in this report, extending social protection via targeted cash transfers is also relatively affordable, and in

Table 9.1. **Public social expenditure in selected countries**

		Total public social expenditure (% of GDP)
OECD total	2007	19.3
France (highest)	2007	28.4
Mexico (lowest)	2007	7.2
of which: Oportunidades	2007	0.4
Brazil	2005	16.3
of which: Bolsa Familia (CCT)		0.3
China	2008	6.5
India	2006/7	4.6
South Africa	2007	8.1
of which: Old Age Pension	1998	0.8
Bolivia	2006	10.0

Note: Data from different sources are not strictly comparable. Data cover old-age, survivors, incapacity-related benefits, family, health, active labour market policies, unemployment, housing and others.
Source: *OECD SOCX Database*, OECD (2010b), ECLAC, Fiszbein and Schady (2009).

some cases over an even shorter timeframe (Table 9.1). Brazil, Indonesia and Mexico reach between one-quarter and one-third of the population with relatively modest transfers and at a rough cost of between 0.3 and 0.6% of GDP. Brazil's conditional cash transfer programme, "*Bolsa Familia*", has a cost of around 0.3% of GDP and reaches 25% of the total population (Box 9.1). Similarly, Mexico's "*Oportunidades*" scheme cost 0.32% of GDP in 2009 (Barrientos *et al.*, 2010) and covered roughly one-quarter of the population. More comprehensive, ambitious programmes will require larger fiscal resources: India's Mahatma Gandhi National Rural Employment Guarantee Scheme (NREGS) – a rights-based workfare programme guaranteeing 100 days of paid work to every rural household in India – is expected to cost between 1 and 5% of GDP once it reaches its implementation target level. OECD countries invest much more heavily in social protection – generally over 20% of GDP.[1]

Box 9.1. **Consolidating social protection: Conditional cash transfer policy in Brazil**

Over the years, Brazil has built a relatively sophisticated social protection network. Contributory pension schemes were established in the country in the 1920s. They were supplemented by a semi-contributive scheme focused on small farmers, and a non-contributory scheme targeted at the elderly and disabled poor in the 1970s. The Constitution of 1988 strengthened social protection for the elderly and led to more generous eligibility rules and pension levels. Social security coverage for Brazilians aged 65 and over became nearly universal and extreme poverty among the elderly became a residual problem. This social protection structure was not as effective in reducing poverty among other groups. In particular, extreme poverty rates amongst Brazilian children remained more than double those observed for the total population.

This was the context in which the first conditional cash transfer programmes (CCT) arose in Brazil. CCTs started at the local level – in the Federal District and in the municipality of Campinas. These strongly pro-child programmes quickly gained academic and popular acceptance. This endorsement supported the implementation of the first CCTs at the national level, which started in 2001 linked to the Ministries of Education and Health. These programmes had the merit of scaling up local experiences. However, they were implemented by different agencies, which generated co-ordination problems, resulting in low coverage and structural limitations.

Box 9.1. **Consolidating social protection: Conditional cash transfer policy in Brazil** *(cont.)*

The emergence of the *Bolsa Família* Programme was a crucial step to unify the rules, procedures and administrative records of these and other similar initiatives. *Bolsa Família* is a conditional cash transfer policy focused on poor and extremely poor families. Poor families are households with per capita monthly incomes between BRL 70 and BRL 140 (about USD 40 to USD 80) while extremely poor families are those with per capita monthly incomes below BRL 70. The programme grants monthly benefits to 12.9 million families with a budget of USD 7.7 billion. Its conditionalities are conceived as a tool to reinforce rights: to identify the people in the most vulnerable situations so that the state can encourage them to access education and health services.

Its emergence led to a strong expansion in the coverage of social protection and had a significant impact on extreme poverty, which is vital to the reduction of income inequality in Brazil. Its targeted nature and efficiency ensured broad support for the programme by Brazilian society, even among those who are not beneficiaries. Over the last 8 years, the poverty headcount fell from 42.7 to 28.8% and extreme poverty went down from 12 to 4.8%. Inequality has also fallen, with Brazil´s Gini Index dropping from 0.58 to 0.54 between 2003 and 2008 and the income of the bottom 10% of the population growing six times faster than that of the top 10%. According to a decomposition exercise, two-thirds of the fall in income inequality was due to improvements in the distribution of labour income and the remaining third was accounted for by the effects of social transfers (17%), including *Bolsa Família*, and pensions (15%) (FGV, 2008).

Bolsa Família has become one of the key elements of the social protection system targeted towards a population that is outside the formal labour market and therefore excluded from contributory social security. Thus, the programme has a complementary role to the social protection mechanisms that preceded it, especially social pensions. The programme has established the foundations necessary to have a decisive impact on the eradication of extreme poverty. A unique registration database (the *Cadastro Único* or single registry) functions as a consolidated source of information for policies geared towards the low-income population, providing a key tool to reach almost all poor people in the country.

Significant challenges lie ahead, especially given President Dilma Rousseff's commitment to overcome extreme poverty in the country by 2014. Children are still the age group most affected by poverty. As a response, *Bolsa Família* parameters have been adjusted, increasing the relative value of the benefits paid to families with children and increasing the maximum benefit paid to large families – the maximum number of variable benefits (which are paid per child on top of the basic benefit) was increased from 3 to 5. A major effort is being made to reduce errors of exclusion (eligible households who do not receive programme benefits): one of the central goals is expanding the programme to 800 000 more families in the coming years. The ultimate objective is for *Bolsa Família* to reach all families in poverty and extreme poverty in the country and to contribute to the eradication of extreme poverty. The Brazil Without Misery (*Brazil Sem Miseria*) plan – launched in 2011 – aims to eradicate extreme poverty through incremental improvements to *Bolsa Família* and other interventions and programmes including cash transfers and improvements in public service delivery.

Source: FGV (2008), MDS (*Ministério do Desenvolvimento Social e Combate à Fome*).

As the reviewed results of recent studies on the topic show, there are, to be sure, serious challenges to introducing and sustaining large-scale programmes in low-income countries. But it can be done, as a number of low-income countries have demonstrated. Lesotho and Nepal, for example, have managed to introduce social pension schemes (DfID, 2011). With the right external support, this report argues, it would be feasible in many other low income countries too.

Estimates of the cost of a wider set of social services, including health and education provisions, suggest that it is affordable at the global level. Individual estimates are largely dependent on assumptions, time frames and countries, but it is nonetheless important to arrive at a rule of thumb. Mehrotra and Delamonica (2007) estimate that in developing countries between USD 206 billion and USD 216 billion (in 1995 USD) are needed annually to provide basic social services for all, and that an estimated USD 136 billion are currently spent on the services. The result is a USD 70-80 billion shortfall.[2] The health sector makes up the bulk of these additional expenditures. As regards universal primary education, it is estimated that the annual additional cost of "education for all" in developing countries by 2015 will reach USD 9.1 billion (in 1998 USD) – less than 0.03% of world GDP and 0.14% of the combined GNP of developing countries. The global shortfall is thus about 11% of what developing countries currently spend on primary education. In other words, the target of "education for all" seems to be affordable, at least at the global level (Delamonica *et al.*, 2001) while health financing exhibits a significant shortfall.[3]

At the country level, estimates of the cost of basic social protection, including health provision appear affordable as shares of GDP, but in some cases will require a substantial increase in mobilisation of public resources. An ILO analysis of 12 countries finds that the basic package of transfers and health provision is "demonstrably affordable". It would be within the reach even of resource-poor governments if they showed political commitment, phased in increases in revenue collection, reallocated and rationalised existing budgets, and sought medium-term external financing. In all 12 of the countries considered, the initial annual cost of a basic social protection package was projected to be in the range of 3.7 to 10.6% of GDP in 2010. Six countries – Burkina Faso, Ethiopia, Kenya, Nepal, Senegal and Tanzania – would spend more than 6% of GDP (ILO, 2008). In practice however, achieving cash transfer spending on this scale is likely to be very challenging, given both the low level of current overall public spending (typically in the range of only 15 to 20% of GDP in most low-income countries) and the difficulties of reallocating within budgets.

Another study conducted by ODI-UNICEF (2009) into fiscal space in five West and Central African countries (Table 9.2) sounds a more cautious note than the ILO.[4] It finds that the five states under review can be separated into:

- Low-population, oil-rich countries (Equatorial Guinea and the Republic of Congo). They can afford large-scale transfers but lack institutional capacity and currently allocate only a low share of total expenditure to social sectors.

Table 9.2. **Estimating the costs of cash transfers in West and Central Africa**

Scheme and definiton	Measure of cost	Republic of Congo	Equatorial Guinea	Ghana	Mali	Senegal
Universal child benefit	% GDP	2	0.9	8.7	5.9	6.4
(30% of food poverty line for all children aged 0-14)	% recurrent expenditure	16.7	20.8	46.3	42.8	30
Targeted child benefit	% GDP	1.2	n.a.	n.a.	3.2	3.7
(as above, for children in households below the poverty line)	% recurrent expenditure	9.9	n.a.	n.a.	23.5	17.6
Social pension	% GDP	1	0.2	2.6	n.a.	n.a.
(70% of the food poverty line for everyone over 60)	% recurrent expenditure	8.3	5	13.9	n.a.	n.a.

Source: ODI and UNICEF 2009.

StatLink http://dx.doi.org/10.1787/888932519054

- Countries characterised by high base levels of social-sector spending and public financial management systems (Ghana, Mali and Senegal). They are already close to the expenditure limits recommended by the IMF for macroeconomic fiscal sustainability.

A number of individual social programmes are affordable for most developing countries. However, an agenda that calls for more comprehensive health, education and social protection requires substantial increases in social expenditures in many countries, especially among low-income countries. Shifting wealth offers opportunities to increase domestic resource mobilisation, but increased social expenditure can also be achieved by improving the efficiency of public spending and focusing redistributive efforts in well targeted programmes.

The fiscal side: Mobilising resources, gaining efficiency and managing political and social conflicts

Governments around the world are concerned about the fiscal implications and affordability of social security and social protection. While most countries have the fiscal space to kick off with priority interventions, long-term sustainability must be carefully analysed when designing the scale and scope of programmes. Strengthening and extending social protection programmes either involves stepping up the mobilisation of domestic resources (itself a valuable goal) or reallocating within budgets. Combining them, however, could be the realistic starting point of a serious plan to deploy new programmes, with donors playing a supporting role (EUI, 2010).

Revenue earmarking is one potential tool for freeing up social resources in countries with weak fiscal legitimacy. But it should be handled with care. As argued in Chapter 5, when people distrust the way the government uses tax revenue, it should link revenues to specific social programmes in order to build support for more taxation and scale up social expenditure. The Republic of Korea, for example, which put in place a high-performing school system during its own development process, used earmarking to good effect. In 1982, the government found that the general budget was unable to meet the costs of the education system. It introduced a five-year education tax on spirits, tobacco, and interest and dividend income in the banking and insurance industry. Five years later, the tax accounted for 15% of the education ministry's budget. Other Asian countries – China, Nepal, and the Philippines – earmark taxes for education, as do Latin American and African countries. Brazil levies a 2.5% salary tax on the wages of employees in the private sector and the proceeds are used exclusively for primary education (Mehrotra and Delamonica, 2007).

Earmarking is not without its problems and should be accompanied by safeguards to prevent budget rigidity, pro-cyclicality in expenditure, and the creation of vested interests. To offset them, statutory provisions – *e.g.* the automatic expiry of earmarking at a certain level of expenditure – and measures to ensure transparency and accountability in the use of resources could be introduced. An important consideration in the use of resources is that cash transfers are most effective when they are countercyclical. Countercyclical spending is more easily feasible in middle-income countries, and Indonesia, Brazil and Mexico adopted the practice in the last recession with the help of IFI concessional finance.

Low-income countries are, however, hindered by time lags and by the unpredictability and allocation problems inherent in ODA flows.

Turning to the efficiency argument, most developing countries control food and fuel prices, which helps cushion the effects of international price volatility. But price controls are also used as instruments of social policy. Universal price subsidies can distort consumption patterns, are costly, and benefit the better-off more than the poor in absolute terms. A significant number of countries control food and fuel prices as a means of increasing the real incomes of populations and shielding them from price volatility. In a 2006 review of fuel price setting carried out by the IMF, it was found that out of 48 developing and emerging economies, only 16 could be considered as liberalised. Nine fixed prices according to an automatic formula and the remainder controlled prices directly in an *ad hoc* way.

Fuel subsidies in particular can have a significant budgetary cost (Table 9.3). In Indonesia and Yemen, total subsidies in 2005 were higher than the health and education budgets combined (Coady *et al.*, 2006). Oil-exporting countries account for about 60% of global fuel subsidies (Coady *et al.*, 2010). Fuel subsidies, whether explicit or implicit through price controls, are poorly targeted because petroleum product consumption commands a larger budget share for richer parts of the population.[5]

Table 9.3. **Budgetary and implicit costs of fuel and food subsidies in selected countries**

	Year	Fiscal cost of explicit fuel subsidies (percentage GDP)	Implicit fuel subsidies (percentage GDP)	Explicit food subsidies (percentage GDP)
Yemen	2005	9.2		
Jordan	2009	0.2		0.8
Bolivia	2005	0.8	5.2	
Egypt	2005	–	4.1	2.1
Egypt	2009	6		2

Source: Coady *et al.* (2006); Albers and Peeters (2011).

In a number of countries, including North African and Middle Eastern states, food subsidies are an important instrument of social policy. They helped cushion the impact of high food prices in 2008, but did so at a considerable fiscal cost. According to data gathered by Albers and Peeters (2011), four countries in the region (Egypt, Morocco, Syria and Tunisia) spent over 10% of current government expenditure on food and fuel subsidies in 2008. When they fail to target the poor, food subsidies also benefit the non-poor and become very costly, inefficient instruments of social policy. Governments must find ways of phasing subsidies out and protecting the poor from price volatility with better targeted, more efficient methods.

Reducing or eliminating food and fuel subsidies and price controls requires careful sequencing as it can be challenging due to political economy and distributional considerations. For instance, Bolivia recently tried to reduce its fuel subsidies, and compensate for the loss of real income by increasing the minimum wage. But the move led to considerable civil unrest (Mapstone, 2010). This is in marked contrast with the carefully timed and gradual reduction in fuel subsidies in Indonesia, where the distributional effects of the subsidy downscaling were compensated by new targeted cash transfers (Sumarto and Bazzi, 2011). Arguments about the contribution of such subsidies or price controls to

maintaining social cohesion should not be used as an excuse to sustain regressive and economically ineffective policy measures. But governments do need to plan transitions in a way which is politically acceptable and with minimal social disruption.

Framing social cohesion policies

Shifting wealth brings, both directly and indirectly, new dilemmas and challenges for decision makers. Swaziland, for example, had established a widely lauded universal pension scheme, but was compelled by its deteriorating fiscal situation to suspend it. Indonesia diverted expenditure on food subsidies to its safety net scheme, then used it as a counter-cyclical tool. As mentioned previously, in early 2011 civil unrest forced the Bolivian government to rescind on plans to stop fuel subsidies, offset by a compensatory move to raise the minimum wage. The three examples illustrate the difficulty of implementing policy change and the need for buy-in at the top echelons of government.

Committed political leadership

In many countries, elites still enjoy great ease of access to resources, wield enormous power, and have every interest in preserving the *status quo*. Ritzen *et al.* (2000) argue that if social cohesion is to find a place on the political agenda and in policies it "requires credible local leaders who are able to articulate the interests and aspirations of the people, to identify a set of objectives and ideals around which those can coalesce. It requires a genuine sense of ownership and responsibility on the part of all stakeholders, and a commitment to work together." Visionary leaders have the power to change behaviour from the top and bring substantial change in favour of social cohesion. Historical examples are Mahatma Gandhi in India, Nelson Mandela in South Africa, and Habib Bourguiba in Tunisia. All three challenged some existing forms of discrimination and called for a more inclusive society in which all parts of the population could actively participate on an equal footing.

However, leadership is about more than charismatic leaders. In Central America, the Costa Rican consensus regarding the importance of public investment in the social sector cuts across party lines. Costa Rican "exceptionalism" has had a long history. From its inception as an independent state in 1838, Costa Rica has stood out from its neighbours. Though originally the poorest of the five Central American provinces of the Captaincy-General of Guatemala, it has evolved into the country with the highest, and best distributed, standard of living in the region (Reding, 1986). What is most remarkable is that this has occurred without the discovery of valuable natural resources. In fact, Costa Rica remains a country of quite limited means, with a per capita income of only USD 5 560 in 2007. Yet its population enjoys a life expectancy comparable to that in the United States, access to higher education equal to that in France or Norway, and the benefits of one of the world's most long-standing and genuinely representative democracies. It has achieved this through a concerted investment in education and health expenditures, a consensus which, although from different perspectives, neither of the two major political parties has seriously tried to undermine. Like any complex society, the history of Costa Rica has its elements of light and shadow.[6] But in its commitment to inclusive growth and human development, it exemplifies the idea of social cohesion.

Monitoring and evaluating social cohesion policies requires new data

In practice, economic and social policies to foster social cohesion require a framework for *ex ante* and *ex post* assessments of their impact: do they lead to more or less social

exclusion, foster trust and civic participation, and help to improve social mobility? Assessments would look at different groups in society, particularly those that are marginalised or discriminated against. However, to reiterate the argument set out in Chapter 6, a holistic approach towards labour market and social protection policies is vital. Monitoring and evaluation should be both top-down and bottom-up.

The importance of social cohesion for development outcomes suggests that any international development objectives which replace the Millennium Development Goals (MDGs) post-2015 should embrace social cohesion measures. The current MDGs focus on absolute thresholds measuring extreme poverty, which is reduced primarily through growth. They lack any measure for inequality and generally ignore the way in which the different MDGs interlace, viewing development as progress in individual sector silos (Vandermoortele, 2011).

The Stiglitz-Sen-Fitoussi commission's report (2009) on the measurement of economic performance and social progress is instructive as to how broader social cohesion concerns can inform the post-MDG agenda. Any successor to the MDGs would gain from taking into account the commission's recommendations that progress measurement should embrace indicators beyond GDP growth to capture other dimensions of well-being. Absolute and objective measures of progress should be complemented with relative and subjective measures for more effective assessment. In addition, any post-MDG measurement framework should embrace some measure of equity, whether measuring human development goals in health and education according to their incidence by income quintiles (as is done, for example, by the new equity-adjusted Human Development Index [UNDP, 2010]), or by explicitly including a measure of income or consumption inequality directly in development goals themselves.

It is especially important to realise that social cohesion concerns are particularly powerful for informing a progress measurement framework because they do not stigmatise under-development as a problem unique to developing countries. Indeed high-income countries may face social cohesion problems equally as troubling as those poorer countries have to confront. As this report has shown, rising inequality, for example, is a problem in both OECD and non-OECD countries. To ensure that the recommendations of the Stiglitz-Sen-Fitoussi commission inform whatever measurement framework replaces the MDGs post-2015, it is crucial that developing, emerging, and rich countries see eye-to-eye on the challenges facing global development. Social cohesion provides just such a framework.

Efforts to collect data for calculating such measures centre on developed countries and are mostly carried out by private organisations. Comparability, availability and quality of data would gain if national statistical offices (also) gathered them. However, the potential of the data can be fully exploited only if: *i)* there are international standards for data collection; *ii)* statistical capacity building is facilitated in countries where it is needed; and *iii)* data is made public as much as is possible. International organisations such as the OECD, the UN and the World Bank can, and should, play co-ordinating roles in bringing about the three conditions.

One area in which more data collection is vital is the calculation of subjective poverty lines. A subjective measure of poverty reflects the importance of social cohesion in poverty better than dollar-a-day poverty, because it takes into account individual country differences in the nature of social inclusion. International modules for collecting subjective poverty data could be improved and expanded. Instrumental in this respect would be the

approval by national statistical offices around the world of minimum income question modules and consumption adequacy modules.

Data collection for monitoring social cohesion is not limited to statistical agencies. With Internet-based technologies, citizens can easily collect and distribute data – a development that has resulted in the so-called "data deluge", a flood of data that has grown with the rise of technologies and has gained acceptance. As much of the developing world becomes increasingly wired, thanks largely to the expansion of mobile telephony, the possibilities for accurately measuring the daily behaviour of individuals increases dramatically.

How this wealth of information can be used properly and responsibly for public policy making, however, is a tricky question. There is a need for a wider definition of what data governments can and should use to monitor social cohesion as private companies increasingly collect and use data from the Internet and mobile applications. Many organisations, including the OECD and European Central Bank, recognise this and are experimenting with open source technologies for ease of communication and to broaden participation so that is not the preserve of experts.

Towards shared societies

The Council of Europe and the European Commission recently developed a charter and a plan that focus their policies more towards social cohesion:

> "By calling for shared social responsibility – the key principle of the Council of Europe's Revised Social Cohesion Strategy and the European Union's European Platform against Poverty and Social Exclusion – our institutions are seeking to ensure a better understanding and awareness of the strong interdependencies linking stakeholders and citizens" (Council of Europe and European Commission, 2011).

The Council of Europe's "Social Cohesion Plan" seeks to foster the involvement of citizens in defining priorities and responsibilities by promoting the principle of shared social responsibility "in order to channel the knowledge and resource of individual and collective players, strong and weak alike, *vis-à-vis* jointly agreed objectives" (Council of Europe, 2009). Despite some perceived differences, these initiatives are in line with the "big society" as proposed by the British Prime Minister David Cameron in 2009 (Norman, 2010).[7]

While the state has a crucial role to play in fostering social cohesion, society as a whole clearly needs to engage. The state can often set the framework and help different players to take action, but civil society and voluntary organisations, businesses and trade unions also have their role to play. Box 9.2 describes how initiatives at the local level, ranging from environmental and social action to sport, are of particular relevance.

The role of donors in promoting social cohesion

So far this report has focused on the opportunities and responsibilities of national governments in strengthening social cohesion. Clearly, however, in an increasingly inter-related world, the international community should take some responsibility in promoting the same agenda. A check list of things that development partners could and should do to enhance social cohesion would include:

- supporting civil society more vigorously;
- aiding incipient social protection networks in struggling and poor countries;
- avoiding undermining social cohesion.

Box 9.2. **Football and social cohesion**

With an estimated 265 million players all over the world and fast-growing women's participation, football is the planet's most popular sport. Competitions like the World Cup, Champions' League and regional championships attract billions of TV viewers, from the slums of Nairobi to the skyscrapers of Shanghai. The love of football crosses ethnic, religious, and cultural lines, but does the sport's impact go any deeper? Can it foster social cohesion among players and audiences? Can it contribute to social inclusion? There are plenty of examples that suggest it can.

Football has been an effective channel for teaching slum children useful life skills. Programmes like "Goals for a Better Life" in Colombia, run by the voluntary group Colombianitos, aim to reduce crime and drug addiction, while promoting education through football. Over 4 000 girls and boys have learned about self-control, decision making, values, and ethics through the laws of the game. Such has been the success of the programme it has been emulated the world over by NGOs like Right to Play, Sport & Development, and the Oscar Foundation.

Adults can benefit from football, too. On a night when the English Premiership's top teams play, hardly a sound can be heard in Mathare, one of Nairobi's biggest slums. But, just as in slums all across the world, people here are not just viewers, they are also players. The Mathare Youth Sports Association is one of 20 African groups that has benefited from the FIFA-funded "Football for Hope" programme set up in the wake of the 2010 World Cup. The Mathare group used the money to build a field and install a solar lighting system. The result has been higher attendance at training and a rise in the number of volunteers and coaches in youth leagues. The association also runs programmes on HIV/AIDS education and organises clean-up groups to help prevent the spread of disease.

Football has also helped change attitudes towards and foster the inclusion of under-represented groups. The World Cup in South Africa in 2010 prompted more African women to get involved and support than ever before. Star women players like South Africa's Simphiwe Dludlu are inspiring women to challenge society's view of their role and place. But inspiration comes from all ages and walks of life: *Vakhegula Vakhegula* (the Grannies in the local Xitsonga dialect) for instance, are a team of South African women aged 50 to 84, who work as domestic helps and street vendors and who have found in football a way of demonstrating that it is possible to reach heights through family and community support, teamwork and fair play.

Football can have an impact on social cohesion at several different levels:

- Individual: when a player climbs the social ladder by graduating from local leagues to playing for a top team.
- Interpersonal: when being part of a team builds a sense of belonging and team spirit.
- Organisational: when teams from different ethnic backgrounds play together in one league.
- System: When all players, regardless of sex, age, religion, or ethnic background subscribe to football's main values, of which fairness is a particularly important one.

But while all these levels can contribute to social cohesion, they can also worsen social exclusion. Football, like any sport, has a dark side. It can divide, further fractionalise different groups, and even lead to violence. It acts as an amplifier of existing problems such as discrimination towards immigrants and a desire for violence. Yet the dream of one day playing professionally in a premier European league keeps millions of young Africans busy and engaged.

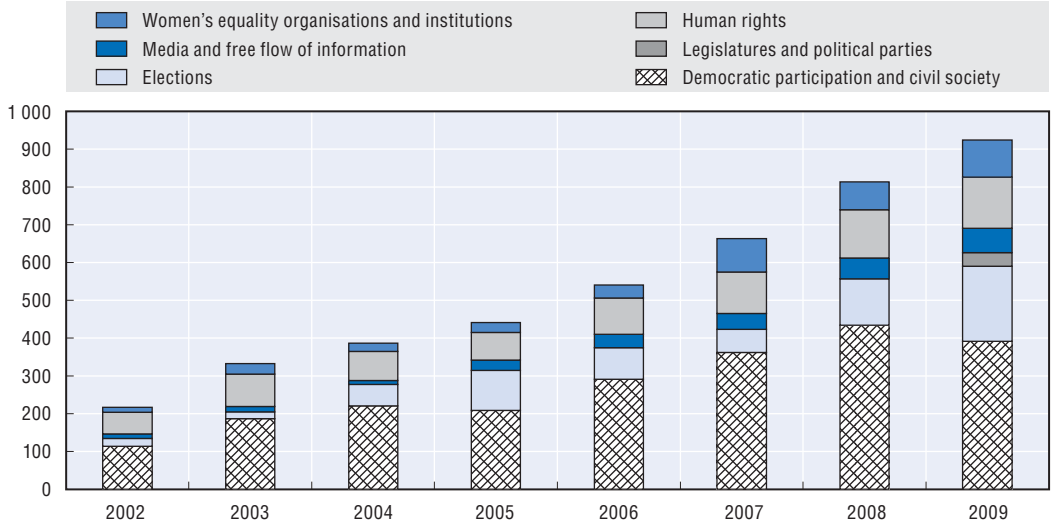
On balance, football – like many other sports – can effectively contribute to creating social cohesion. But to harness the benefits, more could still be done to leverage its potential for creating a sense of belonging beyond those who play it, organise it, and watch and support it. Bringing together different people regardless of their age, sex, nationality and values to share in competition, joy and fairness is perhaps the greatest myth to which football can contribute.

More vigorous support for civil society

Since the end of the Cold War, the promotion of democracy, human rights and participatory approaches to development have been stated priority objectives of many international donors. But how have they articulated them? It is clear that OECD Development Assistance Committee (DAC) donors have, over the last decade, gradually been increasing their funding for activities designed to strengthen civil society and democratic participation. Figure 9.1 shows the data for the whole of Africa – by 2009, DAC donors were spending approximately USD 900 million on support for civil society activities. To put these figures in context, it is worth recalling that total DAC ODA to sub-Saharan Africa that year was USD 47 billion. In other words, approximately 2% of aid budgets are being dedicated to civil society related objectives. The bulk of that, however, is designed to muster electoral support, with relatively little for the kinds of organisations which promote civic participation and plurality. Furthermore, rural organisations which represent the poor or have mass memberships arguably receive relatively limited assistance, with most of it accruing to a small number of urban-based organisations with middle-class leaderships.

Figure 9.1. **DAC donors' aid to Africa for strengthening civil society and democratic participation, 2002-09**

USD million



Source: OECD (2011).

StatLink http://dx.doi.org/10.1787/888932518864

Apart from the question of resources, what are the main underlying challenges in the sphere of civic participation and the promotion of democracy? One has been the way in which donor policy is excessively linked to the establishment of a formal set of institutions or processes, such as support for the holding of elections. For instance, the EU is increasingly seen as a key player in the field of election monitoring and most independent assessments consider that it carries out the role effectively. The EU has been active in election observation missions across the world – in Afghanistan, Burundi, Guinea-Bissau, Lebanon, Liberia, Ethiopia, the Democratic Republic of Congo, Venezuela and Sri Lanka, to cite just a few examples. And, as the EU itself declares, "in all these missions, the EU has

gained visibility while becoming an increasingly critical actor in the reinforcement of the democratic process" (EC, 2006).

However, in a study of the promotion of democracy in Ghana, Crawford (2007) notes that the donor community has generally restricted its help to the organisation of elections, but has been much more timid in supporting the more qualitative side of democracy (*e.g.* judicial reform or the quality of parliamentary control). A worst-case scenario would be that the policies of the EU and other donors in building democracy in developing countries might aggravate a situation whereby democratic institutions end up being little more than an ineffective pretence. Many new and restored democracies have found themselves in an uneasy stage of democratisation: while possessing the formal trappings of democracy, their modes of governance tend to exhibit resilient autocratic features (Diamond, 1996; Santiso, 2003; Heller, 2006).

An alternative approach for the donor community would be to increase the support for strengthening the more qualitative side of democracy: civil society, the free press, union movements, and any counterweight to the constitutional power of the state. In principle, aid donors can provide a valuable source of backing for civil society organisations (CSOs) which have only limited access to material resources and are vulnerable to government control and repression (Robinson and Friedman, 2005). The policy, to be sure, is not easy to implement: in Ethiopia, for instance, NGOs which receive external support are banned from any kind of political activism. With foreign support, civil society groups which press for progressive reform are easily tarred with the brush of serving foreign interests. Numerous developing and developed countries prohibit political contributions from non-nationals. Moreover, the best examples of civil society organisations mobilising and making a significant contribution to changing government policy tend to be home-grown. One such group is the Treatment Action Campaign (TAC) which, since the end of the 1990s, has successfully harnessed civil society activism in South Africa to press for the right of HIV-positive people to antiretroviral drugs.

Nevertheless, the pretence that donors adopt a totally apolitical approach is difficult to sustain. Their interventions are inevitably political, especially in areas of governance reform (Birdsall, 2005). Abandoning the apolitical stance is particularly critical in the case of pro-poor reforms, since effective anti-poverty programmes usually undermine powerful interests and have weak domestic constituencies. Part of the strategy could include greater support for parliamentary reform, which is currently weak (Santiso, 2003). Solutions could also involve providing greater backing for southern-based initiatives such as the African Peer Review Mechanism (APRM), which provides an interesting example of peer-learning through a review process similar to that of DAC donor reviews, but covering the whole range of economic, social and governance policies.

Finally, it is worth remembering that incentivising political participation is not dependent on a set of institutions; it is a mindset. Political participation took many centuries to cultivate in Western countries and has suffered many setbacks along the way.[8] Truly participative institutions are still work in progress even in the most "mature" democracies. In the case of the United Kingdom, for instance, one recent critique (Hutton, 2010) angrily documents a litany of deficiencies in the political system, including the excessive influence of powerful interest groups, highly concentrated ownership in the media, a lack of popular participation, etc. Democracy and civic participation from this perspective are aspirational goals, rather than ones that have been definitively achieved. Reaching compromise solutions

in cases of conflicts of interest is surely one of the most important lessons to be learned for countries aspiring to establish truly participative and socially cohesive political systems. If the donor community spent more time reflecting on ways of helping to promote this, rather than focusing simply on putting in place the right institutional mechanisms, a much more effective pro-democracy policy might be devised (Mold, 2007).

Aid for incipient social protection networks in struggling and poor countries

Donors need to pay careful attention to ways in which they can help build social cohesion. They can do this in a number of ways. One of the most obvious is to support the expansion of social protection programmes. On the whole, this report argues that the best policy option is that such programmes should be funded from domestic resources. For some poorer developing countries, however, financial support, whether through budget support or more targeted assistance, is still required for some incipient social protection – ambitious programmes would not be sustainable at all without aid from external donors. An example is Ethiopia's Employment Guarantee Programme, which ensures employment for some 7 million people and was recently expanded to provide assistance to an additional 4.4 million in the wake of the global economic downturn. Assessments of the programme are broadly very positive (DfID, 2011; EUI, 2010; Hanlon *et al.*, 2010; Gilligan *et al.*, 2008). But the Ethiopian government would find it difficult, if not impossible, to sustain were it not for the generous budgetary support provided by the donor community.

That being said, in countries where efforts to raise taxes are weak, there are debates about whether the donor community should be providing aid at all to compensate for insufficient domestic resource mobilisation (see, for instance, Von Haldenwang and Krause, 2009). There is a sense in which aid sends the wrong signals about the importance of domestic resource mobilisation (and is likely to be unpopular with citizens in the donor countries). One way of bridging the gap is for donors to provide help for the financial viability of expanded social programmes by placing greater stress on public-sector financial management and, in particular, on tools to improve tax collection. As noted in Chapter 5, as of 2008, 2% of all technical co-operation aid funds in Africa were allocated to activities related to public-sector financial management (AfDB *et al.*, 2010).

The risk of undermining social cohesion

Donors need to be careful both to back measures that enhance social cohesion and not to back ones that undermine it, as has happened. Although it is not a difficult matter to rectify such policy mistakes, donors do need a better realisation of the implicit and explicit costs of some of the policy measures that they support (Brown and Stewart, 2007). Below are some examples.

- In a form which was once termed "urban bias" (Lipton, 1977), aid projects and programmes to reduce poverty often focus on the areas that are easiest to reach – those around the capital city – and neglect remote districts. The result is that horizontal inequalities are worsened.
- Policies of structural economic reform often exacerbate horizontal inequalities where more privileged groups are in the favoured tradable sectors and worse-off groups are concentrated in subsistence and non-tradable sectors. In Mozambique, for instance, reforms in the 1990s and 2000s led to gains by producers of cashews, cotton and sugar, mainly located in the centre and south, while the losers were the much poorer groups in the North.

- Some programmes designed to favour particular groups contribute to the widening of inequalities. In the 1980s, transmigration programmes in Indonesia, supported by the World Bank and other donors, privileged the Javanese and marginalised some local groups, thereby worsening unequal land and income distribution.
- Processes of implementation often lead to a bias in the benefits of aid distribution, as particular groups gain control over resource flows. For instance, a study of the capacity-building programme for Kenyan civil servants found that, in practice, senior officials used it to favour their own ethnic group (Cohen, 1995).

Avoiding such perverse effects on social cohesion ultimately resides in a greater awareness among donors of the political, economic and social realities of the partner country.

Conclusion

Social cohesion is not a new paradigm – there is already very much a palpable paradigm fatigue in evidence in many development circles. Rather, this report modestly argues that social cohesion provides a useful conceptual framework for guiding public policy making. It helps bring together different policy areas that are otherwise treated separately: tax and fiscal policies, employment, social protection, discrimination, etc. It also reminds policy makers of the importance of not overlooking key areas of policy making like civic participation, open-access political systems, accountability. Often considered the software of development policy, they are in reality crucial to society's just, efficient functioning. A social cohesion agenda seeks to leverage different sector policies so that they promote social inclusion, build trust and civic participation, and foster social mobility. Taking these three dimensions as the pillars of a social cohesion agenda goes beyond the traditional "pro-poor-growth" approach that has been extensively discussed in the last five years (*e.g.* OECD, 2009). Pro-poor growth policies certainly help to focus on specific aspects of social cohesion, but they need to be complemented with an "inclusiveness agenda".

The structural transformation of economies brought about by integration into the world economy offers various unprecedented possibilities for fostering social cohesion in society. The availability of greater fiscal resources can be used to develop more comprehensive social security systems to protect all sections of the population. The success of some countries in changing institutions that discriminate against women can be an inspiration to others. In a more fully integrated economy, it becomes imperative to develop an educational model that enables upward social mobility.

To promote social cohesion is not to promote an apolitical vision of the challenges facing society. Fostering it as an overarching objective can only be realised if the main stakeholders of a society – the authorities, business organisations, and civil society groups – are involved and actively work together to jointly address collective action. Donors can lend their support by helping to develop an environment where people can actively participate and speak out, and where the government is held accountable. The transition process that many converging countries are now undergoing is likely to be turbulent and prone to conflict. If managed carefully, however, it offers the opportunity of reducing long-standing inequalities, building trust and social cohesion, and enabling upward social mobility.

Notes

1. *OECD Social Expenditure Database*.
2. This is about twice as high as an earlier estimate made at the time of the World Summit on Social Development in March 1995 of between USD 30 billion and USD 40 billion, calculated in 1994 and based on available data from the early 1990s. The approximate doubling of the estimated additional resources required by universal access to basic social services is due to the growing population, rising prices, and better estimates of costs.
3. The World Bank estimates that, if countries improved their policies and institutions, the additional foreign aid required to reach the Millennium Development Goals by 2015 would be between USD 40 billion and USD 60 billion a year (Delamonica *et al.*, 2001).
4. See EUI (2010) for a review of the evidence.
5. However, they are not necessarily regressive. Petroleum product subsidies and price controls usually distinguish between kerosene, gasoline and diesel. Kerosene, which is used as lighting and heating fuel when households have no access to electricity, is used mainly by the poor. Kerosene subsidies are usually better targeted, therefore, than gas or petrol subsidies.
6. In recent years, for instance, a number of political leaders, including no less than three ex-Presidents, have been embroiled in serious corruption cases. Historically, there have also been issues surrounding the treatment of migrants (principally from Nicaragua), and also ethnic minorities from the Atlantic region of Puerto Limon.
7. Critics of these proposals have stated that they endorse a shift in responsibility towards citizens away from governments and that it is a neoliberal attempt to reduce the role of the state, in particular in public service provision (see, for instance, Freedland, 2010).
8. None of this is to subscribe to the Eurocentric idea that development of democracy is inimitably European. As Amartya Sen (2003) eloquently argues, democracy as a concept has universal roots. Moreover, although it may be argued that our contemporary understanding of democracy has Greek origins, democracy may well have been forgotten had it not been for the Arab-Islamic heritage that conserved the idea during the European Dark Ages (Tibi, 2005).

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Perspectives on Global Development 2012
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STATISTICAL ANNEX

The Four-Speed World Classification

	Population 2010 (Millions)	Four-speed world classification		Gross national income per capita	Income group
		1990s	2000s	2010	2010
				Current USD (Atlas method)	
Affluent					
United States	309.1	Affluent	Affluent	47 240	High-income
Japan	127.5	Affluent	Affluent	42 130	High-income
Germany	81.7	Affluent	Affluent	43 290	High-income
France	64.9	Affluent	Affluent	42 390	High-income
United Kingdom	62.2	Affluent	Affluent	38 560	High-income
Italy	60.5	Affluent	Affluent	35 150	High-income
Korea	48.9	Affluent	Affluent	19 890	High-income
Spain	46.1	Affluent	Affluent	31 750	High-income
Poland	38.2	Struggling	Affluent	12 410	High-income
Canada	34.11	Affluent	Affluent	. .	High-income
Saudi Arabia	27.45	Struggling	Affluent	. .	High-income
Australia	22.33	Affluent	Affluent	. .	High-income
Netherlands	16.6	Affluent	Affluent	49 750	High-income
Greece	11.3	Affluent	Affluent	27 260	High-income
Belgium	10.9	Affluent	Affluent	45 360	High-income
Portugal	10.6	Affluent	Affluent	21 850	High-income
Czech Republic	10.5	Struggling	Affluent	17 890	High-income
Hungary	10.0	Struggling	Affluent	12 980	High-income
Sweden	9.4	Affluent	Affluent	50 000	High-income
Austria	8.4	Affluent	Affluent	46 690	High-income
Switzerland	7.8	Affluent	Affluent	70 030	High-income
Israel*	7.6	Affluent	Affluent	27 170	High-income
Denmark	5.5	Affluent	Affluent	59 210	High-income
Slovakia	5.4	Struggling	Affluent	16 210	High-income
Finland	5.4	Affluent	Affluent	47 160	High-income
Singapore	5.1	Affluent	Affluent	41 430	High-income
Norway	4.9	Affluent	Affluent	85 340	High-income
Ireland	4.5	Affluent	Affluent	40 720	High-income
Croatia	4.4	Struggling	Affluent	13 780	High-income
New Zealand	4.37	Affluent	Affluent	. .	High-income
Oman	2.78	–	Affluent	. .	High-income
Slovenia	2.1	Affluent	Affluent	24 000	High-income
Trinidad and Tobago	1.3	Struggling	Affluent	15 400	High-income
Estonia	1.3	–	Affluent	14 370	High-income
Bahrain	1.26	–	Affluent	. .	High-income
Cyprus**	1.1	Affluent	Affluent	. .	High-income
Equatorial Guinea	0.7	Converging	Affluent	14 540	High-income
Greenland	0.6	–	Affluent	. .	High-income
Luxembourg	0.5	Affluent	Affluent	79 630	High-income
Malta	0.41	Affluent	Affluent	. .	High-income
Bahamas	0.34	Affluent	Affluent	. .	High-income
Iceland	0.3	Affluent	Affluent	33 990	High-income
Convergers					
China	1 338.3	Converging	Converging	4 260	Middle-income
India	1 170.9	Poor	Converging	1 340	Middle-income
Indonesia	239.9	Poor	Converging	2 500	Middle-income
Brazil	195.0	Struggling	Converging	9 390	Middle-income
Pakistan	173.6	Poor	Converging	1 050	Middle-income
Nigeria	158.4	Poor	Converging	1 180	Middle-income

	Population 2010 (Millions)	Four-speed world classification		Gross national income per capita	Income group
		1990s	2000s	2010	2010
				Current USD (Atlas method)	
Bangladesh	148.7	Poor	Converging	700	Low-income
Russian Federation	141.8	Struggling	Converging	9 910	Middle-income
Philippines	93.3	Struggling	Converging	2 060	Middle-income
Viet Nam	86.9	Converging	Converging	1 110	Middle-income
Ethiopia	83.0	Poor	Converging	390	Low-income
Egypt	81.1	Struggling	Converging	2 440	Middle-income
Iran, Islamic Republic of	73.97	Struggling	Converging	. .	Middle-income
Turkey	72.8	Struggling	Converging	9 890	Middle-income
Thailand	69.1	Struggling	Converging	4 150	Middle-income
Democratic Republic of the Congo	66.0	Poor	Converging	180	Low-income
South Africa	50.0	Struggling	Converging	6 090	Middle-income
Colombia	46.3	Struggling	Converging	5 510	Middle-income
Ukraine	45.9	Poor	Converging	3 010	Middle-income
Tanzania	44.8	Poor	Converging	530	Low-income
Sudan	43.6	Poor	Converging	1 270	Middle-income
Argentina	40.4	Struggling	Converging	8 500	Middle-income
Algeria	35.5	Struggling	Converging	4 450	Middle-income
Uganda	33.4	Poor	Converging	500	Low-income
Morocco	32.0	Struggling	Converging	2 900	Middle-income
Nepal	30.0	Poor	Converging	480	Low-income
Peru	29.1	Struggling	Converging	4 780	Middle-income
Malaysia	28.4	Converging	Converging	7 760	Middle-income
Uzbekistan	28.2	Poor	Converging	1 280	Middle-income
Ghana	24.4	Poor	Converging	1 230	Middle-income
Mozambique	23.4	Poor	Converging	440	Low-income
Romania	21.4	Struggling	Converging	7 840	Middle-income
Sri Lanka	20.9	Converging	Converging	2 240	Middle-income
Syrian Arab Republic	20.5	Struggling	Converging	2 790	Middle-income
Angola	19.1	Poor	Converging	3 940	Middle-income
Chile	17.1	Converging	Converging	9 950	Middle-income
Burkina Faso	16.5	Poor	Converging	550	Low-income
Kazakhstan	16.3	Struggling	Converging	7 440	Middle-income
Mali	15.4	Poor	Converging	600	Low-income
Ecuador	14.5	Struggling	Converging	4 290	Middle-income
Cambodia	14.1	Converging	Converging	760	Low-income
Zambia	12.9	Poor	Converging	1 070	Middle-income
Cuba	11.26	–	Converging	. .	Middle-income
Chad	11.2	Poor	Converging	620	Low-income
Rwanda	10.6	Poor	Converging	520	Low-income
Tunisia	10.6	Struggling	Converging	4 060	Middle-income
Bolivia	9.9	Struggling	Converging	1 810	Middle-income
Dominican Republic	9.9	Converging	Converging	5 000	Middle-income
Belarus	9.5	Struggling	Converging	6 130	Middle-income
Azerbaijan	9.1	Poor	Converging	5 080	Middle-income
Honduras	7.6	Struggling	Converging	1 880	Middle-income
Bulgaria	7.5	Struggling	Converging	6 250	Middle-income
Serbia	7.3	Struggling	Converging	5 810	Middle-income
Tajikistan	6.9	Poor	Converging	800	Low-income
Paraguay	6.5	Struggling	Converging	2 940	Middle-income
Lao People's Democratic Republic	6.2	Poor	Converging	1 040	Middle-income
Jordan	6.1	Struggling	Converging	4 390	Middle-income
Sierra Leone	5.9	Poor	Converging	340	Low-income

	Population 2010 (Millions)	Four-speed world classification		Gross national income per capita	Income group
		1990s	2000s	2010	2010
				Current USD (Atlas method)	
Kyrgyz Republic	5.4	Poor	Converging	880	Low-income
Turkmenistan	5.0	Poor	Converging	3 800	Middle-income
Costa Rica	4.7	Struggling	Converging	6 550	Middle-income
Georgia	4.5	Poor	Converging	2 690	Middle-income
Lebanon	4.2	Converging	Converging	9 080	Middle-income
Congo	4.0	Poor	Converging	2 150	Middle-income
Bosnia and Herzegovina	3.8	–	Converging	4 790	Middle-income
Panama	3.5	Struggling	Converging	6 980	Middle-income
Uruguay	3.4	Struggling	Converging	10 590	Middle-income
Lithuania	3.3	Struggling	Converging	11 390	Middle-income
Albania	3.2	Struggling	Converging	3 960	Middle-income
Armenia	3.1	Poor	Converging	3 090	Middle-income
Mongolia	2.8	Poor	Converging	1 850	Middle-income
Namibia	2.3	Struggling	Converging	4 500	Middle-income
Latvia	2.2	Struggling	Converging	11 620	Middle-income
Lesotho	2.2	Poor	Converging	1 040	Middle-income
Botswana	2.01	Struggling	Converging	6 790	Middle-income
Mauritius	1.28	Converging	Converging	7 750	Middle-income
Djibouti	0.89	Poor	Converging	. .	Middle-income
Bhutan	0.73	Converging	Converging	1 880	Middle-income
Suriname	0.52	Struggling	Converging	. .	Middle-income
Cape Verde	0.5	Struggling	Converging	3 270	Middle-income
Maldives	0.32	–	Converging	4 240	Middle-income
Samoa	0.18	Struggling	Converging	2 860	Middle-income
Saint Vincent and the Grenadines	0.11	Struggling	Converging	4 850	Middle-income
		Struggling			
Mexico	113.4	Struggling	Struggling	8 930	Middle-income
Venezuela	28.8	Struggling	Struggling	11 590	Middle-income
Yemen	24.05	Poor	Struggling	. .	Middle-income
Côte d'Ivoire	19.7	Poor	Struggling	1 160	Middle-income
Cameroon	19.6	Poor	Struggling	1 180	Middle-income
Guatemala	14.4	Struggling	Struggling	2 730	Middle-income
Senegal	12.4	Poor	Struggling	1 090	Middle-income
Papua New Guinea	6.9	Poor	Struggling	1 300	Middle-income
El Salvador	6.2	Struggling	Struggling	3 360	Middle-income
Nicaragua	5.8	Poor	Struggling	1 090	Middle-income
West Bank and Gaza	4.15	–	Struggling	. .	Middle-income
Mauritania	3.5	Poor	Struggling	1 030	Middle-income
Jamaica	2.7	Struggling	Struggling	4 770	Middle-income
Gabon	1.5	Struggling	Struggling	7 740	Middle-income
Swaziland	1.2	Struggling	Struggling	2 630	Middle-income
Fiji	0.9	Struggling	Struggling	3 580	Middle-income
Guyana	0.8	Converging	Struggling	3 300	Middle-income
Solomon Islands	0.5	Struggling	Struggling	1 030	Middle-income
Belize	0.3	Struggling	Struggling	3 740	Middle-income
Vanuatu	0.2	Converging	Struggling	2 760	Middle-income
Saint Lucia	0.2	Struggling	Struggling	4 970	Middle-income
Micronesia (Federated States of)	0.1	Struggling	Struggling	2 700	Middle-income
Tonga	0.1	Struggling	Struggling	3 390	Middle-income
Kiribati	0.1	Struggling	Struggling	2 010	Middle-income
Grenada	0.1	Struggling	Struggling	5 550	Middle-income

	Population 2010 (Millions)	Four-speed world classification		Gross national income per capita	Income group
		1990s	2000s	2010	2010
				Current USD (Atlas method)	
Seychelles	0.1	Struggling	Struggling	9 760	Middle-income
Antigua and Barbuda	0.1	–	Struggling	10 590	Middle-income
Dominica	0.1	Struggling	Struggling	5 410	Middle-income
Saint Kitts and Nevis	0.1	Struggling	Struggling	9 520	Middle-income
Marshall Islands	0.1	Struggling	Struggling	3 450	Middle-income
Palau	>0.1	–	Struggling	6 470	Middle-income
		Poor			
Kenya	40.5	Poor	Poor	790	Low-income
Madagascar	20.7	Poor	Poor	430	Low-income
Niger	15.5	Poor	Poor	370	Low-income
Malawi	14.9	Poor	Poor	330	Low-income
Zimbabwe	12.6	Poor	Poor	460	Low-income
Haiti	10.0	Poor	Poor	650	Low-income
Guinea	10.0	Poor	Poor	400	Low-income
Benin	8.9	Poor	Poor	780	Low-income
Burundi	8.4	Poor	Poor	170	Low-income
Togo	6.0	Poor	Poor	490	Low-income
Eritrea	5.3	–	Poor	340	Low-income
Central African Republic	4.4	Poor	Poor	470	Low-income
Liberia	4.0	Poor	Poor	200	Low-income
Gambia	1.7	Poor	Poor	450	Low-income
Guinea-Bissau	1.5	Poor	Poor	590	Low-income
Comoros	0.7	Poor	Poor	750	Low-income

Notes: Four-speed world classification based on average per capita growth rates for 1990-2000 and 2000-10.
For a full explanation of the Four-Speed World Classification, see Chapter 1.
The Four-Speed World Classification of countries in the 1990s is based on OECD (2010), but excludes countries for which updated data for 2000-10 were not yet available. For the complete 1990s Four-Speed World Classification please see the original report.

Income classification based on World Bank criteria, GNI per capita Atlas method:
– High-income economies: GNI per capita > USD 9 265 in 2000 for 1990s; GNI per capita > USD 12 276 in 2010.
– Middle-income economies: USD 755 < GNI per capita < USD 9 265 in 2000 for 1990s; USD 1 006 < GNI per capita < USD 12 275 in 2010.

. . Data not available.
– Not applicable.

Time series for Australia (1990-2009), Bahamas (1990-2009), Bahrain (1990-2009), Cyprus (1990-2009, only GNI per capita), Dijbouti (1990-2009). Greenland (1990-2009), Iran (1990-2009), Malta (1990-2009), New Zealand (1990-2009), Oman (1990-2009), Palau (1990-2008).

Footnote by Israel: * The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Footnote by Turkey: ** The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

Footnote by all the European Union member states of the OECD and the European Commission: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

Source: Authors' elaboration based on OECD (2010), *Perspectives on Global Development – Shifting Wealth*, OECD Development Centre, OECD, Paris; and World Bank (2011), *World Development Indicators Database*, accessed October 2011.

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