

Chapter 7: Development Priorities in the Middle Income Developing Countries

“Middle Income” is an omnibus term for countries with diverse economic characteristics and at very different stages of development. Countries such as Bolivia, Egypt, Sudan, and Thailand are predominantly rural and have significant proportions of their population still at subsistence levels. By contrast, at the upper end of the income spectrum are countries with average income per person of over US\$2,500, such as Singapore, Venezuela, and some countries in Southern Europe. Included in the Middle Income group are mineral exporting countries, whose average incomes are particularly deceptive because there are extreme differences between the mineral and non-mineral sectors of the economy. Levels of industrial development vary, from some African economies with only rudimentary manufacturing capacity to major industrial countries, such as Brazil or Yugoslavia, that export machinery. The demographic characteristics also vary, from countries whose fertility rates have already declined to quite low levels to countries where they are still rising. Amid this diversity, however, most of the Middle Income countries share two common characteristics as distinct from the Low Income countries: their growth prospects are more sensitive to economic conditions in the industrialized countries, particularly the environment for trade and commercial capital flows; and they have more resources to raise the living standards of the poor.

The first of these characteristics contributed greatly to the growth of the Middle Income countries in the last two decades, when the international environment favored the rapid growth of earnings from exports, tourism, and workers' remittances. In the next five to ten years, the environment for international trade is likely to be less favorable. This chapter explores the implications for policies to sustain rapid growth and raise export earnings. It then discusses strategies for alleviating poverty, centering on measures that modify the patterns of growth so as to benefit the low income groups.

In any particular country, the appropriate composition of investment and the policy priorities will depend on a complex set of circumstances that would require detailed analysis. The areas of action suggested in this chapter and

the possible benefits for countries with different economic structures and policy environments are illustrative, as are the country examples used.

Industrial and Trade Policy

A country's best response to a deterioration in export prospects depends not only on how dependent its economy is on trade but also on its economic structure and on its trade policy. Large countries tend to be less trade-oriented and to industrialize more rapidly than small ones, because they generally have more diverse endowments of resources and can rely on larger domestic markets to justify production on an economic scale. Countries rich in natural resources tend to industrialize more slowly than those poor in resources, which must export manufactures from an early stage in order to meet their import needs. The extent of differences among Middle Income countries in the size of their markets and their degree of openness is illustrated in Table 43, by data for a small sample of countries. The market for industrial products in Argentina is 150 times as large as the market in Togo. The contrast in the degrees of openness of the different economies is illustrated by the fact that in Malaysia and Colombia, which have markets of approximately equal size, the import ratios differ widely.

43. Size of Industrial Markets and Import Ratios in Middle Income Countries, 1975

	Market for Industrial Products (million US dollars)	Imports as Percentage of Market for Industrial Products
Togo	249	52
Ghana	2,005	26
Malaysia	5,297	42
Colombia	7,534	16
Korea, Republic of	12,736	29
Turkey	18,282	17
Yugoslavia	23,736	22
Argentina	39,013	7

Note: The market for industrial products is defined as gross industrial output plus imports minus exports. The data in this table are drawn from a variety of sources and are based on definitions that are not strictly consistent. Thus the comparisons only indicate broad orders of magnitude.

In general, it will be necessary to find ways of preserving the growth of foreign exchange earnings, while pursuing policies that will sustain economic growth as foreign exchange becomes scarcer. Measures of the first sort include increasing export incentives, negotiating strategies to improve access to markets in industrialized countries, increasing trade with other developing countries and increasing the domestic value added in existing exports. Policies to sustain economic growth based on domestic demand include the promotion of engineering industries, services, and agriculture. Some of these in fact have implications for export earnings as well: the promotion of engineering products may be an important means of diversifying the composition of manufactured exports away from products that face protectionist barriers; and the stimulation of agriculture may increase supplies of products for which export demand is expected to be strong.

Increasing Export Incentives

As countries progressively substitute domestically produced goods for imports, it gradually becomes less efficient to use domestic resources to save foreign exchange through displacing imports than to earn foreign exchange through increasing exports. Where there is little further scope for industrial import substitution, and simultaneously exports are growing slowly or not at all, scarcity of foreign exchange quickly becomes the principal bottleneck for further development.

Argentina and Turkey are among the several countries that have been in this position. Domestic industry has been protected by a complex system of tariffs, non-tariff levies, quotas, import prohibitions, differential exchange rates, and prior deposits on imports. On the available evidence, the levels of effective protection are high and vary among industries; and industrial products are much more expensive than they are internationally. Since there has been continued pressure to reduce imports, the items that continue to be imported are critical intermediate and capital goods that would be extremely costly to make locally. Economic growth thus depends heavily on the availability of imports. This, combined with unavoidable fluctuations in foreign exchange earnings, results in persistent balance of payments problems and erratic growth rates.

To strengthen the balance of payments in these countries, it would be necessary to reduce the bias against production for export relative to domestic sales, with the long-run goal of

equalizing the incentives for sales in domestic and foreign markets. Even though the outlook for manufactured exports is less favorable than before, in countries approaching the economic limits of import substitution it would be desirable to shift the structure of incentives in favor of exports.

In addition to the usual instruments of trade incentive policy—exchange rate intervention, protection against imports, and export subsidies—the instruments available for industrial policy, such as investment incentives, production and wage subsidies, and government promotional activities, can strongly influence the structure of industrial investment even in the relatively market-oriented developing economies. Government promotional activities include project identification, preparation, finance, and implementation; the design and location of infrastructure such as ports, highways, power generation facilities, and industrial estates; and the organization of research, marketing, and the import of technology.

A structure of industrial incentives which rewards firms that are efficient and can compete internationally tends to foster rapid growth in industrial employment and in incomes; a strong bias toward protection in the structure of industrial incentives tends not to favor long-term sustained growth at high rates. Changes in strategies will involve changes in industrial structure that will cause dislocation, including the loss of employment in industries where domestic production is very inefficient. This can be extremely painful, especially in countries where unemployment and underemployment are already very high, making it very difficult for displaced workers to find alternative employment. Measures can be devised to ease the transition, and to reduce the social costs associated with structural change. The justification for incurring these costs is the higher rates of growth and employment that they can help achieve.

Increasing Value Added in Exports

Countries that already export manufactured goods can raise their net earnings of foreign exchange through increasing both the volume and value added content of these exports. Raising the value added domestically does not increase market penetration in the industrialized countries, and has obvious advantages in the case of products that are subject to quantitative import restrictions in industrialized countries. However, in textiles and clothing, as noted in Chapter 3, the developing countries have

already taken the upgrading of quality and unit price a long way, so that there are unlikely to be further large gains.

Another method of raising value added is to undertake additional stages of production and marketing. Here, too, there are economic limits which must be recognized. Investments in the production of intermediate goods designed to replace imports need to be evaluated particularly carefully for economic efficiency. The production of basic intermediates such as petrochemicals and steel must be on a very large scale if it is to be economic, and a premature attempt to manufacture them domestically can jeopardize the international competitiveness of the export industries which use these intermediates. In this regard, the larger and more advanced semi-industrialized countries have an advantage over countries whose industrial markets are still small.

Almost all countries that export primary commodities seek to increase their export earnings by undertaking additional processing of the products before export. Whether they can do so efficiently can only be assessed separately for each country and commodity. It depends on a number of technical and institutional circumstances, among them the scale and capital intensity of the processing to be undertaken, and its energy needs, and marketing and freight arrangements. The major mineral exporters have already exploited the scope for domestic processing, and localizing further stages of production will probably involve large-scale and

capital-intensive investments. Exporters of timber appear to have favorable prospects for increasing domestic processing. Further processing of tropical beverages by producers is rendered extremely difficult by the fact that the processing companies in consuming countries control the marketing networks. It is unlikely that producers could establish alternative networks in importing countries.

Even though in some of the important markets the differences are modest, as Table 44 shows, import tariffs that are higher on processed than on raw materials can be an important handicap for increased processing in the developing exporting countries.

Trade Negotiations

It was emphasized in Chapter 3 that the export prospects of the developing countries were affected not only by quantitative restrictions but also by the complexity of the proliferating barriers to trade; and that the adverse effects of the new protectionism would be felt not only by the major exporters of manufactures but also by countries that were just starting to be successful exporters of manufactures, such as the Philippines or Tunisia. Maintenance of access to markets in industrialized countries and the rolling back of non-tariff barriers are of overriding importance to developing countries. To make progress in the face of protectionist pressure from producers in the industrialized countries requires, at a minimum, active participation in future trade negotiations. So far, this has generally been lacking.

In the past, the main objective of developing countries in multilateral trade negotiations has been to acquire special preferences. This led to the Generalized System of Preferences established in 1971. Two aspects of the scheme are worth noting here. The first is its very limited scope, since each industrialized country has established its own restrictions on the preferences granted, excluding some developing countries and some products, especially agricultural products, textiles, clothing, shoes, and petroleum products. In addition, there are limits on the amounts of imports receiving preferential treatment, for individual products or supplying countries, or sometimes for both simultaneously. Second, analysis has shown that most of the benefits from the scheme are derived not from its preferential features but from the additional trade that has resulted from the reduction of import tariffs. These findings probably apply more generally to unilateral preferential schemes, which are apt to be designed

44. Industrialized Countries: Average Tariff Levels in Broad Classes of Products, including Raw Materials, 1973

	Raw Materials	Semi-finished Manu- factures	Finished Manu- factures
European Community	0.5	8.1	9.3
United States	2.7	7.6	7.9
Japan	5.9	8.6	11.2
Canada	0.3	8.4	10.2
Australia	0.9	11.1	21.0
Sweden	0.0	4.5	6.6
Austria	5.9	8.4	16.0
Switzerland	0.3	4.4	3.6
Finland	0.0	4.1	8.0
Norway	0.1	4.8	7.4
New Zealand	0.6	8.5	32.6
Combined Average	2.0	8.0	9.8

Source: *Summary by Industrial Product Categories; Tariff 1973, Imports 1970 and 1971.* (Geneva; General Agreement on Tariffs and Trade, March 1974.)

so as to avoid harming producer interests in industrialized countries. They emphasize that although efforts to retain tariff preferences can be important to fledgling exporters of manufactures, it is even more important to assure access to markets in industrialized countries.

The major trade issues facing developing countries are not how to gain preferential tariff treatment from industrialized countries, but rather how to prevent the further growth of non-tariff barriers against imports. The concentration of multilateral tariff cuts on products that are not of central concern to developing countries, and the imposition of quantitative restrictions on major exports of developing countries, may be attributed in part to their lack of active participation in trade negotiations.

The negotiating position of the developing countries would undoubtedly be strengthened and the protectionist pressures in importing countries could be more effectively addressed if non-tariff barriers were negotiated on the basis of reciprocal concessions from developing countries. The different interests of countries at different stages of industrialization suggest that they can reach bargains that benefit them both. The agenda for negotiations could usefully include the following elements:

- Assured growth in the volume of industrialized countries' imports of currently restricted products that are of special interest to developing countries;
- Strict rules to prevent the creation of new non-tariff barriers, except for brief periods under agreed criteria and under strict multilateral surveillance;
- Progressive removal of present quantitative restrictions on imports and rationalization of administrative procedures;
- Progressive liberalization of imports by major

developing country exporters;

- Limitations on permissible measures to promote exports, with continued exceptions for less advanced developing countries to enable them to subsidize their export industries to redress the effects of excessively protective trade regimes;
- Agreements facilitating the growth of trade among developing countries.

By participating more fully in multilateral trade negotiations on a reciprocal basis, the more advanced developing countries can help to ensure that the international trading environment will better reflect developing countries' interests, and can attempt to counter the increasing discrimination against imports from developing countries. If this can be achieved, more countries could derive substantial benefits from a strategy where trade is the engine of growth.

Trade Among Developing Countries

Nearly a quarter of the exports of developing countries goes to other developing countries. The most dynamic category of these exports is manufactures: as shown in the last column in Table 45, these accounted for about 39 percent of the real increase in trade among developing countries during 1960-75. Acceleration of the growth of trade among developing countries must be led by manufactured exports.

Trade in manufactures among developing countries has increased rapidly during the last decade or so. It grew by 10.6 percent a year during 1960-75, accounting for a rising share of developing countries' imports of manufactures, which rose by 7.3 percent a year. Between 1970 and 1975, nearly a third of the growth in the trade in manufactures among developing countries was in machinery and transport equip-

45. Developing Countries: Product Composition of Merchandise Trade, 1975

	Imports from Developing Countries	Imports from Industrialized Countries	Imports from Other Developing Countries, as Percentage of Total Imports	Product Composition of Increase in Trade between Developing Countries, 1960-75 (percent, at 1975 prices)
	(billion US dollars)			
Food and Beverages	9.2	15.7	33	16
Non-food Agricultural Products	2.9	3.4	41	5
Non-fuel Minerals and Metals	1.8	2.8	37	5
Fuel	20.7	2.4	57	35
Manufactures	<u>13.1</u>	<u>123.3</u>	9	<u>39</u>
Total	47.8	147.6	22	100

ment. However, apart from textiles and clothing, not more than 15 percent of developing countries' imports of manufactures come from other developing countries, and the proportion is especially low in the machinery sector, as shown in the last column of Table 46.

46. Product Composition of Trade in Manufactured Goods among Developing Countries, 1975
(Percentages)

	Developing Countries' Imports from Other Developing Countries	Developing Countries' Imports from Industrialized Countries	Share of Total Imports Obtained By Developing Countries from Other Developing Countries
Textiles	14	4	28
Clothing	5	1	39
Machinery and Transport Equipment	31	55	6
Chemicals	13	12	11
Iron and Steel	6	10	7
Other Manufactures	31	19	15
Total	100	100	9

60

Much of the growth of trade in manufactures among developing countries has been based on preferential treatment in regional arrangements. Significant expansion of trade among developing countries will require stronger regional understanding, or a more general liberalization of imports.

Recent structural developments in certain groups of developing countries favor the growth of mutually beneficial trade. Some developing countries have greatly increased their industrial capabilities and can supply an increasing proportion of the capital goods required by other developing countries, possibly at lower cost and with design characteristics that are more suited to operating conditions in those countries. The tremendous expansion of developing countries' exports to major oil exporters illustrates the potential for such growth.

The more advanced Middle Income countries could realize sizable gains from trade with other developing countries, particularly in products such as chemicals where economies of scale can be overwhelmingly important. Exploiting such opportunities will require changes in industrial and trade policy. For example, these countries, which are at roughly similar levels of industrial development, all have plans to promote domestic production of machinery and chemicals,

but trade among them is only likely to expand vigorously on the basis of specialization. More detailed cooperation in the planning of industrial expansion and more liberal policies toward imports from one another will be required if trade among developing countries is to expand rapidly.

To increase trade in engineering products among developing countries will also require a considerable effort to overcome technical and marketing problems. Some of these problems, especially inadequacy of local capacity for engineering design and product development, hamper the development of this sector for domestic as well as export sales; they are discussed in the following section. Problems that pertain especially to trade among developing countries are licensing arrangements that prevent sales outside the domestic market; restrictions on the use of external financial assistance that require developing countries to purchase their equipment from industrialized countries; and the difficulties faced by capital deficit countries in financing export credits, which place them at a disadvantage in relation to suppliers in industrialized countries. None of these problems is overwhelming—as attested by the growth of trade in the past. But they do impede the rate of expansion and will have to be tackled at the international level if trade among developing countries is to expand at its potential rate.

Promotion of Engineering Industries

Metal working and electrical machinery industries play a very important role in industrial development, as countries progress from repair workshops to making replacement parts and simple implements and then to a wide variety of industrial equipment. Most developing countries have tended to discriminate against the engineering industries in favor of other branches of manufacturing. Not only are many simple products produced in small enterprises that operate under many disadvantages; in most countries, lowering the effective cost of imported machinery has been a principal means of encouraging modern manufacturing activities. With over half of the imports of developing countries from industrialized countries consisting of machinery and transport equipment, their poorer export prospects will encourage more developing countries to attempt local manufacture of these goods in order to reduce their dependence on imports.

The appropriate policies will differ according to the level of industrial development. Most of

the poorer Middle Income countries mainly need to foster the development of metal working skills and to improve the organization and technical competence of small workshops, particularly in rural areas, since a major source of demand will be agricultural. Local production of even rudimentary agricultural tools and equipment can serve an important function in the diffusion of technology, as well as providing employment and supplying implements that are adapted to the needs of local farming systems and make full use of locally available materials.

In the more industrially advanced developing countries the promotion of efficient engineering industries involves a different set of considerations. Trained workers are not as scarce as in the Low Income countries, although training institutions will undoubtedly need to be upgraded and made more responsive to the demands for specific skills. The main problems in these countries are likely to lie in design, marketing, and the economic scale of production. It is striking that even advanced producers of capital goods such as Argentina, Brazil, India, the Republic of Korea, and Mexico have a relatively limited capacity for design and development of engineering products, making it especially difficult for them to remain competitive internationally in products whose characteristics change rapidly with technical advances. Sometimes even the facilities for accurate measurement and testing of such standardized products as screws or hand tools are inadequate.

The machinery sector in the more advanced developing countries has an excellent potential for exporting as well as meeting domestic demand. The policy priorities in expanding exports of machinery differ between the standardized products whose specifications are fairly stable and the more complex products whose characteristics change continually and rapidly.

Among the standardized products, those sold to producers are likely to be much more difficult to market than those sold to consumers. Exports of consumer goods have been facilitated by the efforts of large wholesale and retail organizations in the industrialized countries that have scoured the developing countries for low cost sources of supplies. But to expand exports of producer goods will require producing countries to identify potential purchasers, and will mean they must ensure that the technical services and financing conform exactly to purchasers' needs. In producer goods, lower prices cannot make up for poor quality—a casting that is not sufficiently durable for a high speed loom cannot gain acceptance by a lowered price.

The second group, consisting of more complex products, are almost exclusively designed and developed in industrialized countries, and production in developing countries is typically undertaken under license from companies in industrialized countries. The more advanced developing countries should give priority to developing a capacity for design and technological innovation that will permit them to overcome the licensing restrictions on exports and thus to take a bigger share in the growth of trade in engineering products, both with industrialized and other developing countries.

As their industrial labor skills improve, the developing countries may benefit from an increase in subcontracting of the production of components from firms in industrialized countries. This is how the trade in electronics has grown—by shifting the assembly phases of a production process to the developing countries.

Investment in Infrastructure

Another way of sustaining high rates of growth when the prospects for exports are relatively poor is to raise investment in infrastructure, such as communications, electric power, and housing, for all of which there is generally a latent demand in developing countries. The main problem this raises is, of course, the scarcity of resources, whether of government savings to finance public investment; or of the credit that can be extended to the private sector to finance private investment; or of foreign exchange to pay for the additional imports necessitated directly by the investment and indirectly by the expenditure of the incomes that it may generate. In general, expanding investment in infrastructure will require new efforts to raise government resources, either through taxation or through fees charged to the users of the services. Because of rapid urban growth, current plans for the construction of infrastructure already strain the resources of governments, especially local governments which are responsible for a large part of investment in these sectors.

Agriculture

The major issues in agricultural development in the Middle Income countries are how to sustain a rate of growth that allows for a balanced expansion of all parts of the economy, and how to ensure that the pattern of agricultural growth is such as to make a strong and direct impact on rural poverty and, indirectly, on the migration of the poor to urban areas.

In the drive to industrialize, it has been easy

to overlook the critical role of the agricultural sector in development and to neglect the interrelation between policies to encourage the growth of domestic industry and the performance of agriculture. Despite the recent rapid rise of industry and growth of cities, there are few developing countries in which the share of population in rural areas is much below half. Agriculture is still the single most important source of livelihood in most semi-industrial countries. In several countries, its share in domestic product is about the same as, or larger than, that of industry.

Though agriculture in the Middle Income countries has generally grown more rapidly than in the Low Income countries, much of this growth has typically been in the commercial farming sector and has stemmed from extensions in cropped area rather than increases in yields. As with other generalizations about Middle Income countries, this needs an important qualification: extension of the cropped area has relied heavily on the spread of irrigation in some countries, for example Iran and Mexico; and yield increases have been important in some countries, such as Egypt, Ivory Coast, the Republic of Korea, Malaysia, and Thailand.

Even where agriculture represents a relatively small proportion of the domestic product, as in the most advanced of the Middle Income countries, the rate and pattern of agricultural growth have important implications for income distribution and poverty. Disparities between agricultural and non-agricultural incomes are often a major source of inequities in income distribution, and in most of these countries extreme poverty tends to be concentrated in the agricultural sector. Furthermore, differences in income levels within agriculture are frequently at the heart of the problems of regional poverty that plague policymakers in many countries (for example, in Brazil, Ivory Coast, Malaysia, Thailand, or Turkey; and the problems of the Sierra in countries on the west coast of South America).

An important consequence of the failure to deal with rural poverty is accelerated migration to cities. This is one of the principal causes of the continued rapid expansion of urban areas which places a heavy fiscal and administrative burden on the economy.

Sustaining rapid growth in agriculture will require a range of measures. Where there is still scope for further increases in the cultivated area, substantial investments in transportation, power, irrigation, and marketing will be necessary. Expansion of the cultivated area con-

tinues to have high priority in many Middle Income countries, for example Brazil, Colombia, Ghana, Iran, Nigeria, and Venezuela. As most of the arable land area is drawn into cultivation, and growth requires more intensive cropping practices, the need for effective research and extension services becomes more evident. Even where agricultural technologies can be imported, they have to be further researched and adapted to local conditions. Relatively few countries have so far established the institutions capable of doing such research.

In a large number of countries, it will be necessary to reform the policy framework affecting agriculture in order to accelerate growth and to ensure that it is more broadly based than in the past. The deficiencies in policy are deep-seated and essentially derive from a tendency to view the agriculture sector as a source of revenue, foreign exchange, and cheap labor with which to support rapid industrialization. Agriculture is taxed in many ways, both explicit and implicit, and agricultural investment discouraged, through overvalued exchange rates to protect industry; taxes on agricultural exports; and domestic terms of trade that support industrial profits and assure cheap food in urban areas at the expense of agricultural producers. The *ad hoc* measures sometimes taken to offset these policy biases—cheap agricultural credit, subsidized fertilizer, and price supports for crops—are difficult to sustain because they impose a heavy fiscal burden; they also accentuate rural inequalities as they primarily benefit the larger farmers engaged in commercial production. Of course, these problems do not exist in all countries. Malaysia, Ivory Coast, and the Republic of Korea are among those that have used price policies fairly successfully to encourage broadly based agricultural growth.

Excessive protection of industry involves a strong inherent bias against agricultural growth which is exceedingly difficult to offset by other measures. Moreover, while it is obviously necessary to tax agriculture, it is desirable to do so without adversely affecting the incentives to produce. This implies a reliance on income taxes and land taxes rather than taxes on exports and manipulation of the domestic terms of trade. In addition, industrial incomes should be made to bear a share of the tax burden commensurate with their share in national income. This cannot be achieved without a properly enforced income tax or value added tax, both of which are still uncommon even in economies with sophisticated industrial capacities.

Rural inequality is very much greater in some

countries than in others, primarily because of differences in agrarian structure. Two broad structural patterns can be distinguished, which have been termed unimodal and bimodal. In countries with unimodal agricultural sectors, land is fairly evenly distributed, most farmers use rather similar cropping technologies and have similar relations with industrial and export activities. Bimodal agricultural structures, by contrast, are characterized by highly unequal distribution of land and extreme dualism in access to markets, technology, credit, and other services. Table 47 illustrates the sharp differences among countries in the most important element of agrarian structure—the distribution of land holdings.

last few decades. The other solution, resettlement schemes, has been tried in Malaysia and Brazil, for example. The main problem is the high cost per resettled family because of the need to extend infrastructure and technical support to frontier areas. In addition, where there are large differences between urban and rural income levels, the settlement schemes have to provide income opportunities attractive enough to compare with those that might be obtained from migration to cities.

At a minimum, countries with bimodal agrarian structures should seek to redirect investments in infrastructure and institutional activities toward the needs of the small farmer. The allocation of credit is a case in point. Agri-

47. Distribution of Holdings by Size and Area in Selected Middle Income Countries

	Size of Holding					
	0-5 Hectares		5-50 Hectares		Over 50 Hectares	
	Percentage of Holdings	Percentage of Area	Percentage of Holdings	Percentage of Area	Percentage of Holdings	Percentage of Area
Brazil	28	1	52	13	20	86
Chile	38	1	30	5	32	94
Egypt ^a	97	67	3	27	—	6
Korea, Republic of	100	100	—	—	—	—
Turkey	79	27	20	59	1	14
Venezuela	36	1	43	7	21	92

Note: The data in this table are drawn from different official national sources. They are not strictly comparable and should be construed only as orders of magnitude.

^aThe categories used for this country are 0-4 hectares, 4-40 hectares, and over 40 hectares.

Unimodal structures are typical of the densely populated East Asian countries—the Republic of Korea and the Republic of China, other examples being Egypt and Malaysia. In these countries, policies that accelerate agricultural growth almost certainly help to reduce poverty as well, because their effects are spread relatively widely in the rural economy. This is not necessarily true in the bimodal agrarian structures of many countries in Latin America (Brazil, Colombia, and Venezuela are examples) and other countries such as Turkey and Iran. Here the benefits of agricultural growth have been unevenly spread and policies to promote further growth will have only a slight impact on poverty unless they explicitly favor the smallholder.

The crux of the problem in bimodal structures, the uneven distribution of land, can be addressed only by effective land reform or by shifting smallholders to new settlements. The political difficulties in enforcing land redistribution are well known and there have been very few instances of successful land reform in the

cultural credit extended by formal institutions is subsidized and is almost always captured by the larger farmers. Small farmers meet numerous bureaucratic obstacles that deny them subsidized credit, forcing them to rely on informal credit channels that are very much more expensive. Thus the credit system, as it now operates, frequently worsens existing income inequalities in agriculture.

Distributing the Benefits of Growth

The issues of development strategy discussed above have a crucial influence on how different sections of society participate in a country's economic growth. It is this, rather than extreme poverty, that is the main problem confronting policy makers in the Middle Income developing countries. The close interaction between policies affecting industrialization, external trade, and agriculture can result in inequities in the pattern of economic growth which are quite unintended but nevertheless large enough to

offset the attempts to improve the well-being of the relatively poor through welfare measures.

A striking example of the problem is the effect of a strong policy bias toward import substitution in industry which, over a long period of time, tends to encourage investment in sectors which are not justified on the basis of the country's comparative advantage. Investments to produce substitutes for imports become increasingly intensive in capital and technology rather than labor, keeping the growth of employment slower than it could otherwise be. The failure of employment to keep pace with the expansion of the labor force, even when output has grown rapidly, is one of the most serious problems facing many Middle Income countries. At the same time, workers who are fortunate enough to find employment in the modern industrial sector begin to form an elite; they organize and obtain supporting labor legislation and social insurance schemes. This often leads to wage rates inconsistent with current levels of productivity and opposition to adjustments in the industrial structure—both of which tend to make the long-term prospects for employment more difficult.

A policy bias in favor of import substitution in industry also tends to discriminate against agriculture, particularly small farmers growing food. Price controls tend to accentuate this bias, causing increasing inequalities in agriculture. Another consequence is a growth in migration from rural to urban areas. Added to the natural growth of urban population, this results in very rapid urbanization.

Rapid urbanization poses very difficult problems. First, urban population growth rates of about 5 percent or more a year are common in developing countries, and lead to corresponding increases in the need for housing, sanitation, roads, and other infrastructure, straining the fiscal and administrative capacities of local governments. Second, rapid urban growth is associated with growing dualism within the city, as only a small proportion of the increase in the work force finds employment in modern indus-

try. Most of the others earn meager incomes in service occupations, so purchasing power does not rise as fast as the number of people. Third, city administrations devote little finance or administrative talent to improving the conditions of the poor, most of whom live in squatter settlements in otherwise open areas or on the outskirts of the city. The distribution of public services is more skewed in countries with workers' insurance schemes that subsidize housing and hospital care for workers in the modern sector but not for others.

A prerequisite for improving the availability of essential public services to the poor in the Middle Income countries is a strong commitment to mobilizing financial resources. While these countries have more resources than Low Income countries, relatively few of them have fiscal systems capable of mobilizing funds efficiently on an adequate scale. Part of the reason for this weakness is the heavy reliance on taxes on international trade, which cannot be raised without seriously distorting the allocation of private investment in the economy. A direct approach to alleviating poverty would have to include a reform of the fiscal system.

Fiscal reform needs to be undertaken with the commitment to direct a much greater share of public expenditures toward the poor. This applies most forcefully to the extension of water supply and sanitation facilities to the urban fringes where the poor live and the establishment of health care and housing facilities that the poor can afford. To extend these services, it would be desirable for governments in Middle Income countries to devote substantially more attention and resources to the research and development of cheaper alternative designs and more effective administrative and institutional arrangements. This will involve a good deal of experimentation and continued evaluation of programs in many countries. It will be necessary to strengthen collaboration between developing and industrialized countries, particularly in finding solutions to the problems of technology and design.