Inequality Worsens across Asia, *Wall Street Journal* Cheers

BY JOHN MILLER

Inequality Check

A report from the Asian Development Bank, comparing more than a decade's worth of data from 22 developing countries, found significant increases in inequality across the region [Asia].

But, as the ADB notes, this doesn't mean the rich are taking food from the mouths of the poor. Rather, the rich are getting richer faster than the poor are. In all but one developing country, per capita incomes for the bottom fifth of the work force increased at least slightly; Pakistan was the only exception.

Poverty remains a serious problem throughout Asia—the ADB estimates 600 million people still live below the $1-a-day line, to use one popular measure. But "fixing" inequality won't fix poverty. As even the ADB recognizes, inequality can be a symptom of economic growth.

While inequality of outcome can be a good thing, inequality of opportunity is another matter.

The ADB worries that too much of the good inequality can lead to the bad variety by entrenching a new set of self-interested elites.

The danger is that all this talk of "inequality" will lead to policies that, in the name of redistributing income, reduce economic growth and thus make it harder for Asia's poor to join the middle class. The Asian "pie" is growing for everyone. The challenge is to keep it that way, instead of quarreling over the relative size of the pieces.

—*Wall Street Journal* editorial, 8/21/07

When ideologues of global capitalism step out of line, who better to let them know about it than the editors of the *Wall Street Journal*, the keepers of the free-market flame?

Just ask the economists and policy wonks at the Asian Development Bank (ADB), financial capital's Manila-based outpost in East Asia, who had the temerity to report in August that increasing inequality was a serious problem for Asia's economies. The *Journal*'s editors let them hear about it. "The danger," scolded the editors, "is that all this talk of 'inequality' will lead to policies that, in the name of redistributing income, reduce economic growth and thus make it harder for Asia's poor to join the middle class."

But the warning issued by the *Journal* editors is not just misleading, it is wrong. The evidence shows that countries that enjoy rapid economic growth are not more unequal than countries that grow slowly. In fact, a more equal distribution of income is not merely *compatible* with rapid growth; there are a number of avenues by which greater equality can actually *promote* growth. Finally, and most important for millions of people across Asia: poverty reduction depends on both raising a nation's income *and* reducing its inequality.

It is not that the ADB's bean counters got the numbers wrong. Of the 22 developing Asian economies in the ADB study, 15 saw inequality worsen since the early 1990s. That includes economic powerhouse China, where inequality worsened more rapidly and to higher levels than in any other country in the study other than Nepal. Even South Korea and Taiwan, once paragons of rapid *and* equitable growth, have seen inequality rise since 1993 .

Economists at the ADB tracked changes in the levels of inequality using Gini coefficients, economists' standard measure of economic inequality, in the 22 developing Asian countries for which there are sufficient data. The Gini coefficient ranges from zero to one: zero corresponds to perfect equality (every household has the same income), and one corresponds to maximal inequality (one household gets the entire national income). In the real world, Gini coefficients range from around 0.25 (Sweden, Denmark, Hungary) to nearly 0.60 (South Africa, Brazil, Haiti).

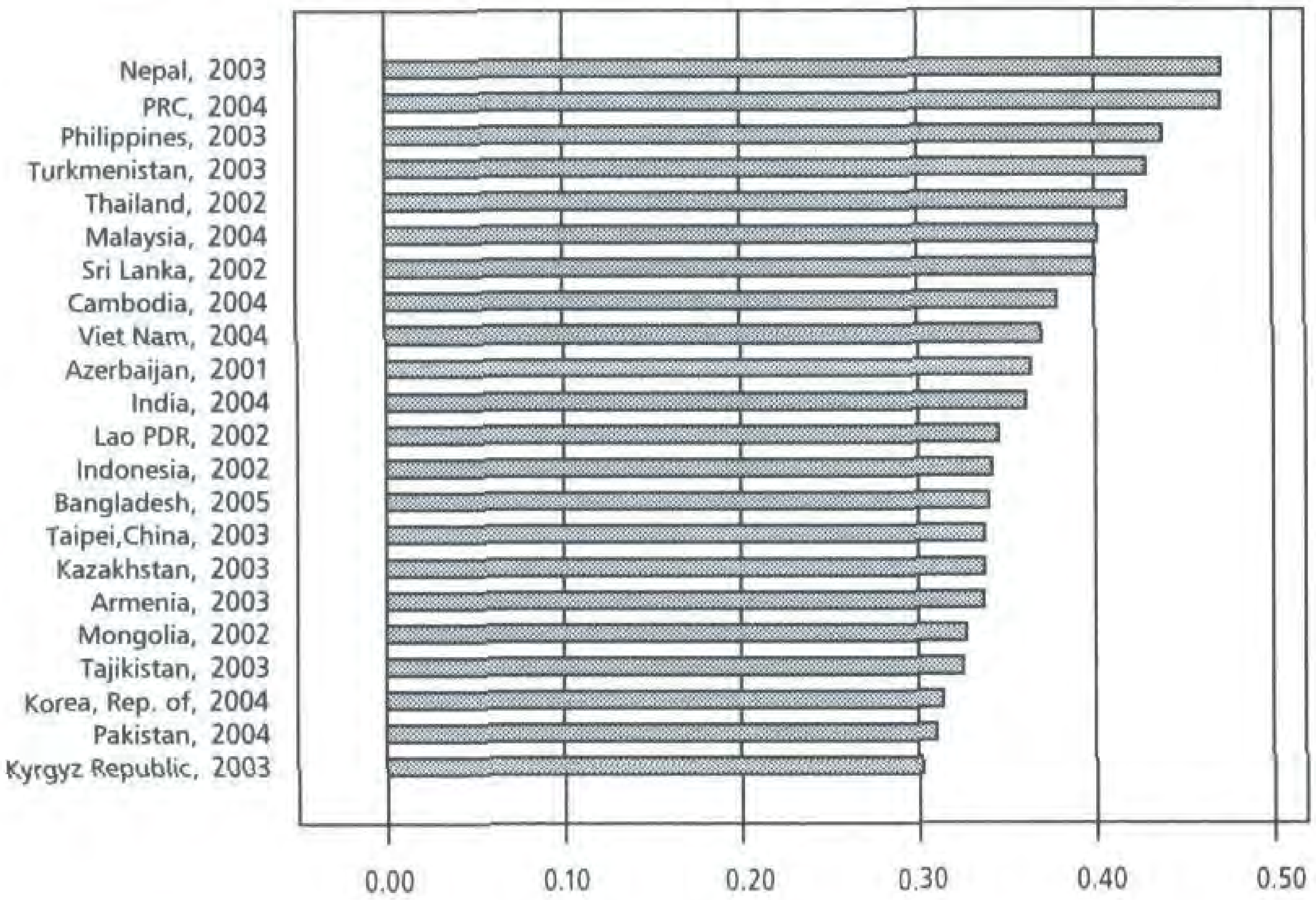
The ADB report found Gini coefficients rising across Asia. China's, for instance, rose from 0.41 in 1993 to 0.47 in 2004; it is now higher than that of the United States, 0.46 in 2004. (See Figure 1, which shows inequality levels by country, and Figure 2, which reports on changes in inequality levels.)

The trend toward a widening gap between the rich and poor in Asia is actually more alarming than even the ADB tables suggest. For one thing, the Asian financial crisis of the late 1990s sucked millions of dollars out of the caches of the continent's economic elites. Had it not been for this hit, Malaysia, Indonesia, and probably Thailand as well would have joined the worsening inequality column of the ADB report. Plus, the ADB tables rely on household expenditure data as opposed to the more difficult-to-obtain income data used in some countries to measure inequality. Inequality levels calculated from expenditure data are normally lower than those calculated from income data for the same population. In the Philippines, for example, where inequality data are available on both measures, the expenditure-based Gini coefficient is 0.40 for 2003, while the income-based figure is about 20% higher at 0.48.

The East Asian Miracle Under the Gun

While inequality can be a symptom of economic growth in capitalist economies, as the editors argue, what is remarkable about many East Asian economies is that prior to the 1990s they grew rapidly with far lower levels of inequality than else-

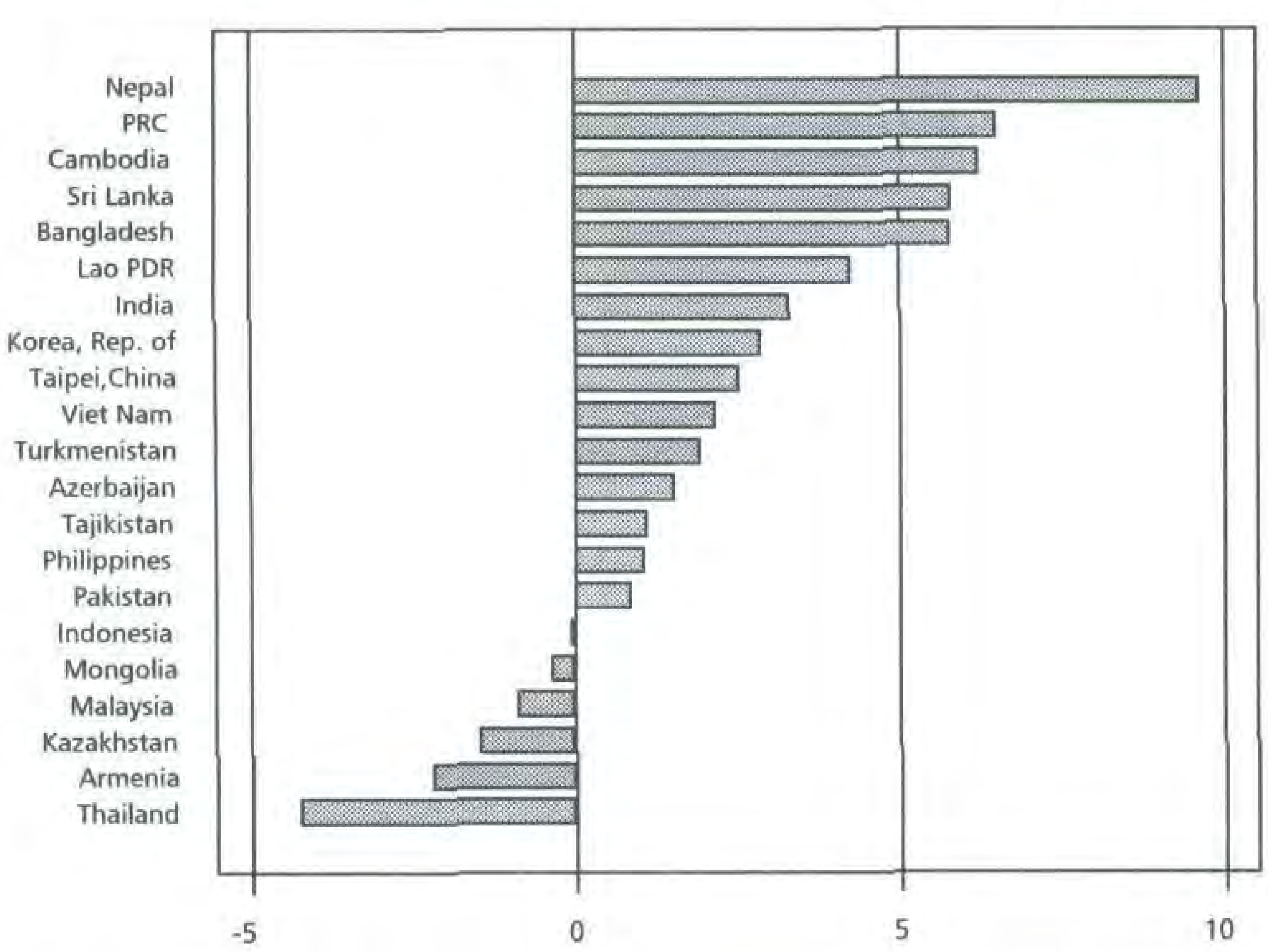
FIGURE 1
GINI COEFFICIENTS IN DEVELOPING ADB MEMBER COUNTRIES



Note: Per-household income distributions are used for Korea (urban wage and salaried households only) and Taipei, China [Taiwan]. Per-capita expenditure distributions are used for the rest.

Source: Asian Development Bank, "Inequality in Asia: Key Indicators 2007 Special Chapter Highlights," August 2007.

FIGURE 2
CHANGES IN GINI COEFFICIENTS, 1990s-2000s (percentage points)



Note: Years over which changes are computed are as follows: Armenia (1998-2003); Azerbaijan (1995-2001); Bangladesh (1991-2005); Cambodia (1993-2004); People's Republic of China (1993-2004); India (1993-2004); Indonesia (1993-2002); Kazakhstan (1996-2003); Republic of Korea (1993-2004); Lao PDR (1992-2002); Malaysia (1993-2004); Mongolia (1995-2002); Nepal (1995-2003); Pakistan (1992-2004); Philippines (1994-2003); Sri Lanka (1995-2002); Taipei,China (1993-2003); Tajikistan (1999-2003); Thailand (1992-2002); Turkmenistan (1998-2003); and Viet Nam (1993-2004). Gini calculated on income distribution for Republic of Korea and Taipei,China; expenditure distribution for all other countries.

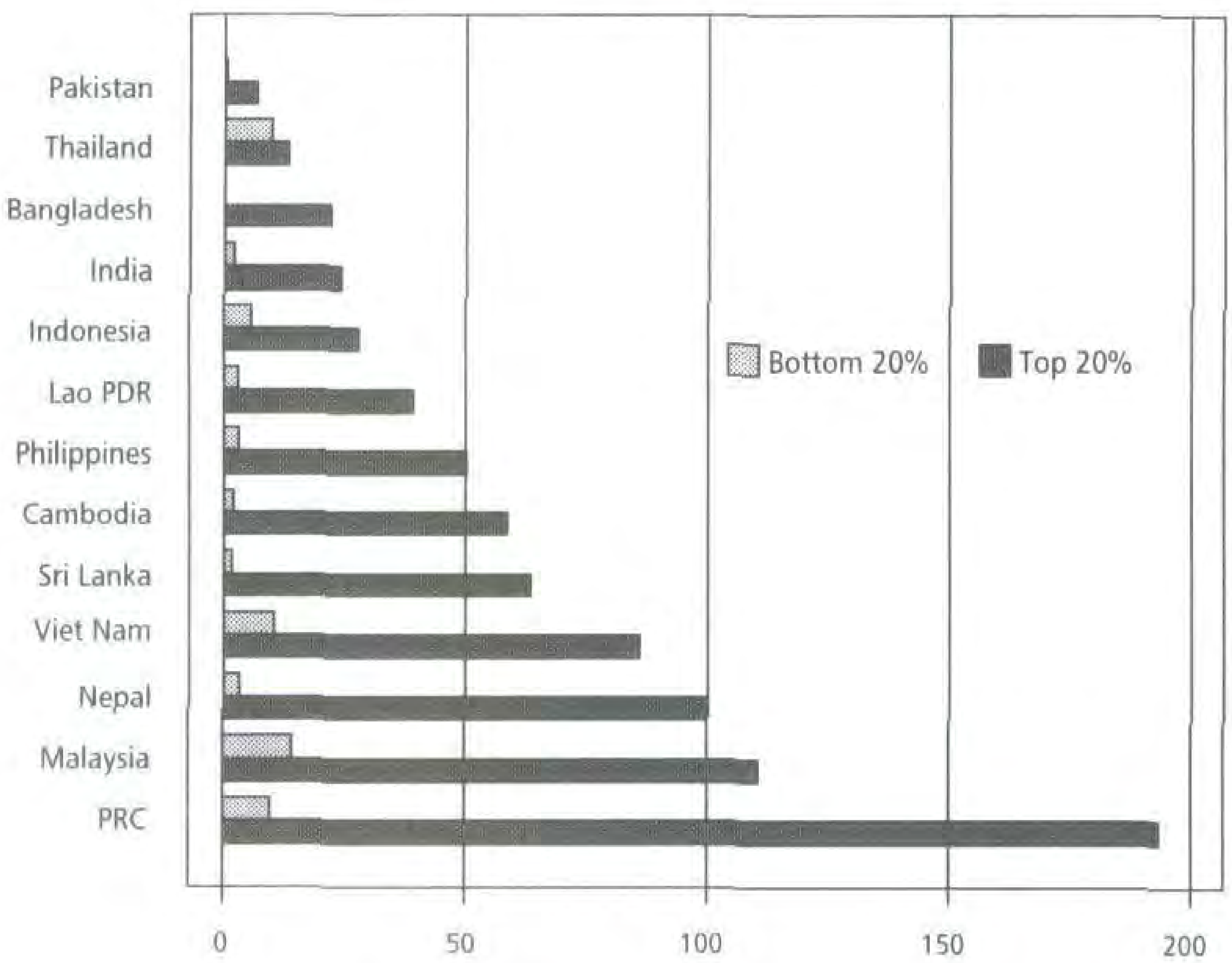
Source: Asian Development Bank, "Inequality in Asia: Key Indicators 2007 Special Chapter Highlights," August 2007.

where in the developing world. In some cases they saw inequality decline rather than worsen. For instance, in South Korea inequality declined from 1976 to 1993 even as the country's economy grew rapidly, posting average growth rates of 7.5% a year. Compared to Brazil, Latin America's fastest growing economy of the period, South Korea grew twice as quickly—with about half of Brazil's level of inequality.

The World Bank's famous 1993 "East Asian Miracle" study celebrated East Asia's "remarkable record of high growth *and* declining inequality." (Emphasis in the original.) From 1965 to 1990 the 23 economies of East Asia grew faster than all other regions of the world, three times as fast as the economies of Latin America and the Caribbean. Rapid growth in the region was spearheaded by the miraculous growth of eight high-performance economies—Japan; the "Four Tigers," Hong Kong, South Korea, Singapore, and Taiwan; and the three newly industrializing economies of southeast Asia, Indonesia, Malaysia, and Thailand—in which inequality remained low or improved over the same period. Because they were "unusually successful at sharing the fruits of growth," as the World Bank report put it, poverty declined rapidly and living conditions, from life expectancy to access to clean water and adequate shelter, improved dramatically in these high performance economies. A 1997 World Bank report went so far as to call rapid growth in East Asia "Everyone's Miracle."

"Everyone's" was surely an exaggeration even then. The editors of the *Wall Street Journal* nonetheless contend that today's much more unequal economic growth in Asia should still be considered everyone's miracle. As they read the ADB report, despite widening inequality, at least some of the benefits of the economic growth have trickled down to the poorest 20% of households in these economies. Since 1993 the expenditures of the bottom quintile increased in all of these 22 Asian economies with the exception of Pakistan, albeit by far less than the expenditures of the richest 20%. (See Figure 3.) "These increases in inequality are not

FIGURE 3
CHANGES IN PER CAPITA EXPENDITURES OF TOP 20% AND BOTTOM 20%, 1990s-2000s (in 1993 PPP dollars)

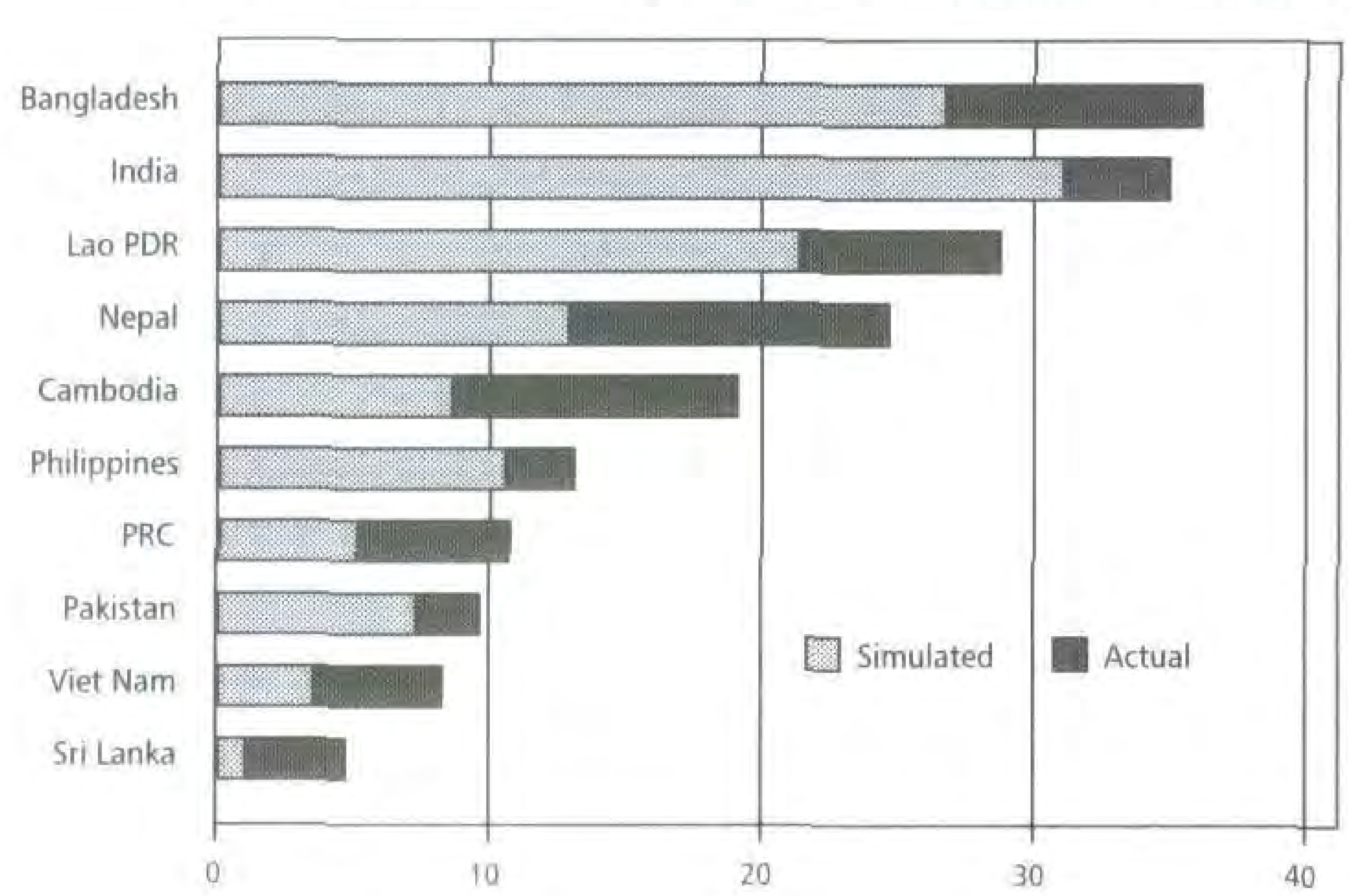


Notes: PPP, or purchasing power parity, refers to the adjustment made to currency comparisons across countries according to the price of a "basket" of goods in each country; in other words, PPP values control for the different prices of goods in different countries.

Years over which changes are computed are as follows: Bangladesh (1991-2005); Cambodia (1993-2004); People's Republic of China (1993-2004); India (1993-2004); Indonesia (1993-2002); Lao PDR (1992-2002); Malaysia (1993-2004); Nepal (1995-2003); Pakistan (1992-2004); Philippines (1994-2003); Sri Lanka (1995-2002); Thailand (1992-2002); and Viet Nam (1993-2004).

Source: Asian Development Bank, "Inequality in Asia: Key Indicators 2007 Special Chapter Highlights," August 2007.

FIGURE 4
$1-A-DAY POVERTY RATES, ACTUAL VERSUS SIMULATED



Note: Reference years for each country are as follows: Bangladesh (2005); Cambodia (2004); People's Republic of China (2004); India (2004); Lao PDR (2002); Nepal (2003); Pakistan (2004); Philippines (2003); Sri Lanka (2002); and Viet Nam (2004). Simulated poverty rates are computed using expenditure/income distribution of initial year and average expenditure/income of recent year.

Source: Asian Development Bank, "Inequality in Asia: Key Indicators 2007 Special Chapter Highlights," August 2007.

a story of the 'rich getting richer and the poor getting poorer'," confirms the ADB report. "Rather it is the rich getting richer faster than the poor."

That is enough to qualify as "pro-poor growth," according to the editors' absolute definition of the term: economic growth that does anything at all to alleviate poverty, no matter now lopsidedly it benefits the well-to-do.

What Is Pro-Poor Growth?

It is true that rapid economic growth usually does more to alleviate poverty than slower economic growth. But if inequality grows at the same time, then much of the poverty-fighting potential of rapid economic growth is being lost. In some sense it may be accurate to say that the rich are not taking food from the mouths of the poor—but it's just as accurate to say that the benefits of economic growth that might otherwise have ended up on the tables of the poor have instead gone to the rich.

The evidence is clear. Had levels of inequality only remained unchanged over the last decade in the 15 countries that suffered worsening inequality, they would have seen a dramatic difference in the numbers of their citizens lifted from poverty. The ADB report documents the large reductions in the percentage of the population living on less than $1 a day (a standard U.N. measure of poverty) that would have occurred had economic inequality not worsened. In China, the number would have been just about halved. (See Figure 4.)

By that standard, economic growth in most of these countries can hardly be considered pro-poor. Each percentage point of economic growth now does less to alleviate poverty than in the past. For instance, economists Hafiz Pasha and T. Palanivel found that national poverty in China fell 9.8% during both the 1980s and 1990s. But the economy needed a 9.0% per capita growth rate in the later decade, as opposed to a 7.8% rate in the earlier one, to effect the same reduction in poverty rates.

And contrary to the claims of the *Journal* editors, a widening difference between rich and poor can be, and at times has been, so great as to bring poverty alleviation to a halt altogether. In Thailand, for instance, the same 1993 World Bank study found that despite growth rates averaging 6.4% a year from 1975 to 1986, poverty rates *increased* over the same period. Rural Thais were hard hit by the falling prices of farm products, and economic differences between urban and rural dwellers widened. Similarly, between 1984 and 1991, rural Chinese suffered worsening poverty as prices for farm products fell and rural output stagnated—even as the national economy was growing at double-digit rates.

While China's agricultural output subsequently picked up and poverty alleviation resumed, the widening gap between the economic standing of rural and urban Chinese continues to sap Chinese growth of its potential to ease poverty. Neglect of agriculture and of rural areas is a common feature that has contributed to rising inequality in many Asian economies; to improve the lot of the poor, the ADB recommends switching some public expenditures from urban to rural areas and from post-secondary education, which favors urban dwellers, to basic education, which is still not available to all, particularly in rural areas.

Tackling Poverty and Inequality

Neglecting to address inequality surely can compromise even the most dynamic economy's ability to fix poverty. That is not to say that fixing inequality alone will fix poverty. But there is now plenty of reason to believe that fixing inequality can enhance economic growth at the same time that it fights poverty. And contrary to the editors' admonishment, the ADB's talk about inequality might help lift the 600 million Asians who still live on less than a dollar a day out of poverty.

Today, even some mainstream economists are moving beyond the notion that rising inequality is necessary during developing countries' initial periods of rapid growth to establish the incentives to work, save, and invest. The record of the East Asian miracle economies provided an important exemplar of simultaneous rapid growth *and* low or declining inequality.

In recent years, economists and other social scientists have developed several explanations of how greater equality can in fact *promote* economic growth. More equal economies have more political stability, grant greater access to credit, spend more on education, and have more widespread land ownership than economies racked by inequality—each a factor that contributes to economic growth. Relative equality eases the social discontents and political conflicts that would otherwise discourage foreign investment and hamper economic growth. A more equal distribution of income allows the poor, who pay much higher interest rates than the rich in many developing countries, greater access to credit, adding to their personal investments and promoting economic growth. In relatively equal societies, more families have the savings necessary to send their children to school—obviously a spur to growth. And land reform, a key policy for reducing inequality in South Korea and Taiwan, raises agricultural productivity because small farmers cultivate their land more intensively than large landholders.

Had inequality not worsened over the past 15 years in China, half as many people there would be living on $1 a day or less.

The ADB acknowledges several of these arguments. For instance, in the Beijing news conference launching the report, Ifzal Ali, the ADB's chief economist, called the rise in inequality in Asia today "a clear and present danger to the sustained growth," and warned that growing inequality could in some countries lead to "greater social conflict, from street demonstrations to violent civil wars."

Nonetheless, the ADB was not about to embrace massive redistribution policies that would dull market incentives. They do, however, endorse redistributive policies targeted at promoting "equality of opportunity" and "funded through mechanisms that do not detract from economic growth." Chief among their recommended polices are putting more public moneys into rural infrastructure including irrigation, electricity, transportation, and agricultural extension services, as well as expanding access to basic health care and primary education.

These measures are generally uncontroversial—although that does not mean they will be adopted any time soon. They would surely help. But they would be unlikely to arrest the widening inequality of the current period. To do that, public policy must also address the big picture: the decline in labor's share of the economic pie that corporate-led globalization has brought about.

Greater openness to trade, as economist Dani Rodrik has argued, erodes the bargaining power of labor by exposing workers, especially unskilled workers, to the competition of having their services replaced by imports from abroad.

Beyond that, export-led growth in many developing economies has failed to bring on the expected boom in manufacturing employment. As manufacturing exports from these countries increased with greater openness, so too did the quantity of manufactured goods imported into their domestic markets. So while export expansion was adding jobs, other jobs were being lost because of import penetration. Moreover, the new export industries are typically less labor-intensive than the older industries they replace. In China, for instance, relatively labor-saving joint ventures and foreign-owned firms in the country's new export zones have taken the place of relatively more labor-intensive state-owned manufacturing firms.

As a result, export promotion has done little to tighten labor markets and thereby improve labor's bargaining power. In the most detailed study to date, economists J. Felipe and G. Sipin found that in the Philippines, labor's share of national income fell by 6 percentage points from 1980 to 2002 as its economy globalized.

continued on page 31

INEQUALITY IN ASIA

continued from page 13

The case of China is also instructive, as economic sociologists Peter Evans and Sarah Staveteig point out. According to official statistics, manufacturing employment in China, the world's workshop, increased steadily from 1978 to 1995, nearly doubling from 53 million to 98 million jobs. But since then Chinese employment in manufacturing has fallen off. Manufacturing's *share* of Chinese employment began falling even earlier, in the late 1980s, even as China's share of world manufactured exports has increased more than fivefold.

With the manufacturing share of Chinese employment stagnant, hundreds of millions of people currently dependent on agricultural production for their incomes must either stay in that sector or move to the service sector. Both options suggest increased inequality and a more precarious quality of life for the vast majority of the Chinese population, argue Evans and Staveteig. If they stay in agriculture, the Chinese peasantry are likely to face stagnating incomes. A move into the service sector would allow a few new entrants to gain access to the more lucrative service jobs, but the vast majority will find poorly remunerated, insecure jobs offering personal services as the nannies, maids, drivers, and gardeners that their luckier compatriots will be able to hire.

While this widening inequality in the very countries that not long ago served as exemplars of growth with equality might not present a problem to the editors of the *Wall Street Journal*, it surely is a serious problem, as even the ADB acknowledges. But genuinely pro-poor economic growth will only come about when public policy confronts the current rules of the global economy—rules that the editors are so dedicated to defending, and that the ADB itself is reluctant to challenge. ■

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SOURCES Asian Development Bank, *Key Indicators 2007, Part 1: Inequality in Asia*, August 2007; "Inequality Check," *Wall Street Journal* editorial, 8/21/07; Richard McGregor, "ADB warns on rising inequality in China," *Financial Times*, 8/08/07; Alan Wheatley, "Rising inequality danger for Asia, says ADB," Reuters, 08/08/07; "For whosoever hath, to him shall be given, and he shall have more: Income inequality in emerging Asia is heading towards Latin American levels," *The Economist*, 8/09/07; World Bank, "The East Asian Miracle: Economic Growth and Public Policy," 1993; Vinod Ahuja et al., "Everyone's Miracle," World Bank, 1997; Peter Evans and Sarah Staveteig, "Late 20th Century Industrialization and Changing Employment Structures in the Global South," Univ. of Calif. Berkeley, 8/22/07; Hafiz A. Pasha and T. Palanivel, "Pro-Poor Growth and Policies: The Asian Experience," U.N. Development Programme, 2004; Judith Banister, "Manufacturing Employment in China," *Monthly Labor Review*, July 2005.