

Income Equalization vs. Polarization

Alternative Paths for High-growth Economies



Japanese rural youths migrating to Tokyo to work, 1960s

Chinese workers going home for Lunar New Year, 2010



Anti-government protesters in Thailand, 2015



Korea's Saemaul (New Village) Movement, 1970s

Kenichi Ohno (GRIPS)
Tokyo, March 2017
(Revised for class presentation)

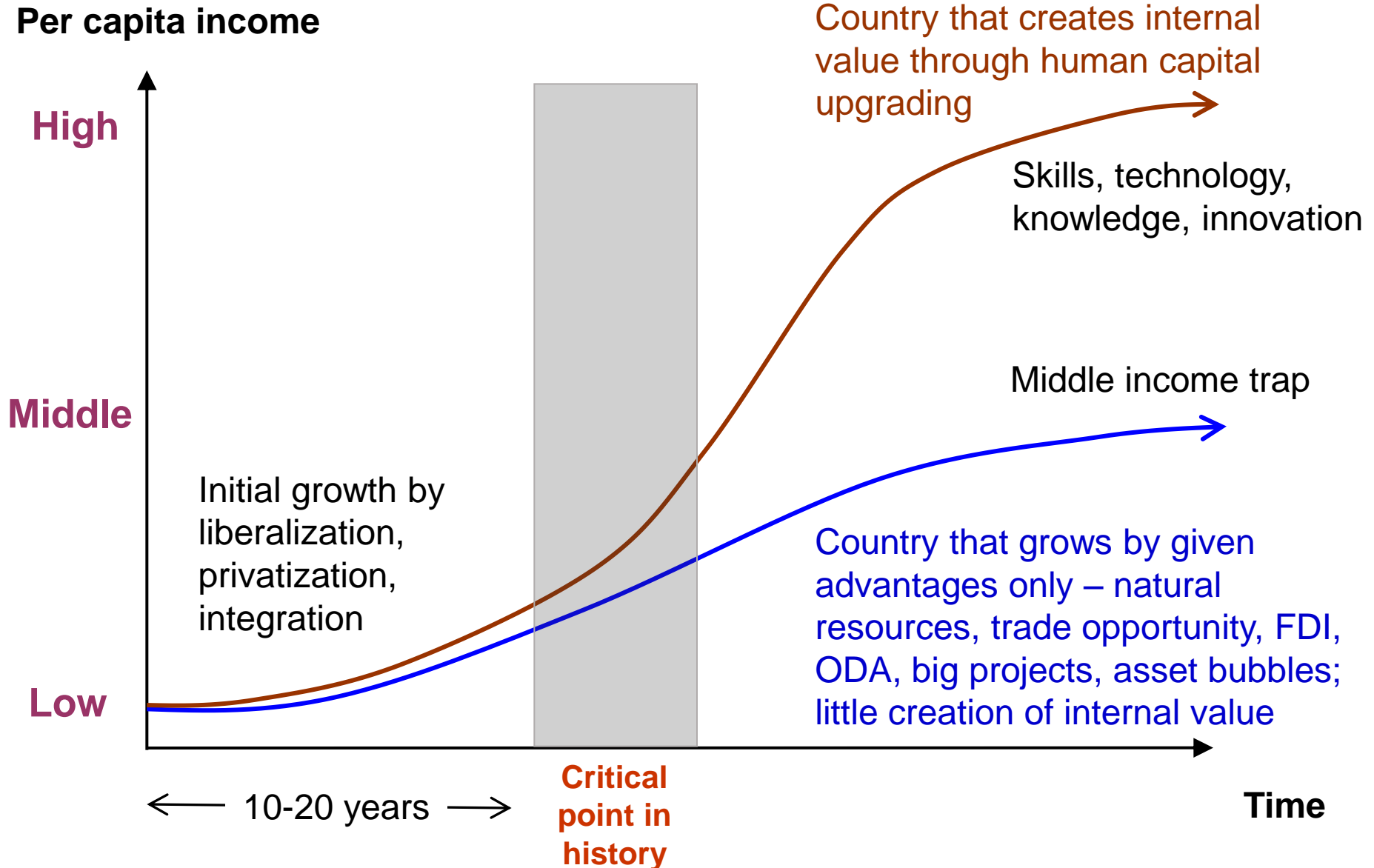


Middle Income Traps

(Structural Definition)

- Inability of a nation to create and augment value beyond what is delivered by given advantages.
- “Given advantages” include natural resources, cheap & young labor, new trade opportunities, FDI, aid, locational & geopolitical advantages, big projects, etc.
- Endowment of natural resources is a disadvantage for manufacturing—Dutch Disease (factor bias & overvaluation), lack of proper mindset & hard work, diverted interests, corruption and political lobbying.
- An economy starting from a very low level may grow rapidly for a decade or two even without good policy. But one-time freeing effect will eventually end.
- A trapped country may still grow, but at a speed too slow to reach high income even in the long run.

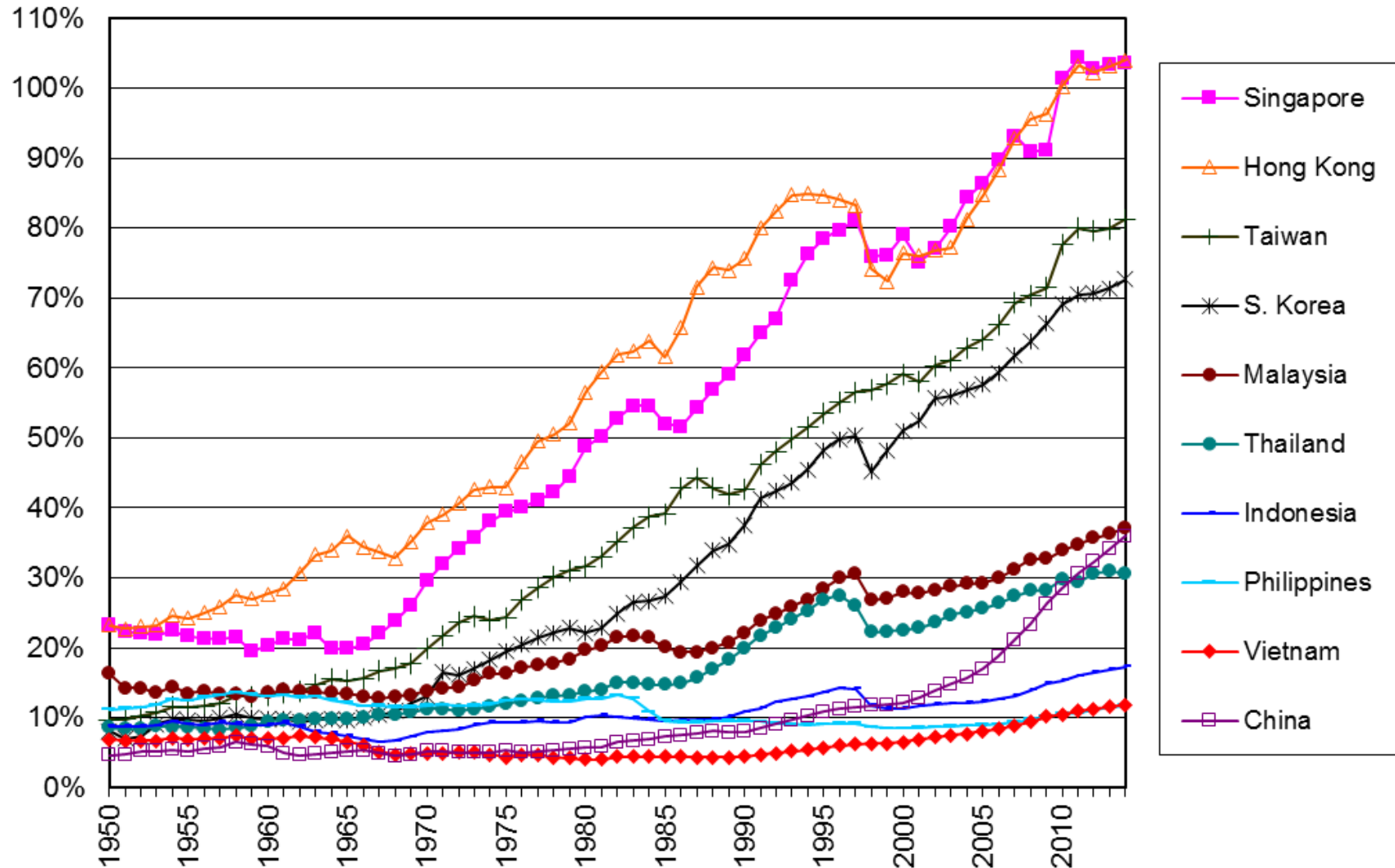
Why Do Countries Diverge?



Speed of Catching Up: East Asia

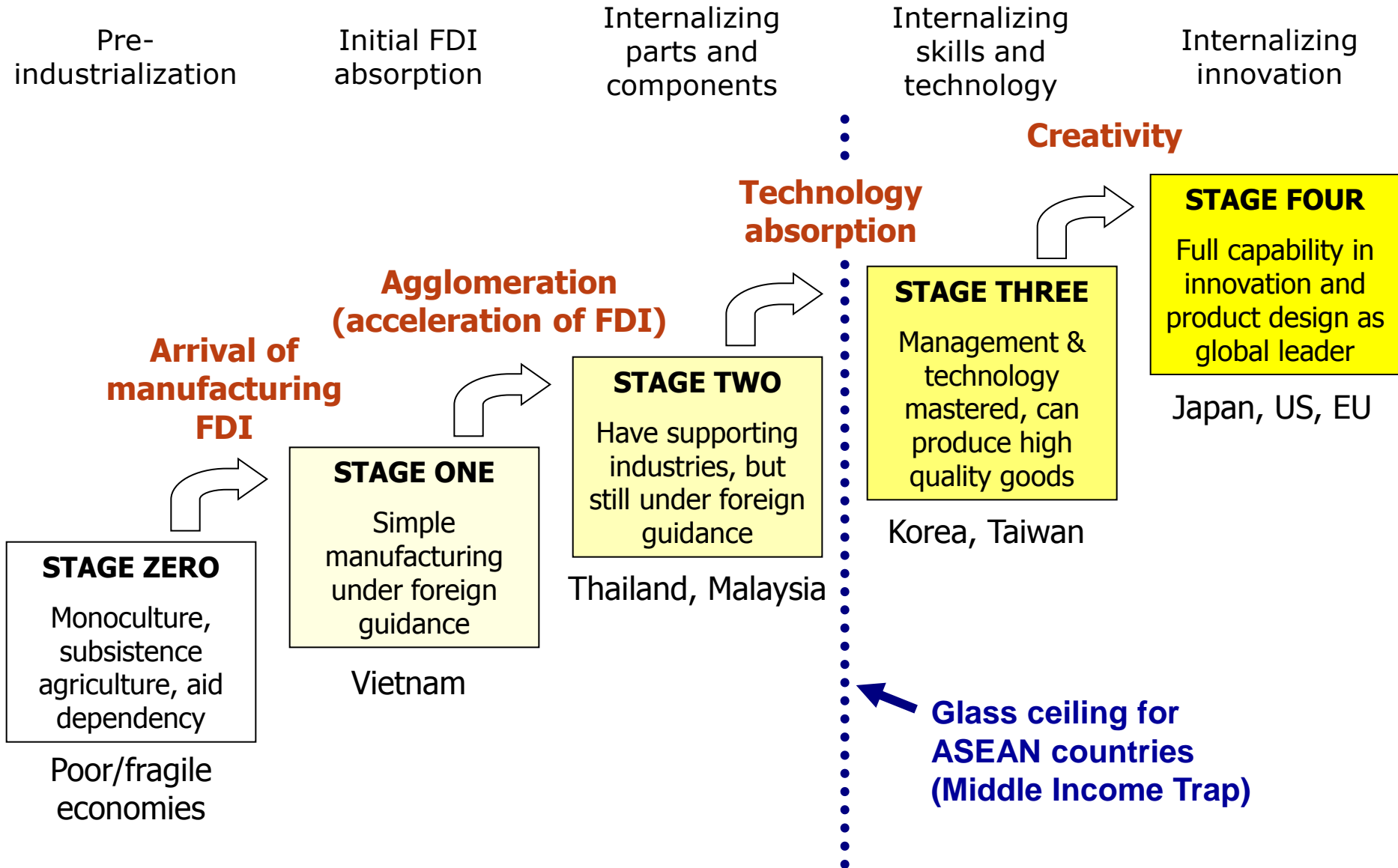
Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)



Sources: Angus Maddison, *The World Economy: Historical Statistics*, OECD Development Centre, 2003; the Central Bank of the Republic of China; and IMF, *World Economic Outlook Database* (for updating).

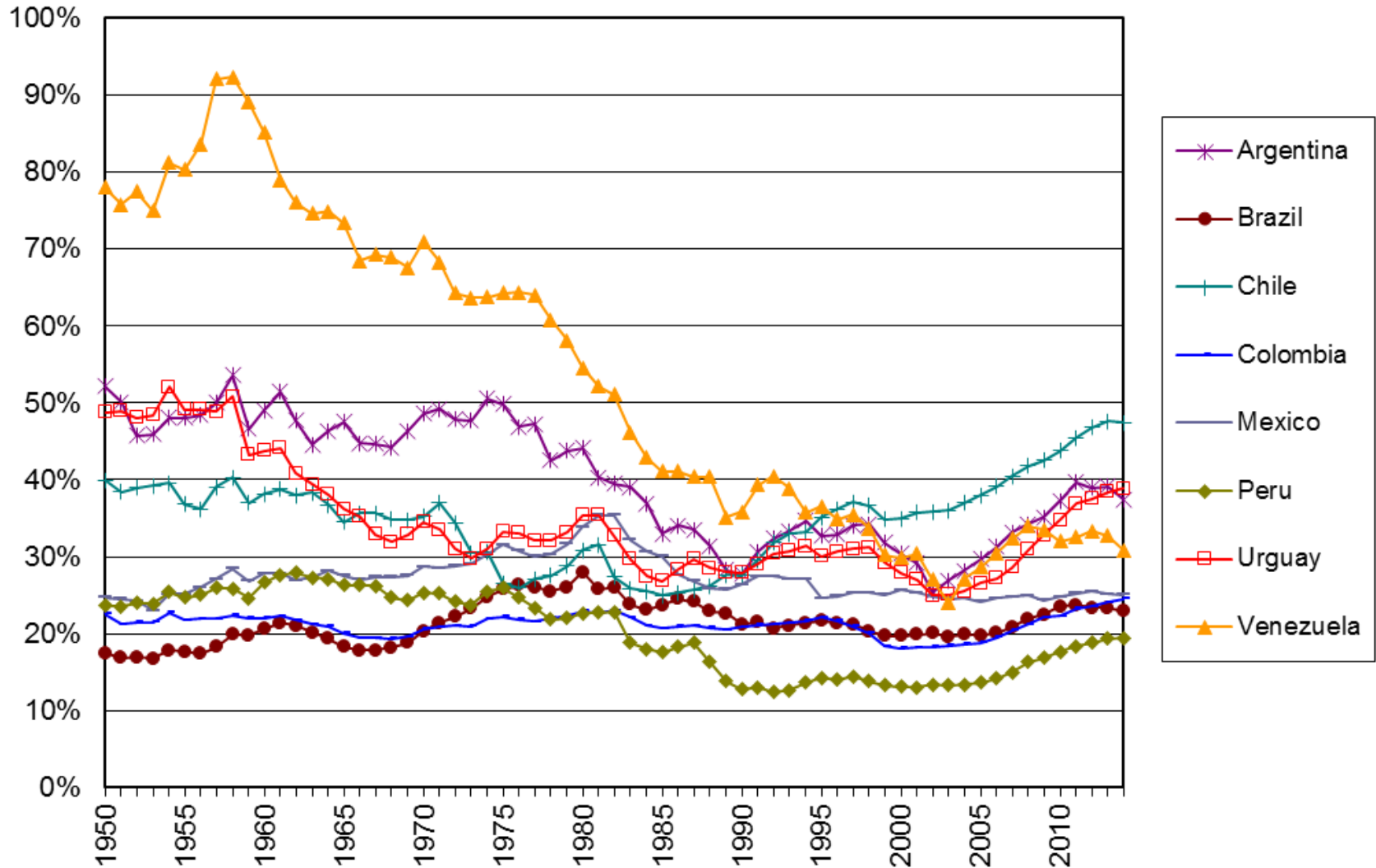
Stages of Catching-up Industrialization



Latin America

Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)

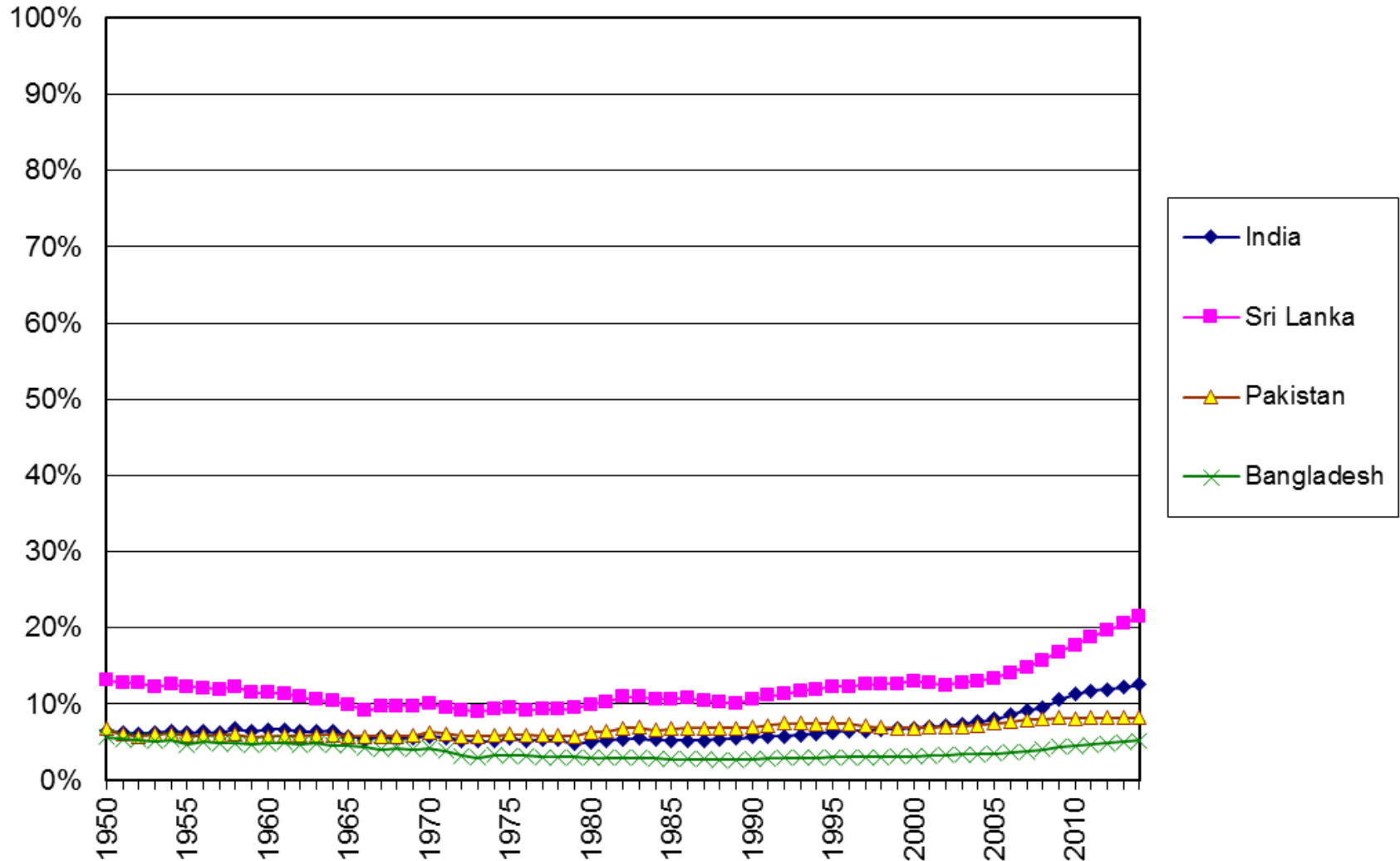


Sources: Angus Maddison, *The World Economy: Historical Statistics*, OECD Development Centre, 2003; the Central Bank of the Republic of China; and IMF, *World Economic Outlook Database* (for updating).

South Asia

Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)

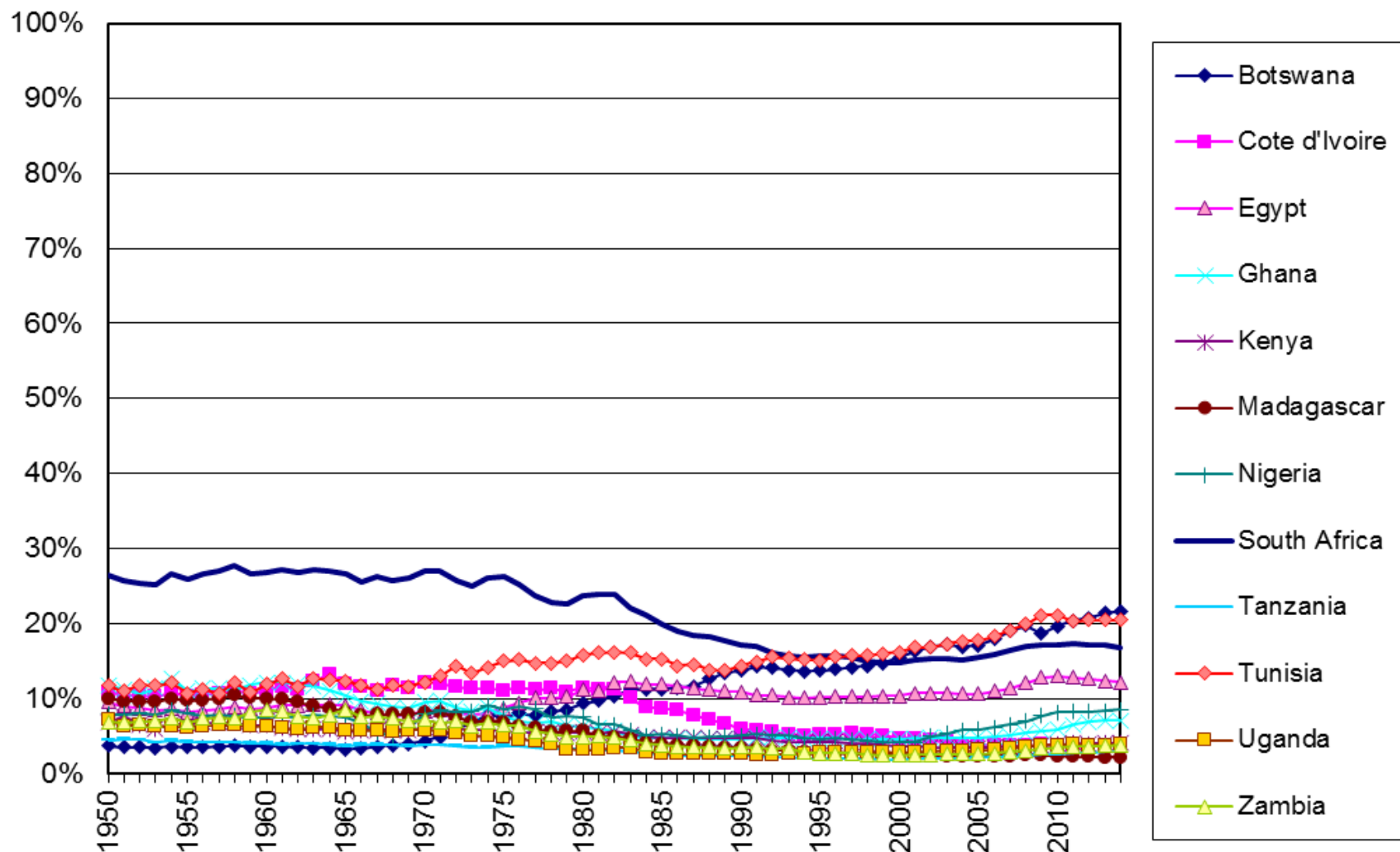


Sources: Angus Maddison, *The World Economy: Historical Statistics*, OECD Development Centre, 2003; the Central Bank of the Republic of China; and IMF, *World Economic Outlook Database* (for updating).

Africa

Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)

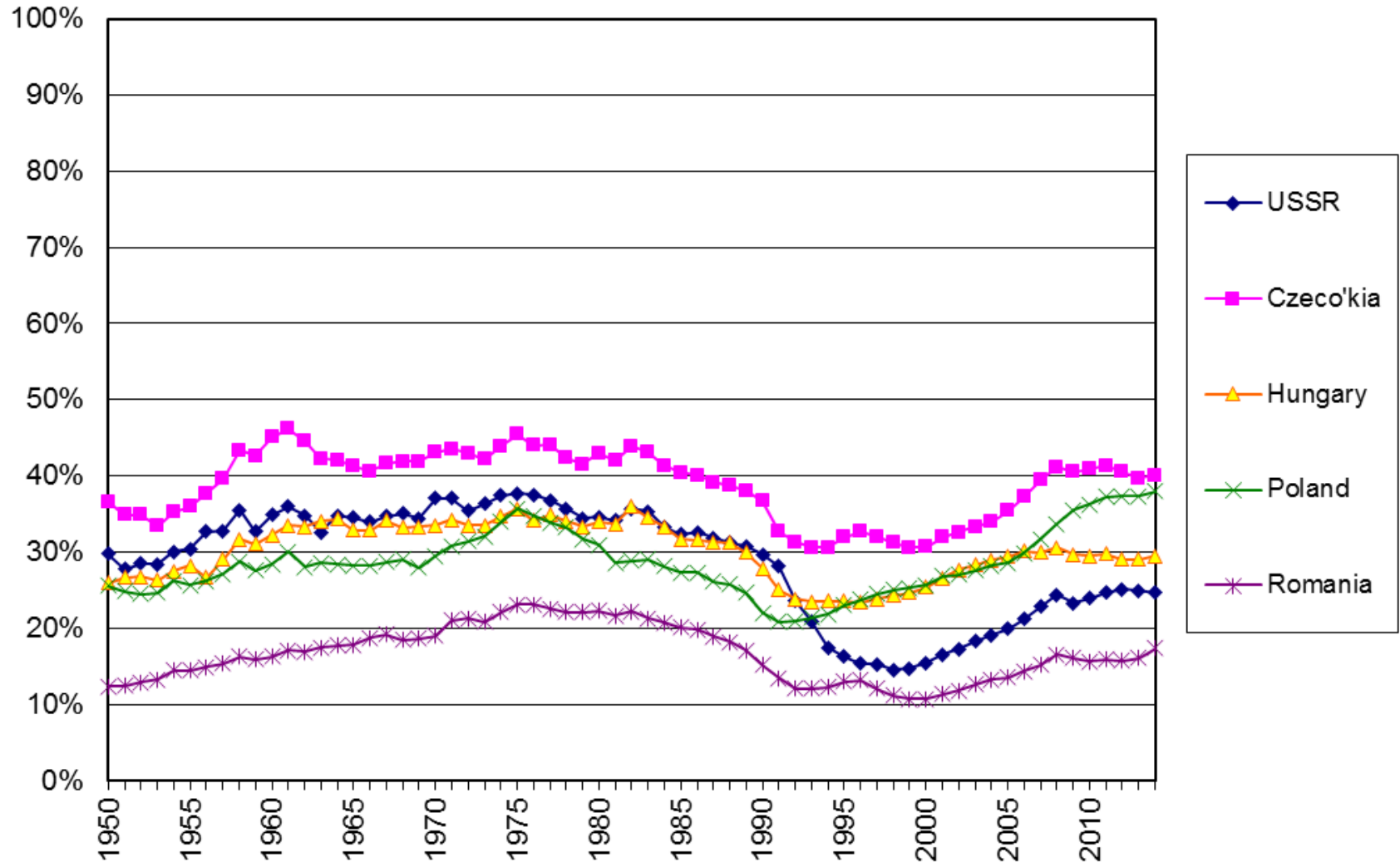


Sources: Angus Maddison, *The World Economy: Historical Statistics*, OECD Development Centre, 2003; the Central Bank of the Republic of China; and IMF, *World Economic Outlook Database* (for updating).

Russia & Eastern Europe

Per capita real income relative to US

(Measured by the 1990 international Geary-Khamis dollars)



Sources: Angus Maddison, *The World Economy: Historical Statistics*, OECD Development Centre, 2003; the Central Bank of the Republic of China; and IMF, *World Economic Outlook Database* (for updating).

Three Essentials for Overcoming Middle Income Traps

- ❑ **Growth policy**—promotion of value-creating people and enterprises for productivity and innovation (the quality of industrial policy matters)
- ❑ **Social policy**—coping with new problems caused by high growth: gaps, congestion, pollution, bubbles, migration, social change, materialism, corruption...
- ❑ **Macroeconomic management under globalization**—avoiding or minimizing regional and international shocks

Unless the three policies are firmly in place, a path to high income is not available.

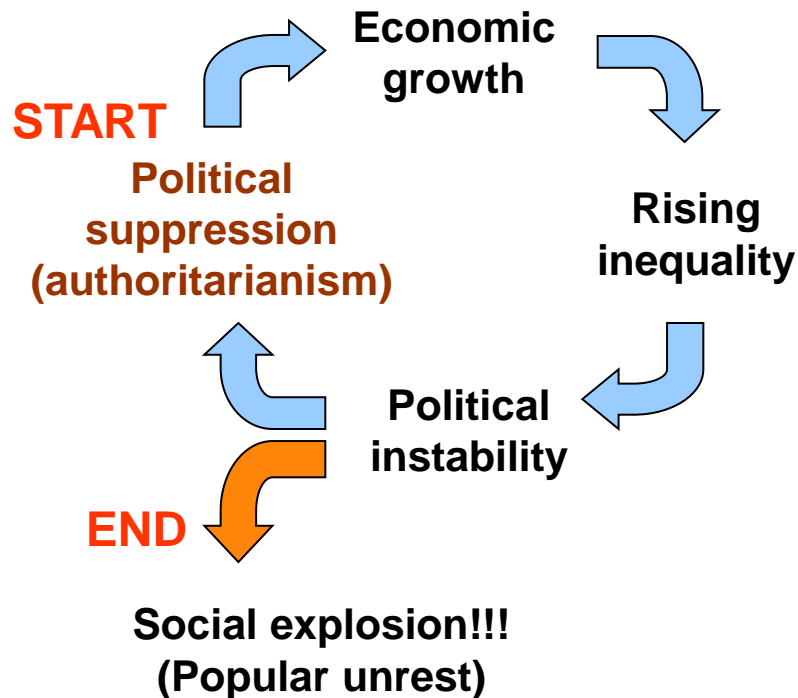
Growth versus Inequality

- ❑ Based mainly on Latin American experiences, Huntington & Nelson argued that development would surely fail whether you started with **growth** (developmental dictatorship) or **equality** (populist democracy).
- ❑ However, there is another way. Some economies in East Asia overcame the dilemma and achieved high growth and income equality simultaneously—Japan, Taiwan & Korea.
- ❑ This was done by an appropriate combination of **growth policy** and **social policy**. The former created growth while the latter solved problems caused by high growth. These policies are separable, and both are essential for development.

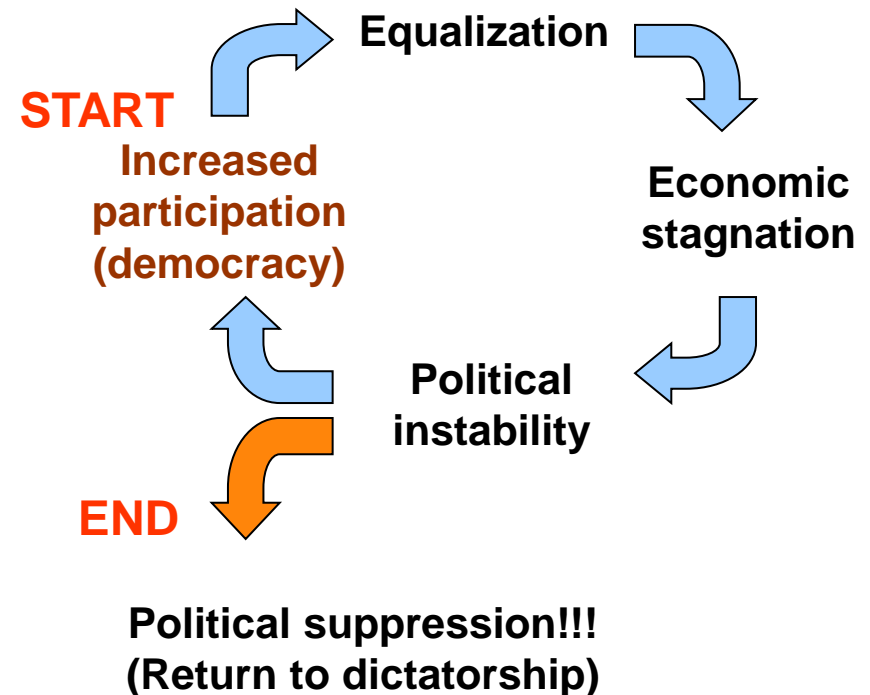
Guaranteed Failure of Development?

Samuel P. Huntington and Joan M. Nelson, *No Easy Choice: Political Participation in Developing Countries*, Harvard University Press (1976).

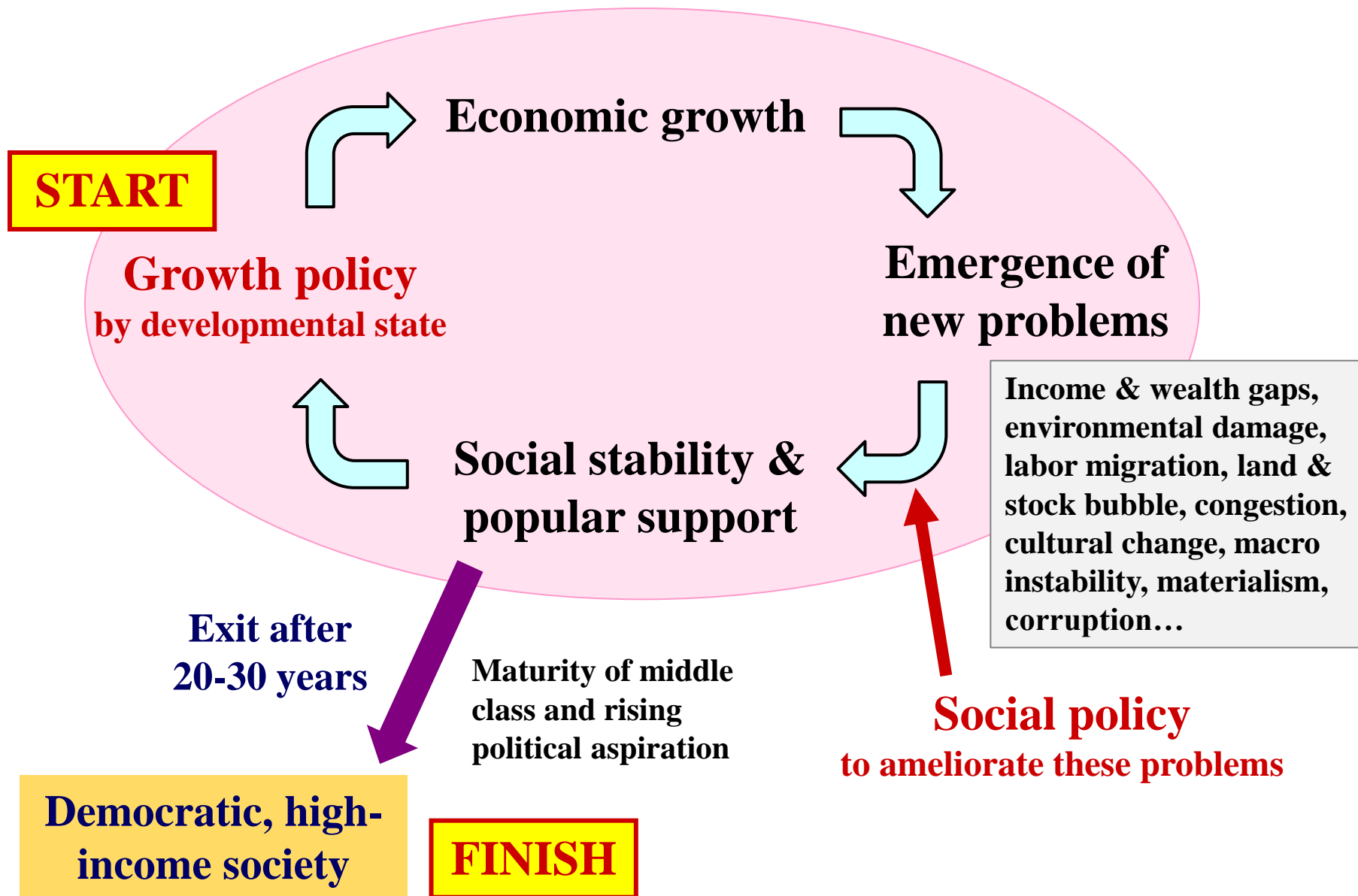
Technocratic Model



Populist Model



Growth & Social Policy: East Asian Solution



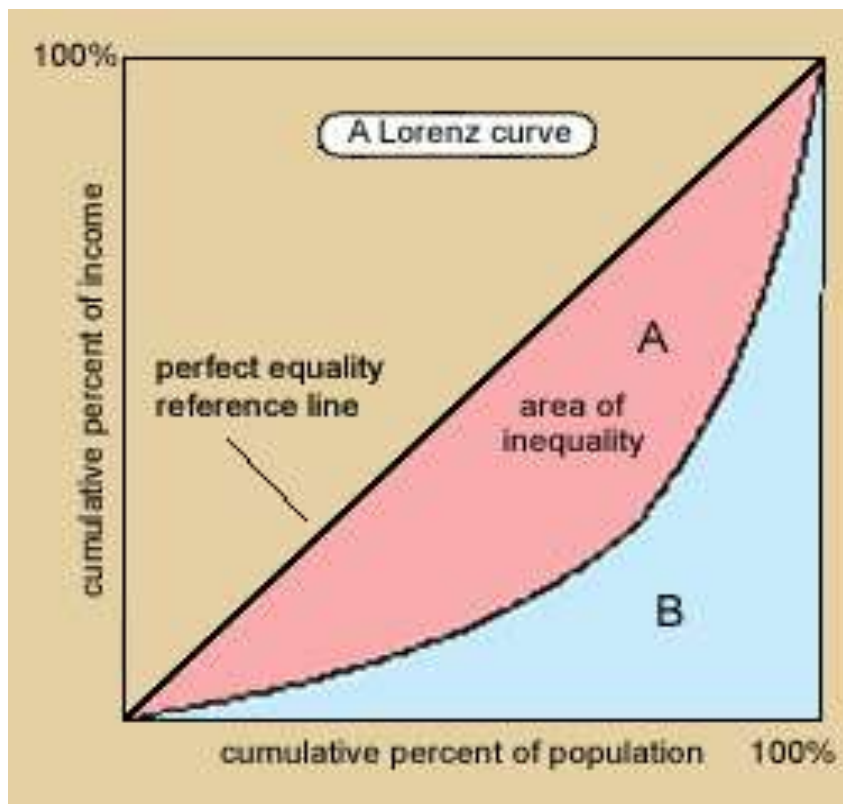
Inclusive Growth vs. East Asian Way

Both approaches aim at growth and equality simultaneously, but there is an important difference.

- Under **Inclusive Growth**, growth policy must be ***integrated*** with social policy. Growth policy must be designed and executed in such a way that it empowers and benefits the underprivileged through participation, job & income creation, etc.
- Under the traditional **East Asian way**, growth policy and social policy are in principle ***separable***. FDI attraction, TVET, industrial location, technology transfer, etc. must be planned for growth and competitiveness. Empowerment and income redistribution should be pursued by another set of measures. These policies should not be mixed.

Lorenz Curve and Gini Coefficient

- ❑ A Lorenz curve shows cumulative income against population.
- ❑ The Gini coefficient measures the degree of income inequality and ranges from 0 (perfectly equal) to 1 (perfectly unequal).



$$\text{Gini coefficient} = A / (A+B)$$

0 → Everyone has the same income

1 → Only one person monopolizes wealth, others have no income.

Actual numbers come in between:
[Up to 30%: relatively equal
[40% and above: highly unequal

Two Groups in East Asia

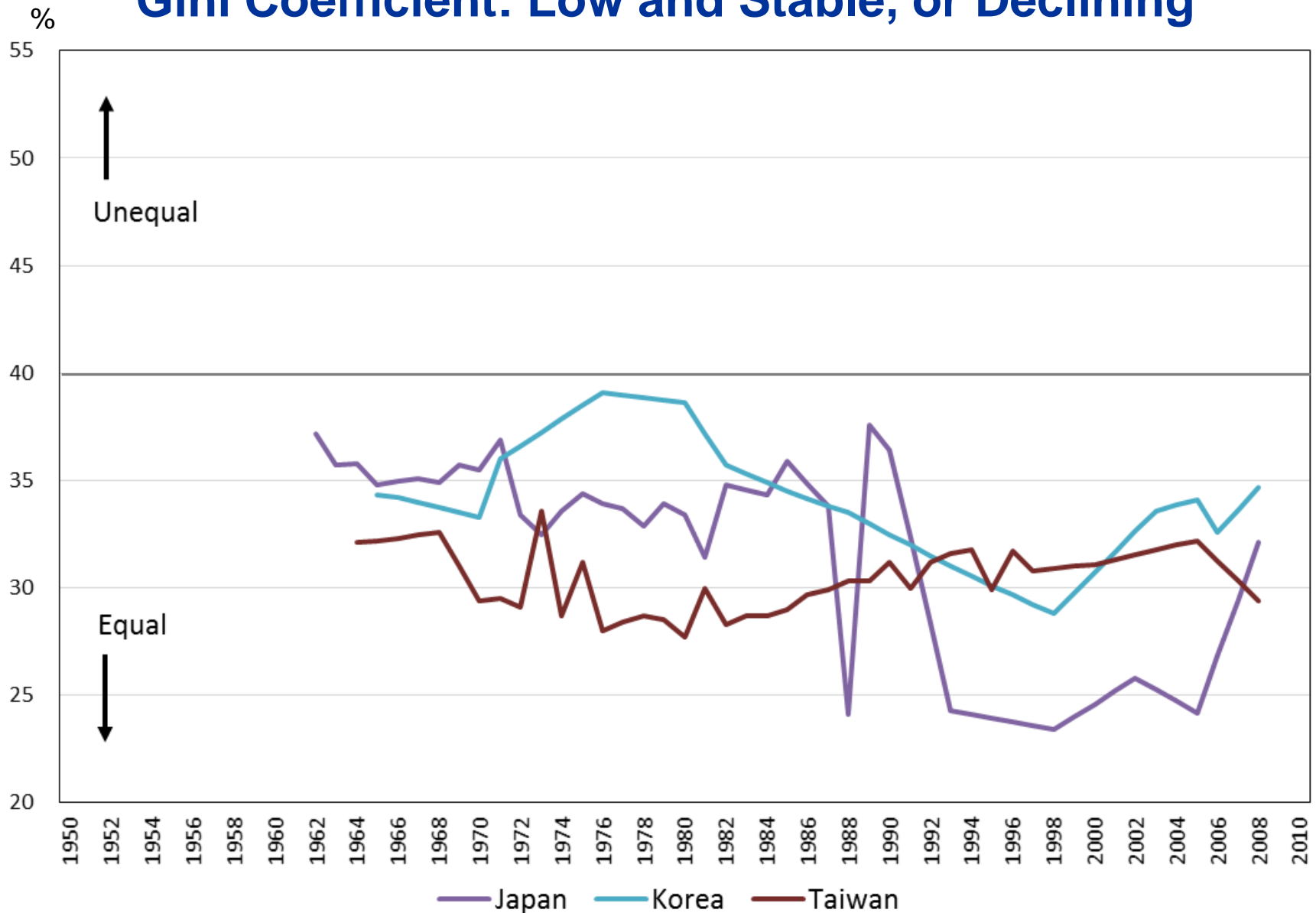
Economies that had equal or equalizing income during a high growth period

- Japan, 1950s-60s
- Korea, 1970s-80s
- Taiwan, 1960s-80s

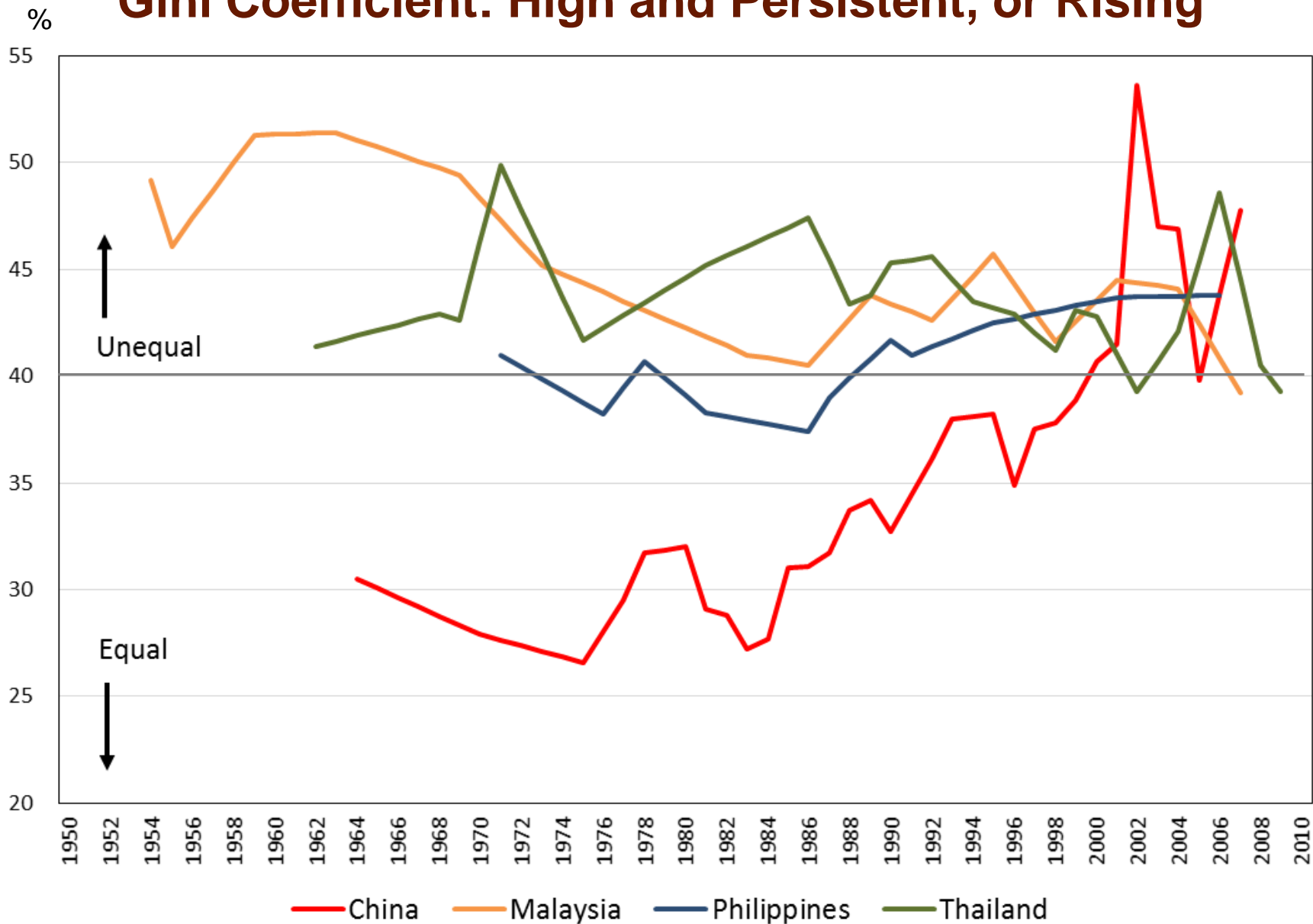
Economies that had unequal or polarizing income during a high growth period

- China, after 1980s
- Thailand
- Philippines
- Malaysia
- Indonesia & Vietnam—beginning to be unequal

Gini Coefficient: Low and Stable, or Declining



Gini Coefficient: High and Persistent, or Rising



Source: World Bank's combined and standardized Gini data, <http://data.worldbank.org/data-catalog/all-the-ginis>.

Remedies and Measures

Market force

- ▣ Labor migration & remittances—permanent, temporary, seasonal, etc.

Social policy

- ▣ Supporting and protecting migrant workers & their families
- ▣ Social policy for rural development
- ▣ Productivity Movement and productivity-wage balance
- ▣ Job & income creation (SMEs & labor-intensive FDI)
- ▣ Rights and power of workers & SMEs against exploitation
- ▣ Fiscal transfer from cities to villages
- ▣ Public investment in favor of rural areas
- ▣ Price support and import protection for agriculture
- ▣ Subsidies, quotas and affirmative measures for rural and/or underprivileged population

Remedies and Measures (cont.)

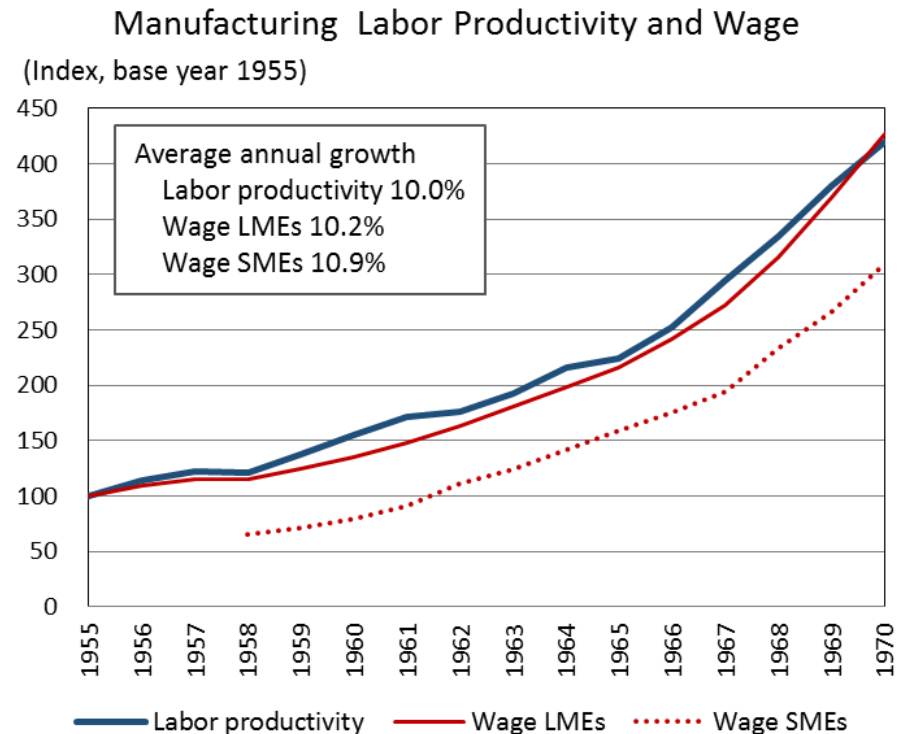
Politics

- ▣ Balanced cabinet composition and power distribution
- ▣ Social compact among government, management and labor
- ▣ Sensitivity to labor, land, ethnic and cultural issues

Japan:

Rapidly Rising Productivity & Wages

- During the High Growth Era (1955-1970), labor productivity and wages rose about 10% per year. Under this rapid income improvement, social stability and labor discipline were maintained. All Japanese people felt that they belonged to the middle class.
- The ruling Liberal Democratic Party (LDP) secured votes by offering subsidies, price control, agricultural protection, public investment, etc. in favor of rural farmers. Tokyo taxes were channeled to build railroads, highways, ports and airports in rural constituencies.



Korea:

Saemaul Undong & Equalization

- ❑ Saemaul Undong (New Village Movement) was launched in 1970 by President Park Chung-hee to narrow the gap between industrializing cities and backward villages.
- ❑ It was a top-down order for local community initiative. All villages in Korea were given resources, training & instruction, and evaluated by their action and performance.
- ❑ Although some criticized Saemaul Undong as forced political propaganda, it brilliantly succeeded in eliminating urban-rural gaps. In fact, some rural regions became richer than Seoul.

Inequality Indicators: Regional Incomes Converged

	1971	1981	1991
Max/min ratio	2.0471	2.0143	1.7531
Coefficient of variation adjusted by economic size	0.2873	0.1643	0.1572
Gini coefficient	0.1597	0.0846	0.0644

Note: Data covers regional per capita GDP of 17 cities & regions of South Korea.

Source: Huh Mun-Gu, "Changing Inter-regional Income Disparities in Korea: A Gross Regional Domestic Product Analysis," Osaka Prefectural Univ. (1995).

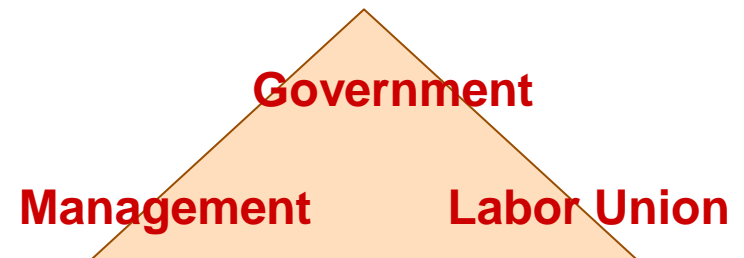
Taiwan: Strong SMEs as Main Exporters



- Taiwan's SMEs have been very dynamic and served as the main engine of growth since the 1960s.
 - In 1981, SMEs' share of export was 68.1%.
 - In 1986, SMEs accounted for 96% of establishments, 47.9% of employment and 31.0% of value added.
 - In 2010, SMEs occupied 97.8% of establishments, 76.7% of employment, 29.8% of sales, and 17.9% of export
- 80,000-90,000 new firms are created every year; the start-up ratio is 7.1%, which is very high.
- SME Administration under the Ministry of Economic Affairs provides a large number of SME support incl. management, finance, incubation, regional clusters, etc.
- Emergence of large IT firms (Foxconn, TSMC, UMC, AUO, Acer, Asus, etc.) reduced the relative importance of Taiwanese SMEs, but their absolute contribution is still large.

Singapore: Productivity Movement under Social Compact

- Since independence (1965), Singapore pursued productivity under a social compact among government, management and labor unions.
 - Three parties actively contribute to productivity
 - Fruits of productivity shall be shared to improve workers' life
- The compact was introduced to reduce resistance from labor unions which regarded "productivity movement" as an excuse to lay-off workers. This political agreement is valid even today.
- Japan taught productivity (kaizen) to Singapore in the 1980s. Singapore learned well and became a teacher of productivity to other countries in the 1990s.



Malaysia: Bumiputra Policy

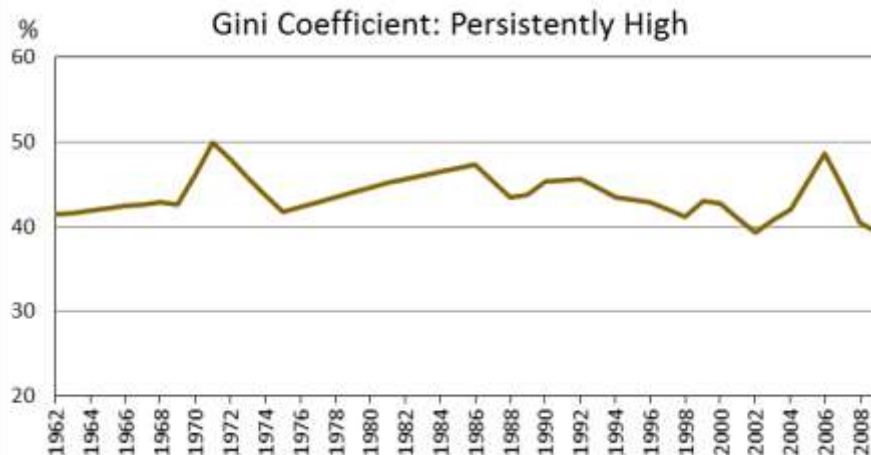


- Malaysia's main ethnic groups are Malays (60%), Chinese (25%) and Indians (10%). Chinese and Indians are good at business and wealthy, while Malays are poor and less dynamic.
- Ethnic riots between Malays & Chinese erupted in 1969. Since then, Malaysia has offered privileges to Malays in business ownership, management, employment, etc. There is always tension between economic efficiency vs. ethnic equality.
- Despite long-standing affirmative actions, Malays remain less active. Government hopes to transform them from privilege receivers to vibrant value creators—with little success.
- The Malaysian economy slowed down recently and seems to be trapped in an upper-middle income trap. Ethnic income gaps remain large.

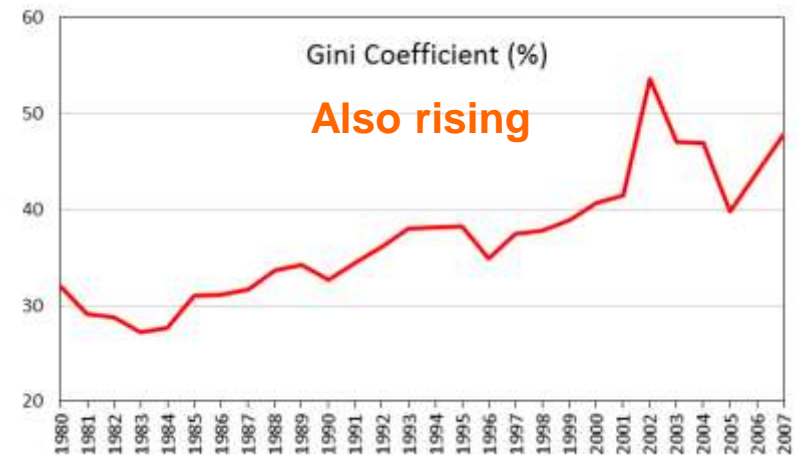
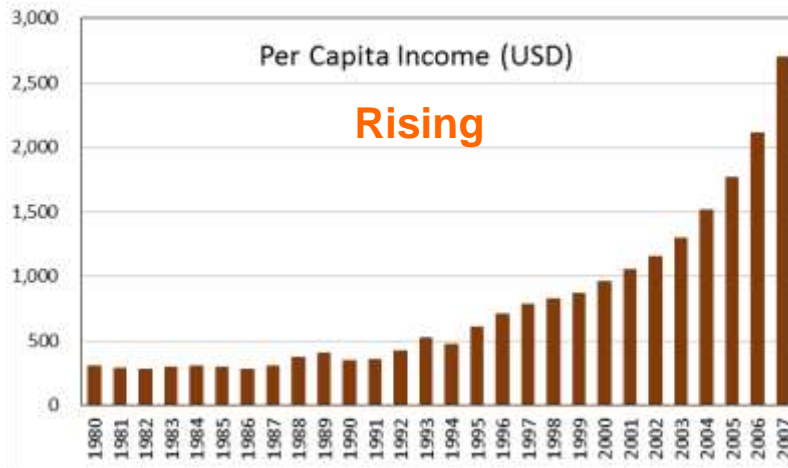
Thailand:

Yellow Shirts vs. Red Shirts

- ❑ Thailand has industrialized rapidly overcoming many economic and political crises. Automotive, electronics & agro-processing sectors have grown.
- ❑ However, government failed to reduce the gap between rich & privileged in Bangkok (Yellow Shirts) and poor farmers (Red Shirts). The Gini coefficient remained high (0.4-0.5) and the two groups were structurally separated.
- ❑ PM Thaksin (2001-2006) provided subsidies to rural farmers. This ignited political fights between Yellow and Red Shirts.



China: Growth Slowdown and Growth-caused Problems



- Under Mao's rule, economy was stagnant and everyone was equally poor. After Deng's liberalization (1990s-), growth accelerated but income gaps also greatly widened.
- China's double-digit growth is over and it has grown at 6-7% since 2012 ("New Normal"). It reached upper middle income but faces the risk of 未富先老 (Not Yet Rich, but Already Old).
- China is challenged by many social problems including income gaps, pollution, corruption, materialism, property bubbles, labor mobility and the lack of political reform.

Vietnam:

An Emerging Property Gap

- ❑ Vietnam has grown rapidly since the early 1990s but the main engines of growth were external forces (trade, FDI & ODA) and property bubbles. Skills & productivity show little result.
- ❑ The Gini coefficient is rising from 0.35 to 0.40, but asset gaps (not reported) are far worse than income Gini.
- ❑ From about 2005, a division emerged between urban property rich versus all others. Hanoi's land is as expensive as Tokyo suburbs, but Vietnam's per capita income is still at 6.5% of Japan's. Urban land value dominates Vietnam's wealth.

