



## The End of ‘Growth with Equity’? Economic Growth and Income Inequality in East Asia

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# AsiaPacific

## I S S U E S

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**SUMMARY** During the closing decades of the twentieth century, much of the world witnessed a substantial increase in economic and social inequalities. Following a period of “growth with equity” that featured economic growth and social redistribution in East Asian countries shortly after World War II, a new era of “growth with inequality” has been ushered in. This leads not only to a divided society, it threatens democratic institutions and suffocates economic growth. Looking forward to the next half century, will East Asia, a major area of economic growth of the twenty-first century, become increasingly unequal economically and socially? The experience of China, a country that has seen a period of both spectacular economic growth and rapid income inequality increase, suggests that the state can serve both as an inequality creator and an equality enforcer. As equitable distribution of benefits of economic growth requires forces beyond the market alone, national policies are required to address the causes of rising inequality and create opportunities that will have beneficial long-term effects.

Over the last half century economic growth in Asia, especially East Asia, has fundamentally altered the world's economic and, consequently, political landscapes. In a short 50 years this region has grown into the economic powerhouse of the world. In 1955 China, Japan, South Korea, and Taiwan encompassed over one quarter (26.66 percent) of the world's population but generated only 9 percent of the world's gross domestic product (GDP).<sup>1</sup> Five decades later East Asia's population, measured against the world's total, had fallen to 23.24 percent while its share of the global economy had grown nearly three-fold to 25 percent. The region is now the home of the world's second and third largest economies. With China spearheading the region's further expansion in global economic power, followed by Japan, South Korea, and Taiwan, East Asia's economic ascendance is continuing. During the five decades since 1955 these East Asian economies grew from among the poorest to among the richest in the world.

What is equally remarkable is that in the 1960s and 1970s and into the mid-1980s growth in three of these East Asian economies—Japan, South Korea, and Taiwan—was associated with a particular identity, that of “growth with equity.”<sup>2</sup> The economic upsurge not only increased their total GDP it also benefitted most, if not all, of the population through rising income levels and rising standards of living. The economic growth seen in Japan, South Korea, and Taiwan was accompanied by a relatively equitable distribution of income throughout their populations. This pattern of economic growth coupled with a relatively equitable income distribution helped these economies avoid social unrest and develop or consolidate democratic governments.

At the close (2005) of this half-century of economic progress, the future of the East Asian growth with equity model was already in serious question. The limited income inequality observed in the middle stages of this regional economic growth is today increasingly being replaced by growing income inequality. The largest economy in the region, China, which now leads the region's economic growth, also leads in the region's growth of income inequality.

What happened to the growth with equity model? What caused this current reversal? And what are the prospects of a return to growth with equity?

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### **Growth with Equity**

In the last half century, economic growth in the East Asian region was an unprecedented success story. Between 1960 and 1987 per capita income in Japan quadrupled from \$4,000 to \$16,000 (these and all following income figures in US\$). Similarly impressive growth took place in South Korea and Taiwan somewhat later. In South Korea per capita income quadrupled from \$2,000 to \$8,000 between 1969 and 1989. In the next 15 years it doubled again, to \$16,000 by 2003. Income increased at a similar speed in Taiwan with per capita income reaching \$16,000 in 1999, having quadrupled from around \$4,000 in 1977. In China, the last of these economies to show massive improvement, per capita income also quadrupled in about two decades time, from around \$1,000 in 1980 to over \$4,000 by 2002. And, since early in the first decade of 2000, the rate of rise in Chinese per capita income has continued to accelerate.

For the early economic successes in this region—Japan, South Korea, and Taiwan—the acclaimed model of growth with equity indeed finds empirical support, at least until the mid-1980s (Figure 1). In all three locales the degree of economic inequality, measured by the Gini index of inequality of per capita gross income, declined in the initial stages of increasing GDP. The Gini index of inequality ranges from 0 to 1, with 0 being total equality (every member of the population receiving exactly the same income) and 1 being total inequality (all income being in the hands of only one individual).

Earlier trends of declining inequality were most evident in Japan and Taiwan. In Japan, where a more complete data series is available, inequality dropped substantially with the Gini index declining from 0.45 in the beginning of the 1960s to below 0.40 by the late 1970s until it reached 0.34 in 1982.<sup>3</sup> In Taiwan, where only sporadic numbers are available for earlier years, the same inequality index dropped from close to 0.50 in 1961 to 0.35 in the late 1960s and to below

*‘Growth with equity’ benefitted most of the population through rising income levels and standards of living*

0.30 in the late 1970s. At that time this was among the lowest in the world.

In South Korea over the same period the Gini index fluctuated without a clear trend. South Korea differs from Japan and Taiwan in that inequality did not drop—but it still fits well with the growth with equity model as inequality did not rise with an increase in GDP. This is in contrast to patterns seen in other parts of the world, such as in Mexico and Brazil, where economic growth was accompanied by rising inequality.

China at this time was a category unto itself. Under a socialist planned-economy system, income inequality was kept at a very low level. This was achieved, in part, by the creation of other types of inequalities such as the separation of its urban and rural populations.

Through roughly the 1960s into the mid-1980s, concurrent trends of rapidly rising incomes and sustained declines in inequality in the region generated the identification of growth with equity. East Asia became a model not only of economic growth but also of equitable income distribution. East Asia's experience contradicted the popular belief that rising

income inequality was inevitable during the initial stages of sustained economic growth.<sup>4</sup>

### What Created the Model of Growth with Equity?

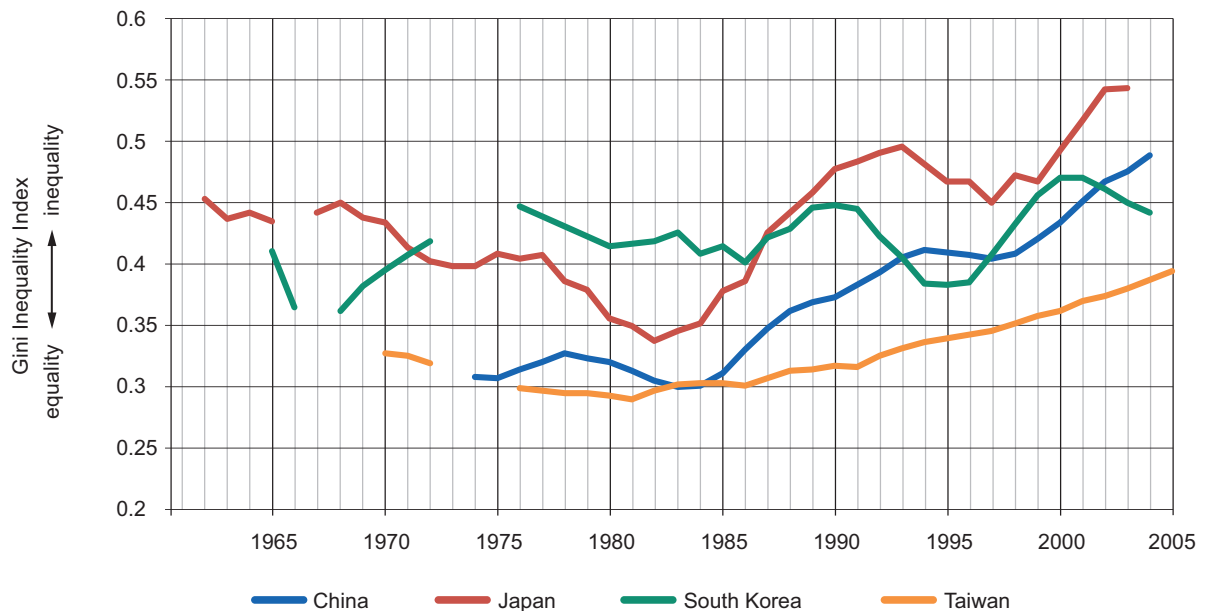
The underlying causes for East Asia's economic growth with declining income inequality have not previously been well articulated. While the causes are many and complex, there are several notable explanations.

The East Asian region shares a cultural tradition of collectivism honoring shared material benefits. Subjugating individual needs and interests to those of the collective (whether it be the family or the state), the social and cultural tradition of collectivism was built on the premise of guaranteeing the minimum well-being of all members of the collective. As East Asia transformed from agricultural- to industrial-based economies the collectivist cultural tradition that focused on sharing among family members in the agrarian context was, to some extent, carried over into the new urban industrial society. Early in this transformative half century, companies in Japan, South

*East Asia's experience contradicted the popular belief that rising income inequality was inevitable*

**Figure 1. Trends in income inequality (per capita gross income) in East Asia, 1960–2005**

Gaps in lines indicate years for which data is unavailable.



Source: Frederick Solt, "The Standardized World Income Inequality Database" (see note 3).

*China has the world's most spectacular economic growth and most rapidly increasing income inequality*

Korea, and Taiwan often provided such benefits as childcare, company housing, guaranteed life-long employment, health care, and subsidized meals in addition to wages. Moreover, reflecting familistic considerations, wages and bonuses were often set with an employee's age and family composition in mind. In China, up to the end of the 1970s and under a socialist planned economy system, urban work organizations also provided benefits and services from cradle to grave to all employees.

Economic transformations in East Asia also followed a model of export-driven growth. Export-oriented production, a common feature of East Asia's economic growth, created a continued demand for a large number of factory-based employees. As young people migrated from the countryside to cities they quickly found jobs with higher wages. The structure of large-scale manufacturing allowed more equitable wages for most employees. Urban-bound migrants often sent a portion of their earnings home to support their farming parents and the education of younger siblings, helping reduce income inequalities between urban and rural societies.

While largely lacking democratic political systems during the economic upsurge, paternalistic political rule in this region addressed popular desires for equitable growth as a means to derive political legitimacy. Each society largely controlled the creation of an export-oriented economy generating jobs and income. Societies in this region notably expanded public education and promoted public health. In this half century the youth of the region participated in the world's greatest improvement in life expectancy and educational attainment. This contributed to a broad-based increase in labor productivity and in income enhancement. Whereas various of these factors were also present at other times and in other societies, no other time or place had all these factors working simultaneously to produce such rapid economic growth with relatively equitable income distribution.

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### **The Great Reversal**

By the mid-1980s East Asia's growth with equity ended. Sustained increases in income inequality began to

emerge in almost every part of the region. As shown in Figure 1 (previous page), in Taiwan the reversal began in 1982, in Japan in 1983, and in South Korea in 1987 (where inequality increased for a number of years followed by a break and then a rebound). By the early twenty-first century, a half century after the emergence of the growth with equity pattern, levels of income inequality in these societies had mostly surpassed what they had been a half-century earlier.

The most significant case of rising inequality in East Asia is China. China not only has the world's largest population but also, in recent years, the world's most spectacular economic growth and most rapidly increasing income inequality. Income inequality measured by the Gini index rose from around 0.30 in the early 1980s to over 0.45 by the turn of the century. Such a change marked China as having the fastest income-inequality increase of any large country over the last three decades and, now, one of the countries with the highest income inequality in the world.

What caused such a radical change? The global rise in income inequality occurred during a period of worldwide capitalist expansion fueled by an unconstrained free-market ideology and the rise in power of multinational corporations challenging and undermining state and local authority. The collapse of most global communism near the close of the 1980s further contributed to a sense of the triumph of the capitalist system.

Over the last several decades, the world's more advanced economies moved from industrial to post-industrial based. Large-scale manufacturing industries, frequently associated with more equitable wages, were replaced by the expansion of service sectors where pay is much more heterogeneous and unequal. At one end of these service sectors (e.g., finance and information technology) are a small number of extremely well-compensated individuals while at the other end of the spectrum (e.g., temporary hires) are far more numerous lowly paid individuals.

An accelerating trend of rising income inequality has since been observed almost everywhere in the world. In the United States, for example, the real income of 60 percent of all families has remained essentially constant since the 1970s while by the late 1990s the

real income of the top 5 percent of the US population had risen by nearly 50 percent.<sup>5</sup> In almost all other major industrialized countries (e.g., Australia, Canada, France, Italy, Sweden, the United Kingdom, and the former West Germany) income inequality also increased after the 1970s. A comprehensive study of 73 countries reports that, for the period of 1950 to 1995, in all but 9 countries inequality either increased (in 48 countries) or remained constant (in 16 countries). These 73 countries accounted for 80 percent of the world's total population and 92 percent of the world's GDP.<sup>6</sup>

Adding to the global forces driving rising inequality was the lessening, among East Asian societies, of localized forces that earlier had contributed to growth with relatively equitable distribution. Declining fertility and mortality rates marked a rapid demographic transition in this region. Families and kin networks, previously the main sources transmitting and nurturing the values of collectivism, became older, smaller, and weaker. Western individualistic values, introduced and disseminated through the arrival of modern media ranging from TV to the Internet, greatly challenged and undermined traditional collectivist values.

In East Asian societies including Japan, South Korea, and Taiwan, as the pace of economic growth began to slow and the service sector began to expand, opportunities became scarcer and competition more intense. In China a deliberate state policy of economic growth targeted to "make some people rich faster and earlier" has more than fulfilled its intent.<sup>7</sup> Over time the differences in income and wealth, relatively small to begin with, have become wider and wider and have evolved into an apparently durable new social stratification of income inequality.

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### **Return to Growth with Equity?**

The great East Asian reversal from growth with equity to growth with inequality has become an increasingly pressing social and political concern in these regional societies as well as in the rest of the world. Following the worst global financial crisis since the Great Depression of the early twentieth century, the world now appears prepared to question the wisdom of an

unregulated market economy and the benefits of unconstrained greed and inequality.

What lessons, if any, can be drawn from the earlier East Asian model of growth with equity? Is there any likelihood of a return to an era of economic growth that is also equitable and that benefits most members of a society?

The first lesson is that the market alone cannot serve the role of a redistributive arbitrator. Economic growth has not been and cannot be counted on to be a panacea for reducing inequality. For a limited period of time economic growth did indeed produce a spectacular reduction of poverty in the noted East Asian societies. But alleviating poverty and reducing inequality are not necessarily the same thing. In many societies, including those in East Asia, poverty reduction and rising income inequality proceeded hand in hand.<sup>8</sup> Early relatively equitable income distribution in East Asia benefitted most members of these societies. Beyond just an escape from poverty, societal opportunities for significant and sustained economic and social mobility became increasingly available. In the absence of equitable income distribution, however, more recent market-based economic expansion is leading to more unequal and divided societies.

Nonetheless the East Asian experience also demonstrates that income redistribution by the government is not the only solution for achieving greater income equality. State governments have long been regarded as the key institutions both to ensure market competition and to carry out income redistribution to restrict the negative social consequences of the market economy.<sup>9</sup> During East Asia's modern economic upsurge individual governments have all played active roles in economic strategizing, attracting capital, regulating labor, and opening up export markets. To varying degrees the governments in this region have also played the role of income redistributors through designing and implementing social-welfare programs.

The record of income redistribution in reducing inequality is, at best, mixed among these societies. In some, such as in Japan and Taiwan, taxation policies and social-welfare programs served to ameliorate but did not stop increasing inequality. Using per

*Alleviating poverty and reducing inequality are not necessarily the same thing*

capita net income, which is adjusted by redistribution effects, in all settings except China the trend of inequality rise becomes less evident. While per capita net income inequality was still higher after the 1980s than the period before, there is not the same “U-turn” as seen with the gross household income distribution. Even in societies where state redistribution has played a role, its effectiveness has weakened in the more recent years of inequality increase. The most pronounced flattening effect was only observed during the early years of economic growth.

State redistribution may have contributed to the growth with equity model of the 1960s and 1970s and into the mid-1980s but, in more recent decades, it has been less successful in countering the trend of rising inequality.

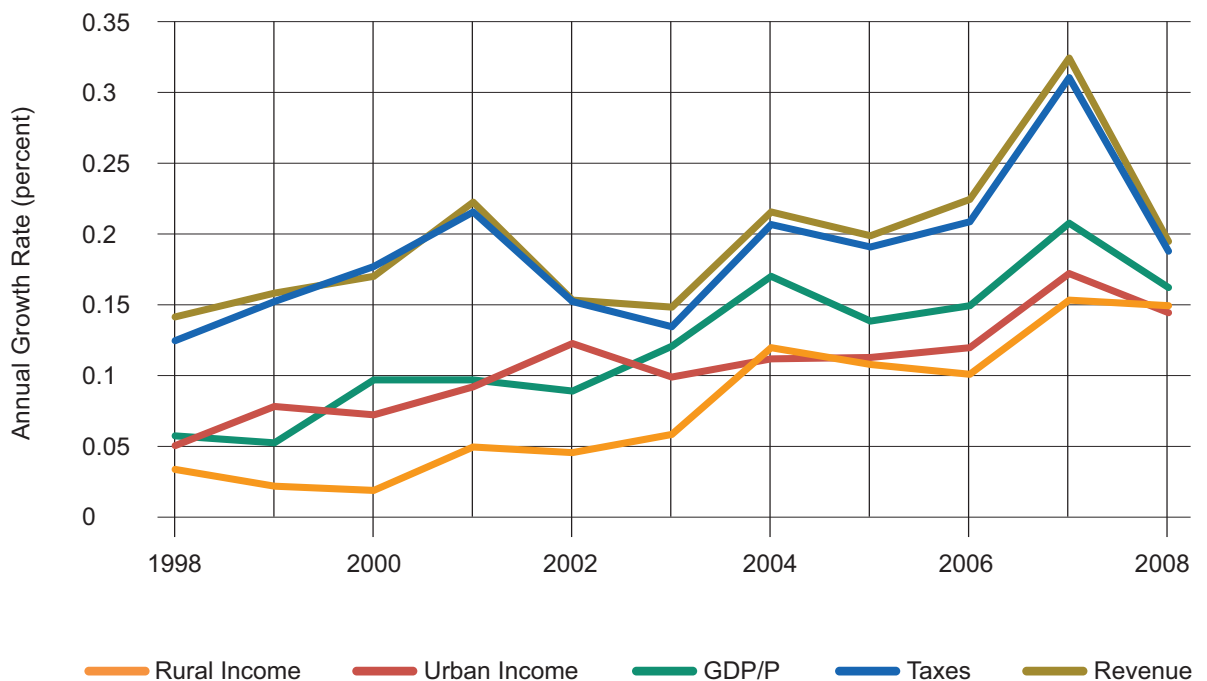
China, a country supposedly making great efforts to reduce inequality through redistribution, demonstrates that redistribution alone does not effectively prevent rising income inequality. Two important institutional forces, both state mandated or supported, have largely defined China’s rising income inequality.

*China demonstrates that redistribution alone does not effectively prevent rising income inequality*

The first is the segmented nature of the Chinese economic and social landscape. Individuals are still highly stratified by their residence location and employment. Inequality between rural and urban areas, between urban employees working in different industries, and between firms largely accounts for both the existing income inequality and for the trend of rising income inequality.<sup>10</sup> While China’s recent economic boom moved hundreds of millions of rural laborers into manufacturing sectors as was the case in other East Asian economies, state-backed institutional barriers such as the household registration (*hukou*) system in China continued to segregate urban residents and rural migrants.

The second is the state’s increasing control over economic resources in recent years, achieved largely by accelerated taxation and resource extraction. Between 1998 and 2008, unadjusted for inflation, China’s GDP per capita grew by 3.34 times; at the same time its per capita household income increased by only 2.91 times in urban areas and by 2.20 times in rural areas. Government revenue increased in the same time

**Figure 2. Annual rate of change of economic indicators, China, 1998–2008**



Source: National Bureau of Statistics of China, *China Statistical Yearbook 2009*.<sup>11</sup>



period by 6.21 times and taxes increased by 5.85 times, far outpacing the growth of the economy (Figure 2). In a decade's time the share of government revenue as a proportion of total GDP almost doubled, from 11.7 percent in 1998 to 20.4 percent in 2008.

Without breaking up the Chinese state-supported monopolies there is little chance that income inequality will be reduced. The same is true regarding the heavy concentration of financial resources in the hands of the state. The government may use its extracted resources for public projects aimed at reducing poverty or inequality—but such projects will likely more greatly benefit those closest to the state's power. China's redistribution policies have demonstrated a lack of equality. In the more privileged urban sectors redistribution is more generous and progressive whereas in the traditionally underserved rural areas state redistribution remains highly restricted and regressive.<sup>12</sup> Studies in other societies in the region find that the effects of redistributive tax policies are also generally small.<sup>13</sup> Individual governments cannot by default be counted on as benign redistributors of income.

Recent trends in China, combined with the earlier experiences of other East Asian societies, indicate that an unfettered free market will not alone generate economic growth with equitable income distribution. Growth with equity does not just occur naturally in a political and social vacuum. The belief in the separation between the market and the society, and the corresponding belief that the market will generate growth and the society will equitably redistribute the benefits, is not supported. Governments have not adequately redistributed benefits to address income inequality.

To the contrary, economic growth with an equitable distribution of the fruits of that growth require forces far beyond those simply of the market or state redistribution. "Growth with equity" requires institutional redesigns and collective acknowledgment, determination, and efforts to achieve this goal. It requires national policies addressing the causes of rising inequality rather than those just attempting to

address the outcome. Such policies include labor-market regulations prohibiting discrimination by ethnicity, gender, and other social backgrounds. Policies are needed to address equitable educational opportunities and health care access that target the poor and the less privileged, which will empower and enable individuals and have demonstrated beneficial long-term effects.

Confronting rising inequality is now a major national agenda in almost every East Asian society. For the next half century, if not longer, growth with equity will continue to be a goal pursued within the region—however not one that will be easily achieved. As elsewhere in the world, as East Asian inequality has moved from simple labor-market earnings to accumulated wealth and corresponding life opportunities, the foundation for a durable inequality has already been laid.

Deepening economic inequality leads not only to a divided society, it threatens democratic institutions and suffocates economic growth. Large segments of the population are left lacking the human capital needed to become effective producers and, thus, also lacking the economic resources to become effective consumers. Growth with equity is not just something to which the population which produces the growth and creates the wealth is entitled, it is also a critical element in the long-term interests of the society. Significant income equality is needed for sustained economic growth and for social, as well as political, stability.

As East Asia has transformed itself into a leading global economic powerhouse, income inequality in the region has reached historic heights. These societies are now being challenged to understand the global, regional, and societal origins of rising inequality and to embark on society-wide reforms to counter rising income inequality. East Asia must now institutionalize economic models that are inclusive and provide patterns of growth benefiting the broadest segments of their societies. Once East Asia was the envy of the world by providing an example of growth with equity. It has the promise to again be that example.

***Significant income equality is needed for sustained economic growth and for social, as well as political, stability***

## Notes

<sup>1</sup> These and the following numbers on economic performance are calculated from Angus Maddison, *Historical Statistics of the World Economy, 1–2008 AD* (2009). Gross domestic product (GDP) and income are measured by purchasing power parity (PPP). Available online at [http://www.gdc.net/maddison/Historical\\_Statistics/horizontal-file\\_02-2010.xls](http://www.gdc.net/maddison/Historical_Statistics/horizontal-file_02-2010.xls) (accessed May 25, 2011).

<sup>2</sup> This terminology is addressed in John C. Fei, Gustav Ranis, and Shirley W. Y. Kuo, *Growth with Equity: The Taiwan Case* (New York: Oxford University Press, 1979). Also see Economic and Social Commission for Asia and Pacific, United Nations, *Growth with Equity: Policy Lessons from the Experiences of Selected Asian Countries* (New York: United Nations, 1999).

<sup>3</sup> Income inequality figures used here are based on Frederick Solt, “The Standardized World Income Inequality Database,” Version 3 (July 11, 2010), <http://hdl.handle.net/1902.1/11992>. A description of this data source is found in Frederick Solt, “Standardizing the World Income Inequality Database,” *Social Science Quarterly* 90, no. 2 (2009): 231–242.

<sup>4</sup> Such a belief is best known through the work of the Nobel Prize-winning economist Simon Kuznets who, in the mid-1950s, postulated the well-known inverted-U-shaped relationship between economic development and income inequality. Kuznets speculated that income inequality would first rise during the process of economic growth and would then level off.

<sup>5</sup> Charles Tilly, *Durable Inequality* (Berkeley and Los Angeles: University of California Press, 1998), 231.

<sup>6</sup> Cited in Giovanni Andrea Cornia, eds., *Inequality, Growth, and Poverty in an Era of Liberalization and Globalization* (Oxford: Oxford University Press, 2004).

<sup>7</sup> A popular slogan, originating from Deng Xiaoping.

<sup>8</sup> United Nations, *Growth with Equity*.

<sup>9</sup> See Karl Polany, *The Great Transformation: The Political and Economic Origin of Our Time*, 2nd ed. (Boston: Beacon Press, 2001).

<sup>10</sup> E.g., the income gap between urban and rural Chinese residents has been consistently greater than two-to-one. This gap has not been narrowed despite the drastic reduction in rural poverty in the last three decades. Between 1995, the year prior to the massive layoffs in state-owned enterprises, and 2009, the latest year with available official statistics, employees in state-owned work organizations in urban China enjoyed a six-fold increase in earnings. This may be contrasted with the five-fold and four-fold increases, respectively, in the categories of “collectively owned” and “other” (including private and foreign joint venture) organizations. Data calculated from National Bureau of Statistics of China, *China Statistical Yearbook 2010* (Beijing: China Statistics Press, 2010), Table 4–12.

<sup>11</sup> National Bureau of Statistics of China, *China Statistical Yearbook 2009* (Beijing: China Statistics Press, 2010).

<sup>12</sup> Qin Gao, “Redistributive Nature of the Chinese Social Benefits System: Progressive or Regressive,” *The China Quarterly* 201 (March 2010): 1–19.

<sup>13</sup> United Nations, *Growth with Equity*, 41.

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