INCOME INEQUALITY IN ASIA - MAJOR TRENDS AND CHALLENGES

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Abstract

Income inequality in Asia is high and it is growing in recent years. Economic research shows that ever since the beginning of the 1990s, developing Asia achieved significant economic growth. It has reduced poverty faster than any other region of the world, but for many countries this was also a period of experienced rising income inequality. The main drivers for the speedy economic growth of the region were foreign direct investments along with technological change, globalization, and market-oriented deregulation. Yet, they also contributed to income disparities, especially in terms of prioritising skilled over unskilled workers, owners of capital over labor, and coastal urban areas with industrial clusters when compared to rural and agrarian inland regions. Additionally, the process was aggravated by institutional weaknesses and the prevalence of extractive institutions, which were never reformed to provide for a just distribution of opportunities and create a favourable business environment. In this paper we discuss the source of inequalities in Asia, their key drivers as well as the approaches needed to be implemented and good examples when trying to deal with high inequality levels in Asia.

Key words: *Inequality, Gini coefficient, Asia*

1. INTRODUCTION

Since the beginning of the 1990s, developing Asia achieved significant economic growth. It has reduced poverty faster than any other region of the world, yet for many countries this was a period of experienced rising income inequality. The main drivers for the speedy economic growth of the region were foreign direct investments along with technological change, globalisation, and market-oriented deregulation. But they also contributed to income disparities, especially in terms of prioritising skilled over unskilled workers, owners of capital over labor, and coastal urban areas with industrial clusters over rural and agrarian regions. The process was additionally aggravated by institutional weaknesses and the prevalence of extractive institutions which were never reformed to provide for a just distribution of opportunities and create a favourable business environment. All of these factors have led to a falling share of labor income in total national income and rising income inequality.

This paper discusses the major trends of income inequality in Asia and how they can be resolved through rebuilding institutional models, which provide for better opportunities and equal income distribution. In Section 2 we make a thorough literature overview of the income inequality, tracing the developments since the 1990s. Section 3 is outlining the major factors, contributing to inequality in Asia, while Section 4 focuses on the perspectives for overcoming those inequalities. Section 5 summaries and concludes.

2. AN OVERVIEW OF INCOME INEQUALITY IN ASIA SINCE 1990

It has been estimated that for the last thirty years, from 1990 to 2017, the average annual growth rate of GDP for developing Asia reached 7.0% in 2011 purchasing power parity (PPP) terms. In comparison, this represents more than double the 2.8% for Latin America and the Caribbean (Figure 1). The data also reveals that much of the growth was driven by the People's Republic of China (PRC) and India, as they are the two most densely populated countries, with annual GDP growth for the period 1990-2017 reaching 9.7% and 6.7%, respectively. In addition, this rapid growth has dramatically improved living standards of Asian people and reduced extreme poverty in the region. During this almost thirty-year period, the region's average per capita GDP in 2011 PPP terms increased approximately 5 times from $2,423 to $10,725, which is in fact more that 300% increase. The proportion of the population living on or below the $1.9-a-day poverty line, as defined by the World Bank, fell from 53% in 1990 to nearly

9% in 2013, and more than 1 billion people were lifted out of poverty. In fact, it was determined that fifteen countries reduced poverty by more than 15% during that period. [1]

When comparing the data in Figure 1, it is evident that from all developing regions, Asia has been most successful both in generating growth and in reducing poverty for the period 1990-2017. It is followed by Sub-Saharan Africa and Latin America. Last in the ranking is the region of Middle East and North Africa, where growth of 3.8% is commensurate with poverty reduction of 3.9%. **Hence, it can be concluded that poverty reduction is greater in countries with extreme poverty and also that the positive tendencies in growth rates lead to reduction of poverty, whereas the opposite - weak changes in growth lead to insignificant decrease in poverty reduction. What about inequality? Does the same principle apply?**

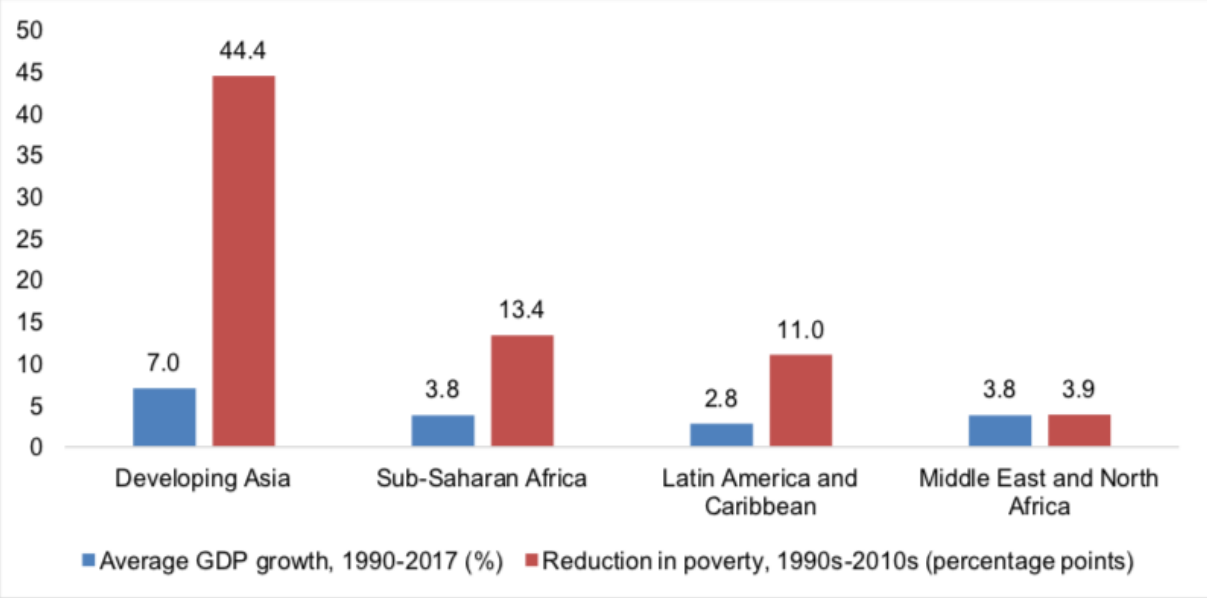

Fig. 1. Annual GDP growth and cumulative poverty reduction [1]

The statistical data [1] shows that this positive tendency in growth and poverty reduction has been accompanied by rising income inequality in many countries. Nine countries out of the 30 countries that have reported comparative data between the 1990s and early 2010s experienced rising inequality, and these account for more than 80% of developing Asia's population in 2016 as illustrated in Figure 2. The Gini coefficient of per capita expenditure worsened in those nine economies, including the three most populous countries, i.e. China, India, and Indonesia. It can be observed that from the early 1990s to 2013, the Gini increased from 32 to 40 in China, from 32 to 35 in India, and from 31 to 38 in Indonesia, and obviously the three countries went through almost similar processes of inequality increase. The Gini coefficient has declined slightly since 2008, but the level remains among the highest in Asia [2].

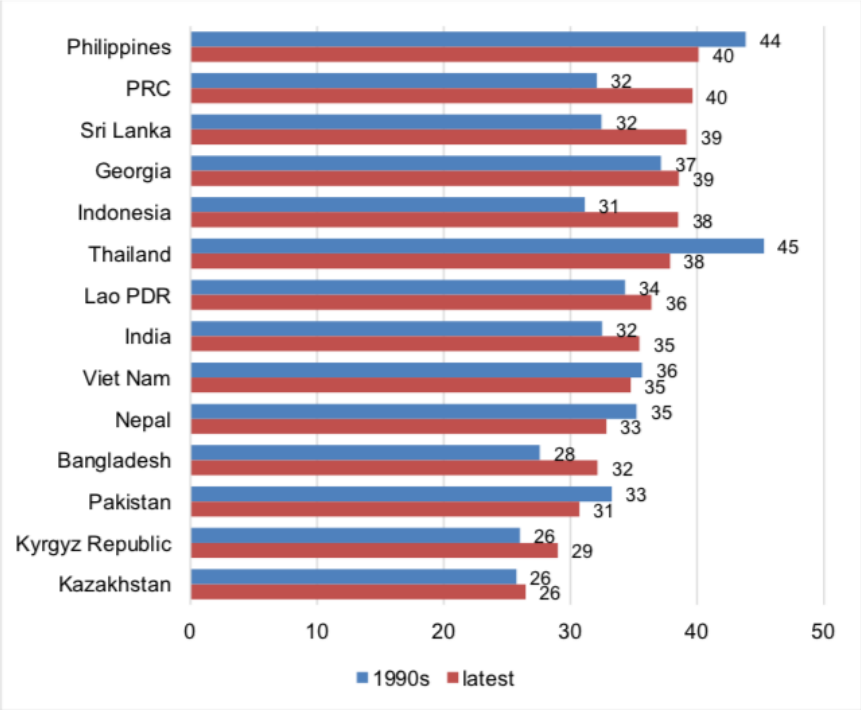

Fig. 2. Gini coefficient, selected Asian economies, 1990s and 2013 or latest [1]

Although Asia's inequality levels are generally below those in other developing regions, as seen in Fig. 1, inequality declined elsewhere, with the exception of OECD countries, which also experienced rising inequality in the last three decades. In Figure 2 the comparative data shows that inequality increased for the last 30 years in 9 Asian countries - China, Sri Lanka, Georgia, Indonesia, Lao, India, Bangladesh, Kyrgyz Republic, and Kazakhstan, while it decreased in 5, namely the Philippines, Thailand, Vietnam, Nepal, and Pakistan.

3. FACTORS CONTRIBUTING TO INEQUALITY IN ASIA

With the increase in inequality there is a growing disproportion in income and wealth, leaving more people at the bottom and less and less at the top, means a waning number, and gradual disappearance, of the middle class society, while economic growth driven by the middle class is more likely to be sustained.

One of the main factor contributing to increased income inequality is the inequality of opportunity, which is prevalent in developing Asia [3]. It is evident that disparities in the means to raise a person's living standards like capital and land, human capital (e.g., education and health), and market access (e.g., labor and finance) - are common. Inequality of opportunity is basically generated due to unequal access to public services, especially those of health and education. According to national household surveys, school-age children from the poorest households were three to five times as likely to be out of primary and secondary school as their peers in the richest group in some countries. In tertiary education poorer college-age individuals were 10–20 times more likely not to attend college than their richer peers. Also, in some countries infant mortality rates among the poorest households were two or three times higher than the rates among the richest households. The chance of a poor child dying at birth was more than 10 times higher than for a child born in a rich family.

There are many factors contributing to inequality, including the quality of institutions and institutional policies aimed at social welfare, land ownership rights, taxation methods, public spending, as well as differences in individual effort and entrepreneurship.

Yet, it should be also considered that greater inequality may lead to putting too much political pressure for governments to enact populist policy measures. As a result, the political process may introduce policies which would benefit the lower groups of the income distribution for the short term, but in the long run these could also decrease economic efficiency and growth. This is an institutional challenge, which is valid both for developing and developed countries alike when it comes to identifying effective measures for decreasing inequality. In case of crisis, or unforeseen events causing stress for the economies, such as the COVID-19 pandemic or growing inflation, it becomes even more complicated to identify the most appropriate social measures for the lower income groups and the role of fiscal institutions becomes even more important [4]. This also leads to changes in the fiscal policies [5], which however need to be implemented to solve the concrete social impact of the crisis, rather than provide a long term and sustainable solution, particularly for the lower income groups.

Also, education has a great impact on qualified labour and thus wage rates could increase faster for the better educated and skilled workers than for the less educated workers who are also lacking qualifications and skills [1]. It is also claimed that globalisation and technological progress have increased the demand for skilled workers relative to that for unskilled workers in many developing countries, leading to an increasing skill premium. For example, in China the market-oriented reforms introduced after 1979 replaced the fixed-wage system that existed under central planning with a new and more flexible system in which wages were more reflective of workers' skills and education.

In addition, the geographical distribution of investments has a great impact in the concentration of human capital. This is relevant for all Asian countries and as a result there are differences in the wage rates between richer coastal and urban areas and the poorer interior and rural areas, leading to increasing inequality. This is due to the fact that coastal regions are closer to trade routes and world markets than interior regions and also because urban areas have better infrastructure than rural ones, they are more likely to attract investment and new technologies, especially during the initial phase of economic growth. In China, for example, land and housing prices have increased much faster in coastal areas and urban cities than in inland provinces and rural areas in the last 30 years or so [1].

Figure 3 illustrates the urban-rural income gaps in selected Asian economies for the period 1990-2010. It is evident from that data that the gap is higher for China and the Philippines than for India and Indonesia. Also, this trend is increasing since the mod-2000s, highly influenced by the impact of technological innovations and the speedy and remarkable economic growth achieved in the region for that period.

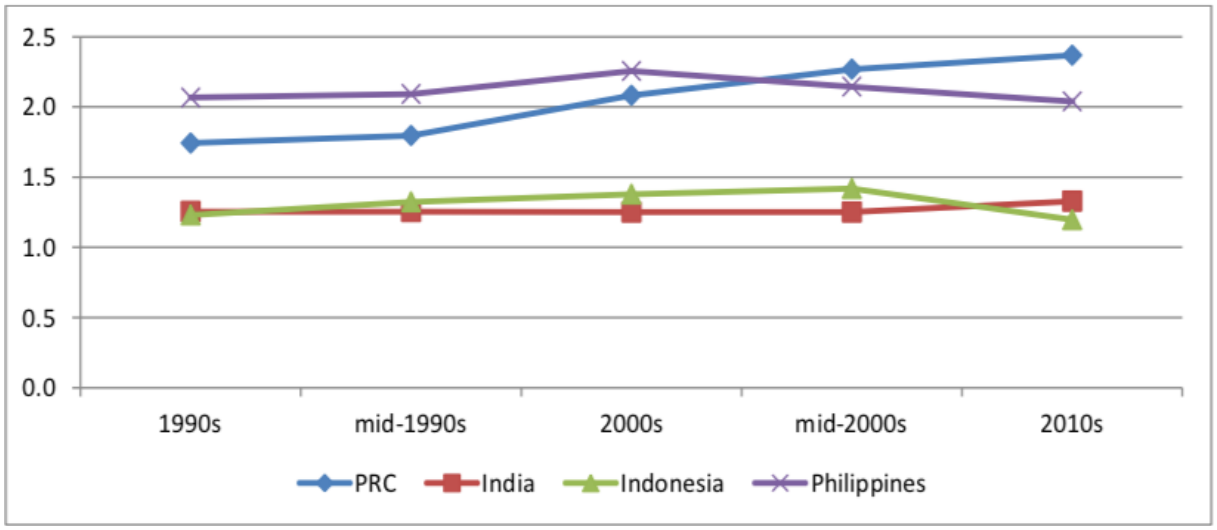

Fig. 3. Urban–rural income gaps in selected Asian economies, 1990s–2010s [1]

4. PERSPECTIVES FOR OVERCOMING INEQUALITY IN ASIA

Inclusive institutions contribute greatly to economic growth and eradication of inequality [7] and so does inclusive growth, which should have the following policy pillars [8]:

- **Sustaining robust economic growth.** A large percentage of people in Asia are employed in the informal sector, and tens of millions of workers are set to join the region's labor force each year in the coming decades. Robust economic growth is needed for job creation. But to be inclusive, growth must provide decent, productive jobs for a wide spectrum of the population and expand economic opportunity for all.
- **Promoting social inclusion.** Every person must have equal access to opportunity. In many Asian economies, large portions of populations cannot benefit from economic opportunity created by growth for reasons beyond their control. Ensuring equal access to opportunity requires, on the one hand, investing in education and health care, especially for the disadvantaged, to enhance human capacities; and on the other hand, correcting market and institutional failures and eliminating social exclusion to level the playing field.
- **Developing social safety nets.** Programs are needed to mitigate the risks and vulnerabilities associated with transitory shocks to livelihoods that often are caused by ill health, economic crises, industrial restructuring, or natural disaster. Programs that cater to the special needs of the disadvantaged and chronically poor also are needed to prevent poverty.
- **Mobilising more fiscal revenues.** Greater spending on education and health and social protection programs requires Asian governments to mobilise more fiscal revenues to ensure fiscal sustainability. In many Asian countries, there is large room for greater revenue mobilisation by improving tax administration and introducing taxes that are inherently progressive such as those on capital gains, properties, and inheritance—which also help to reduce wealth inequality.
- **Promoting good governance and sound institutions.** Each of the above pillars and their implementation must be supported by good governance and sound institutions.

It has been argued that over the past decades of globalisation, economies in Asia and the Pacific had grown rapidly up to the point when the global economic and financial crisis appeared in mid 2007. This acceleration of growth, in which international trade has played an important role, has assisted Asia-Pacific countries and as a result they have made impressive achievements in economic development. At the same time, empirical evidences suggest that in Asia and the Pacific, prosperity through trade has also been accompanied by rise in inequality within and across countries [9].

Fiscal policy can play an important role in lowering inequality. The good management of tax policies and the proper choice of taxation has a fundamental role in fighting inequality. It has been claimed that tax and expenditure policies need to be carefully designed to improve their distributional objectives [10]. Although taxes are primary aimed at collecting revenue to finance redistributive transfers, improving their progressive application and reducing exemptions and preferential rates would naturally contribute to improving their efficiency and increasing equity. Therefore, expanding and broadening the coverage of social spending is critical for more effective redistribution. This should also include improving low-income families' access to education, particularly higher education to provide for the creation of more skilled human capital, and adequate health services. Also, a better targeting of social benefits is needed, which can finance an expansion of their coverage.

As mentioned, broadening the tax base for income and consumption taxes while increasing their progressiveness is important. In addition, tax compliance needs to be improved to support effective collection. When discussing spending patterns, designing well-targeted transfer programs while avoiding costly universal price subsidy schemes is key. A good example is that when administrative capacity improves, conditional cash transfers could be introduced and increased gradually in many countries with high income inequality, e.g. Bangladesh, Cambodia, India, Indonesia, Nepal, and the Philippines. Also, public spending which is targeted at improving and broadening access to health services and higher education is important, particularly for improving earnings levels and reducing the increase in income gaps.

It needs to be highlighted that Asia has performed relatively well in boosting financial access among all segments of its population. In a number of Asian countries, government policies have been introduced with the intention to expand the coverage of financial services, providing low-income households and small and medium enterprises access to credit.

According to the IMF, more can be done to build on this success, as the access to financial services of the bottom 40 percent of the population remains limited. The IMF has found that certain financing approaches like enabling firms to access credit, financing a greater share of investment with bank credit, increasing the number of households with bank accounts, and using bank accounts to receive government transfers and wages are beneficial [11]. Yet, policies to foster financial inclusion have to be designed carefully, considering the implications for financial stability, and they should be accompanied by upgrades to bank supervision and regulation to protect stability.

Another approach, considered by the IMF [10], is the reduction of the labor market duality and informality. This should be done while putting in place well-designed labor market policies to boost job creation and consequently can reduce income inequality. It has been estimated that in high-income Asian countries efforts to reduce labor market duality should be accelerated, in particular addressing gaps in legal protection for regular and non-regular workers. Also, the encouragement of new hiring to take place under contracts that balance job security and flexibility, is important. It has been observed that in low- and middle-income economies, policies to reduce informality could lead to more inclusive growth and measures to improve the overall business environment, to simplify business registration and reduce red tape, as well as to provide incentives to facilitate registration and legal recognition, would greatly assist in reducing the incentives to remain in the informal sector.

These observations further touch upon the question as to what explains the declining rates of inequality in Malaysia, Philippines, and Thailand. There are several drivers of inequality, leading to long-term downward trend, which can be attributed to various policies [10]:

- ***Fiscal policy.*** The Philippines implemented a range of measures in the 2000s to alleviate poverty and inequality. It is observed that in 2002, the Kapit-bisig Laban sa Kahiparan (Comprehensive and Integrated Delivery of Social Services) program was implemented, providing resources to poor rural municipalities to invest in public goods. Also, after removing fuel subsidies in the 1990s a package of pro-poor spending programs was launched in mid-2008 to mitigate the effects of the food and fuel crisis. In addition, conditional cash transfers introduced in 2008 set health and education goals for participants, which aim at alleviating the persistent inequality in access to education. It covered 3.9 million households at the end of 2013, which is roughly 75 percent of all households identified as poor as per the national targeting scheme. Yet, the budget outlay stayed below 0.4 percent of GDP by 2013. After being introduced, the 2011–16 development plan has aimed to improve access to basic social services and build stronger safety nets.
- **In Thailand** there were also different initiatives during the same period. For example, the Universal Health Coverage Scheme, introduced in 2001, has been found to significantly reduce the share of the uninsured, benefiting the poor more than the rich citizens. It was also protecting the latter from becoming impoverished. In recent periods, energy subsidies have been reduced, but the vulnerable population stayed protected through means-tested procedures. In addition, the rice-pledging scheme was replaced by direct cash transfers to small-scale farmers only. The Eleventh National Economic and Social Development Plan, spanning 2012–16, aimed at improving access to social services and ensuring a fair distribution of development benefits. Also, this also aimed at covering the whole population under the national welfare system by 2016.
- **In Malaysia**, on the other hand, there is high level of infrastructure, which dates back to a package of reforms in the 1980s and 1990s. It is assumed, that this might have contributed to spread the gains from growth more evenly and also the Government Transformation Program was launched in 2009 to improve public service delivery. This resulted in new assistance reaching more than a quarter of the extreme poor. The Malaysian government also aimed in its development plan for 2011–15 at equitable opportunities for all and providing a social safety net for disadvantaged groups. As part of this policy, the government eliminated petroleum subsidies in 2013-2014, which was confirmed to have benefitted

the higher-income households relatively more than the lower income ones. Also, like in Thailand, improving the quality of education and expanding access to higher education have become a priority through the Education Blueprint 2013–2025 and a minimum wage was introduced in 2013.

- ***Financial Inclusion***. It is claimed that for the Philippines efforts to expand financial access are mainly driven by microfinance institutions. Microfinance loans have experienced constant rise over the period 2002– 13. Also, congress mandated that from 2008 to 2018 at least 8 percent of banks' loan portfolio should be allocated to micro and small enterprises and hence micro insurance has also been picking up over the last years. This has made the Philippines one of the top micro insurance markets in Asia.
- **Thailand** has been the most ambitious when considering financial inclusion policies. The government established village funds nationwide in 2001. It was designed to provide seed money of one million baht to each to encourage savings and provide credit. AS a result, this turned out to be one of the largest microfinance initiatives in the world. Risk mitigation was improved through extending risk coverage to the informal sector in 2011, along with the launch of an Agricultural Insurance scheme in the same year and the setting up of the National Catastrophe Insurance Fund in 2012. In effect, a bureau of Financial Inclusion Policy and Development was established and it is housed in the Ministry of Finance. In effect, as of 2011Thailand achieved the highest level of financial usage in South East Asia.
- **In Malaysia**, promotion of financial inclusion through development of microfinance, consumer education, and a protection framework has been a leading objective since 2009. Another aim of Malaysia's Financial Sector Blueprint 2011–20 has also been the enhancement of financial inclusion. The first results were observed as various inclusion parameter demonstrated a remarkable improvement between 2011 and 2014. This was evident in the share of individuals owning an account at a financial institution, which increased from 66.2 percent to 80.7 percent. Also, the share of the population borrowing from a financial institution grew from 11.2 percent to 19.5 percent.

5. CONCLUSION

In conclusion, this paper discussed that developing Asia has achieved significant economic growth since the end of the last century. As an emerging economy, it has reduced poverty faster than any other region globally. However, the data also shows that for many countries this was a period of experienced rising income inequality. The main drivers for the speedy economic growth of the region were foreign direct investments and technological change, globalisation, and market-oriented deregulation. However, they also contributed to income inequality, particularly in rural and agrarian regions. Inequality also increased due to institutional weaknesses and the prevalence of extractive institutions. They were never reformed to provide for a just distribution of opportunities and to create a favourable business environment. It has been argued that all of these factors have led to a falling share of labor income in total national income and rising income inequality.

This paper added to the discussion of the major trends of income inequality in Asia. It commented on how they can be resolved through rebuilding institutional models, which provide for better opportunities and equal income distribution. A thorough literature review was made of the income inequality, tracing the developments since the 1990s and also the paper outlined the major factors, contributing to inequality in Asia. Finally, the perspectives for overcoming those inequalities were commented.

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