



How Social Equality Influence Economic Growth: Lessons from East Asia and Latin America

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Abstract

This article compares the income distribution's equality in the economic growth of East Asia and Latin America, with the conclusion that the degree of social equality is not significant better in east Asia. And this article analyzes how the characteristics of social equality affects the economic development by the factors including industry policy, education, land reform, social security, urbanization etc.

Keywords: Social equality, Growth, Income distribution, East Asia, Latin America

1. A comparison to the income allocation's gap in East Asia and Latin America

1.1 *The income's distribution in East Asia*

The economy growth in East Asia has been maintained at a high speed since 1960s, while the newly industrialized economies' average growth rate per year was above 8 percent, and the Southeast Asian countries grew at 7 percent. As a result, the income level in these countries made a great leap also. In 1960, the NIEs' GNP per capita was only 16 percent of the US's but in 1995, it rose up to 77 percent. For Southeast Asian countries, the percentage changed from 4 percent to 10 percent. In such income improving process, the inequality of income distribution in these countries has not been worsen and not improved either. The Gini ratio' variation in the countries indicates the inequality of income distribution was much lower than Southeast Asian countries.

Table 1.1 shows, except China, the East Asia countries had a relatively low Gini ratio. Japan, Korea and Taiwan of China's Gini ratio was approaching to the average level of industrial countries. China's income gap rapidly enlarged since its reform and openness in 1978, and achieved the highest rank in East Asia. The degree of income inequality in Southeast Asian countries is much more significant than NIEs. Among these countries, except that Indonesia's average gini ratio was 0.33, Vietnam 0.35, Philippine, Thailand and Malaysia's gini ratio are all over 0.4, indicating a high degree of inequality. Philippines' GDP per capita improved less than 100 percent during the last 15 years in the 20th century, but its gini ratio improved 5 percent. Such dissimilarity from other countries revealed its slow economic growth coexisted with expanding income gap.

The wealth inequality reflects the situation of income disparity in another way. Japan's gini of property ownership is estimated at 0.60 in 1996, and gini of financial assets at 0.49 in 1995. Korea's gini of personal wealth is estimated at 0.58 by Korean Development Institute, and 0.60 for real assets and 0.77 for financial assets (Arsenio,2006). Compared to their relatively low gini ratio measured by income, both two countries showed a much higher degree of inequality in wealth distribution.

1.2 *The income's distribution in Latin American countries*

Latin American countries had the most unequal income distribution in the world for a long history. This inequality has become a main characteristic of social development since its modernization. During the 1950s and 1960s, the economy of Latin America has achieved rapid development by implementing the import substitution industrialization. But in the process of urbanization and economic growth, plenty of rural population flowed into the cities, and caused labor surplus. Therefore, about 30 percent of population were in the status of unemployment or worked in informal department. These fringe urban civilians and rural farmers made up of the main components of the poverty population in Latin America. After the debt crisis in 1982, many countries abandoned the inward development mode of import substitution, turned to outward development mode, and made obvious progress in stabilizing the economy. However, the income distribution was not improved along with economic recovery. The world average gini ratio was 0.4 in the 1990s, while except Jamaica, all Latin American countries is above world average level, and 11 countries had a gini ratio above 0.5. Most of Latin American countries' gini ratio didn't go down during the 1990s, with the exception that Columbia's gini slid down 0.01 slightly, which still indicates a severe unequal social allocation.

On the other side, the share of poverty population's income in the social total income kept decreasing. According to the official statistics, the 10 percent of high-income population occupied 39.6 percent of gross national income in 1960, up to 53.2 at the beginning of 1990s in Brazil. In Mexico, the top 20 percent of wealth families' income owned 49.5 percent of national income in 1984, up to 57.5 in 1994 (Yao,2005). In Argentina, the income gap between the richest class and poorest class was 6 times in the mid 1970s, rising to 20 times in 1980s, 29 times in 1999, 46 times in 2002 due to the economic crisis (Yuan et.al, 1999). As a whole, 40 percent of national income in Latin America was possessed by 10 percent of wealthy population, and bottom 30 percent of poor population only owned 7.5 percent of national income (Jiang, 2005). Compared with the rest of the world, such an unequal allocation status only appeared in few Africa countries whose income per capita only equals to half of Latin American countries.

1.3 An analysis of income's gap in East Asia and Latin America

As statistical data and institutional characteristic is regarded, we could conclude that the difference between Asian and Latin American countries in the degree of social equality is not as great as people usually imagined. Except that a few developed economies like Japan, Korea and Taiwan of China had relatively small gap in the income, many East Asian countries' allocation of income was far away from optimistic. For example, Malaysia, Thailand and Philippine's gini ratio are all beyond the international alert line 0.4, and HongKong, Singapore's gini ratio are over 0.4 too. China's gini ratio was transcending 0.4 during its regime reformation and economic growth. On the other hand, the share of the poor in the total population helps explanation. Except Brazil and Mexico, Latin American countries' poor population only accounts for less than 7 percent, while in East Asian countries, Philippine, Indonesia, Vietnam have 30, 18 and 19.5 percent of population in poverty respectively. The data tells that poverty is an urgent problem for Southeast Asian countries likewise.

However, the continuous growth of East Asian countries still distinguished itself from the sluggish economy of Latin American countries. The greatest difference between them lies in the dynamics, where the poverty in East Asia is descending lastingly, while in Latin America, it's not decreasing at all, even rising in some countries. Hence, it is worthwhile to ask behind this brief scenario, why the social inequality in East Asia, especially for the developing countries, have not impeded economic growth, and how the deteriorating equality of allocation in Latin America influenced and blocked the economy growth, and what kind of institutional and social characteristic we should concern.

2. The Equality in East Asia: Why It Drives Economic Growth

2.1 A balanced development between manufacture and agriculture

The proportion of public investment in the total investment in East Asia was higher than other middle-low income countries. Compared to other developing countries, Indonesia, Korea and Thailand allocated its public investment in sanitation and irrigation works between city and rural area more balancedly. Korea and Taiwan have realized the electrization in rural area since 1980s. In Malaysia and Thailand, the rural population who had access to electric power was near half of total population, while in same period, in Argentina, Bolivia and Brazil, this proportion was lower than 20 percent(World Bank, 1995). The fundamentals in rural area were improved step by step and rural labors were utilized in full capacity, which allowed the economic development further.

The main characteristic of East Asia's economic development is its dependency on the external market, i.e. importing intermediate and capital goods and exporting them after process by local labors. Because most of processing industries were labor intensive, they absorbed plenty of non-skilled labors in the population and the opportunities in the cities allowed the low income and poor people went out of poverty. For example, in Korea, the ratio of urban and rural population was 43.3 against 56.7 in 1970, turning to 57.3 against 42.7 in 1980. In Taiwan, the absolute number of rural labors reduced 350 thousand during 1953 and 1985, while the number in industry increased to 3080 thousand from 520 thousand. The labor in service department increased to 3050 thousand from 790 thousand(Hu,2004).

2.2 Successful land reform

Compared to Latin American countries, East Asian countries carried on a more thorough land reform. Korea and Taiwan both issued the law of land reform in postwar period, readjusted the land ownership to make land allocated to farmers more equably. The amount of cottiers and semi-cottiers in Korea was 84 percent of the whole farmers before land reform, and it fell down to 7 percent in 1970. The yaomen' proportion rose to 69 percent. Taiwan's land reform also took obvious effects. The proportion of big farmer, who had 3 units of land and above, dropped from 11 percent before land reform to 3 percent. The proportion of those who owned less than one half unit of land fell to 21 percent from 43 percent, indicating a more equable trend in land allocation(Jiang,2001).

Malaysia, Thailand, Philippine and Indonesia also reformed their land system one after another to different degrees, although less thorough than Korea and Taiwan. The success in land reform provided a solid basis for East Asia's rural sector. With the fair allocation of land ownership, the production efficiency was improved and the income distribution in rural area was evidently going better. The surplus labor force became the growth source of labor-intensive industrial sectors, satisfied the great demands for non-technical workers in manufacture, construction, trade and service sector.

2.3 The rational allocation of education resources

Education was the field where social equality was realized most successfully in East Asia. Due to the fair and broad application of educational resources, the quality of education in East Asia was higher than other developing countries and improved the human capital and economic efficiency. According to the research of World Bank, except for Thailand, the children who were in the school age accepted a higher quality of education than children in other countries in same income level. After HPAEs (High Performing Asian Economies) popularized its secondary education in the whole nation, they shrank the gap of education between boys and girls ten and several years earlier than other countries in same income level.

But corresponding to the success, the spending on education in East Asia was average among developing countries. For example, the public spending on education accounts for 2.5 percent of GDP in 1960, while 2.2 percent among developing countries. In 1989, this proportion was 3.7 percent in East Asia, and 3.6 percent for all developing countries. The factors that determined the success more lay in the ways how East Asian governments allocate the spending between fundamental education and advanced education. The proportion of expenditures in secondary education was highest, while it was low in advanced education. Such a policy aimed to develop the basis of education pyramid in priority. When secondary education was populated, the demand for higher education would increase gradually. On the other hand, the subsidy to secondary education could guarantee the opportunities that children in low income family could receive education.

2.4 The weak social security offset by family security

In regards of its high-speed growth, the social security system in East Asia was not sound. Unlike that Japan has already made out the development strategy which gave same concern on growth and allocation, and realized a balanced development, built a universal social security, the Central Provident Fund in Singapore and Korea's social insurance plan are both old age allowances. The portion of spending on social security in the fiscal budget was quite small. Some countries even put limits on transferable payment turning to social welfare. However, different from Latin American countries, the families in East Asia had high saving rate which meant people could secure themselves through saving. Because the family was the core social unit which took more responsibilities in social security, the defects of an unsound social security system was partly offset. Moreover, though the governments of Singapore and HongKong held the liberalism idea, such as Small Society with Great Government, only provide a security to poor people to satisfy basic human demands, they set up a relatively sound housing and medical care system, which lessened the social conflicts brought by social allocation gap.

3. Why the social equality in Latin America impeded the economic growth

3.1 The ideology and economic policy which despised the fair allocation

Latin America was a conservative continent where the conservatism idea was in the leading position during its modernization process. Such an ideology believed the economic growth must be promoted without great changes in the social structure, notion of value and power's allocation. Directed by this direction, the social wealth more and more concentrated in the rich classes. Taking the development theory proposed by Latin America Economic Committee in the 1950s as example, this theory held that economic would improve people' life and eliminate social inequality gradually following the development of economy. And it paid little attention to the reallocation of income while took industrialization as a main tool to make people' life better. Due to the social policy led by such ideology, many social problems arose or got severer like unemployment, lagged rural area, imbalanced regional development, increasing poor population etc. Between late 1980s and early 1990s, Latin American countries implemented the macro economic adjustment plan and new liberalistic policy, but none of them involved social development, only listed the plans and measures to supplement or lessen the negative effects what economic policy and reform brought. These measures had no significant effects on social equality.

3.2 Excess urbanization

The level of urbanization in Latin America was much higher than East Asia. It took Europe 50 years to improve its share of city residents in total population to 60 percent from 40 percent, while in Latin America the process was completed in 25 years. The number of great cities whose population was over 1 million increased to 48 in 1980 from 7 in 1950(Su, 2006). The urbanization was too fast to suit the economic development, during which plenty of rural labors flew into cities but only could made lives in unofficial sectors or kept unemployed, and this made social problem more acute. Many big cities were surrounded by slums, where there were no roads, orderly supply of water and electricity, and public sanitation system. Because these regions were at the same time grey belts that the law order couldn't reach out, the crime and gangsterdom was everywhere within them. The crime problem not only affected the social stability, but also the normal economic development.

Though the governments have taken macro administrative measures to prevent city from expanding too fast, only the problem of urbanization around the biggest city was alleviated. The mode of urbanization appeared in the social

development has not been solved. Because of the increasing development gaps between different areas, the population and capitals kept moving to developed area from poor area. The governments had to increase investment in central cities to cope with the expansion of city size, leading to a reduction in investments in lagged area. The potential of lagged area's economic development was further weakened.

3.3 Limited domestic demand and insufficient capital accumulation

The people with middle and low income in Latin America were not able to share the benefit of economic development, which prevented the expansion of public and individual consumption. The domestic demand to goods was limited and trapped into the vicious circle of slow growth and insufficient demands. The governments of Latin American countries has adopted a series of policies like expanding employment, raising wage and controlling price to stimulate the increase of demands, but couldn't eradicate the basic contradiction. Because the social wealth was concentrated in the rich estate, who had greater demand to handwork goods and luxuries, the market of fundamental demands were atrophic. The structure of imports also showed a bigger weight of slap-up goods with faster growth. Therefore, though the rich class held most of wealth, the saving propensity was not high in Latin America. The neo-classicalism's hypothesis that unequal allocation could lead to higher saving rate didn't stand in Latin America. The data showed the individual saving rate in East Asia had been rising since 1970s, from 0.15 in late 1970s to 0.25 in 1995, while such indicator of Latin America was going down after mid 1970s, to 0.14 in 1994(Huang,1999).

On the other hand, most of Latin American economies were of small size and easily impacted by capital flows or the decay of world economy. When external impacts came, the poor class who had limited real assets and financial assets were affected most. Because the poor was the greatest part in population, the gross demand would descend obviously. Gottschark(2003) held that the more unequal of income and asset's distribution, the higher volatility the economy had(Patrica,2003). This volatility could do inestimable harms to the economic growth. In 1990s, Mexico, Brazil and Argentina have broken out three crises one and another, and every crisis was spread to other countries. It took 55.1 billion dollars, 14.4 percent of its GDP, just to save the bank system during the Mexico crisis in 1994(Su, 2003).

3.4 The inefficient utilization of human capital

The import-substitute industries in Latin America were mainly capital intensive. During 1960 and 1966, the ratio of capital to output was 4:1. Because capital intensive industry could only absorb technical and semi-technical labors with male majority, the unemployment rate in Latin America kept high. The economic reform since 1994 have tried to shift its economy from inward structure to outward structure, with the measures including developing export oriented industries and reforming the labor market. But these measures couldn't lower the unemployment rate mainly because the open-up of domestic markets was too fast. The middle and small firms were not of competence facing the external challenges, could not create opportunities of employment. On the other hand, the export-oriented mode made the resource processing industry become a pillar industry, but the firms pervasively improved their competition capability by introducing the new technology, updating equipment, meliorating the management, which increased the demand for labors with more specialized skill and reduced the demand for labors with less skill. The high unemployment rate compelled the government to increase its social expenditure, hence weakening its capability in construction investment. In fact, just for much of social expenditure was used for social security in Latin America, the investments in fundamental facilities were compressed to reduce the debt in public sectors.

4. What could be learned from East Asia and Latin America's experiences?

At first, the policy makers shouldn't only pay attention to the growth without concerning equality. From the development experiences of East Asia and Latin America, we could find out that although the degree of social inequality was high in East Asia, especially in some Southeast Asian countries, the inequality was still in the bound which the social development and economic growth could maintain. The problems like immaturity of social protection, insufficient public spending were alleviated by a relatively fair income allocation, hence the running of society didn't influence the growth of economy. For Latin American countries, the social inequality produced serious problems like unemployment, crimes, corruption and poverty. And the fact that economic reformation aimed to promote growth had little effect and couldn't solve its social problem could tell us, when the social inequity is deteriorating to certain extent, it will obstruct the growth of economy, and the social cost to correct the aftermath of social inequality would be much higher than preventing the social equality from deteriorating further in advance.

Secondly, improving the educational equality would increase the whole national stock of human capital and advance the growth. Education is the only way to improve the human capital and the main field where public policy could effectively work to reduce inequality. The experience of Latin America tells us, though there were plenty of labors who have received advanced education, they mainly distributed in the government departments or some certain lines. The ordinary labors who engaged in production had rather education demands, but couldn't receive enough education to improve their skills. Thus the accumulation of human capital can't be finished. The experience of East Asia, however, shows the success of human capital policy by developing fundamental and secondary education with emphasis. The

proportion of spending on advanced education in the public spending in East Asia was quite limited, making it a rather different characteristic from other middle and low income countries who subsidized the advanced education.

Thirdly, expanding the coverage of social security and increasing the resources of social security would help realize the social equality. A consummate social security system could provide reliable safety net to society members and help to realize the optimal allocation. It also helps to facilitate the flow of labors and stabilize the social surroundings. The protection function of social security in East Asia is not strong, and Latin America countries have relatively integral social security system. However, in Latin America countries, it was the labors in formal sector and employees of government who took the protection from the security system much more than those employees in informal sectors and jobless people due to the limited budgets on social security. Thus, the security system was out of function and strengthened the inequality instead. An unsound social security system should not only be punctuated from the angle of morality and fairness. The economic growth at the cost of a fragile security system can't find a basis for persistent and long-term performance. Once it is impacted from outside, the damage to stability and growth would be hard to remedy.

Finally, the excess urbanization should be prevented in the development of economy. The urbanization is a necessary phenomenon when a country's economy evolves to a certain stage, characterized by the rural population transforming to non-rural population and farmers turning to citizens. With the quick pace of economic system's reform in China, the separation situation between cities and countries that formed in the history is vanishing, and the trend that rural population flowing into cities becomes irreversible. Hence, the negative influence what urbanization brings should be noticed. There are two lessons from Latin America' urbanization. One is the overestimation to the capability of formal sectors in creating jobs, and another is the neglect of employment in non-formal sectors. Above two factors caused the formal sectors in the cities couldn't provide enough opportunities for employment and plenty of jobless people stagnated in the cities which influenced the social stability. In China's urbanization, the process of agriculture land turning into industry land would produce plenty of farmers losing their land. How to secure the benefit of these farmers and make sure they could share the advantage of economic growth should become one important aspect in China's public policy.

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Table 1. Economic growth and gini ratio variation in East Asia countries

	Gini Ratio			GDP per capita (dollars)		
China	0.32(1981)	0.346(1990)	0.447(2001)	483	1332	4059
Korea,South	0.353(1970)	0.386(1980)	0.320(1995)	1032	2573	11676
Taiwan(China)	0.29(1970)	0.28(1980)	0.31(1993)	2797	5839	n.a.
Japan	0.355(1970)	0.350(1990)	n.a.	4256	19194	n.a.
Philippines	0.41(1985)	0.438(1991)	0.461(2000)	2373	3167	3897
Indonesia	0.307(1970)	0.356(1980)	0.31(1999)	400	836	2736
Malaysia	0.513(1970)	0.491(1980)	0.443(2000)	1371	2318	8884
Thailand	0.429(1975)	0.473(1981)	0.432(2000)	776	1572	6777
Vietnam	0.357(1993)	0.361(1998)	0.364(2002)	893	1744	2240
Singapore ^a	0.41(1972)	0.41(1980)	0.38(1993)	6218 ^b	11516	n.a.

Source: Garbis Iradian (2005). a) from Quibria(2002),b)GDP per capita in 1970. Other data corresponds to the data of same year in left column.

Table 2. The changes of gini ratio of Latin American countries

Year	GINI ratio						
	1970	1990	2000	Year	1970	1990	2000
Argentina	0.44	0.48	0.49	Honduras	0.63	0.57	0.58
Brazil	0.66	0.57	0.58	Mexico	0.59	0.53	0.54
Columbia	0.61	0.57	0.56	Panama	0.57	0.56	0.56
Costa Rica	0.49	0.46	0.46	Peru	0.60	0.46	0.49
Chile	0.48	0.55	0.56	Venezuela	0.50	0.44	0.47

Source: Cesar P.Bouillon et.al (2003)