CHAPTER 11

POVERTY REDUCTION AND INCOME DISTRIBUTION

11.1 Introduction

The past half century has seen a dramatic reduction in extreme poverty across developing Asia. This has not only improved people's welfare, but also helped create a stable environment for economic growth and development.

From 1981 to 2015, the proportion of developing Asia's population living below the $1.90 per day international poverty line (in 2011 purchasing power parity [PPP] terms) declined from 68% (1.6 billion out of 2.4 billion) to 7% (264 million out of 3.8 billion). The region contributed most to global poverty reduction. According to Asian Development Bank (ADB) projections, developing Asia could eradicate extreme poverty by 2025 if its recent growth trajectory continues.[1] At $3.20 per day, typical of national poverty lines used in lower-middle-income countries, the region's poverty rate will fall from 29% to 13% during 2015–2025.

Rapid economic growth has been the key driver of poverty reduction in Asia by generating better-quality jobs for the poor. At the same time, policies such as land reform; use of Green

[1] According to ADB projections, developing Asia's extreme poverty at $1.90 per day will fall to 3% by 2020 and 1% by 2025.

Revolution technologies; open trade and investment; education and health programs; and measures that broaden access to finance, infrastructure, and markets have helped raise the income-earning capacity of the population, including poor and low-income households.

However, developing Asia's progress in improving income distribution has been uneven. During the 1960s–1980s, most developing Asian economies managed to keep income inequality stable, regardless of its initial level, despite large differences in the pace of economic growth. Many economies in East Asia and Southeast Asia grew rapidly, while income inequality remained stable or even declined somewhat—a pattern referred to as "growth with equity," due to the expansion of labor-intensive manufacturing exports and inclusive policies. During the same period, South Asia saw generally stable inequality levels with slow growth.

Since the 1990s, rapid growth and poverty reduction have been accompanied by rising income inequality in many Asian countries. Technological progress and globalization have led to rising wage differentials between skilled and less-skilled workers—although they have increased incomes for both. They also increased capital earnings more than labor income. Further, technological progress and globalization have created opportunities for entrepreneurs to gain from the "first mover effect," and for large landowners in newly favored locations to benefit from appreciation of land values. Widening urban–rural income gaps, increasing regional disparity, and unequal access to opportunity have also contributed to rising income inequality. In response, developing Asia has launched major policies in recent years to make the benefits of growth more widely shared.

This chapter looks at developing Asia's experiences in reducing poverty and its changing income distribution over the past half century. Section 11.2 discusses Asia's approach to tackling poverty and inequality. Section 11.3 reviews Asia's success in poverty reduction. Section 11.4 describes the experience of stable inequality in the 1960s–1980s. Section 11.5 examines why income inequality has widened in many countries since the 1990s. Section 11.6 looks at what policy actions can address poverty and income inequality in the future.

11.2 Asia's approach to poverty and inequality

Why poverty and inequality matter

Economic growth, poverty reduction, and income distribution are among the most important dimensions of development, as they determine people's well-being and a country's prosperity. Eliminating poverty and making income distribution equitable have both intrinsic and instrumental values. The intrinsic value is based on justice, fairness, and human rights as desirable goals a human society pursues. People also prefer to live in societies with less deprivation, poverty, and inequality. This idea of altruism features prominently in many cultures and religions. The instrumental value is related to the importance of poverty reduction and equitable income distribution to sustaining growth. Growth may not be sustained if its benefits are not widely shared.

More specifically, persistently high poverty and inequality can undermine growth through several channels. One is to constrain an economy from achieving its full potential, as poor and low-income households—with fewer resources and opportunities—are less able to invest in human and productive capital. Another is to constrain the growth of a middle class, a key source of domestic consumption. A further channel is to create social tension and conflict, which are detrimental to sustained growth. Finally, high poverty and inequality can undermine the quality of institutions, for instance, by leading to "elite capture" (for example, regulations and public services biased to those in power), or by pressing politicians to enact populist policies that often distort resource allocation and hamper macroeconomic stability.

Poverty is often measured by the number of people or proportion of the population belonging to households with per capita income or consumption expenditure below a threshold, or poverty line. This chapter uses two types of poverty lines. One is international poverty lines. These are useful for comparing poverty across countries. A prominent example is the $1.90 per day per person threshold (in 2011 PPP) used by the international community to measure the level of extreme poverty. This poverty line reflects the expenditures required to meet a person's minimum food and nonfood needs. The other type is national poverty lines set by individual countries. National poverty lines typically represent different levels of consumption and/or income and are often used for country-specific poverty analyses. A key advantage of poverty estimates based on national poverty lines is that they are more often available over long periods of time.

Income inequality, on the other hand, refers to how income is distributed across individuals or households. A commonly used measure of income inequality is the Gini coefficient, which is 0 when everyone receives the same level of income in a society, meaning perfect equality, and 100 when all incomes go to one person, meaning perfect inequality. Other widely used measures are income (or wealth) shares of the richest 1%, 5%, 10%, or 20% of the population; those of the poorest 1%, 5%, 10%, or 20%; or the ratio of the two. Income inequality can be measured either on a pre-tax and pre-transfer basis, which captures inequality in market income, or on a post-tax and post-transfer basis, which incorporates income redistribution by government.

While data on the distribution of individual or household incomes within a country are a natural source for estimating income inequality, in many developing countries they are unavailable, and hence, data on household consumption expenditures are often used. There is also an argument in favor of measuring consumption expenditure inequality because consumption is more closely related to human well-being. Further, in aging societies, a consumption-based inequality measure may better capture true inequality as incomes of individuals and households will fall when they grow old even if they consume more based on their wealth.

Although poverty and inequality are distinct concepts, they are related to one another as well as with the pattern of economic growth. While inequality concerns the distribution of incomes of the entire population, poverty focuses on the lower end of that distribution—specifically on those who fall below the poverty line. For example, when growth creates more jobs for the poor, both poverty and income inequality will fall. In contrast, when growth is driven by skill- and capital-intensive production, the incomes of people who have skills and own capital are likely to rise more, leading to increased income inequality. In these situations, poverty may still decline as the benefits of growth trickle down. As will be shown, Asia has witnessed both patterns over time.

It is often suggested that a country's income inequality is related to its stage of development. According to the so-called

Kuznets hypothesis,[2] a country's income inequality is likely to rise in the initial stage of development, stabilize when its income reaches a certain level, and fall when the country becomes more developed (the "inverted U-curve").

There can be several reasons for this inverted U-curve. Kuznets noted that urbanization could raise a country's inequality initially when workers begin to move to higher-income urban industrial and services sectors—away from the traditional, lower-income and more equal rural agriculture sector. This is especially the case when there is abundant surplus labor in rural areas (Chapter 3). Others noted that economic takeoff often starts with a small number of entrepreneurs investing in new technologies and productive assets and accumulating capital before generating higher incomes for the wider population. Some argued that this process of capital accumulation in the early stage and its usage for further investment in productive assets contributed to industrialization.

As more people move from lower-income rural farming to higher-earning urban industries, surplus labor in rural areas becomes exhausted, leading to even higher wages in industries. Farmers' income also increases because of improved productivity associated with the availability of more land per capita. This urbanization process and ensuing decline in the urban–rural income gap can lead to a decline in overall income inequality. Moreover, as countries become rich, inequality can decline due to political pressures for greater income redistribution through taxes and transfers, often associated with an expanding middle class and more egalitarian ideas. But this process is not automatic, necessitating appropriate government actions.

The Kuznets hypothesis was based on empirical data largely observed in Germany, the United Kingdom, and the United States in selected years between 1875 and 1950. However, it has been noted that the decline in inequality in the United States in the early 20th century (from 1915 to 1945) was mostly due to the adverse effects of World War I, the Great Depression, and World War II on capital incomes, instead of following the process in the hypothesis.[3]

[2] Kuznets, S. 1955. Economic Growth and Income Inequality. *American Economic Review*. 45 (March). pp. 1–28.

[3] Piketty, T. 2006. The Kuznets Curve: Yesterday and Tomorrow. In Banerjee, A. V., R. Bénabou, and D. Mookherjee, eds. *Understanding Poverty*. New York: Oxford University Press. pp. 63–72.

Evolution of thinking on poverty, inequality, and growth

In the 1950s and 1960s, throughout developing Asia, countries placed improving standards of living for all and eradicating poverty at the core of nation-building strategies and development. Poverty reduction would come through rapid industrialization and accelerated economic growth. That approach was necessary with widespread poverty and 80%–90% of the population living in rural areas relying on subsistence agriculture. In the People's Republic of China (PRC), for example, Premier Zhou Enlai stated in his government report at the first National People's Congress in 1954 that the PRC "would not be able to escape from backwardness and poverty without modernizing its industry, agriculture, and transport and communications." In India, under Prime Minister Jawaharlal Nehru, the First Five-Year Plan for 1951–1956 noted widespread poverty and inequalities in income, wealth, and opportunity afflicting the country and called for a simultaneous advance in raising production, eliminating poverty, and removing inequality.

While most countries stressed industrialization and accelerated economic growth to eradicate poverty, the path to achieve these goals differed significantly across countries. One group of countries, including Mongolia, the PRC, Viet Nam (the northern part before 1975), and all Central Asian countries (former Soviet republics), adopted a socialist centrally planned model with public ownership of land, factories, and natural resources. The model held until the 1980s or 1990s when market-oriented reforms began (Chapter 2).

Most other developing countries, on the other hand, adopted a mixed-economy model that relied on both market forces and state intervention in resource allocation. But within this group, there were also large variations, especially in the early stage of development. Economies in South Asia (Bangladesh, India, Pakistan, and Sri Lanka) leaned more toward socialist policy with greater reliance on state-owned enterprises (SOEs), state control over industries, and an inward orientation that restricted trade and foreign investment. On the other hand, many economies in East Asia and Southeast Asia leaned more toward market-friendly policies, greater reliance on the private sector, and an outward orientation that promoted trade and attracted foreign investment.

In economies adopting the mixed-economy model, efforts to reduce poverty through accelerated growth were often supplemented by various programs to broaden access to land, education, health, and infrastructure for the general population. In East Asia, for example, land reform programs were implemented in the Republic of Korea (ROK) and Taipei,China in the late 1940s and early 1950s to redistribute land from richer landowners to poor landless peasants. India and the Philippines also undertook land reform, although implementation was more limited (Chapter 4). Many countries also worked hard to improve rural infrastructure such as roads, irrigation, and electrification.

In the 1960s and 1970s, there was wide acceptance across developing Asia of the need for the public sector to expand access to health care, nutrition, and education (Chapter 6)—factors that create greater equality of opportunity. In the newly industrialized economies, for example, pro-market and pro-business policies led to the rapid growth of labor-intensive manufacturing in the 1960s and 1970s, and the expansion of basic education equipped the labor force with the ability to learn skills needed by manufacturing firms, significantly contributing to poverty reduction.

By the 1980s, a consensus emerged in global development thinking that growth would be better promoted by a market-oriented approach (Chapter 2). This would imply more focus on using available labor resources and less on promoting capital-intensive industries. Thinking on poverty reduction began to emphasize two equally important elements. One was to promote market-based growth drawing on the productive use of labor.

The other element, in line with the idea of "basic human needs" popular at the time, was to provide essential public services to the poor, including basic education and primary health care. This was also influenced by the "capability approach" developed by Nobel laureate Amartya Sen.[4] This approach argued for going beyond gross domestic product (GDP) to measure economic welfare. It emphasized the importance of "empowering people" to choose a life that they themselves value. Critically, human beings need access to good health care, education, markets, and finance.

The capability approach also inspired the development of the United Nations Human Development Index in 1990. It led to a broadening of the scope of poverty to include non-income dimensions. The Millennium Development Goals adopted in 2000 included health, education, water and sanitation, and gender equality as targets

4 Sen, A. 1985. *Commodities and Capabilities.* Amsterdam: North-Holland.

for poverty reduction on top of eradicating income poverty. The subsequent Sustainable Development Goals adopted in 2015 further expanded the development agenda by adding targets on climate action, clean water, life on land, sustainable cities, and "decent" work. The Global Multidimensional Poverty Index, developed in 2010 by the Oxford Poverty and Human Development Initiative and the United Nations Development Programme, also aims to measure non-income poverty.

A market-oriented approach to development meant that growth was the priority, especially if rapid growth would lead to rapid poverty reduction—as many believed. Thus, in 1978, the PRC started to shift to the model that allowed markets to determine prices, encourage private sector development, and promote trade and foreign investment. According to the PRC leader Deng Xiaoping, by "allowing some people to get rich first," this policy shift can bring prosperity for all. After 1986, Viet Nam followed. India launched major liberalization reforms beginning in 1991 on trade and investment. Market-oriented reforms were implemented in many other countries in South Asia, Southeast Asia, Central Asia (after the collapse of the Soviet Union), and the Pacific (Chapter 2).

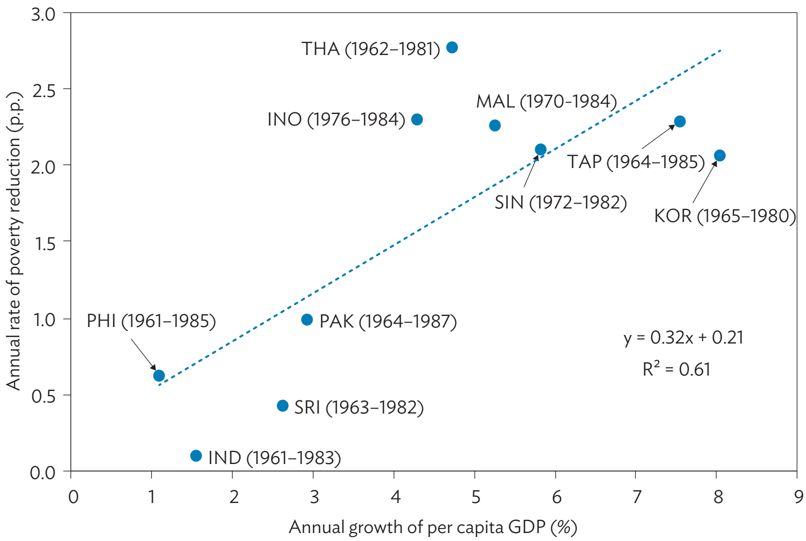
These market-oriented reforms unleashed powerful incentives for private firms and entrepreneurs to expand trade and investment. They allowed many Asian countries to benefit from technological progress (for example, information and communication technology, and automation), globalization (in trade, investment, and finance), and increased exchange of knowledge and ideas across countries. But growth and poverty reduction since the 1990s have been accompanied by rapidly rising income inequality in many countries. As a result, addressing income inequality has become a key policy focus across developing Asia.

11.3 Asia's success in reducing poverty

The broad trend in poverty reduction

There were two waves of dramatic poverty reduction in Asia during the past half century. The first was in the 1960s, 1970s, and 1980s (especially the early 1980s), coinciding with rapid economic growth in the newly industrialized economies and several Southeast Asian economies (Figure 11.1). Faster-growing economies had larger reductions in poverty.

Figure 11.1: Economic Growth and Poverty Reduction, 1960s–1980s



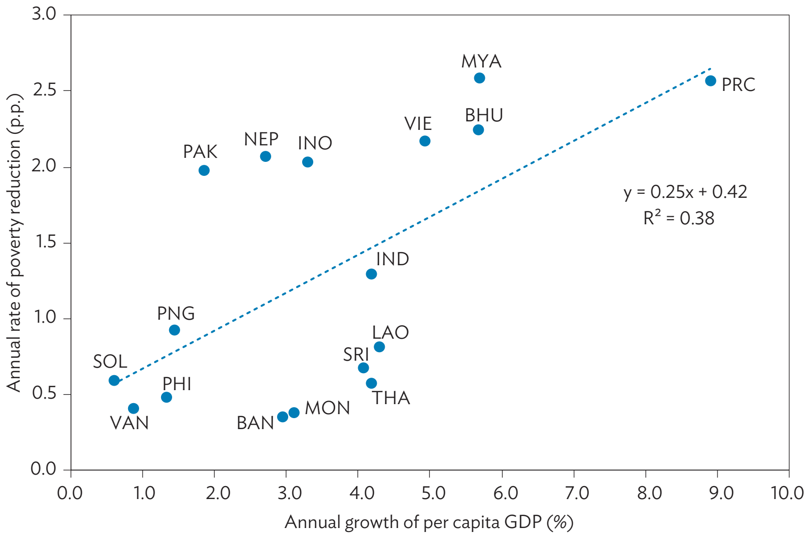
GDP = gross domestic product; p.p. = percentage point; IND = India; INO = Indonesia; KOR = Republic of Korea; MAL = Malaysia; PAK = Pakistan; PHI = Philippines; SIN = Singapore; SRI = Sri Lanka; TAP = Taipei,China; THA = Thailand.

Note: Poverty rates are measured using national poverty lines.

Sources: For India: Datt, G. 1998. Poverty in India and Indian States: An Update. *The Indian Journal of Labour Economics*. 41 (2). pp. 191–211; for Indonesia: Tjiptoherijanto, P., and S. Remi. 2001. *Poverty and Inequality in Indonesia: Trends and Programs*. Paper presented at the International Conference on the Chinese Economy "Achieving Growth with Equity." Beijing. 4–6 July; for Malaysia: Abhayaratne, A. 2004. *Poverty Reduction Strategies in Malaysia, 1970–2000: Some Lessons*; for Pakistan: Kemal, A. R. Undated. *State of Poverty in Pakistan: Overview and Trends*. http://siteresources.worldbank.org/PAKISTANEXTN/Resources/pdf-Files -in-Events /Briefing-on-PRSP/OverviewAndTrends.pdf; for the Philippines: World Bank. 1995. *Philippines: A Strategy to Fight Poverty.* http://documents.worldbank.org/curated/en/340011468758997924/ pdf/multiopage.pdf; for the Republic of Korea: Kwon, H. J., and I. Yi. 2009. Economic Development and Poverty Reduction in Korea: Governing Multifunctional Institutions. *Development and Change*. 40. pp. 769–792; for Singapore and Sri Lanka: World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press; for Taipei,China: Warr, P. 2000. *Poverty Reduction and Economic Growth: The Asian Experience*. Manila: Asian Development Bank; and for Thailand: Warr, P. 2004. Globalization, Growth, and Poverty Reduction in Thailand. *ASEAN Economic Bulletin*. 21 (1). 1–18.

The second wave occurred from the 1980s and continues today. This wave includes India, the PRC, and many other countries, broadly coinciding with economic reforms and acceleration in economic growth (Figure 11.2). As a result, there has been a dramatic decline in both the number of poor as well as the share of poor (Table 11.1).

Figure 11.2: Economic Growth and Poverty Reduction, 1981–2015
(based on international poverty lines)



GDP = gross domestic product, p.p. = percentage point, BAN = Bangladesh, BHU = Bhutan, IND = India, INO = Indonesia, LAO = Lao People's Democratic Republic, MON = Mongolia, MYA = Myanmar, NEP = Nepal, PAK = Pakistan, PHI = Philippines, PNG = Papua New Guinea, PRC = People's Republic of China, SOL = Solomon Islands, SRI = Sri Lanka, THA = Thailand, VAN = Vanuatu, VIE = Viet Nam.

Notes: Poverty rates are measured using the $1.90 per day international poverty line for extreme poverty. The initial year is 1981 for most economies, but 1984 for the Lao People's Democratic Republic and 1990 for Solomon Islands.

Sources: World Bank. PovcalNet Database. http://iresearch.worldbank.org/PovcalNet/home.aspx (accessed 7 November 2019); and World Bank. World Development Indicators. https://data.worldbank.org (accessed 2 August 2019).

India and the PRC together contributed 82% of the total poverty reduction for developing Asia from 1981 to 2015. For developing Asia as a whole, 68% of the population (or 1.6 billion people) lived below the $1.90 per day poverty line in 1981. By 2015, the extreme poverty rate had fallen to about 7% (or 264 million people).

Strong economic growth in Asia over the past decades was also accompanied by the emergence of a sizable middle class.[5]

[5] Asian Development Bank (ADB). 2010. *Key Indicators for Asia and the Pacific 2010: Asia's Emerging Middle Class: Past, Present, and Future*. Manila.

Table 11.1: Poverty Reduction in Developing Asia, $1.90 per Day International Poverty Line, 1981–2015[a]
(number of poor in million; headcount ratio in % in parentheses)

	1981	1990	2002	2010	2015
Developing Asia	**1,604.8 (68.1)**	**1,503.8 (53.6)**	**1,107.2 (33.1)**	**620.3 (17.0)**	**263.9 (6.9)**
Central Asia	6.3 (11.4)	8.1 (12.3)	22.3 (31.1)	10.1 (12.8)	5.3 (6.2)
East Asia	876.5 (84.7)	752.2 (63.7)	405.7 (30.5)	149.9 (10.8)	10.1 (0.7)
People's Republic of China	875.3 (88.1)	751.8 (66.2)	405.4 (31.7)	149.6 (11.2)	10.0 (0.7)
South Asia[b]	506.4 (55.7)	530.0 (47.3)	546.4 (38.6)	393.8 (24.6)	212.4 (12.4)
India	409.4 (57.4)	412.4 (47.4)	445.4 (40.9)	342.9 (27.9)	175.7 (13.4)
Southeast Asia	213.4 (60.1)	210.4 (48.8)	128.8 (24.7)	63.2 (11.0)	33.1 (5.4)
The Pacific[c]	2.2 (49.9)	3.0 (51.1)	4.0 (45.7)	3.3 (32.3)	2.9 (25.7)
Latin America and the Caribbean	**49.5 (13.5)**	**65.5 (14.8)**	**63.1 (11.8)**	**36.7 (6.2)**	**24.3 (3.9)**
Sub-Saharan Africa	**193.9 (48.8)**	**280.2 (54.7)**	**390.9 (55.3)**	**408.5 (46.5)**	**416.4 (41.4)**
Developing World[d]	**1,897.8 (51.7)**	**1,892.9 (43.2)**	**1,595.9 (30.2)**	**1,084.9 (18.4)**	**727.1 (11.6)**

[a] Subregional estimates are derived using World Bank's PovcalNet common reference year data, which are based on either actual surveys or extrapolation/interpolation methods.
[b] Data for 1981 and 1990 for Maldives are not available.
[c] Data for 1981 for the Federated States of Micronesia, Samoa, Timor-Leste, and Tuvalu are not available.
[d] Developing World refers to "world less other high income."

Sources: Asian Development Bank estimates; and World Bank. PovcalNet Database. http://iresearch.worldbank.org/PovcalNet/home.aspx (accessed 7 November 2019).

Defining the middle class as those in households with per capita expenditures from $3.20 per day to $32 per day (in 2011 PPP), only 13% of developing Asia's population could be considered as middle class in 1981.[6] By 2015, this had increased to almost 69% of the population. Consumer expenditures in developing Asia increased rapidly reflecting the growing middle class, supporting regional and global growth.[7]

Country experiences in poverty reduction

Country examples show more clearly the importance of economic growth for poverty reduction.

The ROK provides one of the most celebrated success stories of poverty reduction. The economy was among the poorest in the 1950s with most people relying on subsistence farming. There was widespread hunger and deprivation with much of the infrastructure destroyed during the 1950–1953 Korean War. Even as late as the mid-1960s, between 60% and 70% of the population was estimated to be living below the national poverty line. Over the following 3 decades, the ROK's GDP grew about 10% annually and, by the mid-1990s, the absolute poverty rate had declined to 3.4%. The decline was accompanied by significant gains in human development.[8]

In the PRC, after nearly 30 years of Soviet-style central planning, extreme poverty at the $1.90 per day international poverty line in 1981 remained at 88.1% (Table 11.1). But the following 40 years of reform led to rapid economic growth (close to 10% annually) and a dramatic reduction in the poverty rate (to 0.7%). Half of this decline occurred before 1995, coinciding with major reforms in agriculture. These included the introduction of the household responsibility system in 1978–1984 and rounds of price liberalization for agricultural products, which significantly increased farming household income. Also, rural incomes rose from the shift of surplus labor from agriculture to manufacturing and services.

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6 ADB estimates based on PovcalNet data for 29 developing Asian economies in 1981 and 2015. The range of $3.20–$32 per day in 2011 PPP is more or less equivalent to the range of $2–$20 per day in 2005 PPP, which was used by ADB in estimating the size of the middle class in its *Key Indicators for Asia and the Pacific 2010*.

7 ADB. 2019. *Asian Development Outlook 2019 Update: Fostering Growth and Inclusion in Asia's Cities*. Manila.

8 Henderson, J., et al. 2002. Economic Governance and Poverty Reduction in South Korea. *Working Paper*. 439. Manchester Business School.

In Viet Nam, extreme poverty declined from 76.3% in 1981 to 2.4% in 2015, with the underlying reasons similar to the PRC. Economic reforms, which began in 1986 and accelerated in 1989, also focused initially on agriculture through de-collectivization, land reform, and lifting price controls. A major beneficiary of this reform was rice production. Viet Nam quickly became the world's third-largest rice exporter after years of importing the grain. The reform increased rural incomes, leading to a large reduction in poverty. As reforms broadened to cover the urban and industry sectors, it created jobs for urban residents and rural surplus labor.

In Indonesia, the poverty rate measured at the national poverty line declined from 60% to 15% from 1970 to 1990. The drop was supported by strong economic growth (averaging 6.6% a year), with rapidly expanding labor-intensive manufacturing absorbing surplus labor from rural areas. The 1970s Green Revolution also played a critical role in reducing rural poverty. But the 1997–1998 Asian financial crisis disrupted the poverty reduction process. Growth contracted 13% in 1998, which led to massive unemployment and a surge in poverty—from 17.5% in 1996 to 23.4% in 1999. With a speedy economic recovery from 2000, supported by macroeconomic stabilization policies and structural reform, poverty reduction resumed. The poverty rate at the national poverty line declined to 14% in 2009 and 9% in 2019.

In India, from 1951 to the early 1970s, growth was slow and volatile, with the poverty rate based on national poverty lines showing no discernible trend, fluctuating between 40% and 60%.[9] This began to change from the mid-1970s, first as a result of the effects of the Green Revolution, and subsequently due to more stable and higher growth as early trade and industrial reforms took effect. Poverty reduction accelerated further when India began major economic liberalization in 1991. The poverty rate at the national poverty line declined from 55% in 1970 to 22% in 2011. After 1991, growth in urban areas and in manufacturing became important contributors to poverty reduction.

In Bangladesh, the poverty rate at the national poverty line was estimated at 70% in 1971 when it gained independence. It fell to around 50% by 2000 and further to 22% in 2018. After a period of inward orientation and heavy state control, the country introduced

9 Panagariya, A. 2008. *India: The Emerging Giant*. New Delhi: Oxford University Press.

market-oriented reforms—including liberalizing agriculture input markets in the late 1970s, industrial deregulation in the 1980s, and a more liberal trade policy from the early 1990s benefiting the garment industry. Nongovernment organizations and community-based organizations played a crucial role in poverty reduction.[10]

Central Asian countries (Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan) gained independence in 1991. Despite large variations among these countries in extreme poverty during the Soviet era, data show rising extreme poverty after independence, reaching 31.3% for the subregion as a whole in 2002, compared with around 12.3% in 1990 and 11.4% in 1981. Extreme poverty dropped sharply to 12.8% by 2010 and to 6.2% in 2015 (Table 11.1).

In the Pacific, after 2 decades of generally poor economic performance in the 1980s and 1990s, and fairly rapid population growth, extreme poverty (at the $1.90 per day international poverty line) was 45.7% in 2002 for the subregion. Better growth since, partly driven by resource exports, helped reduce extreme poverty to 25.7% in 2015 (Table 11.1). While Pacific island countries are targeting poverty reduction in remote rural areas, they are vulnerable to natural disasters and external economic shocks, often interrupting progress in poverty reduction.[11] Development assistance plays an important role in poverty reduction in the subregion.

11.4 Stable levels of inequality in the 1960s–1980s

The limited data available suggest that, in the 1960s, several East Asian economies including Japan; the ROK; and Taipei,China had relatively low income inequality as measured by the Gini coefficient of per capita disposable income (in the 31–34 range). In the PRC, as a socialist country, income inequality was also believed to be low, although no data are available. However, several Southeast Asian economies—including Malaysia, the Philippines, and Thailand—had higher income inequality with a Gini coefficient in the 40–50 range. South Asian

[10] World Bank. 2003. *Bangladesh - Development Policy Review: Impressive Achievements but Continuing Challenges*. Washington, DC.

[11] Although poverty, as measured by daily monetary consumption, comes out high in the Pacific, extreme hardship is rare in the subregion as large segments of the population are supported by subsistence agriculture and informal community-based social safety nets. Nonetheless, vulnerability to sudden episodes of hardship—brought about by environmental or economic shocks, particularly in remote outer island communities—remains a predominant concern.

countries including Bangladesh, India, Pakistan, and Sri Lanka were in the middle, with a Gini coefficient ranging from 30 to 40.[12]

World War II, its aftermath, and postwar reforms can largely explain the low levels of inequality in Japan; the PRC; the ROK; and Taipei,China in the 1950s. Land reform allowed poor and low-income farmers to acquire land from richer landowners at low prices (Chapter 4). In the PRC, land was confiscated from landowners and redistributed to poor peasants. In Southeast Asia and South Asia, former colonies were left with different property systems and agrarian structures; and land reform was not as sweeping as in East Asia. Implementation proved difficult and slow, and its impact on income distribution was far more limited.

Since the 1960s up to the 1980s, most developing Asian economies managed to keep income inequality stable, regardless of its initial level, despite large differences in the pace of economic growth. Many economies in East Asia and Southeast Asia grew rapidly while income inequality remained stable or even declined somewhat—a pattern referred to by many as "growth with equity." The eight high-performing Asian economies representing the "East Asian Miracle," including Hong Kong, China; Indonesia; Japan (Box 11.1); Malaysia; the ROK; Singapore; Taipei,China; and Thailand, grew by 5.5% on average in per capita GDP during 1965–1990. Over this period, their Gini coefficients declined or remained stable at low levels.

The pattern of "growth with equity" has been attributed to two major factors. One is that growth in East Asia and Southeast Asia during the period was broad-based and supported by a dynamic agriculture sector, vibrant labor-intensive manufacturing, expanding trade, and the development of small and medium-sized enterprises.[13] This growth pattern created jobs for a wide swath of the population and increased earnings of the low-income rural population and urban workers. The other major contributing factor was inclusive social policies and rural development.

By comparison, in most South Asian countries, while levels of income inequality remained moderate and stable from the 1960s to the 1980s, economic growth was slow. For example, in India, inequality in household expenditures fluctuated mildly around an

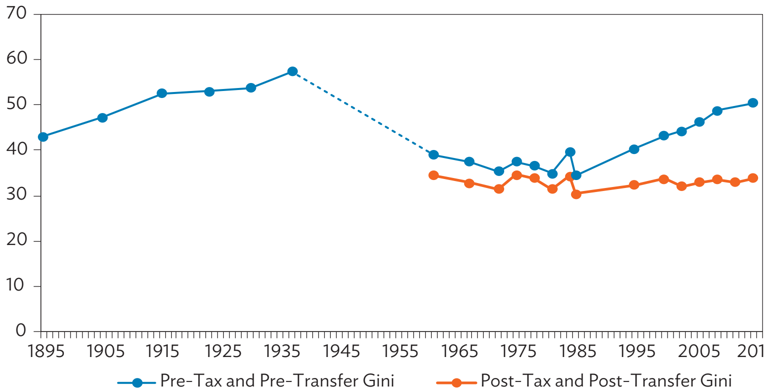
[12] World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press.

[13] World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. New York: Oxford University Press.

Box 11.1: Japan's Economic Inequality Over the Past 50 Years

Japan has often been considered a society with relatively low income inequality. However, prior to World War II, the country had very unequal income distribution. The Gini coefficient of market incomes was estimated at 53 in 1920 and 57 in 1937 (Box Figure). The income share of the top 1% income earners was around 20% in 1937.[a] Prewar industrialization led to dramatic increases in income gaps between rich and poor.

Box Figure: Japan's Gini Coefficient, 1895–2015



Sources: For 1895 to 1939: Minami, R. 2008. Income Distribution of Japan: Historical Perspective and Its Implications. *Japan Labor Review*. 5 (4). pp. 5–20; for 1960 to 1984: Tachibanaki, T. 2006. *Kakusa Shakai: Nani ga mondai nanoka* [The Divided Society: What Are the Issues?] Tokyo: Iwanami Shoten; and for 1986–2015: Organisation for Economic Co-operation and Development (OECD). OECD Statistics. https://stats.oecd.org/ (accessed 21 June 2019).

Japan's income inequality fell sharply after World War II. The top 1% income share fell to 8% in 1948 with capital earnings almost nil. The Gini coefficient of market incomes was estimated at 39 in 1961. The dramatic decline in income inequality was due to war-related destruction, high inflation, and policies implemented immediately after the war, including drastic land reform and dissolving family-owned zaibatsu (large business conglomerate).

During the 1960s and 1970s, despite rapid economic growth, income inequality remained stable and actually declined somewhat. This pattern of growth with equity was due to several factors, including (i) broad-based growth; (ii) agricultural policies such as administered rice prices and government support to increase farmers' access to credit and technology; (iii) large public infrastructure investment in rural areas to promote the

continued on next page

Box 11.1 *continued*

"harmonized development of the whole nation"; (iv) central government fiscal transfers to poorer local authorities; (v) good public education, the introduction of universal health coverage (in 1961), and an improved social security system; (vi) increased influence from trade unions after labor law reform; and (vii) highly progressive personal income and inheritance taxes (until the late 1980s, with the maximum marginal rate of as high as 70% for national income tax and 18% for local income tax, adding up to 88%, and the maximum marginal rate of 75% for inheritance tax, before reducing them).

However, Japan's income inequality has been rising, following the trend in most advanced economies. The Gini coefficient of market incomes increased from 34.5 in 1985 to 50.4 in 2015. The Gini coefficient of disposable incomes post-tax and post-transfer increased from 30.4 to 33.9.

Like many other countries, technological progress and globalization likely have contributed to rising income inequality since the 1980s. Other important contributors include changes in labor market practices such as the increased use of fixed-term labor contracts and part-time workers—especially after the asset bubble burst in 1990—and population aging. Estimates show half of the increase in income inequality in Japan since the 1980s can be attributed to population aging.[b] Compared with younger generations, older people tend to have lower incomes. Higher inequality among them also contributes to income inequality.

[a] Moriguchi, C., and E. Saez. 2008. The Evolution of Income Concentration in Japan, 1886–2005: Evidence from Income Tax Statistics. *The Review of Economics and Statistics.* 90 (4). pp. 713–734.

[b] Ohtake, F., and M. Saito. 1998. Population Aging and Consumption Inequality in Japan. *Review of Income and Wealth.* 44 (3). pp. 361–381.

Sources: Asian Development Bank; Moriguchi, C., and E. Saez. 2008; and Ohtake, F. and M. Saito. 1998.

average Gini coefficient of 32 from 1961 to 1988,[14] while per capita GDP grew a little less than 2% annually. The weak growth in most South Asian countries during that period was, to a large extent, attributed to inward-looking economic policies and heavy state control in the economy (Chapter 2). This constrained the growth of modern labor-intensive manufacturing, among others.

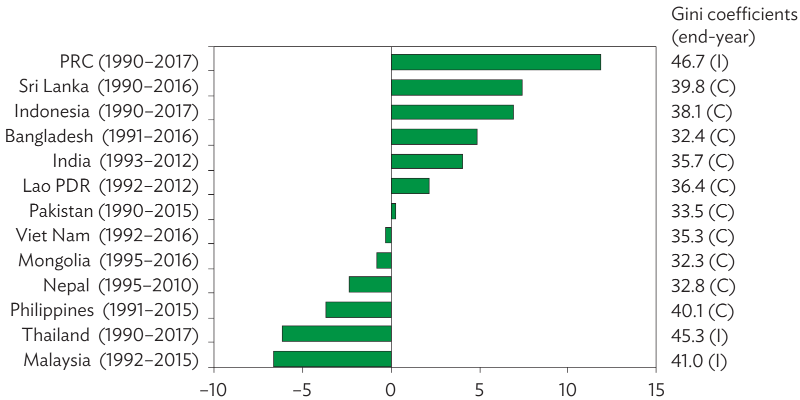
[14] Chancel, L., and T. Piketty. 2017. Indian Income Inequality, 1922–2014: From British Raj to Billionaire Raj? *CEPR Discussion Paper.* No. DP12409. Washington, DC: Center for Economic and Policy Research.

11.5 Rising income inequality since the 1990s

Recent trends of income inequality

Since the 1990s, growth in developing Asia has accelerated and has become more widespread, leading to further poverty reduction. However, in contrast with the "growth with equity" pattern in the 1960s–1980s, income inequality increased in many countries, including the three most populous: the PRC, India, and Indonesia (Figure 11.3). Based on household consumption expenditure data, India's Gini coefficient increased by 4 points between 1993 and 2012 and Indonesia's increased by 7 points between 1990 and 2017. In the PRC, the Gini coefficient of per capita household disposable income increased by nearly 12 points between 1990 and 2017.[15]

Figure 11.3: Changes in Gini Coefficients, Selected Economies in East Asia, South Asia, and Southeast Asia, 1990s–2010s



Lao PDR = Lao People's Democratic Republic, PRC = People's Republic of China.

Notes: Green bars refer to changes in Gini coefficients between the two indicated periods. Numbers in the column on the right refer to levels of Gini coefficients for the final year. Symbols in parentheses indicate whether a Gini coefficient is income-based (I) or consumption expenditure-based (C).

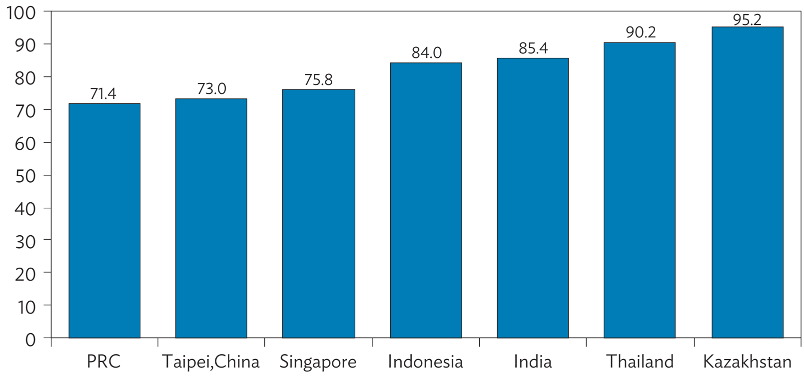
Sources: World Bank. PovcalNet Database. http://iresearch.worldbank.org/PovcalNet/home.aspx (accessed 1 October 2019); for the PRC: National Bureau of Statistics of China. *China Statistical Yearbook*. http://www.stats.gov.cn/english/Statisticaldata/AnnualData/ (accessed 1 March 2019); and for Thailand: National Economic and Social Development Board. *Social Development Indicators*. https://www.nesdb.go.th/nesdb_en/main.php?filename=social_dev_report (accessed 1 March 2019).

[15] The PRC's income inequality started to rise in the mid-1980s.

In some countries—such as Malaysia, the Philippines, and Thailand—the Gini coefficient declined between 1990 and 2017. However, the Gini coefficient may not adequately capture the inequality due to the very rapid income growth for top earners. In Thailand, for example, estimates show that incomes of the top 1%, a group consisting mostly of households headed by business and property owners and company executives, grew almost three times as fast as average incomes in 1988–2011,[16] even though its Gini coefficient declined during more or less the same period. In Malaysia, it has been suggested that the decline in the Gini coefficient in recent decades was mainly due to affirmative actions associated with the New Economic Policy, which narrowed income gaps between ethnic groups.[17]

The Gini coefficient of per capita wealth, another key measure of inequality but available only for a much smaller set of economies, shows that the wealth distribution is much more unequal than income distribution (Figure 11.4). In 2018, the wealth Gini coefficient was

Figure 11.4: Wealth Gini Coefficient, Selected Asian Economies, 2018



PRC = People's Republic of China.

Note: Only those economies with good or fair data are reported.

Source: Credit Suisse. 2018. *Global Wealth Databook 2018*. Zurich.

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16 Pootrakul, K. 2013. *Khunaphap kan charoen toepto jak miti khong kan krajai raidai panha lae thang ook* [The Quality of Growth from the Perspective of Income Distribution: Problems and Solutions]. Paper presented at the Bank of Thailand Annual Seminar. 19 September.

17 Ravallion, M. 2019. Ethnic Inequality and Poverty in Malaysia Since 1969. *NBER Working Paper Series*. No. w25640. Cambridge, MA: National Bureau of Economic Research.

higher than 80 in India, Indonesia, Kazakhstan, and Thailand; and in the range of 70–76 in the PRC; Singapore; and Taipei,China.

Empirical studies show that wealth inequality has also been on the rise in some Asian countries. In the PRC, for example, the share of wealth owned by the top 10% of households increased from 41% in 1990 to 67% in 2015. In India, the same share increased from 51% to 63% during 1991–2012.[18] Consistent with these trends, developing Asia has seen a sharp rise in the number of billionaires. According to Forbes, developing Asia had 14 billionaires in 1987 (in terms of net worth). The number increased to 47 in 2000 and 698 by 2019.[19]

Why income inequality has risen

Developing Asia is not alone when it comes to rising inequality. Most Organisation for Economic Co-operation and Development (OECD) countries also saw inequality rise in recent decades. Research and policy discussions cite technological progress and globalization, despite their beneficial impact on rapid growth in Asia and worldwide, as key drivers of rising inequality globally.

Technological progress can affect income distribution through two channels. One is to reduce demand for labor relative to that for capital, leading to rising returns to capital relative to wages. According to one ADB study,[20] in India; Indonesia; the PRC; the ROK; Singapore; and Taipei,China, the share of labor incomes in total manufacturing value added declined (implying an increase in the share of capital earnings) between the early 1990s and mid-2000s. As capital earnings go mostly to wealthier individuals and households, a rising share of capital earnings worsen income distribution. Many OECD countries, including Japan, have also seen a rising share of capital earnings and falling share of labor incomes in recent decades.[21]

The second channel is to increase demand for skilled (or better educated) labor relative to that for less-skilled labor. This leads to a widening wage differential between the two—the

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18 Wid.World. World Inequality Database. https://wid.world/wid-world/ (accessed 26 April 2019).

19 Forbes' billionaires list is based on wealth measured using stock prices and exchange rates on 8 February 2019 (Forbes. *Billionaires: The Richest People in the World*. https://www.forbes.com/worlds-billionaires).

20 ADB. 2012. *Asian Development Outlook 2012: Confronting Rising Inequality in Asia*. Manila.

21 In many OECD economies, a rising share of capital earnings and falling share of wage earnings since the 1980s have also been attributed to weakening worker bargaining positions due to policies that curtail the power of labor unions.

so-called "skill premium." Wage gaps between skilled and less-skilled labor increased over the past 2 to 3 decades in both developed countries and developing countries.

In the PRC, for instance, the hourly earnings premium of workers with a college education or above over those with high school education or below increased from 41% to 58% between 1999 and 2005.[22] The same comparison in Viet Nam between 1992 and 2006 shows a jump from 23% to 57%. In India, among salaried workers, earnings of managers and professionals have grown fastest.[23]

While there is broad agreement on how technical progress contributed to recent increases in income inequality, there are mixed views about how globalization has affected income distribution. Standard trade theory predicts that, for developing countries with abundant unskilled labor, opening up the economy should raise wages of unskilled labor relative to skilled workers, because these countries will concentrate on producing and exporting goods that are unskilled-labor intensive. According to this theory, trade globalization should help reduce income inequality in developing countries. The earlier "growth with equity" story of East Asia and Southeast Asia is consistent with this thesis.

However, more recently, studies found that trade does not necessarily lead to lower income equality in developing countries. One explanation is that trade today is often accompanied by the use of new technologies, especially when associated with foreign direct investment and global value chains. As new technologies usually require more skilled workers relative to those less skilled, greater trade openness can increase demand for skilled labor relative to unskilled workers in developing countries. This causes widening wage gaps, even if wages of unskilled workers also go up and contribute to poverty reduction. Also, as new technologies and capital often work together due to their complementarity, trade liberalization can also affect income distribution between capital and labor earnings: increasing capital's share and reducing labor's share. This is especially true when foreign companies investing in developing countries partner with local businesses that are familiar with local situations. There are also cases where foreign share of investment is limited by investment laws of

[22] Di Gropello, E., and C. Sakellariou. 2010. Industry and Skill Wage Premiums in East Asia. *World Bank Policy Research Working Paper*. No. 5379. Washington, DC: World Bank.

[23] Cain, J., et al. 2010. Accounting for Inequality in India: Evidence from Household Expenditures. *World Development*. 38 (3). pp. 282–297.

recipient countries, and foreign direct investment investors are obliged to find local partners.

In addition, technological progress and globalization create many new economic opportunities, whether in manufacturing, services, property, or finance. Success often comes with substantial economic rents in the form of excessive executive pay or windfall profits. Those able to capitalize on these new opportunities include both entrepreneurs who are the first movers (such as the e-commerce billionaires noted by Forbes) and those with large landholdings in newly favored locations. The increasing number of superrich has been a key contributor to rising income and wealth inequality in Asia and globally.[24] When the tax system is ineffective, this can become a source of social tension.

Technological progress and globalization have not only affected income distribution between capital and labor and between skilled and unskilled workers, but also between urban and rural areas and among different regions. This is because growth driven by technological progress and globalization, as well as market-oriented reforms, usually occurs first in coastal regions (which are closer to trade routes and world markets) and urban cities (which have better infrastructure) before spreading to other areas. This growth pattern can lead to rising spatial inequality, especially in the early stage of development. The dual economic structure and barriers to labor mobility (such as the household registration system in the PRC) can exacerbate these forces. In the PRC, rising urban–rural income gaps and growing regional disparity have been among the key drivers of rising income inequality over the past 3 decades.

Another important contributing factor to rising or persistently high income inequality in developing Asia is the limited role income redistribution plays through taxes and social security transfers, especially compared with developed countries. Income redistribution plays a very important role in reducing inequality in developed countries (Table 11.2). For instance, taxes and transfers reduced the mean Gini coefficient by 33.2% (15.4 Gini points) for OECD countries in 2015, while the reduction was only 6.3% (2.6 Gini points) for developing Asia. The greater role of income redistribution as a country becomes wealthier is one of the underlying assumptions of the Kuznets inverted-U hypothesis.

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[24] Piketty, T. 2017. *Capital in the Twenty-First Century*. Cambridge, MA: Harvard University Press.

Table 11.2: Asia's Income Inequality in the Global Context, 2015

Region	Pre-Tax and Pre-Transfer Gini (mean)	Post-Tax and Post-Transfer Gini (mean)	% Difference
Developing Asia	40.0	37.4	(6.3)
Japan, Australia, and New Zealand	45.7	32.6	(28.6)
Latin America and the Caribbean	47.1	43.4	(7.7)
Sub-Saharan Africa	45.9	45.0	(1.8)
European Union	46.8	29.9	(36.0)
North America	48.6	34.5	(29.1)
OECD	46.4	31.0	(33.2)

( ) = negative, OECD = Organisation for Economic Co-operation and Development.

Note: Mean refers to the simple average of Gini coefficients of the countries in the region.

Source: Solt, F. 2019. Measuring Income Inequality across Countries and over Time: The Standard World Income Inequality Database, Version 8. https://dataverse.harvard.edu/dataset.xhtml?persistentId=doi:10.7910/DVN/ LM4OWF (accessed 1 August 2019).

Country experiences

The PRC's Gini coefficient of per capita disposable income was below 31 in 1981, among the lowest in developing Asia. It declined briefly in the early 1980s, benefiting from the first round of rural reforms. As reforms extended to urban areas from 1984 and industrial growth accelerated, the Gini coefficient started to rise. In the late 1980s and early 1990s, the government introduced its second round of rural reforms, including the decontrol of grain procurement and sales prices, leading to a large increase in rural incomes and a reduction in the Gini coefficient.

From 1997, the Gini coefficient started to climb again, as growth accelerated, supported by deepening SOE reform, rapid trade expansion after PRC accession to the World Trade Organization in 2001, and the emergence of innovative private companies. The coefficient peaked at 49 in 2008. Since then, it has been declining, although very moderately, due to government policy measures such as increases in minimum wages, expanding social protection in rural areas, increased support for poorer provinces, and structural factors such as the shrinking rural surplus labor that increased agricultural productivity and pushed up urban wages.

In India, consumption expenditure surveys show the Gini coefficient fluctuating around an average value of 32 from 1965 to 1993,[25] but rising steadily afterward to reach around 36 by 2011. The increase in inequality since the early 1990s has been driven by rising urban inequality, especially due to a more rapid increase in wages of higher-educated workers. Industrial deregulation and trade liberalization since 1991 have led to a significant increase in exports of skill- and capital-intensive goods (such as auto parts and generic pharmaceuticals) and information technology-related services (such as business process outsourcing). The increase may have been even higher without government initiatives that expanded India's rural road and highway network and introduced a national employment guarantee scheme in the early to mid-2000s.

Indonesia's Gini coefficient of per capita household consumption expenditure was broadly stable in the 1980s. It began to rise in the early 1990s, but was interrupted by the 1997–1978 Asian financial crisis that affected the rich more than the poor. It started to climb again from 2000 as the economy recovered from the crisis. The Gini coefficient rose from 29 in 2000 to 36 in 2007 and 40 in 2013. While it has been declining since, the 2017 estimate of consumption-based Gini coefficient remained high at 38. Rising income inequality is, like in many other countries, driven by rising skill premiums, the rise of skill-intensive services, and uneven gains from recent commodity booms.

Not all economies in developing Asia have had increasing Gini coefficients since the 1990s. In Cambodia, for example, the movement of labor toward light and labor-intensive manufacturing and services gave more job opportunities for the rural poor, decreasing overall inequality. In Singapore, improved social safety nets reduced inequality in recent years. In Malaysia, the Philippines, and Thailand, pro-poor policies have helped narrow the income divide between rich and poor. In the Philippines, one example of these measures was the launch of a nationwide conditional cash transfer program in 2008.

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[25] Chancel, L., and T. Piketty. 2017. Indian Income Inequality, 1922-2014: From British Raj to Billionaire Raj? *CEPR Discussion Paper*. No. DP12409. Washington, DC: Center for Economic and Policy Research.

In Central Asia, following the Soviet collapse, Gini coefficients increased substantially in newly independent countries as fiscal spending and welfare transfers were cut and economies contracted. The Gini coefficient of per capita consumption during 1988–1992 ranged between 25 and 28, but shot up to 52 for the Kyrgyz Republic in 1996, 45 for Uzbekistan in 1998, and 40 for Georgia in 1997.[26] But once economic stability was restored from the late 1990s, income inequality began declining. While the overall declining trend in inequality continued until 2010 for the majority of Central Asian countries, most recent data show inequality is again on the rise in some countries such as Armenia and Tajikistan.

A similar pattern occurred in Mongolia. Before 1990, Mongolia had a comprehensive social security program that included free education, universal health coverage, and high pension benefits. This was disrupted by budget cuts and the end of subsidies from the Soviet Union in the early 1990s. New social security welfare programs introduced from 1994 onward helped reduce inequality.

11.6 Looking ahead

Developing Asia has made impressive progress in reducing poverty over the past 50 years, with most countries expected to eradicate extreme poverty by 2025 (using the $1.90 per day international poverty line in 2011 PPP terms). Asia's poverty reduction has been driven by rapid economic growth and various programs to support the poor more directly. Poverty reduction, in turn, has helped create a stable environment for further development. However, poverty reduction remains an unfinished agenda in Asia. The region's poverty rate in 2015 remained at 29% at the $3.20 poverty line that is typical of lower-middle-income countries.

In addition, in many countries, especially those with rapid growth, income and/or wealth inequalities have risen in recent decades. In others, although inequalities declined or stayed unchanged, they remain high.

Looking ahead, developing Asian economies should continue efforts to eradicate (both income and non-income) poverty, and share the benefits of growth more widely, with the following policy priorities.

[26] Mitra, P., and R. Yemtsov. 2006. Increasing Inequality in Transition Economies: Is There More to Come? *Policy Research Working Paper Series*. No. WPS 4007. Washington, DC: World Bank.

The first is to promote sustained and inclusive growth to create quality jobs. This requires sound macroeconomic management, a continued commitment to open trade and investment, adequate investment in infrastructure and human capital, and promotion of technological adoption and innovation.

The second is to make greater use of fiscal policy for income redistribution. On the expenditure side, there is large scope in developing Asia to increase spending on education, move toward universal health coverage, and strengthen social protection—including national pension systems, unemployment insurance schemes, and social assistance programs. On the revenue side, policy options include broadening the tax base, making income taxes more progressive, introducing inheritance and property taxes, and strengthening tax administration and collection.

The third is to reduce the urban–rural income gap and regional disparity. Policy options include continued infrastructure investment to improve regional connectivity, and measures to increase agricultural productivity, and fiscal reforms to increase transfer to poor localities or revenue sharing among the regions. In countries such as the PRC, continued reform in the household registration system would promote labor mobility and give equal opportunity for migrant workers in education, health care, and social protection.

Lastly, developing Asian economies should continue governance reforms to ensure the entire population enjoys adequate public services, a level playing field, and equal access to opportunity. Continued efforts are needed to eliminate social exclusion and discrimination based on gender, ethnicity, location, and other individual circumstances, and fight against corruption.