RHEE CHANGYONG

Director, Asia and Pacific Department, IMF

It is my honour to be on this panel with my former boss and my colleagues. As at the OECD, inequality has become a really important issue at the Fund. Like the OECD, our research found that excessive inequality is very harmful for economic growth. To differentiate my presentation, let me focus more on some stylized facts about the most recent rise in inequality in Asia. Then I will talk about policy options.

Before I talk about the recent rise in inequality in Asia, let me first emphasise that in absolute terms, Asia is still better than other emerging countries in Latin America and Africa. On average, the Gini coefficient in Asia is around 38, which is well below the figure of 54 in Latin America, for example. However, we are worried about the rising trend and the speed of aggravation of problems related to inequality.

In the last 20 years, many countries in Asia, especially big countries like China, India, Korea and Indonesia, are observing a very rapid increase in inequality. This is quite a different pattern from what Asia experienced in the 1960s and 70s. In the 1960s and '70s, Asian tigers experienced rapid economic growth. At that time, economic growth occurred with inequality remaining more or less the same, or at least we did not see rising inequality at that time. Now, in the last 20 years, Asia has led global economic growth, but with a very rapid increase in inequality. As the previous speaker mentioned, ironically, we believe that the same factors which contributed to the rapid growth in Asia all contribute to the rising trend of inequality. These include technological progress, globalisation and market oriented reform.

Let me give you an example. In the '60s and '70s, when Korea developed its economic structure, we relied on manufacturing companies which hire many workers. If you went to car companies and semi conductor companies around that time, you would see that many workers were working in those factories. However, these days, if you go to car and semi-conductor companies in China, you do not see as many people, but you see a lot of machines. Labour saving technology is one factor.

Globalisation has now introduced a new trend where, under global competition, the best human capital will capture most of the benefit. Market oriented reform and globalisation are having an effect in China, for example, where the coastal areas are developing much more rapidly than the inland areas.

Previous research conducted when I was at the ADB looked into trends in the labour share of income in the last 20 years and showed some interesting developments. In China for example, the labour share of income in the manufacturing sector declined from 48% to 42% in 20 years. In India, the decrease is much more drastic and labour share decreased from 36% to 21%. Labour share of income is going down because of technological progress. If you break this down further, educational differences and factors such as the so called skill premium account for about 25 35% of the change in total inequality.

In China, spatial differences alone between the inland and coastal areas can explain more than 50% of the rise in the Gini coefficient in China. We believe that spatial and educational differences combined with these technologies are driving this trend. That makes policy options quite limited and very difficult. The IMF recently produced a paper about what kind of fiscal policy is effective in reducing inequalities. We generally agree with the previous speaker on the general issues, but our conclusion is that, in general, design matters. Let me give you a few examples.

For one, the education gap is a big issue. If you look at recent trends, tertiary education or higher education enjoys a rising wage premium in the labor market. The educational policy so far in developing institutions focuses on general universal education in primary and secondary school. That may be very effective in reducing poverty, but may not be effective in reducing inequality. We may need to have some kind of educational policy which can support tertiary education of poor families. That may be one option.

Then, also, in order to address spatial inequalities, infrastructure investment from public or international organisations may focus more on the connectivity of the centre to the more remote areas. Then, in the case of China, the Hukou system and constraints regarding labour migration may be the reasons for the spatial differences.

I would like to give one more example, regarding how to address the declining labour share at a time of technological progress. You cannot prevent or slow down technological progress but, on the other hand, our policy has a lagging mentality. In the 1960s and '70s, when we needed the most savings and capital investment, governments introduced many economic policies favouring capital accumulation, such as the investment tax credit. The major objective was just to increase investment. From now on, we probably have to introduce policies that favour employment. I do not mean giving subsidies for employment, but that there may be some distortions which favour capital over labour, and those can be reversed.

Let me conclude with one remark. We have to be very careful when we talk about inequalities. It is not about inequality in general; it is more about inequality in opportunities, and excessive inequality is quite detrimental to growth. However, in lower income countries, there are still inequalities as a natural consequence of economic development. We should not downplay that trend either. Let me stop here.

Susan Liautaud, Visiting Scholar at the Stanford Center on Philanthropy and Civil Society, Founder of Susan Liautaud & Associates Limited (SLA)

I have a couple of follow up questions. Do you have one particular policy initiative that you think is the most important, or should be the top priority? Here we are in one of the most technologically advanced countries, with companies like Samsung, and you mentioned the downside of technology. In Asia specifically, is there an upside to the technology, in terms of the inequality question.

Rhee Changyong, Director, Asia and Pacific Department, IMF

If you ask me what the Fund's general institutional view of how to address these issues is, we have some general conclusions. A transfer policy is much more effective than a tax policy. A tax policy can address many issues, but, in general, transfer policy is more effective than taxation policy. When you talk about how to address inequalities, the other objective is fiscal sustainability. You cannot just put all the fiscal resources into addressing the problem.

In order to address this issue, it is very important to think about taxation together with expenditure. For example, if you look at Value Added Tax in itself, it is not progressive, but there is a lack of experience and ability to collect tax in low income countries. If you introduce Value Added Tax, you can use that as a redistributive transfer, which may be more effective overall as a package. I refer you to our Web site, where you can see that we have papers on fiscal policy and inequalities. We actually recommend several good practices on how to address these issues. I will come back to the second question later in the discussion if there's more time.