

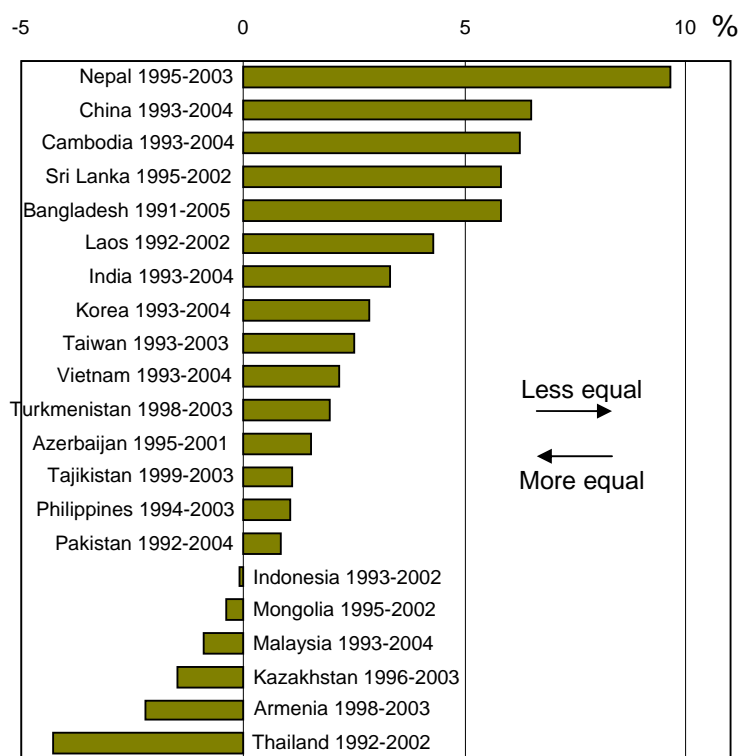
Chapter 4

Inequality in Income and Asset

The rich is getting richer faster than the poor

One of the most important social phenomena associated with fast growth is rising inequality. The Kuznets Curve posits that inequality first rises then falls as income increases (ch.2). According to the Asian Development Bank (ADB 2007), a large number of Asian economies experienced increasing inequality recently as shown in Figure 4-1.

Figure 4-1 Changes in Gini Coefficients



Source: ADB (2007), Table 4.4.

Note: Cumulative changes in the Gini coefficient based on consumption expenditure data.

In recent years for which data are available, the Gini coefficient¹ increased fastest in Nepal, followed by China, Cambodia, Sri Lanka, and Bangladesh (ADB 2007). Vietnam's Gini coefficient also rose from 34.9% in 1993 to 37.1% in 2004. ADB notes that the increases in inequality in Asia are not a story of the "rich getting richer and the poor getting poorer." Rather, it is the rich getting richer faster than the poor. This means that even the poor have improved their living standards and the nation's poverty ratio fell. ADB also cautions that the

¹ The Gini coefficient is a commonly used measure of inequality and ranges from 0 (perfect equality) to 1 (perfect inequality), or from 0% to 100% in percentages. The Gini coefficients cited here are based on consumption expenditure, which tends to be more smooth and less unequal than income data, in living standard surveys.

Kuznets curve is not universally observed in East Asia. The early industrializing economies such as Japan, Taiwan, and Korea did not experience any significant rise in inequality during their fast growing periods.

The Gini coefficients for selected years and countries are shown in Table 4-1. Even for the same year and for the same country, calculated Gini coefficients often differ depending on questionnaire design, under-reporting, non-response, and other data problems. Between ADB data in Figure 4-1 and World Bank data in Table 4-1, Gini coefficient estimates are basically similar² except for Cambodia and Malaysia (not shown in Table 4-1). As for Vietnam and China, they had similar Gini coefficients of 35-36% in 1990, but Vietnam's Gini coefficient rose only moderately while inequality in China is very pronounced in recent years. Thailand, Philippines, and Cambodia are more unequal, and Indonesia is less unequal, than Vietnam. Korea's inequality has been low and stable over the years.

Table 4-1 Gini Coefficients for Selected Countries and Years

| | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|-------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| Vietnam | 35.0 | ... | ... | 35.0 | ... | ... | 36.3 | ... | 35.4 | 35.4 | 35.9 | 36.8 | 37.5 | 37.5 | 37.6 | 37.0 |
| China | 36.0 | ... | ... | 41.2 | ... | ... | 39.3 | ... | 41.0 | 42.6 | 43.9 | 44.9 | 45.7 | 46.7 | 47.2 | 47.4 |
| Thailand | 43.8 | ... | 46.2 | ... | ... | ... | 43.4 | ... | 40.6 | 40.7 | 43.2 | 42.4 | 42.2 | ... | 42.5 | ... |
| Indonesia | 28.9 | ... | ... | 31.7 | ... | ... | 36.5 | ... | ... | 31.0 | 32.2 | 32.1 | 34.3 | 34.1 | 34.7 | 34.9 |
| Philippines | 43.8 | 43.8 | ... | ... | 42.9 | ... | 46.2 | 46.0 | 46.7 | 46.2 | 46.2 | ... | ... | 44.5 | ... | ... |
| Korea | 29.9 | 29.9 | 29.9 | 29.4 | 29.4 | 29.1 | 29.7 | 29.0 | 29.4 | 29.5 | 30.0 | 30.0 | 30.0 | 30.0 | 30.0 | 30.0 |
| Cambodia | 41.6 | ... | ... | ... | ... | ... | 41.6 | 41.6 | 41.4 | 42.3 | 43.9 | 44.6 | 46.2 | 45.4 | 46.3 | 46.0 |

Source: World Bank, *East Asia Update's* Appendixes, various years. For each year, the most recent publication is used.

If everyone is getting richer in East Asia, including the poor, why worry about inequality? ADB (2007) argues that one of the negative effects of inequality is the slower pace of poverty reduction under the same growth rate. However, in the context of rapidly growing developing countries, the most compelling reason that inequality is undesirable is political risk. If people see unfairness and foul play in the growth process, social cohesion will be lost and political stability will be jeopardized (ch.2).

It must be stressed that not all inequality is undesirable, because there is the classical trade-off between growth and equity. In a perfectly equal society, where the government takes away any excess income you earn, there is little incentive to work hard or innovate. In a very unequal society, where the millionaires and the destitute are structurally separated, there is also little stimuli for upward mobility.

As a very rough guide, Gini coefficients in the range of about 30-45%, or the "efficient inequality range," may be compatible with high growth, but not so if they are below 30% or above 45% (Cornia and Court, 2001). By this criteria, Vietnam's inequality as measured by consumption expenditure is comfortably within the safe range, but China's has already

² For Vietnam, the ADB data shows the Gini coefficients of 36.0% (1993), 35.4% (1998), and 37.5% (2002). The corresponding World Bank data are 35.0% (1993), 35.4% (1998), and 37.5% (2002). Another common index, the ratio of collective income of richest 20% to poorest 20%,

entered the danger zone. Political legitimacy in China now critically hinges on solving the inequality problem while Vietnam has not reached that point yet—but it may in the future.

Another important distinction is between effort-based inequality and circumstance-based inequality. Inequalities resulting from differences in efforts are generally acceptable and even desirable, if the society wants to encourage enterprise and hard work. On the other hand, inequalities arising from given circumstances, for which individuals are not responsible, are a cause of unequal opportunities and therefore should be ethically unacceptable. This is the kind of inequality that the government should try to reduce. Unfortunately, in reality the distinction between effort and circumstance is not always so clear-cut; what if a girl is born into a family where parents force her to quit school to make a living? Is she responsible for the subsequent lack of discipline and patience? Similarly, how much of the success of a boy from a rich family who goes abroad to study and becomes a financial analyst attributable to his effort? In actual policy making, a realistic judgment is required to decide which inequalities should be accepted and which to be curbed.

Uneven growth

Fast growth tends to increase inequality because growth impacts are inherently uneven, unless government intervenes to ameliorate the situation. Especially under market orientation and globalization, growth occurs unevenly across individuals, regions and sectors. This generates changes in family fortunes, the rise and the fall of industries, geographical shifts in economic activity, and movement of people and capital to follow growth centers.

Transition from planning to market causes inequality to rise greatly, we may even say from too much equality to too much inequality, if market forces are allowed to dominate the society. In many former socialist countries, equity was pursued as a matter of principle at the cost of efficiency. Income used to be low but highly equal, basic items such as food, clothing and housing were more or less evenly distributed (or rationed), landlords were eradicated, gender equality was guaranteed, and basic education and healthcare were provided for all—even though service quality may not have been very high.

However, when these systems are abolished and the market mechanism is installed, growth accelerates but equality is put on the back burner. Some governments intentionally pursue this policy, as the famous dictum of China's Deng Xiaoping about black and white cats illustrates. In a sense, rising inequality in transition countries is desirable because society needs differentiated rewards to people who make different amounts of effort. However, not all inequalities generated in transition are benign, and circumstance-based inequalities and, worse, connection-based inequalities also emerge. Moreover, if market forces are not monitored and regulated, inequality can swing to the other extreme as China's current situation illustrates.

Similarly, international integration accompanied by trade liberalization and large inflows of investment, aid and remittances from abroad also causes significant social change whose impacts are highly uneven. Relative price and demand structure change dramatically, and there will inevitably be those who seize the opportunity quickly and those who lag behind. People equipped with entrepreneurship and desired abilities begin to earn enormous income, while beneficiaries of the old system fall into poverty. Young people with university degrees and proficiency in English and IT are prepared much better than old workers and farmers in coping with the new economic environment.

To reduce excess inequality, the government should not suppress markets or globalization. The proper policy response is to monitor and regulate the progress of transition while introducing measures to solve growth-generated social problems (ch.2).

Asset inequality

While *flow* inequality in income and expenditure may still be relatively low in Vietnam, asset inequality may be jumping dramatically in recent years. Although there is no systematic data and only casual observation, it is suspected that asset inequality, arising mainly from the speculative sales of urban land and land slated for infrastructure and industrial and commercial estates, is becoming the largest source of inequality and public grievances in Vietnam. Some land acquisitions are legal, but there are many murky and even downright illegal transactions based on corruption and insider information. It is very easy to make a huge sum if one knows exactly where and when, for example, a new bypass road or a new commercial complex will be approved prior to public announcement.

Land speculation seems rampant regardless of project type, whether it is public, private, FDI, or ODA. Land prices of urban centers, suburbs, and project sites are soaring because of the robust construction boom and aggressive public investment. This is a phenomenon unique to countries receiving large amounts of external funds and growing very fast, such as Vietnam and China (ch.5). For this reason, true inequality may be much higher when asset inequality is included than when only Gini coefficients on consumption expenditure are used.

Another widespread and largely unintended source of asset inequality is the division between lucky land holders and unlucky renters. During the planning years, housing and farmland were distributed more or less evenly among citizens according to need. However, as market orientation and integration deepened, new economic values were created, transaction of land use rights became active, and different plots of land began to appreciate at different rates, with some appreciating very sharply. In the process, some enjoyed huge windfall gains while others did not receive any. Still others, especially individuals and families who must rent rooms, are driven closer to poverty as property prices and rents notch up. A Hanoi family which happened to own an average house in the Old Quarter suddenly became rich, to the tune of USD 2,000-3,000 per month if they rented out and USD 0.5-1.0 million if they sold, by urban land inflation³. At the same time, migrant workers who work all day to make USD50 or less per month also walk the same streets. The gap is truly staggering, but not yet captured by the Gini coefficients of ADB or the World Bank.

The first thing to do about this gaping inequality is to collect consistent data on land and dwelling prices at different locations in the country. Past data should be compiled, as consistently as possible, from information accumulated in real estate agencies or real estate sections of newspapers. For future, a more systematic database through regular surveys must be created, step by step, by a reliable organization. Based on such data, studies on the situation, causes, goals, and remedies must be conducted. The existence of land bubbles should be examined theoretically and empirically, and the impact on wealth redistribution should be estimated. Public awareness should be raised, and open debates should be held.

³ According to real estate agents, as of November 2007 a four-storied house facing a street in the Old Quarter of Hanoi, standing on the land of 60-80m², sells at about USD 10,000 per m². The price varies slightly depending on location, front width, and the status of upper structure. If such a house is rented out, the typical monthly rent is about USD 2,000-3,000.

More recently, another source of public discontent is added as the stock market is activated with an increasing number of initial public offerings (IPOs) of state-owned enterprises. There are people who use insider information to become very rich instantly. With prior knowledge about an enterprise's IPO, they buy its stocks directly or obtain employees' right to buy stocks and resell them in the initial sale. This speculation, which is definitely illegal in most countries, can bring them huge profits. It is even argued that such profits are the reason behind the recent "de-frosting" of the urban real estate market and strong demand for luxurious items such as cars and fancy motorcycles.

Without sufficient data and analysis at present, the questions of how alarming land-caused inequality and stock market corruption is, and whether the situation is approaching the social boiling point, cannot be answered with confidence. However, it is quite possible that asset inequality is becoming one of the gravest growth-led social problems in Vietnam. Policy makers are well advised to take a serious heed of its development.

The menu of corrective measures

International experiences show that several measures can be mobilized to reduce undesirable inequalities. Some measures generate jobs and income for people who are left behind while others are aimed at redistributing existing income and wealth. In general, both approaches are needed. Furthermore, these measures often have negative side effects. Vietnam should study the desirability of each measure and formulate a balanced policy package.

First, *improve agricultural productivity*. This is the most direct way to uplift poor farmers. Land reform and agricultural liberalization usually have a large, though one-time, incentive effect on production volume. Farming innovation based on new species and irrigation ("Green Revolution") worked wonders in some countries. Diversification into commercial crops and animal husbandry is another direction. However, Vietnam has more or less tried all these already, and what other measures would significantly boost agricultural productivity is uncertain. Land productivity in Vietnam is already very high, and land is divided into too many tiny plots, especially in the North. Further improvements in farming technology and organization should be considered. But if expected productivity gain is too small to greatly enrich farmers, other measures become necessary.

Second, *promote rural industries and services*. China stimulated rural industrialization with the Township Village Enterprise (TVE) model in the 1990s. The emergence of TVEs was not intended but a spontaneous response to the ownership reform of rural production units. TVEs generated jobs and income for idle population and new demand for local goods and services. While TVEs contributed to rural enrichment and curbed migration to big cities, they worked well only for a certain period in transition. Moreover, such success is rare in other transition countries. In Vietnam, trade villages are spread all over the country and serve the similar purpose of rural job and income creation as in China. However, their economic impact so far seems relatively small compared with Chinese TVEs.

Third, there is market-driven *rural-urban migration*. The flow of rural people coming to cities in pursuit of jobs and cash income is unstoppable in almost all developing countries, and it usually intensifies as economic growth takes off. In Vietnam, too, rural-urban migration is on the rise. It has both positive and negative effects in source and destination areas. While rural-urban migration is basically a private-motive driven phenomenon,

government should conduct policies to diminish its demerits and protect migrant workers from various risks.

Fourth, *install income and non-income transfer schemes*. For this purpose, various taxes, subsidies, price controls, and preferential treatments (“affirmative actions”) can be considered. Because these entail fiscal consequences and market distortion, they should be designed carefully and targeted properly to avoid budget crisis, aiding unintended groups, and political capture. While transfers may go against economic liberalization, they are needed to contain political discontent in rapidly growing countries. In post-WW2 Japan, government redistributed resources from booming urban industries to rural areas through revenue transfer from central to local governments, farm protection and subsidies, and prioritized allocation of public investment in rural areas (see next). This generosity helped to sustain political stability in Japan but it deterred agricultural innovation. Another problem of transfers is the timely exit; protection is difficult to dismantle even when it has outlived its usefulness.

Fifth, *increase public investment in lagging areas*. Construction of public facilities, transport infrastructure, and power supply benefits the targeted region through two channels; first by creating jobs during construction, and second through the service which completed projects provide over the years. As with transfers, however, public investment is a double-edged sword. Lobbying for public investment is intense, and many white elephant projects are carried out with little benefits to residents and at enormous costs to the national budget. Economics and politics are always in interplay, but maximal efforts should be made to use economic reasoning to justify projects.

Sixth, *improve public service delivery*. This is directly targeting the poor in contrast to public investment which aims to invigorate the local economy and thereby indirectly help the poor. Basic education and healthcare should be available everywhere at reasonable cost. Clean water and sanitation should also be provided. The urban-rural gap and blind spots in remote areas should be eliminated. Improving the social security system to encompass all citizens is another important task. Different developing countries show different performance in providing universal public services. Vietnam’s performance is fairly good by international standards, but more should be done.

Seventh, *introduce measures to correct asset inequality*. Inheritance from parents to children is the largest source of circumstance-based inequality. There are also accidental millionaires such as urban land holders. Some people get rich by connection and corruption. Even for those who accumulate wealth honestly through brain and sweat, it is still arguable that part of their assets should be taxed away for the benefit of the population segment who remain destitute. At present, Vietnam does not possess any fiscal measures to redress asset inequality. A corrective mechanism including inheritance tax, property tax, capital gains tax, etc. should be studied and introduced in realistic steps.