SPECIAL **REPORT**

THE GROWTH CONUNDRUM

The economies of the People's Republic of China, India, and Indonesia are growing. But so is inequality

PHOTO: AFP

By Edimon Ginting, Rana Hasan, and Juzhong Zhuang

The Asia and Pacific region has led the world in terms of economic growth and poverty reduction over recent decades. From 1990 to 2010, the average annual growth rate of gross domestic product (GDP) for the region's developing countries reached a remarkable 7%. During the same period, per capita GDP more than tripled. More than 700 million people have been lifted out of poverty by this rapid growth, according to the Asian Development Bank (ADB).

But policy makers and leaders throughout the region are increasingly concerned that hundreds of millions have been left behind. Many of those people live in the expanding and populous economies of the People's Republic of China (PRC), India, and Indonesia.

How has inequality developed in the region and what are policy makers doing to address the issue? Insights into these questions are provided by an analysis of the region's three most populous countries—the PRC, India, and Indonesia.

THE PRC HAS SEEN the fastest economic expansion, but also the region's highest increases in inequality. Between 1990 and 2012, the PRC experienced an annual GDP growth rate of 10.2%. During the same period, inequality increased more than 1.6% per year as measured by the Gini coefficient, making it among the highest in developing Asia.

Inequality in the PRC has manifested in various ways. The urban–rural divide has increased significantly, and it now contributes nearly half (about 45%) of the country's overall income inequality. High urban–rural inequality reflects the country's dual economic structure—comprising the urban economy based on modern manufacturing and services, and rural areas dominated by more traditional but less productive agriculture—and much higher urban growth. But the situation has also been exacerbated by the *hukou* (residency registration) system that limits labor mobility.

The PRC's regional inequality is also high. Coastal areas have been the main beneficiaries of economic reform and have led the country's export-driven economic expansion in the recent decades, as investors built factories near ports to put them closer to their markets overseas. This created jobs and prosperity in much more abundance than in the country's interior areas.

Market-oriented reform has significantly increased earnings differentials among individuals, which, coupled with the forces of globalization and technological

Rising levels of inequality are an additional vulnerability to the region's economies that warrants urgent action.

change, has led to a rising premium on skills and increasing returns to education. Differences in educational attainment accounted for 30% of income inequality in 2007, compared with only 10% in 1995. People with more skills and higher education have benefited far more from the economic boom than those without.

The share of wage incomes in the PRC's industrial output fell from nearly 50% in the mid-1990s to about 40% a decade later. This decrease was due to technological change favoring capital owners, and a large pool of rural surplus labor exerting downward pressure on urban wages. This trend contributes to rising inequality as capital incomes are less equally distributed.

These pressures are exacerbated by unequal access to opportunities that people need to improve their lives through hard work. The *hukou* system limits access to benefits for rural migrants looking for jobs in cities. Employees of state-owned enterprises in certain sectors earn much more due to the monopolistic power of these enterprises. Some people in control of public resources can profit from rent-seeking due to loopholes and weaknesses in governance.

Policy makers in the PRC are addressing the problem of inequality with the stated development goal of building a "harmonious society." This has been enshrined in its development plans, including the Twelfth Five Year Plan (2011–2015), which focus on high-quality, inclusive economic growth rather than simply high growth. The current plan seeks to create 50 million urban jobs in 5 years while expanding compulsory education, health coverage, pension programs, and housing opportunities. The PRC is also addressing inequality through policy measures including tax reform to improve income distribution, a sharper focus on the service sector as a source of jobs and growth, and governance reforms.

One direct intervention to address inequality that has shown some results is the Great Western Development Strategy. The plan covers 11 underdeveloped western provinces and autonomous regions, making up three-fourths of the country's land area but only one-fifth of the PRC's total economic output.

Under the strategy, about $349 billion in infrastructure investments have been made in the area between 2000 and 2009 to attract foreign investors. Education opportunities have been expanded to keep talented workers from migrating to more prosperous regions.

As a result, annual average GDP growth in the western provinces reached 11.9% between 2000 and 2009—higher than the national average. Regional inequality has declined, which has helped stabilize national inequality levels.

LIKE ITS EAST ASIAN NEIGHBOR, India enjoyed strong GDP growth between 1990 and 2012—averaging 6.6% annually. These improvements were also accompanied by an increase in inequality, with the Gini coefficient rising from 32.5 in 1993 to 37 in 2010.

However, the increase in income inequality has been less pronounced than in the PRC, and is a mainly urban phenomenon driven by higher earnings in skill-intensive sectors and occupations.

Non-income inequalities loom larger, especially in education and health. About 5% of children younger than 5 in the richest 20% of households are underweight, compared with 28% in the poorest 20%. These inequalities, however, reflect historical imbalances in the delivery of education and health care services rather than the results of economic liberalization.

Both income and non-income inequality vary widely between regions, some of which have grown faster than others. Incomes tend to be higher in coastal states exposed to trade opportunities, while the poverty rate varies from almost 54% in landlocked Bihar to 17% in Tamil Nadu, a coastal state that has emerged as an important hub for manufacturing of automobiles and automotive components and exports of apparel.

India's growing income inequality partly reflects the common sense notion that when economic growth ignites, it does so in some parts of a country earlier than others, and is driven by certain sectors and not others. However, to some degree increasing inequality exists because India—a labor-rich country—did not exploit its comparative advantage in sectors such as manufacturing, especially its labor-intensive subsectors. This was a missed opportunity to expand production of labor-intensive products, thereby creating more jobs.

PEOPLE'S REPUBLIC OF CHINA:

SLEEPLESS IN SHANGHAI

Two jobs, 18-hour work days, still not enough

Just before midnight, as Shanghai's neon-lit streets fade to black, Gao Changyi makes his way to nearby farm villages to fetch vegetables. While the city sleeps, Gao and his wife sort vegetables to display on their grocery stall when it opens at dawn. In the afternoon, he works at a moving company hauling beer crates and furniture by hand around the city.

Then it's back to the market to help his wife shut the stall. A few hours later his long day starts again.

"I really want to quit because I'm so tired but there's nothing else for me. I don't have much education or skill. Factories won't hire me. If I don't work, no one will support us when we get old."

Life wasn't always this tough for Gao. Business was plentiful and apartment rents low when he migrated to Shanghai from his home province of Henan more than 20 years ago. The 50-year-old believes things started changing a few years ago when prices started rising: "I lost a lot of business. The rent also started rising around that time."

Gao and his wife now live in a 15-square-meter apartment near the market where they work. Rent costs $257 a month and the couple has to find an additional $418 to cover utilities, transport, and shop rent. Gao's income, on the other hand, continues to fall. He complains that most vegetables are 50% more expensive than they were a year ago; as a result, people simply buy less.

"The price goes up and business goes down. The profit doesn't change but sales are down by half. We make no more than $322 a month. We can't save much at all."

"I don't have time to get sick. If I catch a cold, I just ignore it. Going to hospital is expensive. I haven't seen a doctor for 20 years"

-Gao Changyi, 50,
vegetable vendor and furniture hauler

Last year, he took a second job as a porter, hauling heavy boxes up and down stairways for an extra $12 a day. Like most migrant workers in the People's Republic of China, Gao doesn't have social security, medical care, or a pension. All four of his daughters are married and are no longer obligated to financially support their parents.

"I get 5 hours of sleep on an average day and sometimes only 3 hours. I'm used to it. I don't have time to get sick. If I catch a cold, I just ignore it. Going to hospital is expensive. I haven't seen a doctor for 20 years."

Gao envies Shanghai's well-heeled residents. At his age, many of them have already retired and lead a comfortable life. "They get a good pension and medical care. I have nothing. This is the difference between city people and countryside people." BY JOSÉ QIAN

Infrastructure bottlenecks have been an important factor. Peak electricity demand outstrips supply by nearly 10% on average, and small and medium-sized enterprises have been the least able to cope with limited supply of electricity. Similarly, poor connectivity between rural areas and prosperous regions has hampered efforts to reduce inequality. About half of India's roads are not paved.

Burdensome regulations on issues like worker layoffs have made matters worse and have discouraged investment in labor-intensive manufacturing sectors—precisely those that generate demand for relatively less skilled workers.

In sharp contrast, modern sectors such as information technology–enabled services and finance—that are less affected by public infrastructure and by constraining regulatory frameworks—have experienced a boom in private investments and generated strong demand for well-educated workers.

India's challenge is to clear these infrastructure and regulatory bottlenecks. At the same time, better social protection schemes are important. Indeed, reforming regulations on worker layoffs will be difficult without such schemes in place. But no amount of social expenditure will alleviate inequality for long in the absence of economic opportunities for the poor.

The Government of India has reaffirmed a commitment to inclusive growth in the Twelfth Five Year Plan (2012–2017). The government's approach to achieving greater inclusion can be viewed as consisting of two main channels.

The first aims to enhance economic opportunities for the poor by improving agricultural productivity, upgrading infrastructure, and revitalizing the manufacturing sector.

The second hinges on targeted programs to develop the capabilities of poor citizens to exploit economic opportunities. Examples of this are the planned Right to Food and Right to Education programs, and the National Skill Development Policy introduced in 2009 that aims to deliver skills training to 500 million people by 2022.

PHOTO: QUAN FENG


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INDIA:

TRAPPED TRIBE

A community trapped between two worlds. One is disappearing, the other unwelcoming

Jayamali is a member of the nomadic Hakki Pikki tribe, whose name means "catchers of birds." That's how they traditionally made their living, trapping birds in the dense forests that used to cover parts of the sprawling city of Bengaluru (formerly Bangalore) in India's central south.

That livelihood has been all but destroyed since the local government banned trapping in the 1970s, forcing the Hakki Pikki to sell trinkets and cultivate small parcels of land. The forests they once called home are dwindling as development continues apace.

The tribe has been provided with land and housing by the government, as well as subsidies, to help them adjust to city life.

Still, life is difficult for Jayamali and her fellow tribespeople, and it is getting harder despite India's growing prosperity.

"Banks won't give us loans because we have no deeds. So we borrow money from moneylenders who charge us interest at 10%."

-Jayamali, 35,
member of the Hakki Pikki tribe
and mother of three

Her village is perched on the border of Banerghatta National Park, only a few kilometers from Bengaluru's bustling Banerghatta road lined with software parks and gleaming skyscrapers. Most of the tribe is illiterate.

Like many of her tribe, Jayamali, a 35-year-old mother of three who, like many women in southern India, goes by one name, has had to adapt to survive. Her husband, who dropped out of school in grade 4, works as a cleaner in a distant office, earning about $73 a month. Jayamali sells hairpins, earning about $1.80 a day if she is lucky.

Most of the family income goes to food, bus fares, and paying off loans, with little left over. "A monthly bus pass costs 900 rupees ($16)," she says wearily.

Once the tribe hunted at Banerghatta Park; now they are not allowed to enter it. They don't have deeds to their land, which they are involved in a legal battle to recover. As property values soar, developers have begun grabbing land around the village.

Jayamali points to new construction. "These big apartments are coming up right next to us, and the price of everything—rice, vegetables, kerosene—is going up. Before, we could grow *ragi* (a type of grain) on our land, or get firewood, tubers, honey, and greens from the forest."

Jayamali must travel farther to find customers as the city expands. She travels across Bengaluru to sell her wares, but rising bus fares make it difficult. Some of her friends travel as far as New Delhi. Others have taken loans from loan sharks at crippling interest rates. "Banks won't give us loans because we have no deeds," Jayamali adds. "So we borrow money from moneylenders who charge us interest at 10%." Many elders, lacking skills, have resorted to begging.

Jayamali fears for her children's future. Unaccustomed to schooling, two of them are struggling in class. She hopes to get her land back. Exactly when that might happen, if at all, is just another unknown in a life plagued with uncertainty.

BY KAVITHA RAO

PHOTO: CHARUKESI RAMADURAI

INDONESIA HAS EXPERIENCED similarly strong GDP growth. Between 2007 and 2012, real GDP grew by an average of nearly 6% per year. The country has made significant strides in terms of reducing poverty. Based on the national poverty line, the proportion of Indonesians considered poor declined from 16.6% in 2007 to 12% in 2012.

Despite the progress, approximately 30 million Indonesians continue to struggle in poverty. Another 60 million live just above the poverty line and could fall back beneath it if they are hit with economic shocks.

In line with other countries in the region, Indonesia has seen a steady increase in its rates of inequality. Its Gini coefficient has increased from 31 in 1999 to 41 in 2011.

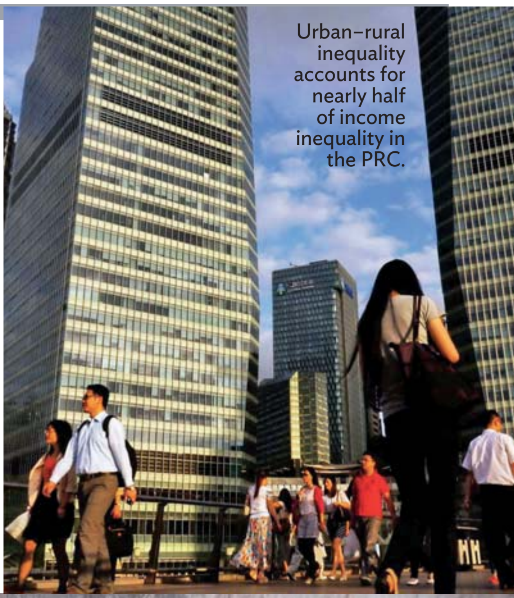
There are a number of drivers behind rising inequality in Indonesia. First, economic transformation has been much slower than expected. The agriculture sector, which absorbs more than one-third of the labor force, has consistently grown at a slower rate than the country's average GDP growth of 3.5% in 2001–2010.

At the same time, the manufacturing sector has experienced slower growth, averaging 4.5% between 2001 and 2010. The manufacturing sector has only started to rebound in the last 2 years.

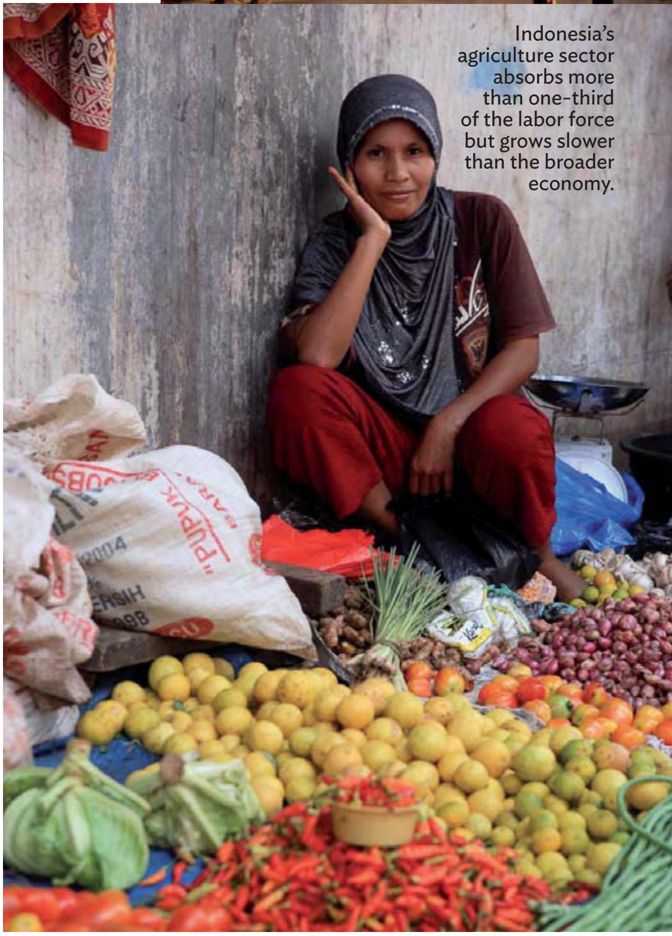
The second factor is persistent unemployment. Although the unemployment rate has declined, about 7.7 million Indonesians in the labor force are still unable to find jobs. Many of them are young people, aged 15 to 24. Of those who are employed, about 62% (about 68.2 million) are engaged in the informal sector, where wages are low.

Third, regressive fuel subsidies help spur inequality. These subsidies form the government's largest public assistance outlay (2.6% of GDP in 2012).

Studies indicate that the richest 10% of households consume 40% of the subsidized fuel and the top half



Urban–rural inequality accounts for nearly half of income inequality in the PRC.



Indonesia's agriculture sector absorbs more than one-third of the labor force but grows slower than the broader economy.

PHOTOS: AFP

of households use about 84%. This is essentially a huge subsidy to middle- and high-income households at the expense of the poor.

Finally, inequality is worsened by poor access to financing by small businesses and bottlenecks in infrastructure that discourage investment and hamper connectivity to rural areas and the country's impoverished eastern regions.

The Indonesian government has recognized the problems associated with inequality and has enshrined inclusive development in its 2010–2014 development plan.

Although progress has been slow, there is now a stronger recognition of the need to reduce fuel subsidies and redirect resources toward infrastructure development, green growth initiatives, and developing the country's poorer regions.

In the 2013 budget, the government expanded its infrastructure spending commitments by 38%, with nearly half of this allocated to the eastern part of Indonesia.

The government is also increasing its investments in education and health care. Indonesia's Constitution now requires 20% of the national budget to be allocated to education.

A number of social safety net programs, first launched after the economic crisis that hit Indonesia in 1997/1998, are in place with refinements to reflect current conditions. These programs cover food security, employment creation, community empowerment, health, and education.

THE COMMON DENOMINATOR of the experiences of the PRC, India, and Indonesia is that all three countries have initiated major economic reforms and leveraged the forces of technological progress and globalization in recent decades. These have brought strong economic growth and great prosperity, but the growth has not been distributed evenly across their societies, leading to greater inequality.

This has emerged in the form of a bias in favor of capital and skills. In the case of the PRC, for example, those who own factories have benefited from economic growth far more than those who work in them. In India, a sharp rise in demand for skilled workers in modern services has increased their earnings relative to those with skills in less demand.

Most noticeably, these forces have afforded greater income and opportunities to people living in areas with superior infrastructure, market access, and scale economies, such as coastal and urban areas.

Asian governments should respond to these challenges with policy measures that reduce inequality while not endangering economic growth. This includes spreading basic infrastructure more widely, rebalancing policies and regulatory frameworks so that sectors that are intensive users of labor—the most important asset of the poor—are not disadvantaged, increased spending on social programs, making

INDONESIA:

BITTER HARVEST

Nowadays, when Wani Hayati Solehin prays, it's for higher onion prices

Six times a year, Wani Hayati Solehin plants a fresh onion crop, spending $2,500 but making less than half that amount when she sells her produce. Sitting cross-legged on one corner of a dusty rug in her sparsely furnished living room, she says she struggles to feed her family.

The 41-year-old mother of three owns just half a hectare of land at Bojong Village on the island of Java. Falling onion prices due to competition from foreign imports means she sinks deeper into debt every year. She lacks the land and the know-how to switch to profitable crops, so she just prays for prices to rise.

"Last year we did not even buy new clothes for the children for Eid. Buying clothes is a luxury."

-Wani Hayati Solehin, 41,
onion farmer and mother of three

Above her, on the wall, is a black and gold tapestry of Mecca. It is the focal point of the room and helps Wani, a devout Muslim, keep going during tough times. "We accept what we are given," she says. "Maybe this is a trial from God."

But her prayers have gone unanswered for years now. As Indonesia's economy liberalizes, many citizens are growing wealthier. Wani is among those who have not yet benefited, and she wonders whether or not life will ever get a little easier.

Wani's lot presents the flipside of globalization. While consumers enjoy cheaper onions and other food items, small producers like Wani are left stranded—unable to compete with such low prices yet usually incapable of switching livelihoods.

Imported onions cost $0.50 a kilo, half the amount local farmers need to break even. Smaller, locally grown onions like the ones Wani produces can't compete with larger, cheaper varieties from overseas. She spends $15,000 a year to plant her crops, but makes only $7,200 at the market. Add to this the rising cost of raw materials like seeds, fertilizer, and insecticide, all of which make life on the land increasingly unsustainable for some farmers.

Wani's two eldest children have finished high school, but she cannot afford to send them to university. She makes ends meet day to day through self-imposed austerity measures.

"Last year we did not even buy new clothes for the children for Eid. Buying clothes is a luxury." Wani wants more attention to be paid to the poor, many of whom are disadvantaged by global economic dynamics they often don't comprehend. Governments face pressure to liberalize their economies on one side and protests from voters like Wani on the other.

Wani, however, hasn't lost hope. In fact, she believes that one day her family will enjoy a better life in a prosperous Indonesia. "Onion farming is the only thing I know," she says, glancing at the Mecca tapestry. "I have no choice but to continue doing this. I will keep trying to send my children to university. I pray their future will be better than mine."

BY NIDHI DUTT

the tax system work better and fairer, and targeting subsidies to those who are most in need.

In addition, programs should be directed toward regions most affected by inequality. They should focus on increasing connectivity to these regions, removing barriers to migration, and improving investments in human capital and access to public services.

As all three countries have recognized, it is vital to increase employment opportunities in order to address inequality. This can be done through growth that balances the needs of manufacturing, services, and agriculture, as well as by support for small and medium-sized businesses.

Removing policies that favor capital over labor would also help, as would public employment programs to temporarily fill gaps in private sector job creation.

The Asia and Pacific region's strong economic growth has been undeniably positive for many of its citizens. But the region has not managed to emulate the example of the newly industrialized countries of the 1960s and 1970s—such as the Republic of Korea and Taipei,China—which were able to spread growth more broadly.

Moreover, the region has not kept pace with Latin America, which has high levels of inequality but has achieved some success in narrowing these inequalities since the 1990s.

Asia and the Pacific will continue to face global uncertainties that will challenge the efforts of governments to maintain strong economic growth. Rising levels of inequality are an additional vulnerability to the region's economies that warrants urgent action.

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PHOTO: RONY ZAKARIA