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Trade and Social Development: The case of Asia

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Executive Summary

Although, some of the Asian economies, like, China, India and Viet Nam, are growing at a faster pace they are not doing well in terms of development of basic capabilities in terms of education, health and skill formation. This we found when we ranked countries in terms of Social Development Index and compared them with ranking in terms of GDP growth rate alone. In fact, the not so fast growing economies, like the Republic of Korea, do well in terms of distribution of resources towards its average citizen and in terms of other development criteria. Much of the cause of inequality in Asia results from inability to absorb predominantly rural based population into urban centric manufacturing and services sector and not because of trade. In fact, trade helps to build capabilities in the region.

Upon regressing Social Development Index on Input Measure Index (a constituent of Trade and Development Index as developed by UNCTAD), the coefficient on the latter came out to be positively statistically significant, indicating trade having a beneficial effect in building capabilities of a region. Capabilities are synonymous with freedom – freedom from hunger, freedom from dying prematurely, freedom from getting oppressed, freedom from ignorance, freedom from crime, and freedom from ecological disaster. Poor people are concerned not only about lack of opportunities to earn income but also having access to quality education, health care, drinkable water, public transport system, financial intermediation, transparent bureaucracy and living in a less polluted environment. Trade helps to build capabilities in two primary ways. First, trade affects mean income positively. Rising income can be instrumental behind getting access to quality health, education and other attributes of good life. Second, trade also embodies flow of resources that can be used to set up both healthcare and education type services, and to build necessary infrastructure in the form of power, water supply, roads and ports.

1. Introduction

There is a difference between growth and development. While growth is a univariate concept measured purely on the basis of growth of per capita Gross Domestic Product (GDP), development is a multivariate concept and refers to achievement of quality life for the average citizen of a region. United Nations Development Program (UNDP) has a way to examine development of a country (region), and they do it through Human Development Index (HDI). The HDI is calculated as the simple average of life expectancy index, education index, and the per capita GDP index, of a country. Development is therefore a broader concept than growth.

A country with a better growth prospects but which neglects development cannot grow in the long-run. Improved standards of living cannot be ensured through increased growth rate alone. For example, during the sixties and the seventies, Brazil witnessed higher growth but as distribution of income along with other quality indicators of life, such as health and education were neglected, policymakers eventually had to follow populist policies in the fear of losing power in the parliament. Because there was a lesser element of development; the larger *have not* group was neglected, and the ruling parties in Brazil were repeatedly thrown out of power. This has put a halt to Brazil's reform programs and prevented them from achieving higher full employment level of output. So the initial reform process although resulted in higher growth during the seventies could not be sustained during the eighties. Hence rising inequality can actually stall economic liberalization, further limiting the ability of economies of benefits from globalization.[1]

Hence, the growth rate of per capita real income is not the only criterion for development; although it is necessary to enable distribution of resources in a meaningful way (that is, increase average well-being). Lucas (1988) stresses the importance of the growth of per capita real income as the primary determinant of human welfare. Lucas's paper begins, 'By the problem of economic development I mean simply the problem of accounting for the observed pattern across countries and across time, in levels and rates of growth of per capita income' (p.3). Lucas admit that this definition of economic development is narrow but when he considers the implication of diverse rates of growth of real per capita GNP over sustained periods he finds stark differences in the average well being of the people across countries. For example, India experiencing 1.4 per cent growth rate for the period 1960-80 whereas people of South Korea experiencing a growth of 7 per cent during the same period. It means, 'Indian incomes will double every 50 years; Korean every 10' (p.4). But to say, an Indian will on average, be twice as well as his grandfather, a Korean five times is to presume a strong positive casual relation between the growth of income per capita and the consequent increase in well-being. The observed positive correlation between the growth of GNP per head and the average quality of life may not be as strong as it appears to be.

Sen (1999) argues, 'it would indicate that the connection tends to work particularly through public expenditure on health care, and through the success of

[1] For more on the effects about income inequality see, Alesina and Perotti (1996), Roine and Waldenstrom (2008), and Barro (2000).

poverty removal. The basic point is that the impact of economic growth depends much on how fruits of economic growth are used' (p.44). So HDI came into being as partial fulfillment of Sen's ideology. However, merely taking into account the simple average of life expectancy, education and the per capita GDP, might hide some richer information in the context of well-being. For example, South Africa is ranked in the group of middle income countries with a per capita gross national income of 3562 USD in 2006 (World Bank Atlas Method), but the income distribution is very unequal - the poorest 10 percent of the population account for 1.4 percent of national income, and the richest 10 percent for 44 percent (Human Development Report, UNDP, 2006, p. 29).

There is therefore a need for constructing a Social Development Index (SDI) by considering income distribution as a separate variable in addition to the other variables that are considered in HDI. Comparing countries without considering income distribution as a separate variable might be problematic for three reasons. First, comparison between the HDI rank and per capita GDP rank draws conclusion on income distribution of a country. Income distribution, as a distinct measure, does not enter the inter-country comparison of development performance. Second, per capita GDP, being an average, can be best interpreted as an end income for an average citizen, not the society as a whole. It suppresses too many information whether the fruits of economic growth indeed reach the bottom portion of the population. In fact, all the three indicators of the HDI are in average terms. Addition of income distribution with other three indicators of HDI captures the inter-country difference in income distributions. Countries with higher SDI have done better job in terms of income distribution compared to countries with lower SDI. Last and importantly, people usually feel content considering that they are better off, or at least similar, in terms of their well-being (happiness) compared to their peers. The utilitarian approach to measure happiness is in terms of life-ability of the person. Life-ability of the person refers to capability of one self to fight against, disease, illiteracy and lesser opportunities to earn (Sen, 1992). [2]

It is therefore important to consider income distribution and more importantly understanding factors leading to a more skewed income distribution. So what leads to more skewed income distribution? An initial effort in this direction, trying to examine relationship between growth and inequality, was undertaken by Simon Kuznets (Kuznets, 1955). Better known as the Kuznets-U hypothesis, it states that when beginning from a low level of economic development as measured by per capita income, income distribution tends at first to become less equal and then more equal as income levels rise (Kuznets, 1955; Kakwani, 1980).

The basic Kuznets formulation, about incorporating income as the basic explanatory variable behind explaining inequality was augmented by various researchers. The idea was to try and figure out influence of other variables, besides

[2] In this context it is worth mentioning that equality of income distribution always might not lead to equity. Equality is a positive concept that describes a state of distribution without commenting about whether this distribution is 'good' or 'bad'. On the other hand, equity is value judgment made on distributive mechanisms and outcomes using principle of justice. Thus, a 'fair' income distribution usually refers to an income distribution that conforms to a commonly accepted principle of justice. Henceforth, commenting about distribution of income the implicit assumption is that we are talking about a 'fair' income distribution.

income, that might contribute to inequality. Ahluwalia (1976), regressed inequality on a number of explanatory variables including logarithm of per capita income and its square, the primary and secondary school enrollment rates, the rate of growth of population, the rate of growth of GNP, agriculture's share in GDP, and dummy variables for developed country and socialist country. In this study, income variables, education variables, and the socialist country dummy, was found out to be significant. Inequalities can also vary according to geographical location.[3] For example countries in Latin America and sub-Saharan Africa are more unequal (World Bank, 1999). Other things remaining equal, even with similar level of income, countries in Latin America are more unequal compared to Asian countries (Schultz 1998; Barro 1991). The significance for Latin American dummy is explained by unequal distribution of land, inadequate infrastructure investments, misallocation of government spending, poor economic and cultural integration, insufficient productive employment and excessive populism.

These above mentioned studies did not incorporate the effect of trade on inequality. However, there might be a link between trade and inequality, and it might happen because trade has an effect on autarkic level of income. It has been widely established that countries that open up, and hence trade more, have better economic performance in terms of growth rate of GDP than others (Srinivasan and Bhagwati, 1999).[4]

Recently, many economies in Asia – China, India, and Viet Nam, in particular – are growing at a fast rate. The reason for this faster growth is attributed to reforms. One major aspect of economic reforms is globalization and this is usually reflected in terms of higher value of trade.[5] For example, countries that have started globalizing (mainly, through tariffs reduction) during seventies have experienced an increase in their GDP growth rate from 2.9 per cent during the seventies, to 3.5 per cent in the eighties, and further to 5 per cent during the nineties. This is in contrast to the countries which didn't undertake the path of globalization – experiencing a fall in their GDP growth rate from 3.3 per cent in the seventies, to 0.8 per cent in the eighties and recovering only to 1.4 per cent during the nineties (Dollar and Kraay, 2004).

In the present context, as both growth of per capita income and distribution of income, enter as components for constructing SDI, it makes sense to examine how trade affects SDI. This aspect has not been examined in the current literature. So besides ranking countries in term of SDI we also examine interaction between SDI, and trade and development index (TDI) developed by UNCTAD. As some studies have pointed about the importance of physical infrastructure in explaining variations in income and export growth among countries (Hall and Jones, 1999; Banik, 2007), we consider trade index – a combination of a country's infrastructure capabilities and trade openness. The rest of the paper is structured as follows: (a) understanding

[3] Most of the studies have taken differences in wage rates as a measure of income inequality. The problem with aggregate measures of income is that income is understated, and also coverage of income sources and taxes tend to varies across countries.

[4] For example, Srinivasan and Bhagwati (1999) argue, 'in-depth analysis of country experiences in major OECD, NBER, and IBRD projects during the 1960s and 1970s have shown plausibly, and taking into account numerous country specific factors, that trade does seem to create, even sustain higher growth' (p. 6).

[5] Other components of reforms, namely, fiscal adjustment, macro economic stabilization, strengthening private property rights and exchange rate reform also have an important bearing on growth of trade.

income inequality, and the case with China and India – the two fastest growing economies in Asia; (b) comparing Asian economies in terms of SDI; (c) examining relationship between trade and SDI; and finally, (e) conclusion.

2. Understanding Inequalities

Inequality (in terms of income earned) can primarily be because of circumstantial reasons, or due to policy failure. Circumstantial reasons are exogenous and cannot be controlled by policy measures. Examples about circumstances led poverty may be because of: (a) caste, (b) natural disaster, (c) gender, and (d) wars. For instance, people taking birth in some lower castes in India (schedule tribes, or castes) are most likely to start with limited opportunities and hence have a lower steady state level of income (read, poor). Similarly, considering case of Bangladesh, which many times are frequented by natural disasters, like flood and tornados - witness a loss in physical capital/assets and hence tend to be poor. Gender inequality is another classic case. While 200 million women entered the global workforce in the decade before 2003, 60 per cent of the one billion poorest people are women (Human Development Report, UNDP, 2007). Lastly, war has an effect in terms of loss of human and physical capital. Much of the poor GDP growth rate in Viet Nam during eighties and more recently the fall in per capita income in Iraq, is because of wars, and political and economic isolation that followed.

Fortunately, much of the other causes of inequality are endogenous and can be addressed. Most Asian economies have a majority share of their population dependent on the agriculture sector. Persistence of equal or unequal income distribution depends much on how policy makers in the region are focusing on their agriculture sector. For example, in Viet Nam the impact of doi moi (reform process) beginning in 1986, have benefited the rural workers by linking domestic coffee and rice market with the international market (Klump, 2006). The close integration of rural and urban labor market, facilitated by rural financial market intermediation has made economic growth pro-poor in Bangladesh (Timmer, 2006).

However in recent times, as reported by publications from two major multilateral organizations – International Monetary Fund (IMF) and Asian Development Bank (ADB) – inequality is on rise in Asia. For example, IMF Regional and Economic Outlook has this to comment, ‘Over the last ten years or so, 13 out of 18 Asian countries for which data are available have recorded increases in income inequality, ranging from around 5 to 35 per cent’ (IMF Regional and Economic Outlook, 2006, p. 63). ADB, in its latest 2007 report titled, ‘Inequality in Asia’, writes that the story of rising income inequality in Asia can be best portrayed as rich getting richer faster than the poor are getting richer – although there has been a stark fall in poverty (by head count measures) in the Asian region.

Table 1: Gains in the battle against poverty

Economy	Poverty index					
	$1-a-day		$2-a-day		Survey Year	
	Initial	Final	Initial	Final	Initial	Final
China	28.3	10.8	64.5	37.8	1993	2004
Cambodia	25.5	18.5	76.5	61.6	1993	2004
India	41.8	35.1	85.1	79.6	1993	2004
Indonesia	17.4	7.7	64.2	52.9	1993	2004
Lao PDR	47.8	28.8	89.9	74.4	1992	2002
Malaysia	0.0	0.0	19.2	9.8	1993	2004
Philippines	18.1	13.2	52.7	43.6	1994	2003
Thailand	6.0	0.0	37.5	25.8	1992	2002
Viet Nam	27.3	8.4	73.5	43.2	1993	2004

Note: Poverty Index = percentage of population under poverty line.
Source: Inequality in Asia, ADB, (2007)

Despite the fall in poverty the benefit of growth is unequally shared by people. The ADB report (Inequality in Asia, 2007) attributed the reasons for growing inequality to a number of factors. In China the reasons for unequal income distribution has to do with market-oriented reforms where coastal areas have a greater concentration of investment, and hence growth, compared to rural hinterlands. In India disparity in attainment of education has given skilled workers more opportunities compared to the less educated/unskilled workers in a newly globalized environment. In Viet Nam income disparity has been more on the basis of circumstances, where mass exodus of ethnic Chinese from industrially developed South Viet Nam to predominantly agriculture prevalent North Viet Nam, has created spatial inequality. In general, people living in rural areas in China and India, have less earning potential compared to their urban counterparts because of slow growth of agriculture vis-à-vis industry and services sectors. Chaudhuri and Ravallion (2007) argue that post-reform growth in both China and India has not been pro-poor.

A way to measure the extent of inequality is through Gini coefficient index which takes value between 0 and 1. The higher the value the more unequal is the income distribution. Figure 1 describes changes in the Gini coefficient for 21 developing market economies in Asia over a roughly 10-year period (a little less or a little more in some cases). As may be seen, an increase in inequality is registered for a majority of the developing member countries, although countries like, Thailand,

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