ADVANCES in ORGANIZATION STUDIES

The End of the 'Asian Model'?

edited by
Holger Henke
Ian Boxill

This is an offprint from:

Holger Henke and Ian Boxill (eds.)
The End of the 'Asian Model'?
John Benjamins Publishing Company
Amsterdam/Philadelphia
2000
(Published as Vol. 2 of the series
ADVANCES IN ORGANIZATION STUDIES)

ISBN 90 272 3299 7 (Eur.) / 1 55619 745 4 (US)

Chapter 5

Public Policy Interventions, Market Economics, and Income Distribution

The Impact on Sri Lanka and Other Asian Countries

Patrick Mendis

1. Introduction

Over the years, economists and policymakers have long been convinced that economic growth fosters greater social equity. Theoretically, it is logical to assume the existence of such a positive relationship between the two. With higher income, people have better access to education and the health delivery system; therefore, the trickle-down of economic growth is said to reach to many people through education and the health care mechanism. Thus, education and health would serve as the wealth and income equalizing forces (Mendis 1995). Furthermore, the World Bank, a perennial advocate of economic growth strategies, has recently taken the position that social development is economic development. Speaking on behalf of the World Bank at the United Nation's Economic and Social Council (ECOSOC), Nancy Birdsall (1993) has highlighted the Bretton Woods position.

It is generally viewed that Japan and the Newly Industrialized Countries (NICs) of Hong Kong, Singapore, South Korea, and Taiwan have such a pattern of relatively more equitable income and wealth distribution as their income has risen. In fact, according the World Bank's The *East Asian Miracle* report, the experience in the NICs has overall shown that there exists a pattern of general direction as they moved toward a more industrialized stage (World Bank 1993). In this process, social inequality is expected to increase in the early stages of economic growth but later on a more egalitarian socioeconomic equilibrium is anticipated and can eventually be achieved. But this pattern is not commonly demonstrated in all Asian countries; each has its own unique experiences, which are influenced by a multiple of economic, social, political, and cultural factors.

This essay surveys the income distribution and economic growth in Sri Lanka and East Asian NICs. There is no universal agreement on problems and issues related to theoretical debate, sources of comparable data, and the methodologies used in countries under discussion. The existence of obvious variations in cross-national experiences should be acknowledged in economic growth strategies, indicators of income distribution and Gini coefficient, level of poverty alleviation, and other indicators of quality of human development. With such caution, this chapter reviews selected studies in theoretical and empirical aspects of income distribution, economic growth, and development strategy in Section 2. The experience of the NICs is discussed in Section 3. Section 4 presents a range of public policy interventions and their impact on income distribution and poverty in Sri Lanka over the past four decades. Section V concludes the chapter with two observations of the analysis as lessons to be learned.

2. Theoretical and Empirical Underpinnings

In an analysis of the general notion of the growth and equity relationship, Simon Kuznets in his 1955 study observed a general pattern of income distribution as economies develop. This well-known Kuznets inverted-U curve pattern demonstrates that inequality exists to a point before more equality appears as countries increase their GNP per capita (Kuznets 1955; see also Bacha 1979). The reason noted for this inverted-U curve is that productivity and income begin to rise more rapidly in the modern industrialized sector than in rural agriculture at the beginning of the industrialization and modernization process. When the agricultural labor surplus is absorbed by the other industrialized and service sectors of the economy, wages and salaries are expected to rise. In practice, the Kuznets theory in the NICs is consistent with the conventional notion of the linkages between economic growth and social equity.[1]

Many researchers in the past, however, have raised questions on the conventional and theoretical understanding of the industrialization and modernization process and its impact on income distribution and poverty alleviation.[2] The theoretically expected transfer of surplus agricultural labor to the industrialized sector did not produce a more satisfying result in income distribution of all these countries, as expected by some economists and policymakers. With direct foreign investment, for example, it is anticipated that Western investors would substitute domestic labor for imported financial and physical capital while the local work force would be fully utilized to produce materials for the export market. The incentive to use surplus labor with lower wages at entry-level manufacturing jobs as opposed to capital investment was seen favorably by both foreign investors and local policymakers.

In the initial transition period, the labor force is transferred largely from rural agriculture to the industrial sector, and foreign companies are expected to manufacture goods and services at relatively low costs. Many countries, like Sri Lanka, have established free trade zones and relaxed strict legislation to encourage foreign investors to resuscitate their stagnated economies, which have experienced high inflation, growing unemployment, rising interest rates, and a shortage of foreign exchange. In the process, when the demand for labor has been fully absorbed by the industrial and service sectors, the excessive labor force has remained unemployed or underemployed. This has created a growing frustration, especially among the educated cohorts on two fronts: there is an increasing income gap between those who are employed and those who are not fully employed. Consequently, some of the unemployed, with their idle time and energy, often express their frustration in destruction, while others find creative forms of adapting to new and different kinds of opportunities in the informal sector. The evidence of such violent expressions in South Korea, China, and even in Sri Lanka has been widely reported in the mass media. Alternative forms of adapting to changes by unemployed youth have also been reflected in illegal activities. The anticipated economic or social equilibrium does not, therefore, appear to take place in these societies, and the continued disequilibrium has created an imbalance in their economic and social systems. This, however, does not suggest that the conditions of those countries have necessarily become worse; it rather seems to indicate that high expectations of the industrialization and modernization process have not been fully satisfied and the negative externalities (such as corruption, prostitution, baby selling, Mafia, and drug problems) have not been completely addressed or resolved.

In countries where income distribution patterns tend to follow the Kuznets curve, those patterns do not essentially result from the introduction of industrialization and modernization processes alone. Some countries had relatively more equitable income distribution before their export-led industrial growth took effect. Prior socioeconomic and cultural conditions have seemingly laid the foundation needed for a comparatively rapid pattern of income distribution. Some researchers have noted that land reform in South Korea and Japan had a major impact on a more equitable income distribution (Mason et al. 1980; Mizoguchi 1985). In the Sri Lankan experience, two World Bank economists have indicated that the already existing conditions of physical distribution of properties (like the ownership of land) and other assets are viewed as more important than the export-led industrialization strategy (Bhalla and Glewwe 1986; Bhalla 1988). This suggests that industrialization strategy alone does not bring about equity in income distribution but a set of public policy interventions does have a significant impact on social welfare. Economic growth strategies do increase per capita income, but the distribution of that accumulated income is a different matter. The experience demonstrates that the level and the pattern of income distribution resulting from both growth strategies and policy interventions are unique for each country.

3. The Equity and Growth Experience of Nics

The East Asian NICs and Japan have demonstrated rapid economic growth with relatively equal income distribution (Rao 1988). Japan's Gini coefficient of .372 in 1968 improved to .316 in 1979 as her per capita income grew (Table 5.1). South Korea has achieved more equality as reflected by the Gini coefficient, which changed from .414 in 1976 to .363 in 1988. This seems to be attributable to the introduction of their export-led development strategy. Prior to the 1970s, South Korea did in fact have a relatively more equitable income distribution. Many observers attributed this to the result of land reform initiatives. In Table 5.1, the Gini coefficient ratio indicates the relative distribution of income in several selected Asian countries as well as Sweden and the United States for the purpose of comparison.

In theory, if all incomes are equal, the Gini coefficient should be zero; if one person or household has all the income, the Gini coefficient should be one. In practice, if the Gini coefficient is .3 or below, it reflects a low level of inequality; if it is above .5, it should be considered high inequality. Table 5.1 indicates that Malaysia's Gini coefficient was over .5 in the early 1970s and continues to remain relatively high in Asia. The higher income earners in Malaysia are largely concentrated in the highest 20 percentile (over 50 percent), higher than any other East Asian nation. Japan, with its .32 coefficient, like Sweden, demonstrates a more equitable income distribution in the Asian region. The share of income distribution in Table 5.1 also illustrates that Sweden with its social welfare policies has achieved a relatively more egalitarian society.[3] India, with its heavy government intervention in the economy, also had a more egalitarian income distribution in 1980s. India's socialistic economy tends to follow a distribution of income similar to that of other South Asian countries.

The experience of income distribution among the NICs of Asia is mixed. Figure 5.1 shows an interesting path of income disparity in Japan and South Korea as well as in Sweden and the Philippines. All these countries have reached a comparatively equitable income distribution after a period of widening income gap (consistent with the Kuznets curve). Prior to 1970, for example, Japan, South Korea, and the Philippines had a pattern of rising income disparity. Stephan Haggard writes of South Korea that "land reform is the most plausible explanation, though no doubt the destruction of the Korean War also had a powerful leveling effect" (1992: 225). This is also prior to the effective period of export-led economic growth under military rule. For other countries, land reform policies, particularly in Japan and the Philippines, may have been associated with the demonstrated pattern. Figure 5.1 further illustrates that other countries, including the United States and Malaysia, have a collection of mixed experiences. The exact reason for the existing pattern in the United States is difficult to discern, but a

Table 5.1: *Share of Income Distribution and Gini Coefficient in Selected Countries*

Country	Year(s)	Share of Income Received by		Gini Coefficient
		Lowest 20%	Highest 20%	
Hong Kong	1970–85	–	–	.450
	1980	5.4	47.0	.428
India	1954–64[a]	–	–	.400
	1963–64[b]	–	–	.418
	1964–65	6.7	35.2	.414
	1970–85	–	–	.420
	1975–76	7.0	49.4	.422
	1983	8.1	41.4	.349
	1989	8.8	41.3	.334
	1992	8.5	42.6	.338
Indonesia	1976	6.6	49.4	.446
	1987	8.8	41.3	.335
	1990	8.7	42.3	.342
	1993	8.7	40.7	.317
Japan	1968[b]	–	–	.372
	1969	7.9	41.0	.389
	1979	8.7	37.5	.316
Malaysia	1970	3.3	56.6	.529
	1973	3.5	56.1	.521
	1987	4.6	51.2	.469
	1989	4.6	53.7	.484
Philippines	1965b	–	–	.465
	1970–71	5.2	54.0	.472
	1985	5.5	48.0	.439
	1988	6.5	47.8	.321
South Korea	1964–70[b]	–	–	.340
	1965[b]	–	–	.344
	1970[b]	–	–	.362
	1976	5.7	45.3	.414
	1988	7.4	42.2	.363
Sweden	1972	6.6	32.0	.351
	1979	7.2	37.2	.346
	1981	8.0	36.9	.328
Thailand	1970–85	–	–	.470
	1975–76	5.6	49.8	.446
	1988	6.1	50.7	.442
	1992	5.6	52.7	.462
United States	1970[b]	–	–	.315
	1972	4.5	42.8	.428
	1978	4.6	50.3	.470
	1980	5.3	52.0	.394
	1985	4.7	41.9	.419

Sources: (a) Chenery (1974); (b) Ahluwalia (1976); other Gini coefficients are calculated by data presented in the UN Development Programme (1991) and World Bank (1986, 1989, 1990, 1994). The latest available data are according to the World Bank (1996: 196–97).

host of factors may be associated with changing public policies, such as direct government interventions in agriculture and industry as well as in social welfare programs. Some economists have argued that the loss of manufacturing jobs to lower-priced imports has been a cause of more inequality in the United States.

4. *Dirigisme* Policies and Analysis of Poverty in Sri Lanka

Surprisingly, a variety of social welfare programs and land reform legislation in Sri Lanka did not yield an anticipated greater income distribution as they did in

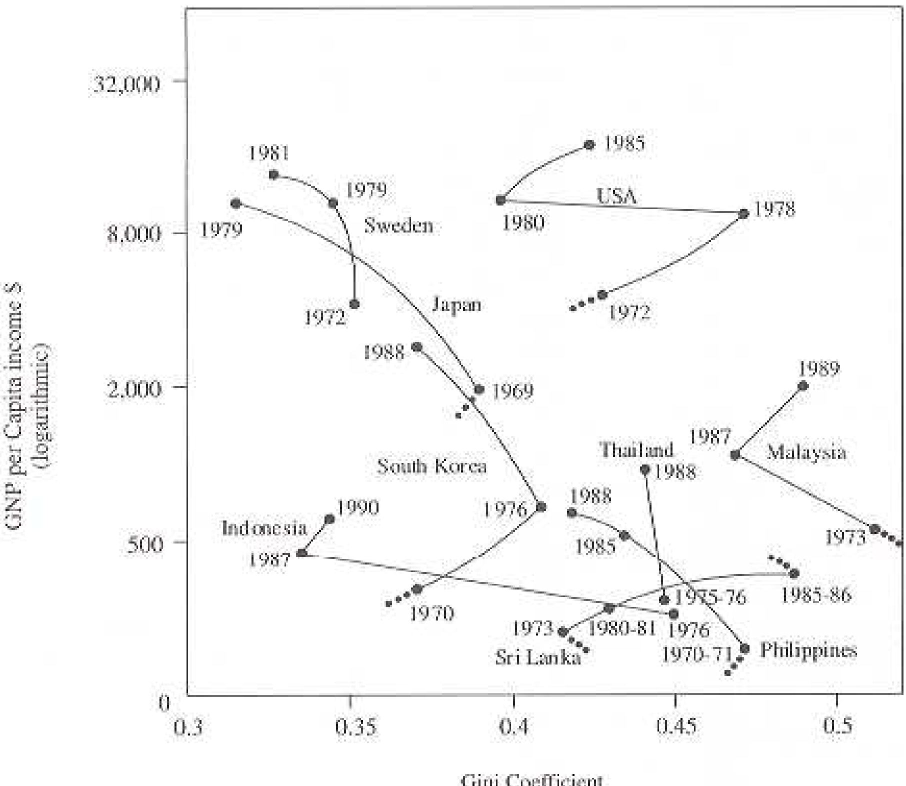

Figure 5.1: *Relationship between GNP per capita income and Gini coefficient in selected countries.*

Sources: *Gini coefficients are calculated from income distribution data presented in UN Development Programme (1991) and World Bank (1986, 1989, 1990, 1994).*

Numbers indicate the survey year(s) of income distribution. Dotted line indicates the direction of previous survey's Gini coefficient.

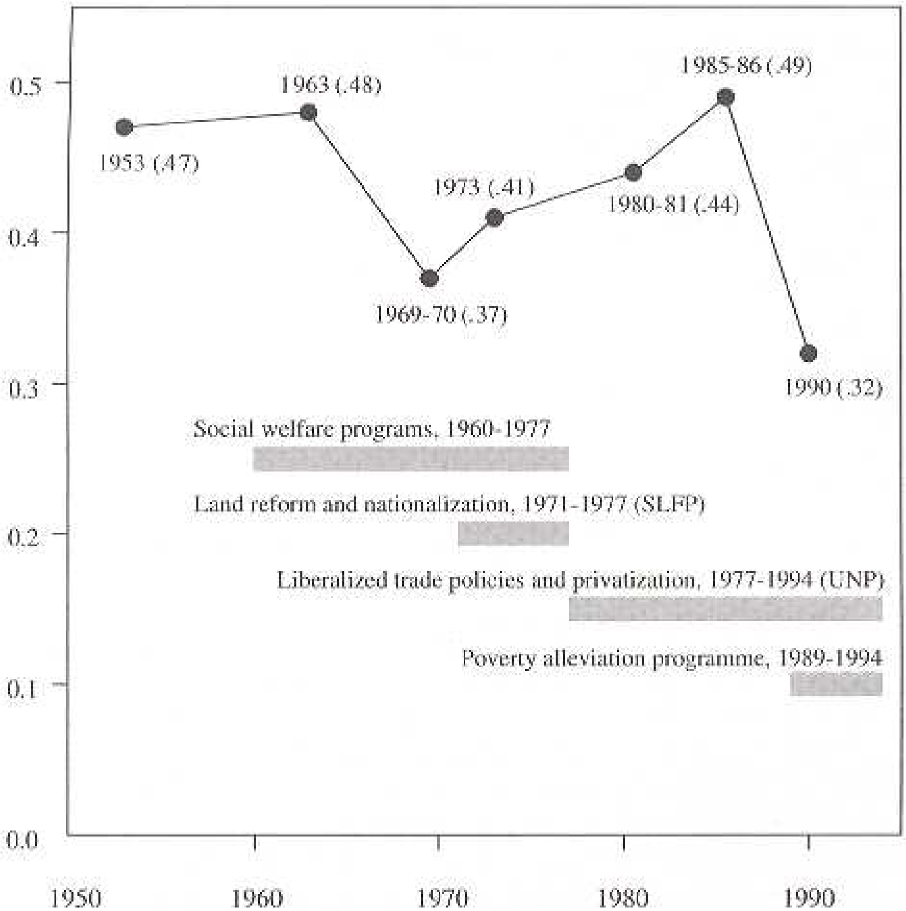

Figure 5.2: *Direction of income inequality and periods of significant policy impact in Sri Lanka.* Sources: *Gini coefficients for 1953, 1963, and 1973 are from Fields (1980); others are from income distribution data presented in UN Development Program (1991) and World Bank (1986, 1989, 1990, 1994).*

some other countries. In fact, the experience in Sri Lanka illustrates that the gap between the rich and poor has increased despite the nationalization and land reform policies of 1972 and 1976. The general direction of Gini coefficient in Sri Lanka suggests that income distribution has widened from the early 1970s to the mid-1980s (Figure 5.2). This period includes both the prosocialist Sri Lanka Freedom Party (SLFP), which implemented the nationalization and land reform, and the procapitalist United National Party (UNP), which introduced open-market policies and trade liberalization. As expected, income inequality accelerated after the introduction of trade liberalization by the UNP administration in 1977.

Table 5.2: *Share of Income Distribution and Gini Coefficient in Sri Lanka*

Year(s)	Share of Income Received by		Gini Coefficient
	Lowest 20%	Highest 20%	
1953[a]	5.2	53.8	.468
1963[a]	4.5	52.3	.476
1963–70[b]	–	–	.450
1969–70	7.5	54.4	.371
1973[a]	7.2	42.9	.412
1970–85[c]	–	–	.450
1980–81	5.8	49.8	.436
1985–86	4.8	56.1	.491
1990	8.9	39.3	.320

[a] Fields (1980: 197).
[b] Chenery (1974: 42).
[c] UN Development Programme (1991).
Note: The remaining Gini coefficients are calculated from data in World Bank (1984, 1989, 1990, 1994).

The most salient feature of income equity demonstrated in Table 5.2 is that the Gini coefficient dropped to .32 in 1990, the lowest recorded in Sri Lankan economic history. The Gini coefficient in Sri Lanka is as low as that of Japan (.316) in 1979 and Sweden (.328) in 1981 (cf. Tables 5.1 and 5.2). One of the most likely reasons for this phenomenon is the massive income transfer through the Poverty Alleviation Programme (known as Janasaviya, which means "people's strength" in Sinhalese) that was implemented in the late 1980s by the UNP government. With the Janasaviya Programme, a target group of people below the poverty line (estimated as one-half of the population) was eligible to receive income in the form of cash and food items (Mendis 1992). Other reasons may include the benefit of the Accelerated Multi-Purpose Mahaveli River Development Programme, which benefited the rural population through irrigation, government-initiated welfare programs (e.g., free school textbooks, midday school meals, and school uniforms), and the Million Housing Programme for the poor (Mendis 1994). The disaggregate impact of these programs on poverty and income distribution is difficult to identify and to verify. It does, however, demonstrate that direct public policy intervention can abruptly change the direction of income inequality. The newly elected coalition government led by the SLFP in 1994 assured the country that they would continue to pursue, even on an aggressive scale, a similar program for the welfare of the poor while advocating free market economic policies, including the privatization of state-owned enterprises. The massive islandwide Janasaviya Programme was somewhat modified and changed to the Samurdhi Programme (which means "prosperity" in Sinhalese). As long as such monetary transfer in the form of public intervention continues, a more egalitarian income distribution can continue in Sri Lanka.[4]

In fact, the share of income distribution from the lowest quintile of income earners increased from 5.2 percent in 1953 to 8.9 percent in 1990 (Table 5.2). A drastic reversal trend is shown for the richest quintile of income earners: 53.8 percent in 1953 reduced to 42.9 percent in 1973, and then to 39.3 percent in 1990. This seems to imply that the poorest 20 percent accrued more income during these years. A series of land reforms, nationalization of estate plantations (tea, rubber, and coconut), and food stamps and food subsidy schemes may have been associated with such changes in the early 1970s but there is still some question that the gap between rich and poor has gradually begun to increase throughout the 1970s, especially after 1973. By 1980–81, for example, the share of income accruing to the poorest 20 percent had declined to 5.8 percent from 7.5 percent in 1969–70. The share further dropped to 4.8 percent by 1985–86.

Furthermore, Table 5.2 indicates that the Gini coefficient of .371 in 1969–70, the lowest since independence from Great Britain in 1948, reached .412 in 1973. The average Gini coefficient during the 1970–85 period was .45. The available data on the share of income distribution also shows that the share of national income for the lowest 20 percent of the population increased up to 7 percent during the 1969–73 period. Simultaneously, the share of the highest 20 percent income earners declined from 54.4 percent in 1969–70 to 42.9 percent in 1973. This is a significant departure from the past, when the share of income accruing to the richest 20 percent remained higher than 50 percent of the total. As the share of income among the poorest quintile accounted for only a little over 7 percent of income, the equity of income distribution improved during this period. This may be associated with the initial land reform legislation in 1972; however, the Gini coefficient of .41 in 1973 remained relatively higher than .37 in 1969–70. A possible reason for this contrasting situation is that the benefits of the fifty-acre ceiling on land ownership did not trickle down to the lowest 20 percent although it adversely impacted the richest 20 percent, whose share of income changed with respect to the lowest income group. The increase of share of income distribution at the lowest quintile does not suggest that the poverty rate changed. The change in the income gap is not a clear indication of relative poverty. The Gini coefficient increased from .41 in 1973 to .44 in 1980–81, and to .49 in 1985–86. The share of income in the richest quintile also grew from 43 to 50 and to 56 percent, respectively, in those years. Two Sri Lankan researchers who also identified a similar trend write that "during the period 1969–70, the inequality in income distribution increased sharply for both the urban and rural sectors. The worsening in income distribution has, however, not led to an increase in poverty. In both sectors, the real incomes of the lowest income groups appear to have increased marginally while those of higher income groups grew rapidly" (Gunatilleke and Perera 1994: 155).

The foregoing analysis attests that the level of poverty as represented by the comparative Gini coefficient ratios has been reduced from 1969–70 to 1990. In terms of the incidence of poverty, Gunatilleke and Perera assert that "while absolute poverty in the rural sector appear to have remained at the same level during 1969–1985, there was a significant reduction of poverty in the urban sector based on available data" (ibid.: 160). This may suggest that the introduction of trade liberalization and export-led development strategies after 1977 may have caused the transfer of agricultural labor to the industrial sector, especially through the newly-created free trade zones.

5. Concluding Remarks

The post-1977 economic strategies in Sri Lanka appear to have increased income inequality. This is in contrast to both the Kuznets curve and the paths of other NICs. But Sri Lanka and some NICs have essentially followed similar economic and trade policies. Some may argue that Sri Lanka, afflicted by entrenched ethnic conflict and guerrilla warfare, may have potentially blocked the path to NIC status. But similar experiences in South Korea, in the form of repression and authoritarian governance, caused some setbacks even after Park Chung Hee (military strongman from 1961 to 1979). The negative impact on economic growth appears to have been milder in South Korea than in Sri Lanka. The nature of the political leadership may be associated with this, since relatively more democratic Sri Lankan leaders must accommodate the will of the people in elections.

The Asian experience suggests that the "best way" would not always result in a more equitable income distribution. Some countries, particularly Sri Lanka, Malaysia, and even the United States, have not necessarily followed the path prescribed by mainstream economists and policymakers, who advocate that greater equity follows with economic growth. Other factors may have influenced the direction of change. A host of public policy interventions could well be associated with such a change as demonstrated in Sri Lanka and other countries.

In general, this analysis provides two lessons for development thinkers and practitioners: First, the socialist experiment in Sri Lanka did not result in a more equitable distribution of income as envisioned. The equality of income distribution tends to follow the direction of economic growth positively if the necessary conditions prevail in the economy during the initial take-off period, as other East Asian countries have demonstrated. The NICs of East Asia, with their efficient and broad-based employment-intensive strategies, have promoted economic growth and social infrastructure in education and health care systems. These education and health care systems in return have reinforced the economic development process, especially in resource development. This has been a "virtuous circle" for them. The best way then for NICs as well as others to achieve a more equitable income distribution is by investing in human capital as a long-term investment for higher rates of return. Second, government intervention in the form of public policies or a set of programs of monetary or nonmonetary transfers to poor people could change the income distribution more effectively and rapidly than the trickle-down of economic growth (see e.g., Bhagwati 1988; Sen 1981). The question of funding such income transfer programs without economic growth would be challenging for some countries, especially Sri Lanka and other South Asian countries, where the foreign debt service rate and the volume of external financial assistance are already relatively high in their national budget portfolios. The best way to achieve a higher human development is then by promoting economic growth while ensuring that growth is closely linked with human well-being, as opposed to jobless economic growth.

Notes

1. There exist numerous studies of evidence of the Kuznets hypothesis, see e.g., Ahluwalia (1976).
2. For some empirical studies on policy effect on income distribution, poverty alleviation, and economic growth, see Adelman and Taft Morris (1973), Adelman and Robinson (1978), and Chenery (1974).
3. Sweden is considered here because of its well-known social welfare programs and relatively less income disparity compared to those of Asian countries.
4. It is too early for a comprehensive analysis of the Samurdhi Programme or other economic strategies of the SLFP alliance because the implications of such policies have not yet been evaluated nor have programs been fully developed and implemented. In late 1995, the government formed the National Development Council to coordinate economic and social welfare strategies.

References

Adelman, I. and C. Taft Morris (1973). *Economic Growth and Social Equity in Developing Countries*. Stanford, CA: Stanford University Press.

Adelman, I. and S. Robinson (1978). *Income Distribution Policy in Developing Countries: A Case Study of Korea*. New York: Oxford University Press.

Ahluwalia, M. (1976). "Inequality, Poverty, and Development." *Journal of Development Economics* 3: 307–42.

Bacha, E. L. (1979). "The Kuznets Curve and Beyond: Growth and Changes in Inequalities." Pp. 52–73 in *Economic Growth and Resources*, Volume 1, edited by E. Malinvaud. New York: St. Martin's.

Bhagwati, J. (1988). "Poverty and Public Policy." *World Development* 16(5): 539–55.

Bhalla, S. S. (1988). "Is Sri Lanka an Exception: A Comparative Study of Living Standards." Pp. 89–117 in *Rural Poverty in South Asia*, edited by T. N. Srinivasan and P. K. Bardhan. New York: Columbia University Press.

Bhalla, S. S. and Paul Glewwe (1986). "Growth and Equity in Developing Countries: A Reinterpretation of the Sri Lankan Experience." *World Bank Economic Observer* 1(September): 35–64.

Birdsall, N. (1993). *Social Development Is Economic Development*. Washington, DC: World Bank.

Chenery, H. (1974). *Redistribution with Growth*. New York: Oxford University Press.

Fields, G. S. (1980). Poverty, Inequality, and Development. Cambridge: Cambridge University Press.

Gunatilleke, G. and Myrtle Perera (1994). "Urban Poverty in Sri Lanka: Critical Issues and Policy Measures." *Asian Development Review* 12(1).

Haggard, S. (1992). *Pathways from the Periphery: The Politics of Growth in the Newly Industrialized Countries*. Ithaca, NY: Cornell University Press.

Kuznets, S. (1955). "Economic Growth and Income Inequality." *American Economic Review* 45(March): 1–28.

Mason, E. S., et al. (1980). *The Economic and Social Modernization of the Republic of Korea*. Cambridge, MA: Harvard University Press.

Mendis, P. (1992). "The Economics of Poverty Alleviation: The Janasaviya Programme in Sri Lanka." *South Asia Journal* 5(3): 289–98.

Mendis, P. (1994). "The Role of Indigenous Culture and Evolving Development Strategies: Is There a Right Policy Mix for Sri Lanka?" *Marga Quarterly Journal* 13(1): 1–32.

Mendis, P. (1995). *Capitalism in Human Scale*. Department of Applied Economics Staff Paper P95-9, University of Minnesota, St. Paul.

Mizoguchi, T. (1985). "Economic Development Policy and Income Distribution: The Experience of East and Southeast Asia." *Developing Economies* 23(December): 312–18.

Rao, V. V. B. (1988). "Income Distribution in East Asian Developing Countries." *Asian Pacific Economic Literature* 2(March): 29–39.

Sen, A. (1981). "Public Action and the Quality of Life in Developing Countries." *Oxford Bulletin of Economic and Statistics* 43: 287–319.

UN Development Programme (various years). *Human Development Report*. New York: Oxford University Press.

World Bank (1993). *The East Asian Miracle: Economic Growth and Public Policy*, Policy Research Report. Washington, DC: World Bank. World Bank (various years). *World Development Report*. New York: Oxford University Press.

With the economic crisis in Asia, which unfolded in recent years, the development 'model' on which the phenomenal earlier success of several countries in the region was built requires increasing scrutiny. This anthology questions the validity of the notion promoted by some observers and international financial organizations that there is a universally applicable model of industrialization common to Asian countries. A number of senior and highly regarded Asia specialists are taking a critical look at the various development experiences of several (and some often neglected) Asian countries and evaluate their experiences in a comparative perspective. Comparing the analyses of countries such as Mongolia, the Pacific Islands, or Sri Lanka with Singapore, South Korea and other countries of the region leads the editors of this volume to the conclusion that the fashionable talk about a 'model' is not justified and that the picture is much more complex.

JOHN BENJAMINS PUBLISHING COMPANY
ISBN 90 272 3299 7 (Eur) / 1 55619 745 4 (US)