

The political economy of distributional equity in comparative perspective*

Kwan S. Kim

Abstract

Growing income inequality within a country ultimately leads to social and political instabilities, and is caused by socioeconomic factors and inadequate government policies. The ideology of supply-side economics in the US and the UK during the 1980s, for instance, induced policies of inequality, which was then perceived as a way to stimulate economic growth. The demise of East European socialism since the late 1980s also led many developing countries to pursue market reforms as a way of resuscitating their moribund economies. There is evidence, however, to indicate that the distribution of income in these countries is becoming more unequal, with the attendant, frequently grave, social and political consequences. JEL codes: O15, D30, D63

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Introduction

Although many economists continue to believe that equity follows growth, an increasing number of them argue that inequality follows growth, which can hamper further growth. Income disparities, especially when accompanied by continued increases in poverty, as is the case in the US, will lead to high economic costs. Since low-income households spend a larger proportion of their income, growing inequality not only leads to less aggregate demand but also to increased costs of social programmes and lost productivity due to reduced access of the impoverished to health care and training. Moreover, real costs in a highly inequitable society may come with increased political instability and social conflicts between the 'haves' and the 'have-nots'.

This paper re-evaluates, from an international comparative perspective, the relationship of distributional equity to growth. While economists mostly look at the measurement, nature and causes of equality or inequality, the question that is given special attention here concerns the social and political consequences of income distribution. The paper compares the broad implications of income distribution for the economy and society by observing cross-country experiences, and collects insights for policy that can be gleaned from the comparisons. The main part of the paper compares the regions of the global economy in terms of levels of and changes in distribution, the relationship of equity to growth, and the social and political consequences of income distribution. The concluding section highlights the policy implications.

*An earlier version of this paper was presented at the joint Notre Dame–Innsbruck conference on Income Inequality held at the University of Notre Dame in September 1995. The author is grateful to the conference participants, in particular to Teresa Ghilarducci, for many constructive comments.

1. Distribution equity: a global perspective

Over the past 50 years since the end of World War II, world income in real GDP rose seven-fold, and three-fold in terms of *per capita* real GDP. However, the fruits of economic growth have not been shared evenly. Between 1950 and 1990 the gap between the industrialised countries (OECD nations) and the rest of the world widened by 60% (World Bank, 1992, pp. 218–219). The richest quintile of the global population now earns income on a *per capita* basis that is about 50 times that of the poorest quintile and accounts for well over four-fifths of global income. One of our greatest contemporary paradoxes is that although current worldwide production of grain, for instance, could provide every person on earth with more than sufficient calories and protein for a healthy daily life, one person in five still lives in hunger and is malnourished (Harvard School of Public Health, 1988).

Growing inequality between nations is accompanied by that within national boundaries. Many developing nations—more recently, several developed nations as well—are experiencing a widening gap in income as well as wealth holdings between their rich and poor citizens. In terms of asset distribution, De Garcia and Johnson (1988) calculated that in the 83 poorest countries of the world, a meagre 3% of their people control more than 80% of their land. Severity in inequality and its consequences have varied from region to region of the global economy. Income inequality is on the whole relatively less severe in the industrialised West, which is a common heritage of political democracy. Recently, diverging trends in levels of inequality within the industrialised group have emerged: beginning in the 1980s, inequality in the US has steadily increased, accompanied by more than its share of poverty-related social violence and instability. In the case of emerging democracies in Asia, Africa, Latin America and the former East bloc, increased income inequalities caused by abrupt market reform threaten the very process of transition to democracy. Distribution inequity in these countries has frequently deepened social crisis by heightening the tensions and conflicts between classes, which has retarded sustained economic development. In what follows, the trends in distribution and its sociopolitical consequences will be examined in different regions of the global economy.

1.1. Industrialised democracies

Trends in growth and distribution. Rich industrialised countries are generally known to have more equal income distribution than low-income, developing countries. Beginning in the early 1980s, however, some diverging trends in income equality have appeared among industrialised democracies. Growth in trade with, and investment in, the developing countries, coupled with rapid technological advance, has reduced demand for unskilled workers, thereby depressing wages in much of the industrialised world (Wood, 1994).

Among the OECD nations, the US—economically the most powerful country in the world—has recently emerged as the least equal country (Atkins *et al.*, 1995). Japan, the other of the two most powerful countries, provides a sharp contrast in terms of income equality: post-war Japan had an equitably shared economic growth, which paved the way for its social and political stability.

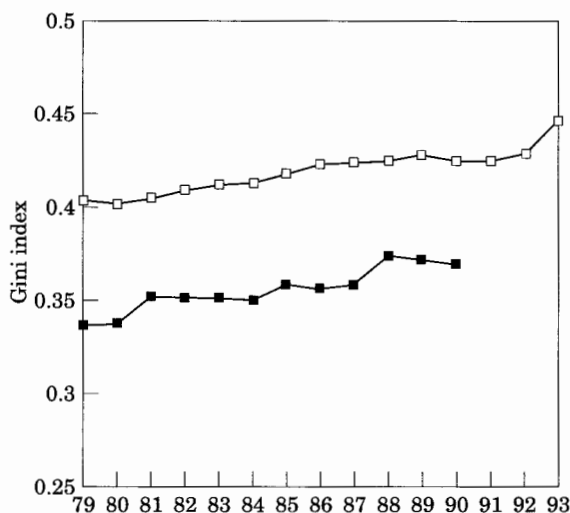


Fig. 1. Trends in income distribution: US and Japan. —■—, Japan; —□—, USA. Sources: For US data, Bureau of the Census; for Japanese data, see Mizoguchi (1992).

During the 1970s the Japanese economy expanded at an average annual rate of close to 10% and had perhaps the most even distribution of income of the industrialised countries. According to Agnew (1987, p. 138), in 1975 the income share of the lowest income class in Japan exceeded that of the welfare-oriented Nordic and other Western European countries and was about twice that of the US. As for the US, the decades of the 1960s and 1970s saw greater equality of incomes; in terms of the Gini index, it fell steadily from a high of 0.364 in 1960 to 0.356 in 1980. The trend then reversed throughout the 1980s, with the Gini coefficient rising to 0.401 in 1989 and to 0.426 in 1990. During the 1980s supply-side policies were introduced in the US, which turned out to reward the well-to-do and extract heavier tolls from more vulnerable groups of society. The US reversal is reflected by the widening of inequality gap between the US and Japan, as shown in Fig. 1.¹

In the US, the experiment of Reaganomics moved the country steadily toward a two-tiered distributional structure of the haves and have-nots. In 1990 the gap between rich and poor reached an all-time high since family income statistics were first published in 1947. According to government estimates,² between 1980 and 1990 the richest fifth of American families were the only ones whose income share increased, while the share received by the other 80% declined. Among the well-to-do, the top 5% received 17.4% of all family income, earning more income than the poorest 40% combined.³ The wealthiest 1% received an astounding 60%

¹ Both the Japanese and US data are the total household money income before taxes and exclusive of capital gains. Comparison of the trends using after-tax income shows similar results.

² US Department of Commerce, Bureau of the Census.

³ From the perspective of an alternative measure, in 1980 the richest 25% of the American population had 6.3 times as much income as the poorest 25%. By 1992 the richest 25% had eight times as much as the poorest 25%.

of the growth in after-tax income between 1977 and 1990.¹ On the other hand, the families at the median of income distribution saw their income go up only 4%, to \$36,000. The bottom 40% of families experienced actual declines in income. In particular, the lowest 20% group's income fell by as much as 9% during the period between 1977 and 1990.²

In Japan the land reform initiated by the Allied Occupation Forces at the end of World War II and subsequent improvements in the agricultural terms of trade gradually eliminated rural poverty.³ Japan's central and local governments quickly enforced a universal education system at the basic and secondary levels. The economic success of the earlier post-war era made it possible for governments to implement comprehensive social security and national health programmes. Japan is now considered as one of the most developed countries in these fields. Over 90% of the population consider themselves belonging to the middle class.

Political and social consequences of inequality. The recent deterioration in income distribution in the midst of economic slowdown in a number of countries of the industrialised West prompted damaging changes in each nation's economic and social fabric, frequently threatening changes in political regime. In the US, the deterioration in the distribution was accompanied by the rise in the incidence of poverty.⁴ The proportion of the nation's population officially counted as poor rose from 11.7% in 1980 to 13.1% in 1988 and to 14.2% in 1991.⁵ Racial minorities, in particular blacks and Hispanics, have been especially hard-hit by economic changes.⁶ The uneven impacts of economic changes have not been confined to the working poor. The burden of the recession in the late 1980s, for instance, fell heavily on middle America as well: job displacement became prevalent among blue- and white-collar occupations, which was then reflected in the rapid increase in the number of the homeless on city streets.

Neoliberal economic policies have had grave sociopolitical implications in the US. According to the UN-developed Human Development Index (HDI), which provides a broader measure of social well-being in addition to income,⁷ the US, which ranked second in *per capita* income in 1987, fell to nineteenth place, or last among the OECD nations in 1990 (UN Development Programme, 1990). Japan was the best in the overall rating, followed by Sweden, Switzerland, the Netherlands and Canada.

¹ In 1977 there were 660,000 families, each of which had an annual income of at least \$310,000 for a household of four. The average pre-tax income of families in the top 1% swelled to \$560,000 annually from \$315,000, for a 77% gain in 12 years (in inflation-adjusted dollars).

² The Congressional Budget Office annual report, 1992, Washington, D.C. Also *New York Times*, 5 March 1992.

³ Mizoguchi and Takayama (1984) claim that poverty in Japan is a sociological and political rather than an economic problem. The existence of poverty pockets in the Japanese community is largely due to social segregation of ethnic minority and psychologically handicapped groups.

⁴ This indicates the proportion of the population whose income falls below a government-defined poverty level. The poverty income for the US household is defined on an annual basis at the level of three times its inflation-adjusted, normal expenditure on food.

⁵ US Bureau of the Census. Also *New York Times*, 4 September 1992.

⁶ In 1988 the incidence of poverty was 10.1% for whites, 31.6% for blacks and 26.8% for Hispanics.

⁷ The HDI compares life expectancy, literacy rate and other health-related variables.

A serious issue in the US, which is not considered in the HDI, is the problem of social unrest and violence. Past failures of US government policies to safeguard an equitable sharing of the benefits from growth are a major cause behind the rise in economic incentive-related crimes and social unrest. The racial riots that have scarred American cities in the recent past may have been fuelled by race-related issues, but their root cause can invariably be traced to economic inequality and deprivation. In terms of social violence, over the period from 1983 to 1992 the crime rate per population rose 19.2%, with the violent types of crime¹ increasing by 40.9% (Federal Bureau of Investigation, 1992). Property crimes, which account for more than 85% of crimes in the American community, also increased over the period, although at a somewhat slower rate of 5.7%. The majority of violent crimes included robberies, which can be considered as related to economic incentives for criminality.

Many state and local governments in the US have been rapidly increasing expenditures on the upkeep and construction of prisons. As of 1993 the number incarcerated reached 1.9% of the male workforce and 8.8% of the black male workforce (Freeman, 1994). Massive imprisonment of criminals has not deterred violence, as the victims of growing inequality and economic deprivation continue to seek redress through violent means. In tandem with rising trends in incarceration, the propensity to commit crime among the non-institutionalised population has persistently risen.

The contemporary American experience contrasts with Japan's. From a historical perspective, Japan's industrialisation strategies in the pre-World War II era led to a concentration of wealth, with consequent widespread poverty. Estimates of the Gini coefficient for pre-war Japan have ranged from a high of 0.62 in 1923 to 0.49 in 1937 (Minami *et al.*, 1994, p. 360). During the 1920s and the first half of the 1930s the rural-urban income gap in Japan widened, accompanied by frequent disputes between urban landowners and tenant farmers. The government, which was allied with the conglomerates of family-owned businesses, *zaibatsu*, largely failed to resolve the disputes. This climate triggered interventions of Japan's young military faction in sympathy with the distressed farmers. Although two mutinies by young officers—one in May 1932 and the other in February 1936—failed, a large segment of the Japanese population began to sympathise with the rebels, paving the path to the rise in Japan's militarism. Thus, Minami (1986, pp. 149–150) points out that behind the move toward militarism in pre-war Japan were increasing income inequality and growing dissatisfaction among the working population.

Post-World War II Japan, after successfully implementing policies for the redistribution of assets, has been relatively free from the epidemic rise in criminality that has accompanied industrialisation and urbanisation in other industrialised democracies, having had one of the lowest crime rates in the industrialised world. The earlier comparisons, as shown in Table 1, are particularly striking. Although different country definitions of crimes and accuracy of crime reports render international comparisons less meaningful, the contrast in magnitude and the trends in crimes rates as reported in the table are nonetheless striking. More recent data

¹ According to the FBI classification scheme, violent crimes consist of murder, rape, robbery, and aggravated assault, as well as property crimes, burglary, larceny-theft and motor vehicle theft.

Table 1. *Crimes on police records in selected countries, 1975 (Rate per 100,000 population)*

Country	Total	Murder	Rape	Robbery	Theft
United States	5282 (+233) ^a	9.6 (+125)	2.6 (+226)	218 (+331)	4800 (+230)
England	4278 (+193)	2.3 (+100)	2.1 (+102)	2.3 (+462)	2483 (+151)
West Germany	4721 (+44)	4.8 (+143)	11 (+6)	33 (+252)	3111 (+123)
Japan	1101 (-11)	1.9 (-21)	3 (-42)	2.1 (-56)	927 0

^aFigures in parentheses show the percentage changes from 1960 to 1975. For the US, the total crime rate in 1992 was 5660.2 (Federal Bureau of Investigation, 1992), which shows an additional increase of 60% over the period from 1975 to 1992.

Sources: Japan: Ministry of Justice; *Hanzai hakusho* (Annual, 1977).

show similar trends: the average number of offences committed per 100,000 inhabitants in 1986–1988 was 1.3 in Japan, as against 5.7 in the UK and 8.4 in the US. The corresponding figure for crimes against property is 1135 per 100,000 as against 4432 in West Germany, 5634 in the UK and 4943 in the US.

There are certainly social and cultural factors contributing to low crime rate in Japanese society: the cultural and ethnic homogeneity in Japanese society leads to fewer internal conflicts than in societies with diverse ethnic origins. In Asian societies, traditional institutions such as family, school and local community are able to exert social control over the behaviour of community members with reasonable effectiveness. Nonetheless, the fact that crime rates, particularly economic-related crimes, declined during the period of rapid growth with sustained equitable distribution in the 1970s reveals that Japanese were generally satisfied with economic conditions.¹

1.2. *The developing world*

Income distribution varies distinctly by regions in the developing world; East Asian Newly Industrialised Countries (NICs) have attained rapid economic growth with equity. In most of Latin American and African countries, the distribution of income has worsened, coupled with increased impoverishment of more vulnerable classes in society. Distributional inequity in these countries has been an important cause of heightened social tensions and conflicts among economic classes, frequently resulting in social unrest and political instabilities. In a number of emerging democracies in Asia, Africa, East Europe and Latin America, increased inequality exacerbated by recent market reforms threatens the very process of democratisation.

Sub-Saharan Africa

Trends in growth and distribution. No region is poorer than Sub-Saharan Africa. In the recent past, many African governments have embraced market realities and

¹ A slight increase in the crime rate in the recent years of the bubble economy may be attributable to the changed economic conditions.

embarked on market reform measures. Although several countries experienced marked gains in economic growth, those adjustment policies have not successfully reduced poverty. Poverty in Africa is largely a rural phenomenon, since most of the poor (about 60% of the continent's population) depend on agriculture for jobs and income. According to a recent UN estimate,¹ the self-sufficiency rate in cereals for Sub-Saharan Africa fell from a high of 97% during 1969–1971 to 86% in 1988–1990 in comparison to the self-sufficiency rate of 91% for all developing countries in 1988–1990. The UN data also show that, during 1988–1990, some 175 million Africans went hungry, and in the absence of viable alternatives to drastically boost production of food crops and livestock products, by 2010 some 300 million people, one third of the continent's population, would suffer the 'scourge of chronic undernutrition'.

African poverty is shaped by social forces reflecting imbalances in resource allocation. Progress in redistributive land reform is limited by political constraints; the rural poor have limited access to credit, land and extension services; lack of both genuine political commitment and strong public sector support for rural producers is another major factor exacerbating rural poverty. In this context, the impacts of structural adjustment policies that typically focus on macroeconomic financial problems have often failed to reach the rural poor and are in some instances blamed for the exacerbation of poverty. The World Bank acknowledges that after a decade of implementing structural adjustment programmes, not many African countries have succeeded in a sound macroeconomic policy.² The Bank considers Ghana to have the most effective adjustment policies, but predicts that the poor in Ghana will not cross the poverty line for another 50 years.

African countries will face a further deterioration in their economies as trade liberalisation on a global scale unfolds. The new General Agreement on Trade and Tariffs (GATT) will probably diminish African export revenues as existing tariff preferences for Africa are eroded under multilateral trade liberalisation. In particular, food-importing countries in Africa will be hit hard by higher world food prices brought on by reductions in agricultural subsidies in European countries. Furthermore, because of the failure to bring the Multi-Fibre Agreement under GATT discipline, many African countries are likely to experience reductions in growth rates of textile exports. Recent OECD calculations, as shown in Fig. 2, show that net annual losses for Africa could reach \$2.6 billion in the period to 2002. In contrast, the industrialised countries reap \$135 billion or 64% of total annual gains in world income from the new GATT (Goldin *et al.*, 1993).

Political and social consequences of inequality. The gravest concern in Africa over the past two decades has been the biological survival of humanity. According to a recent United Nations (1993–1994) study, undernutrition and disease are more widespread today in Sub-Sahel Africa than they were 30 years ago and could remain 'rampant' in the absence of a major effort to increase indigenous food production. The continent is already deep in financial crisis and heavily dependent on food aid,

¹ See also United Nations (1993–1994, p. 8).

² See also United Nations (1993–1994, p. 18).

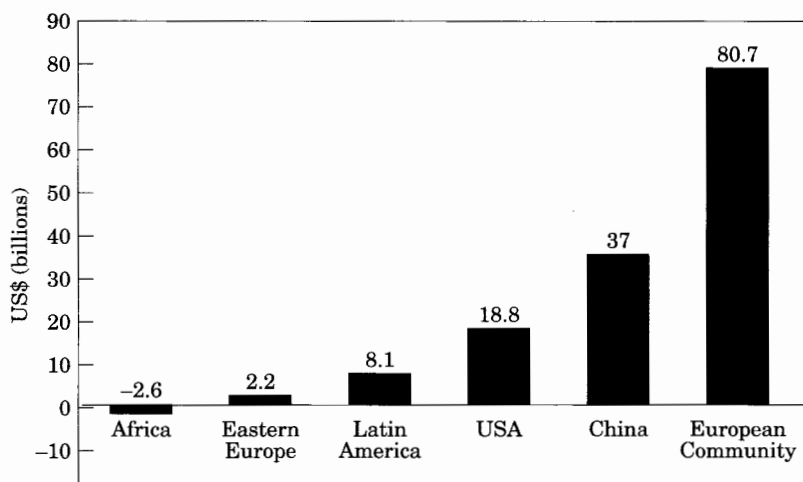


Fig. 2. GATT winners and losers (projections to the year 2002). Source: United Nations 1993–1994.

and faces the prospect of net cereal import needs that are expected to more than double, to some 20 million tons a year by 2010.

The extreme poverty for the masses is exacerbated by a lopsided distribution of resources to a few élites, which largely reflects ineffective and corrupt systems of governance. Widespread hunger in Africa often escalates into famine, political violence and armed conflicts. The recent armed conflicts in both Somalia and Rwanda are illuminating cases. In Somalia, as the grazing land and water wells diminished due to accelerating environmental degradation, disputes over resource use became a major factor in the clan rivalries that eventually led to political violence. In Rwanda, the ruling regime of the Hutu tribe attempted to constrain the use of land by the rival clan, the Tutsi. This ultimately led to the formation of a rebel army by the Tutsi, which took power in Rwanda through force of arms after hundreds of thousands of civilians had been killed.

East Asia

Trends in growth and distribution. As in any other regions of the developing world, income inequality is a serious problem in most Asian countries, with the possible exception of Japan, Taiwan and South Korea. According to World Bank estimates (1990),¹ however, a large number of Asian countries—in particular Southeast Asia's newly industrialising countries, Malaysia, Indonesia and Brunei—have made significant economic progress since the mid-1980s, which has resulted in substantial reduction of poverty as these governments have been able to channel relatively larger public resources into human development.

In contrast, one of the newly industrialising Asian countries facing serious problems with income distribution is China. Since 1976, when full-scale economic reform started, the Chinese economy has expanded at dazzling rates of growth, frequently at a double-digit rate. Its strategy, centred on urban-based growth poles,

¹ Refer to Appendix Table 1.

especially along selected coastal areas, had led to a widening of the income gap between regions of the country and between cities and farming villages within regions. According to a recent estimate,¹ as disposable income per urban resident has steadily increased in real terms whereas that of farmers has remained unchanged, the ratio of farmer income to that of urban residents has plunged from 58% in 1985 to 39.4% in 1993. Taking more specific examples, in 1992 average *per capita* income in Guizhou, the poorest province in China, was about one fifth of that of Shanghai, China's richest city, having fallen from the corresponding figure of 26.6% in 1984. To take an example at the regional level, in 1993 *per capita* income in Longchuan County, the poorest region in Guangdong Province, was only 7.6% of that in Shenzhen, the province's richest city.

The case of South Korea, as a country in rapid transition to political democracy and economic liberalisation, deserves special attention. The distribution of income in Korea drastically improved in the 1960s when government policies emphasised the development of labour-intensive exports. It began to worsen in the mid-1970s when the government resorted to wage suppression and pro-business policies in order to promote exports. After a slight improvement in the early 1980s (Choo and Yoon, 1984), it steadily deteriorated until the reversal in 1990 (Ahn, 1991); the Gini coefficient rose from 0.3472 in 1981 to 0.4318 in 1989. Ahn's estimates deviate somewhat from those of other studies that claimed improvements in distribution in the late 1980s (Choo, 1993). Ahn claims that other studies underestimate income inequalities in the non-worker sector, which causes the Gini estimates to appear smaller. The growing inequality in the late 1980s reflected increased wealth concentration among large corporations and uneven developments between sectors and regions. Soaring real estate prices in the context of highly uneven assets distribution further worsened the distribution of income: between 1987 and 1989 land price rose 93% and landowners, who comprised some 30% of the population, saw their capital gaining 1.7 times the nominal GNP (Lee, 1990).

With the instalment of a civilian regime in 1993, there was a policy shift that defused the state's support of big businesses and allowed greater participation of small- and medium-sized firms. Income inequality consequently fell markedly. Although the lopsided gain by a few rich in the 1980s skewed the inequality index, it is remarkable that the country's poverty incidence was low and continued to fall. Nor did the middle-income class appear to have lost grounds in absolute terms of real income during the 1980s.

Political and social consequences of inequality. Asia's newly industrialising nations have a relatively short experience with democratisation. The members of society who actively support political democracy in these countries consist mainly of the urban middle class, especially the white-collar groups. In Thailand, the civilian government of Chan was able to assert itself in the wake of the bloody military violence in 1992 on the strength of a political coalition essentially supported by Thai's middle-income classes.

More illuminating cases linking political liberalisation to equitable growth are those of South Korea and Taiwan. In these countries, rapid industrialisation

¹ Ryoshin Minami, *The Nikkei Weekly*, 5 June 1995, p. 11.

transformed the social structure by gradually broadening the middle classes. This transformation has had broad political consequences because middle and working classes support democratic systems of government. Taiwan's important steps toward political liberalisation were more peaceful in procedure. Taiwan's Lee Tenghui, who became the island's first native president in 1988, appointed Lien Chan as premier, a civilian profession, to replace the military officer turned bureaucrat Hau Peitsun, a conservative Nationalist leader who was regarded by many as an obstacle to democratisation. All of Lien's predecessors in the premiership had been mainland Chinese who had fled to Taiwan after losing the Civil War to the Communists in 1949. The appointment defied the objections of the Kuomintang party and reflected the island's new initiative toward political democratisation. Lien was expected to pursue democratic reforms. Taiwan's *per capita* income already exceeded US\$10,000, and the rapid growth of the middle-income class led to the formation of strong political support for democracy.

South Korea, the largest and most dynamic economy among East Asian NICs, illuminates the political and social implications of distributional equity. The election of Kim Yong-sam as a civilian president in 1992 reflects the changed situation in Korea, where the middle-income class has emerged as a dominant political force. The middle classes, which steadily grew in number during the previous period of rapid industrialisation, comprise more than 60% of the Korean population. Kim has responded to this class by following a middle-of-the-road approach; economic policies have focused on securing continuous flows of income to wider social groups, especially to small businesses and farmers.

This is a case where the success of rapid growth with equity raised the possibility of the inauguration of democracy in a country that had been under authoritarian rule (Muller, 1988). The future of democracy in Korea will depend critically on successfully continuing to avoid excessive income inequality. Bi-polarisation in income distribution could diminish the middle-of-the-road influence of the middle social classes, allowing the substitution of a repressive regime for political democracy.

In addition to political implications, growing inequality in wealth and privilege engenders social dislocations and disturbances. In China, as the country has become more affluent, disparities in income have also widened, eliminating the sense of security that stemmed from 'equality in poverty'. The growing regional disparities—particularly serious between the highly developed eastern coastal regions and the backward inland areas—portend potential social and political disturbances. Movements of the population have already been restricted by the government, which will worsen inter-regional income gaps and exacerbate ethnic tensions, since many minorities live in low-income inland regions. In South Korea, during the various periods in the late 1970s and the early 1980s, the situation of economic inequity led to a wave of industrial unrest on the part of workers and other forms of social strife initiated by students, which eventually resulted in the fall of Chun's military regime in 1986 and the subsequent restoration of the civilian regime. The realities as well as the perception by the lower groups of extreme inequities between workers and property owners prevailed in Korea. The so-called 'prosperity strikes', based on the concept that workers deserve to share the benefits

of business prosperity, occurred more frequently during the times when the distribution was more uneven. The Korean case tells us that an equitable development constitutes a functional requirement for the country's political and social stability.

Latin America

Trends in growth and distributions. Post-war development in Latin America started with wide income inequalities across the area. Available data *c.* 1979 (Altimir, 1987) indicate that the Gini indexes were relatively high in Latin American countries compared with other parts of the developing world: for instance, Brazil 0.605, Colombia 0.618, both Mexico and Venezuela 0.500, and Peru 0.568. The import-substitution strategy in Latin American countries failed to generate patterns of sustained growth, the fruits of which could be equitably shared.¹ For instance, Mexico and Brazil both had very rapid industrialisation without any significant reduction in under- and unemployment. The working poor did not necessarily become poorer, but the fruits of growth reached them very slowly with the consequence that income distribution became more unequal. The political and social instabilities seen today in many Latin American nations have a historical resonance that precedes the revitalisation policies adopted in the wake of the debt crisis in the 1980s.

That the earlier import-substitution industrialisation strategy in Latin America led to income inequality can be seen from an international comparison by Chenery (1979, table 11.5). He compared the income shares of the bottom 60% of the population in selected developing countries. Two East Asian countries—Taiwan and South Korea—exhibited high growth rates with the poorest 60%'s income share exceeding 30%. The Asian experiences contrasted with those of such Latin American countries as Mexico, Brazil and Peru, although Costa Rica was a notable exception. The growth rates of the poorest group's income in all three Latin American countries were substantially below the respective national average growth rates during the period in consideration.

The aftermath of the debt crisis in 1982 witnessed Latin America's first extended depression; throughout the remains of the decade, income inequality continued to rise. The indebted Latin American countries began to embrace Neoliberal adjustment policies of smaller government, open markets, trade liberalisation, privatisation and deregulation, which resulted in ever-larger contingents of the critically poor, low-paid workers, underemployed and unemployed, while middle-income classes saw their living standards and quality of life deteriorating. Throughout the 1980s external debt servicing, reverse resource transfer to abroad, diminution of domestic investment, deterioration of human and physical capital stocks, and inflation became part of the functioning structure of the Latin American economies. The already impoverished situation of more vulnerable groups of society deteriorated further as international donor agencies' adjustment policies called for the contraction of welfare programmes and the rise in the relative prices of basic needs goods. In addition, as the devaluation of the domestic currency, aimed at switching

¹ Felix (1983) observed that income distribution in Latin America generally worsened during prosperity, when there were more gains to share, and levelled off or improved during depressions, when rents and profits tended to take relatively greater hits. Cyclical fluctuations in the distribution aside, income inequality in Latin America has risen secularly.

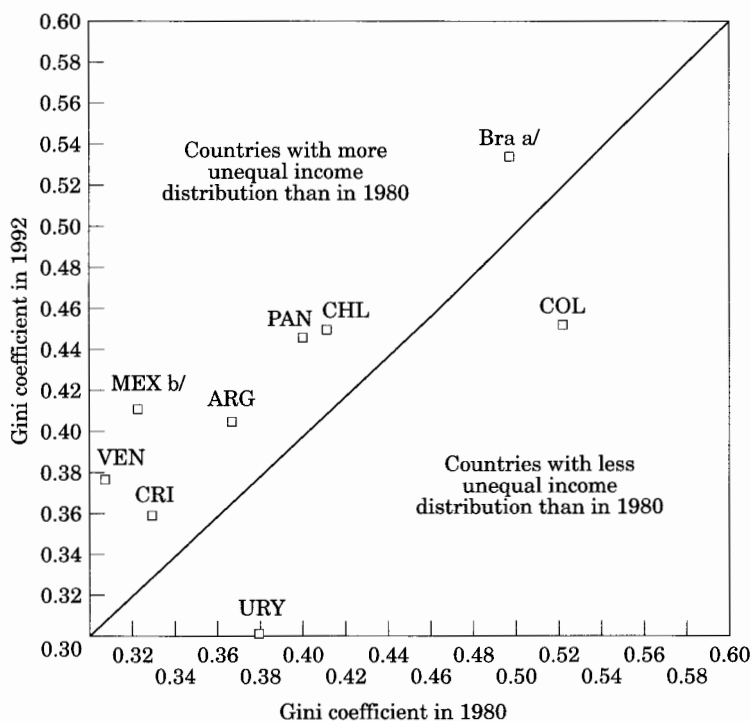


Fig. 3. Changes in income distribution in Latin America (urban areas) during the 1980s and the 1990s. VEN, Venezuela; CRI, Costa Rica; MEX, Mexico; ARG, Argentina; PAN, Panama; CHL, Chile; BRA, Brazil; COL, Colombia; URY, Uruguay. *Source:* ECLA, on the basis of special tabulations of data from household surveys in the countries. ^aThe data correspond to 1979 and 1990. No information is available for 1992. ^bThe data correspond to 1984 and 1992. No information is available for 1980.

expenditures to tradable goods, triggered inflation, it began to affect more vulnerable groups such as wage earners, self-employed workers and retirees, who had less capacity to negotiate or protect themselves against price increases of imported goods.

During the recent economic recovery (1990–1992), some gains in the real incomes of the lower economic classes have been made in a few Latin American countries, but these are the exceptions. According to the Economic Commission for Latin America and the Caribbean (ECLAC) report (1994, p. 37), the relative inequality of income distribution in the urban areas of Argentina, Honduras, Mexico, Panama and Uruguay declined slightly. On the other hand, the households in the upper strata of these countries also increased their income. The continent's income distribution structures are now more uneven than they were in the late 1970s. This can be seen in Fig. 3, which shows changes in real income by income strata over the 1980–1992 period for Latin American countries. In Mexico, the lowest and the lower-middle income groups made virtually no gains in real income while the richest gained more than 50% over the period. Brazil, Venezuela and other Latin American countries display similar results: overall average *per capita*

Table 2. *Real per capita income by income strata in 1992^a*

	(1) Low income	(2) Middle income	(3) High income	Ratio of (3) to (1)
Argentina (Buenos Aires)	1.40	3.79	18.36	13.1
Bolivia	0.52	2.03	9.55	18.37
Brazil ^b	0.56	2.67	15.37	27.45
Chile	0.81	2.63	12.77	15.77
Colombia	0.58	2.31	10.52	18.14
Costa Rica	0.84	2.79	8.55	10.18
Honduras	0.28	1.16	4.96	17.71
Mexico	0.79	2.55	11.43	14.47
Panama	0.64	3.21	11.64	18.19
Paraguay (Asunción)	0.65	2.31	7.23	11.25
Uruguay	1.51	4.22	11.83	7.83
Venezuela	0.71	2.30	8.44	11.89

^aReal income is measured by a multiple of the respective *per capita* poverty line. The low-income stratum consists of the poorest 40%; high income, the richest 10%; and middle income, the remaining in-between groups.

^bBrazil data correspond to 1990.

Source: ECLAC (1994, p. 36).

income declined, with the burden of the decline falling heavily on the lower income groups.

Table 2 presents the comparisons of real *per capita* income for 1992 calculated as a multiple of the country-defined poverty-line income. Real income of the poorest 40% in most Latin American countries declined throughout the 1980s and, despite the recovery in the early 1990s, still remained below the poverty line in 1992: income of the poorest as a percentage of the poverty-line income ranged from 84% in Costa Rica to 28% in Honduras. Moreover, the ratio of income of the richest 10% to that of the lowest 40% was in the range of 10–20 in Latin American countries (Table 2). It is worth noting that this figure is substantially above that of a typical East Asian NIC.

For the Latin American region as a whole, between 1980 and 1987 the average real income of wage salary earners fell 15% in the formal private sector and 30% in the public sector, while the combined employment of the two sectors rose a bare 3% (PREALC, 1990a). The numbers of the economically active population in the urban informal sector rose 55% while their average real income fell 42%. As a result, the proportion of the population classified as 'poor' rose to 43% by the end of the 1980s (World Bank, 1990, p. 14). Over the decade, almost 40 million people were added to the ranks of officially defined poverty. In Brazil alone, the incidence of poverty rose from 24% to 39%, with the number of Brazilian poor totalling more than 10 million. In Mexico, the incidence of poverty rose from 40% in 1980 to 54% in 1987 (Kim, 1991), and the real minimum wage rate in the urban sector continued to fall 26.6% over the period from 1988 to 1994 (Lazaroff, 1995, p. 49). At present, close to 60% of Mexico's population of 86 million is under the age of 30.

These statistics translate into a workforce that will grow by more than a million people each year. With the prospect of fewer jobs, wages will be likely to stay flat or possibly be scaled back.¹

While the urban labour force faces serious difficulties, the situation is worse in the countryside of many Latin American countries. In Mexico, for example, imports of US fruits and vegetables since the reductions in tariffs beginning in the late 1980s have pushed down domestic prices, causing the failure of almost 40% of Mexico's small agricultural businesses (Lazaroff, 1995, p. 49). Privatisation of communal farms into competitive businesses has been difficult given the high prices of imported machinery and bank loans.

Political and social consequences of inequality. Growing inequality and the impoverishment of large segments of the Latin American population have been accompanied by rapidly deteriorating conditions in health care and basic education. In Mexico alone, for instance, as much as 66% of the Mexican population is estimated to be currently suffering from malnutrition (Rothman, 1995, p. 41). Taking the continent as a whole, its educational and health-care standards today are substantially below the levels that would be expected given the region's current *per capita* income. During the early 1990s only a little over a half of those entering primary school reached the fourth grade (Inter-American Development Bank, 1994, p. 13). Enrolment rates in secondary school were less than half the eligible age group. When compared to China, which had only one sixth the average *per capita* income of Latin America, the burden of disease in the region was also about a third greater. This divergence between the actual situation and the expectations based on the region's average income is attributable to the extreme income disparities prevailing in Latin America.

In a number of Latin American countries, the prolonged impoverishment of the working poor coupled with the deterioration in income distribution has led to labour unrest, drug traffics and even political violence. In Central America, the exacerbation of inequalities has played a key role in social and political violence. Since the mid-1970s large-scale revolts in three out of the five Central American countries have erupted against their governments. In 1979 a popular revolution toppled Nicaragua's Somoza regime. A resurgent guerrilla rebellion has continued in Guatemala since 1980, while in El Salvador crippling political violence lasted some 12 years. Booth (1991) contends that government policies for agricultural exports and rapid capital-intensive industrialisation in these countries marginalised landless peasants, urban poor and wage labourers, and, in the absence of policies that could have mitigated the exacerbation of poverty, these groups began mobilising for a rebellion.

In Venezuela, despite a respectable economic growth in 1990 and 1991, the country became more unequal, with an attendant rise in the number of destitute people. The rise in basic goods prices in February of 1989 eventually triggered a riot in the capital city, with the record of deaths exceeding 300. The frequent labour

¹ Many companies are currently laying off workers, including Dina, the heavy-truck manufacturer, and Pemex, the oil monopoly. Nissan and Ford have been slowing automobile production.

strikes that ensued were followed by 1992's twice-aborted military coups to overthrow democratically elected President Perez's government. Perez was the continent's leading Neoliberal policy-maker.

Brazil in 1985 had a democratically elected civilian government for the first time after 20 years of military regime. Eight years after the new democracy, it faced a new crisis. Brazil's first democratically elected president, Fernand Collor de Mello, was ousted amidst a scandal involving the illegal use of campaign funds. The underlying cause of people's disaffection with the government was the inability of his administration to address the ever-aggravated issue of income distribution and poverty. In Brazil, according to a 1990 census, over 24% of the working population received a minimum wage income. The necessary income to maintain a subsistence living standard was estimated at five times the minimum wage. This implies that some 70% of the working population earned below the effective subsistence income.¹

In Mexico, which to begin with has one of the most skewed income distributions in Latin America, the income gap between capital and labour had widened throughout the 1980s, accompanied by increased concentration of wealth. During Salinas's presidency, 25 Mexican families controlled some 55% of Mexican assets; half of these assets are still held by six conglomerates consisting of Grupo Carso, Visa, Vitro, Telmex, Alfa and Grupo Mexico (Rothman, 1995). Some 37 million Mexicans live in poverty, and the Mexican Social Security Institute, the country's largest provider of public health care, covers only a little more than one third of the working population. Economic inequality and deprivation are making Mexican politics more heated than ever. The middle class, which had high expectations of the economic reform, is frustrated with economic conditions. The working masses' unrelenting demands for political participation have been fuelled by the continuous process of economic liberalisation. The ruling party of the Institutional Revolutionary Party (PRI), which had never lost national or local elections since 1929, began to lose wide popular support as it lost the governor's elections in Baja California in 1989, Chihuahua in 1990 and Guanajuato in 1991.

Mexico's economic reform, nonetheless, continues in a top-down fashion. Its political system remains tightly controlled under the absolute power of the presidency of the ruling party, which has created an impetus towards rent-seeking. The extent of rent-seeking has been highlighted most recently by the arrest of Raul Salinas, the brother of the former president, on charges of plotting the murder of rival leader Luis Massieu. Also, the revelations of links between Mexican élites and seven drug cartels and the speculation of drug involvement in three recent assassinations have shed serious doubts on the political system.

A number of clashes, including the recent Chiapas uprising in rural Mexico, have taken place between the existing political structures and the popular forces clamouring for democratisation and economic equity. The political imperative of the future Mexican governments will be to gain greater popular support for

¹ The government raised the minimum income by 140% in May 1992 to appease the masses of the population who were impoverished, but the wage hike policy led to financial bankruptcy and accelerated inflation.

completing economic and political reforms. Securing popular support will, on the other hand, depend on the ability of the government to implement alternative strategies for more equitable economic growth.

In summary, prospects for stable political democracy in Latin America hinge critically on governments' ability to engineer a sustained growth path with equity. The challenge to create a vibrant, equitable economy looms much larger for the emerging democracies in Latin America than elsewhere. In Latin America, growing economic inequality has long solidified the formation and preservation of distinct social classes, planting the seed for social unrest and political instability.

2. Distribution and growth: a political-economy perspective

Economists have long disagreed in their views on the relationship between income distribution and economic growth. The earlier supply-siders and more recent Neoliberal economists have argued that current inequality must be endured for the sake of future growth and equity, since the benefits of economic growth would eventually filter down to the masses. They claim that redistributive policies would reduce the incentives for work and investment.

Empirical evidence, nonetheless, has not been conclusive in supporting the trade-off or the-rising-tide-lifting-all-boats theory (Michaely *et al.*, 1991, pp. 103–112). In a number of advanced industrial economies over the past decade, income inequality rose during economic expansions as well as economic contractions. During 1989–1992 the expansion of industrial production in such countries as Sweden, Finland, the US, the Benelux countries and England was accompanied by rising unemployment, which further deepened income inequalities in these countries. In Ireland, under the Neoliberal export-oriented strategy, the government for a long time benignly neglected the once-prominent agricultural sector. With the failure to create sufficient numbers of high value-added jobs, growing occupations have shifted to low-paying service industries. Low wages, combined with the already highest unemployment rate in the developed world (Callan and Nolan, 1994, p. 3), have been a recipe for rising poverty. At present, the government is not likely to do much to help the poor as the excessive borrowing in the past will continue to constrain future government activities. The lesson is simple: economic expansion does not necessarily engender equity.

Turning to the trade-off between equity and efficiency, the recent cross-sectional study by Glyn and Miliband (1994), which includes a large number of both industrial and developing countries, indicates a positive correlation between the countries with better distribution and those with higher growth rates, as shown in Fig. 4. During the 1980s countries with relatively faster labour productivity growth, such as Japan, Finland, Germany, the Netherlands, Belgium and Sweden, were more equal in income distribution (as measured by the ratio of income of the richest 20% of the population to the poorest 20%). On the other hand, countries with slower productivity growth, such as New Zealand, Australia, Switzerland and the US, were relatively less equal. A positive correlation between growth and equity can also be discerned from the World Bank's (1991, Table 30) much larger sample of both developing and developed countries. The study by Persson and Tabellini

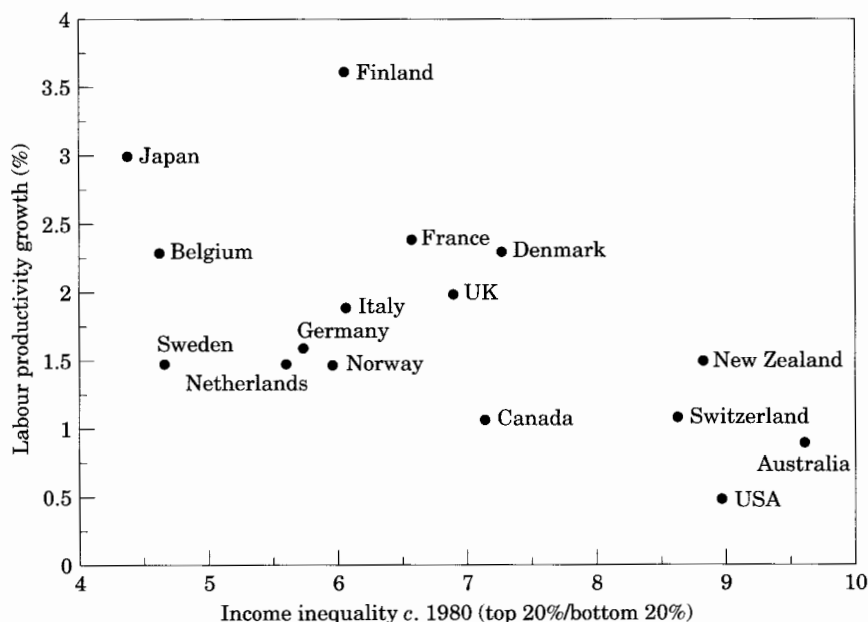


Fig. 4. Income inequality and labour productivity, 1979–1990—Developed countries. Income inequality c. 1980 (top 20%/bottom 20%). Source: Albelda *et al.* (1995).

(1994), on the basis of the cross-sectional data of industrial democracies, also reveals a roughly positive correlation of income equality to growth.¹

It is as well to note that, given the paucity of data and the difficulty of disentangling cause and effect, these findings must not be construed as a generalisable conclusion. Nonetheless, the earlier supply-sider's presumption that the country could start with a worsened distribution to have more rapid economic growth later is not simply borne out by the data. On the contrary, such data as we have suggest that rapid economic growth is compatible with an equitable pattern of income distribution in a wide-ranging number of countries.

If the conventional theory relating distribution to growth is to be debunked, how do we then explain the positive growth effects of increased equality? The economists leaning toward Keynesian economics would look at the role of aggregate demand in a market economy, and deduce the positive effects of increased equity on demand and economic growth.² Other economists have related increased income equality to increased access to health care, training and education for the population at large, which should in the long term raise worker productivity and improve the performance of the economy. In particular, income inequality in poorer societies

¹ Interestingly, a negative correlation of growing inequality to growth is found in the context of the domestic economy. A recent study examining growth in income and employment in 85 US cities shows that cities with high levels of urban/suburban inequality have poorer growth rates of jobs and income than cities with milder income disparities (Albelda *et al.*, 1995, p. 8).

² Greater income equality leads to greater demand, since the propensity to spend tends to be greater with low-income families.

is accompanied by increased incidence of poverty, which directly affects the nutritional level of the workers and therefore their productivity.

Another reason that inequality hampers growth relates to the economic costs of inequality on productivity. Persson and Tabellini (1994) argue that in a society with a widening income gap, policies to improve the distribution most probably result in taxing investment and growth-promoting activities; redistribution becomes economically costly, as a baseline of support needs to be provided for the welfare, health care, education and training of its populace. Moreover, growing inequality leads to increased expenses of enforcing the law and order in order to protect property rights and the market system. As the 'haves' possess more to protect, and the 'have-nots' less to lose and fewer prospects for a better future through work, crime increases. In this respect, it is illuminating to compare the economic performance in recent past of East Asia and Latin America. In East Asia, because of the relative income equality in their societies, governments had a greater degree of freedom to pursue economic policies that promoted growth. In contrast, the extreme inequality in Latin America continued to give rise to intense political pressure to implement expansionary economic policies just to stave off unrest among the marginalised groups. The rich in Latin America, on the other hand, exercised their power to avoid fair taxation that could lead to fiscal balance. As a result, it has been difficult for these Latin American countries successfully to implement a stabilisation programme that could protect savings and investment and induce stable growth. Economic and political instability became recurrent as the countries could not break out of their cycle of self-defeating policies. In a somewhat different context, in highly unequal societies such as the US, the growing number of the incarcerated population has been exacting enormous costs for prison upkeep, which in turn reflects a monumental loss of valuable human resources.

In summary, the relationship of growth to distribution is not an automatic cause and effect. Equitable growth in a market economy is not only a moral imperative; there is compelling reason to believe that it must become an economic imperative.

Conclusions

This paper has argued that economic growth with equity is vital to long-term political and social stability in a democracy and, most importantly, to the very preservation of politically democratic institutions in countries already enjoying a full democracy as well as in countries in transition to it. As Lipset (1969, p. 27) notes, without the continued presence of a viable middle class in society, a genuine, stable democracy would be difficult to preserve. Sustained political democracy thus requires the maintenance of a well-developed and balanced economy, where the majority of the country's population remains in the middle class.

Although systematic cause and effect relationships between types of polity and economy are not easily discernible, history is replete with the examples of societies with extreme bipolarisation of groups that inevitably led to a rule of one group by another. Such instances of a group's usurping resources to preserve its privileged position have been witnessed in the past movements of Bolshevism, Nazism or Tojoism. By the same token, economic prosperity shared by wider sectors and social

groups in some East Asian experiences released impulses for broader political participation, leading to the path toward political democracy.

Economic equity must be seen as a prerequisite for sustained economic growth. There is telling evidence for the mutually reinforcing relationship that can exist between distributional equity and growth of the economy. Available evidence also tells us that blind pursuit of unfettered market systems is not helping to reduce economic inequalities in society. The search for equitable development calls for bold new visions of development strategy. For the emerging democracies in the developing world, unless better governance is complemented by more comprehensive and more radical efforts for increased equality, there simply is no assurance that the tide of democracy will be irreversible. For American society, the urgent question that must be addressed is how to attain balanced combinations of societal forces and processes that will sustain a reasonably equitable income distribution in a competitive market system.

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Appendix

Table A1. *Selected economies in the ESCAP region. Per capita and household incomes and distribution*

	GNP <i>per capita</i> (US dollars)		GDP <i>per capita</i> of lowest 40% of households (US dollars) 1987	Percentage share of household income, by quintiles ^a					
	1980	1988		Year	Lowest 20%	Second quintile	Third quintile	Fourth quintile	Highest 20%
Developed economies									
Australia	10,270	12,340	4270	1985	4.4	11.1	17.5	24.8	42.2
Japan	9870	21,020	8630	1979	8.7	13.2	17.5	23.1	37.5
New Zealand	6910	10,000	3080	1981/82	5.1	10.8	16.2	23.2	44.7
Developing economies									
China	290	330	—	—	—	—	—	—	—
Hong Kong	5210	9220	3270	1980	5.4	10.8	15.2	21.6	47.0
India	220	340	120	1983	8.1	12.3	16.3	22.0	41.4
Indonesia	480	440	160	1987	8.8	12.4	16.0	21.5	41.3
Iran, Islamic Republic of	—	—	—	—	—	—	—	—	—
Malaysia	1680	1940	510	1987	4.6	9.3	13.9	21.2	51.2
Pakistan	290	350	—	1984/85	7.8	11.2	15.0	20.6	45.6
Papua New Guinea	760	810	—	—	—	—	—	—	—
Philippines	700	630	120	1985	5.5	9.7	14.8	22.0	48.0
Republic of Korea	1620	3600	—	—	—	—	—	—	—
Singapore	4570	9070	1200	1982/83	5.1	9.9	14.6	21.4	48.9
Sri Lanka	260	420	160	1985/86	4.8	8.5	12.1	18.4	56.1
Thailand	670	1000	320	—	—	—	—	—	—
Least developed countries									
Afghanistan	—	250 ^b	—	—	—	—	—	—	—
Bangladesh	140	170	70	1981/82	9.3	13.1	16.8	21.8	39.0
Bhutan	—	180	—	—	—	—	—	—	—
Lao People's Democratic Republic	—	180	—	—	—	—	—	—	—
Myanmar	180	260 ^c	—	—	—	—	—	—	—
Nepal	130	180	—	—	—	—	—	—	—

Sources: World Bank, *World Development Report 1990* (New York, Oxford University Press, 1990); *World Tables 1987*, 4th edn.