

# EE460: Income inequality in Thailand

Bhanupong

Lecture 30

# Outline

- Income inequality
- Problems with the Gini coefficient
- Wealth gaps
- Financial inclusion
- Gender inequality

# Economic Liberalization

- Trade liberalization leads to changes in employment and output structure.
- Resources have been allocated to sectors that have comparative advantage.
- The employment structure is also affected by changing output and export composition.

# Defining globalization: Neoclassical argument

- More integration to the world economy through more openness in trade and capital flows
- More usage of market mechanism
- Globalization is measured by Trade/GDP and FDI/GDP.
- Globalization can be a force for poverty reduction because globalizing countries have had faster growth and faster poverty reduction than non-globalizing nations.
- Empirical evidence in China, India, and Vietnam

# Poverty-growth-inequality triangle

*Complex relationship*

**Growth**



**Inequality**

**Poverty**

# Implication of globalization

- Prices of domestic goods cannot significantly deviate from the international prices.
- In the long run, the law of one price states that the prices of traded goods are dictated by the international prices.
- Fluctuations in prices of traded goods affect values of marginal products of factors of production and the overall income distribution.

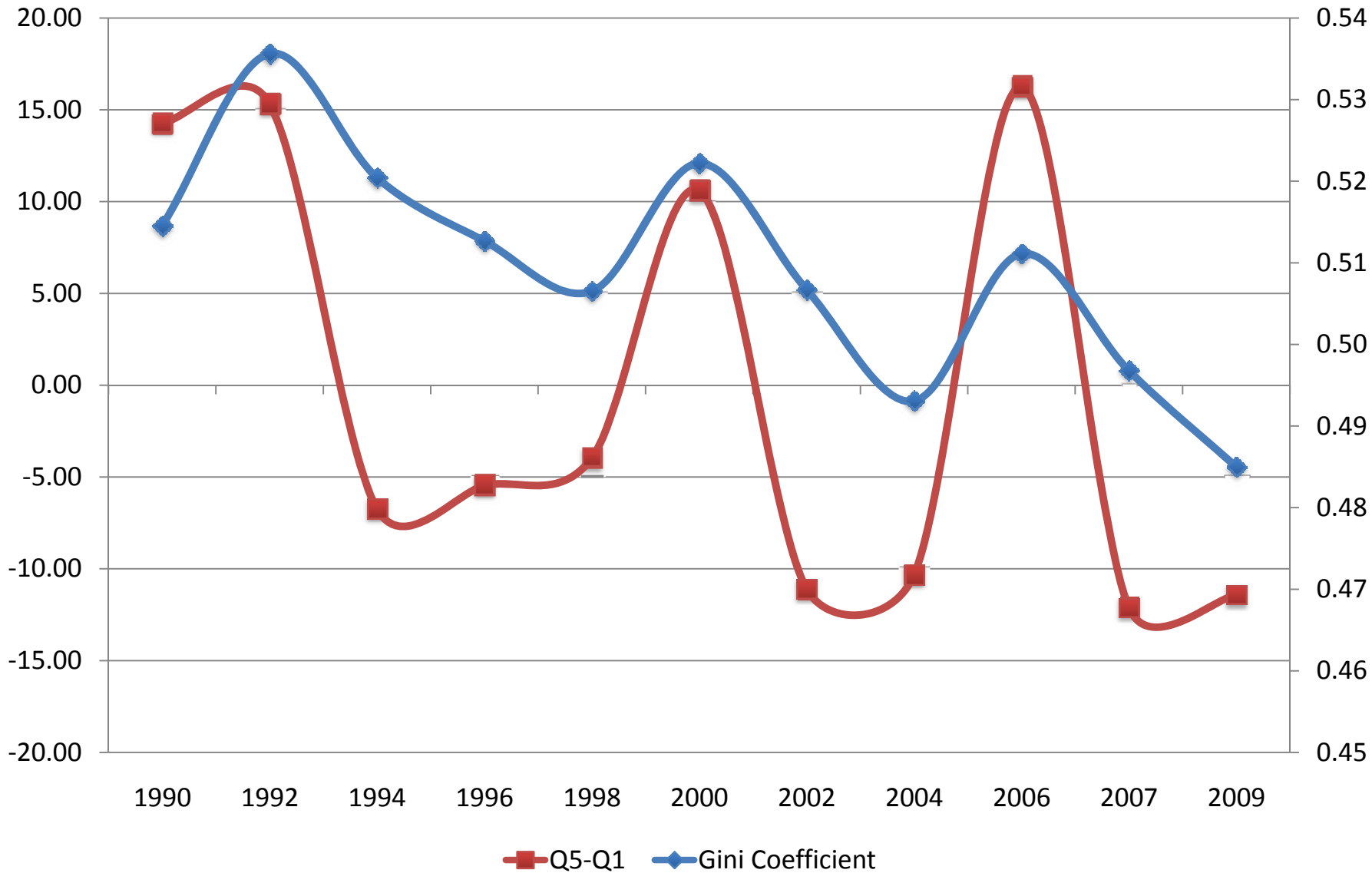
# Agricultural labor income share

- The agricultural share of employment is declining relative to other sectors.
- The wage share of labor in the agricultural sector will be lower if the marginal product of other sectors rises faster than that of agricultural labors.
- If the terms of trade of agricultural goods to manufactured goods declines, income inequality will increase.

# Income inequality

- The Gini coefficient is a measurement of inequality; its value ranges between zero and one.
- The higher the value of the Gini, the higher the degree of income inequality.
- Perfect equality, when the Gini is zero, may not be desirable, because efficiency will be threatened.
- At zero value of Gini,  $x$  % of the poorest will obtain  $x$  % of total income.

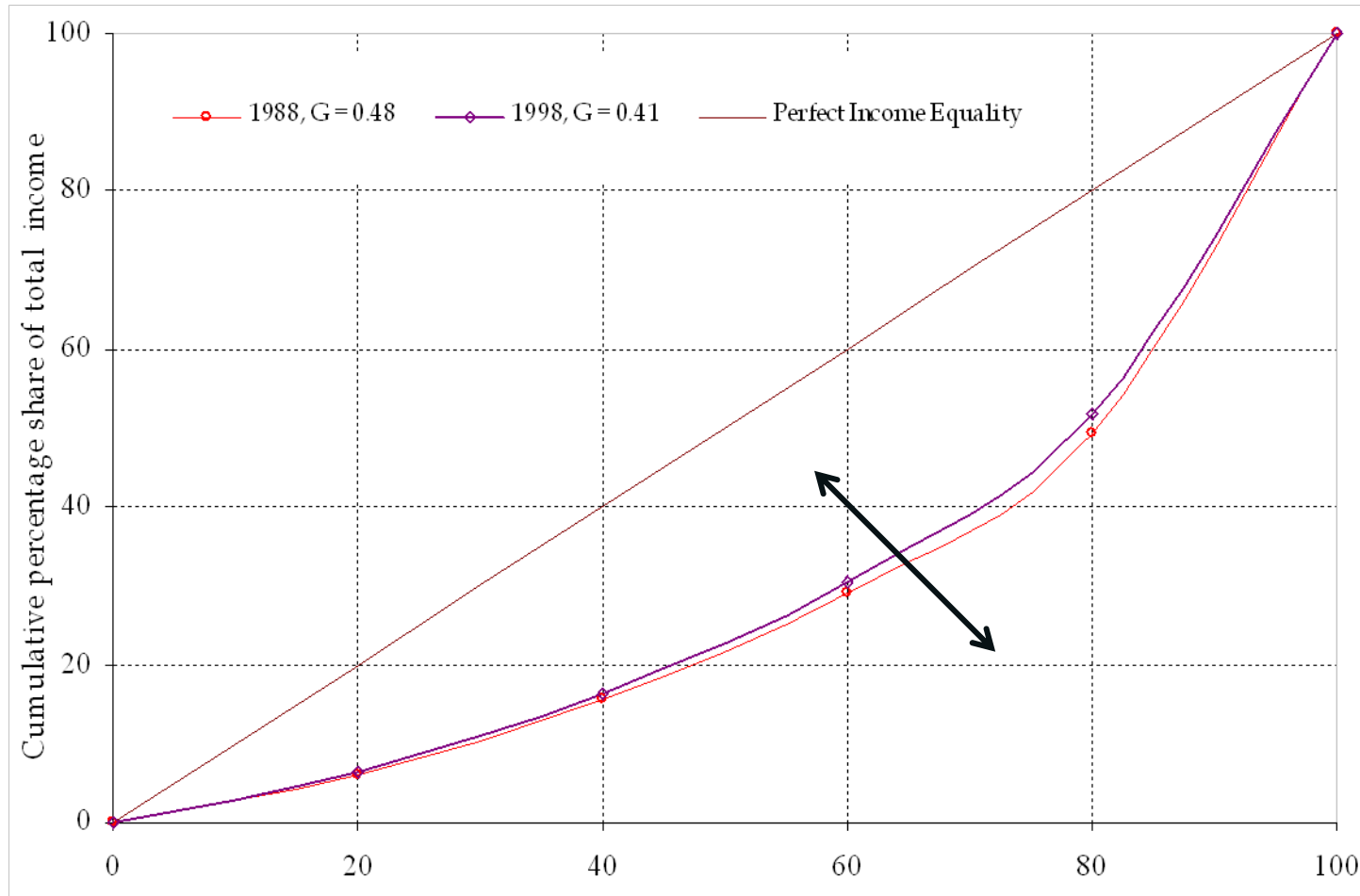
# Income Growth Differentials (Q5-Q1) and Income Inequality



# The importance of farm prices

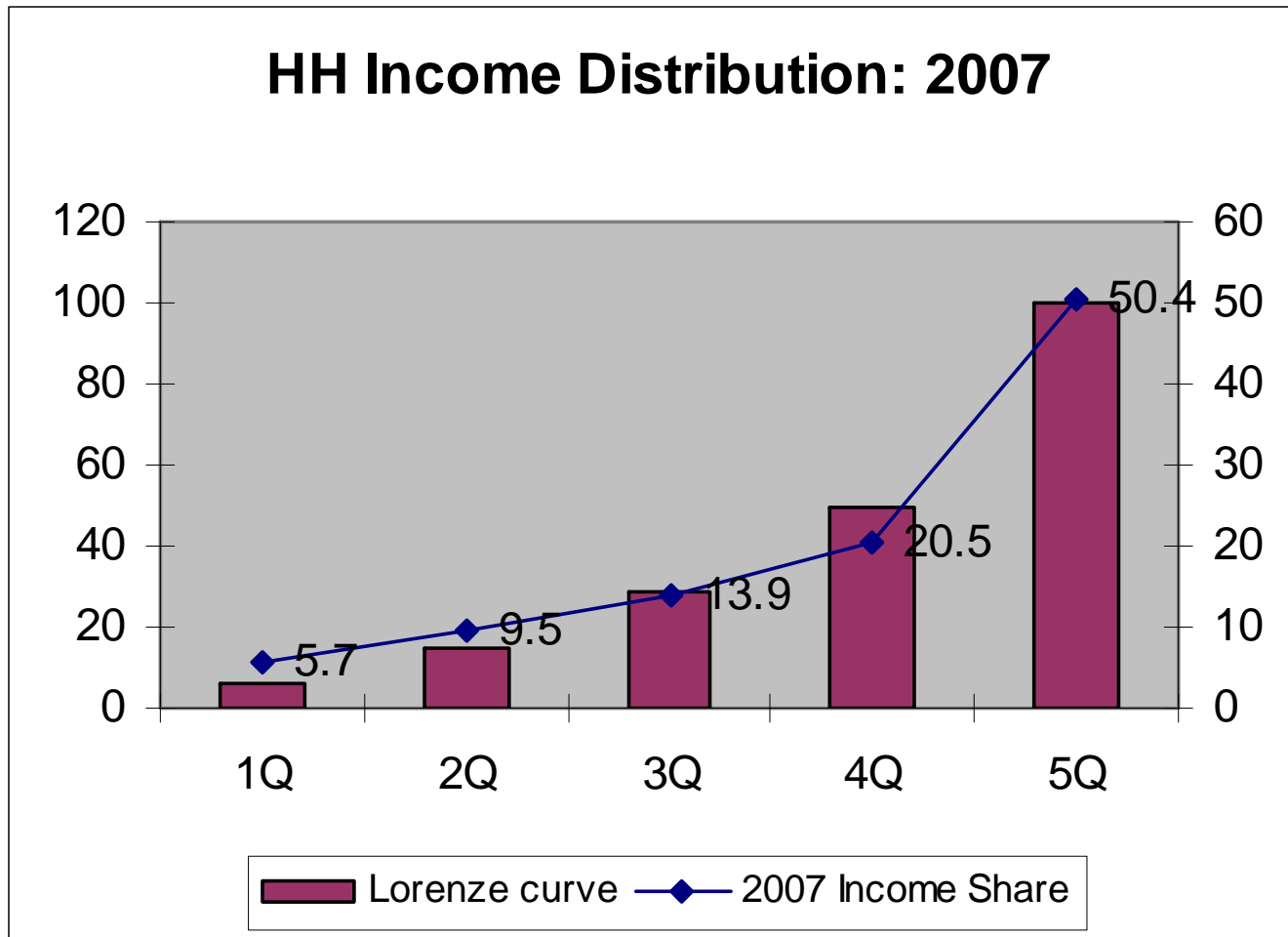
- Income disparity measured by the Gini coefficient did not change substantially in the last two decades.
- Except for 1986 and 1988, the Gini coefficient ranged between 0.42 and 0.45
- Whenever agricultural prices rose relative to manufactured product prices, income share of the poorest 20% was enlarged.
- Source: World Bank (data based on surveys taken between 1993 and 2000)
- Underlying household surveys differ in method and in the type of data collected, the distribution data are not strictly comparable across countries.

# The Lorenz curve: 1988 vs. 1998

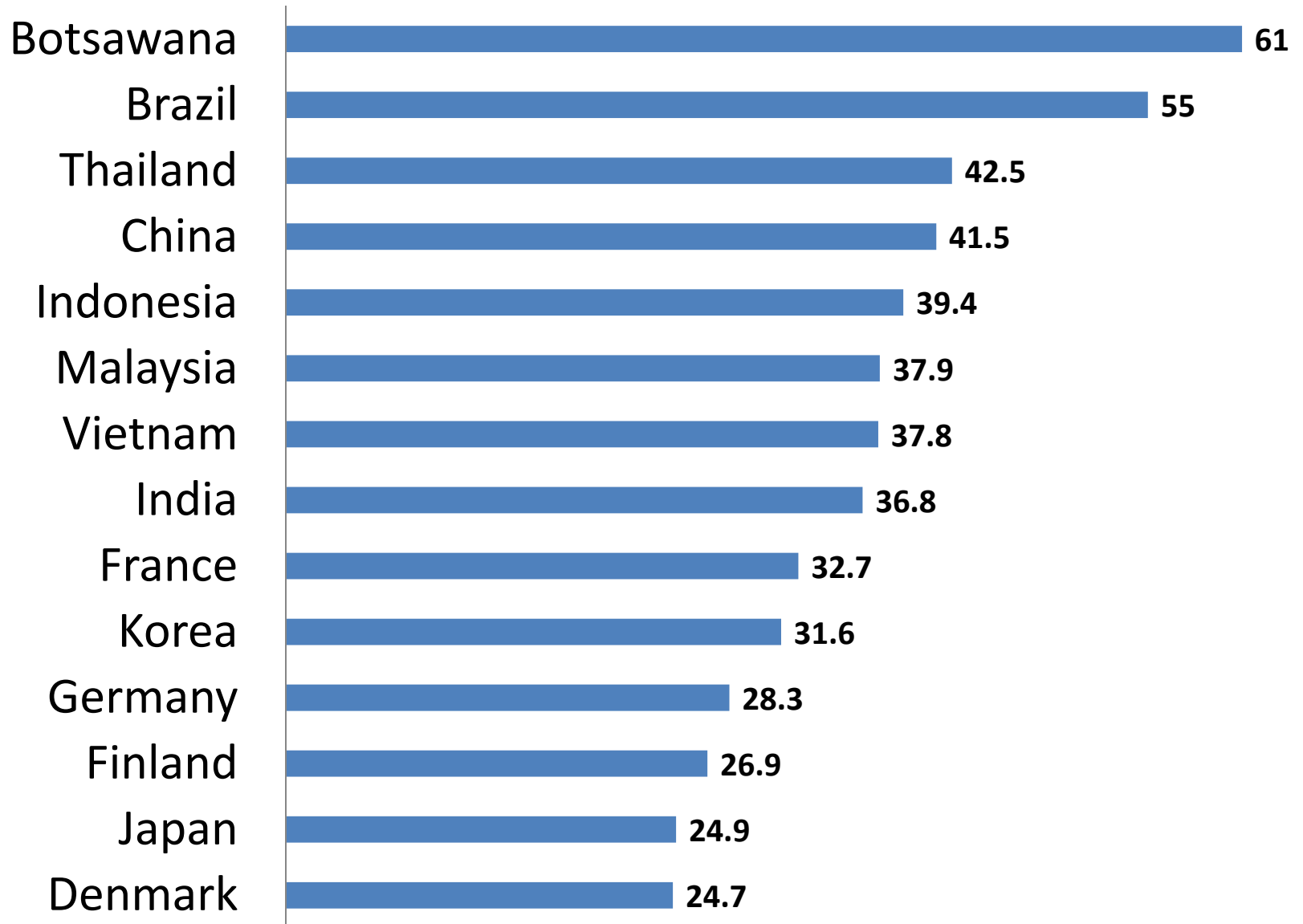


# The Lorenz curve:

By quintile (LHS), Income share (RHS)



### Gini coefficient: 1992-2007



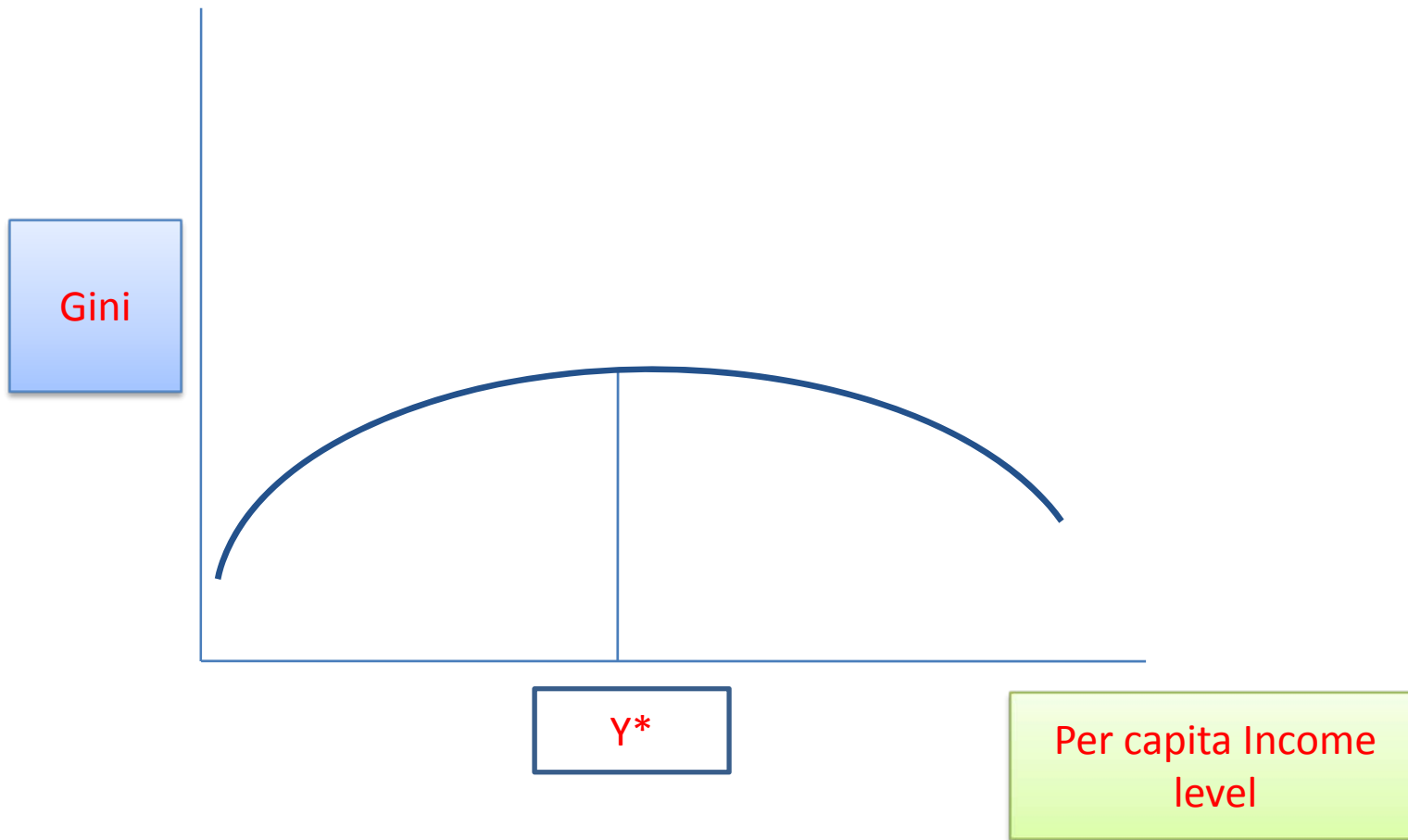
# How far can we trust the Gini?

- The Gini index is *sensitive* to the changes in the **middle of the earnings** distribution rather than the tails.
- Two different Lorenz curves with different shapes can yield the same Gini coefficient.
- *Gross income*, rather than net income, is used; thereby excluding taxation and transfer money payments.
- We must take into account of any major event affecting *transitory income* that might create distortions to the computation of income.

# Inequality in China and India

- There are 36 billionaires in India, according to the annual Forbes list of the world's richest people in Asia (Japan fell to No. 2 for the first time in two decades).
- While 850 million Indians are living on \$2 or less a day.
- Large income inequality exists in the fast growing economies like China and India.

# Kuznets hypothesis



# A complex relationship

- Kutznets (1955) hypothesis states that income inequality widens in the early stage of development and narrows in later stage when income rises above certain threshold levels.
- *“Income distribution must get worse before it gets better.”*
- Developing countries had greater equality in their **early** stages of development because everyone was thought to be more or less equally poor.

# Debatable issue

- The empirical evidence on the Kuznets hypothesis is far from conclusive.
- The inverted U-shaped curve cannot properly capture the intricate relationship between income and inequality.

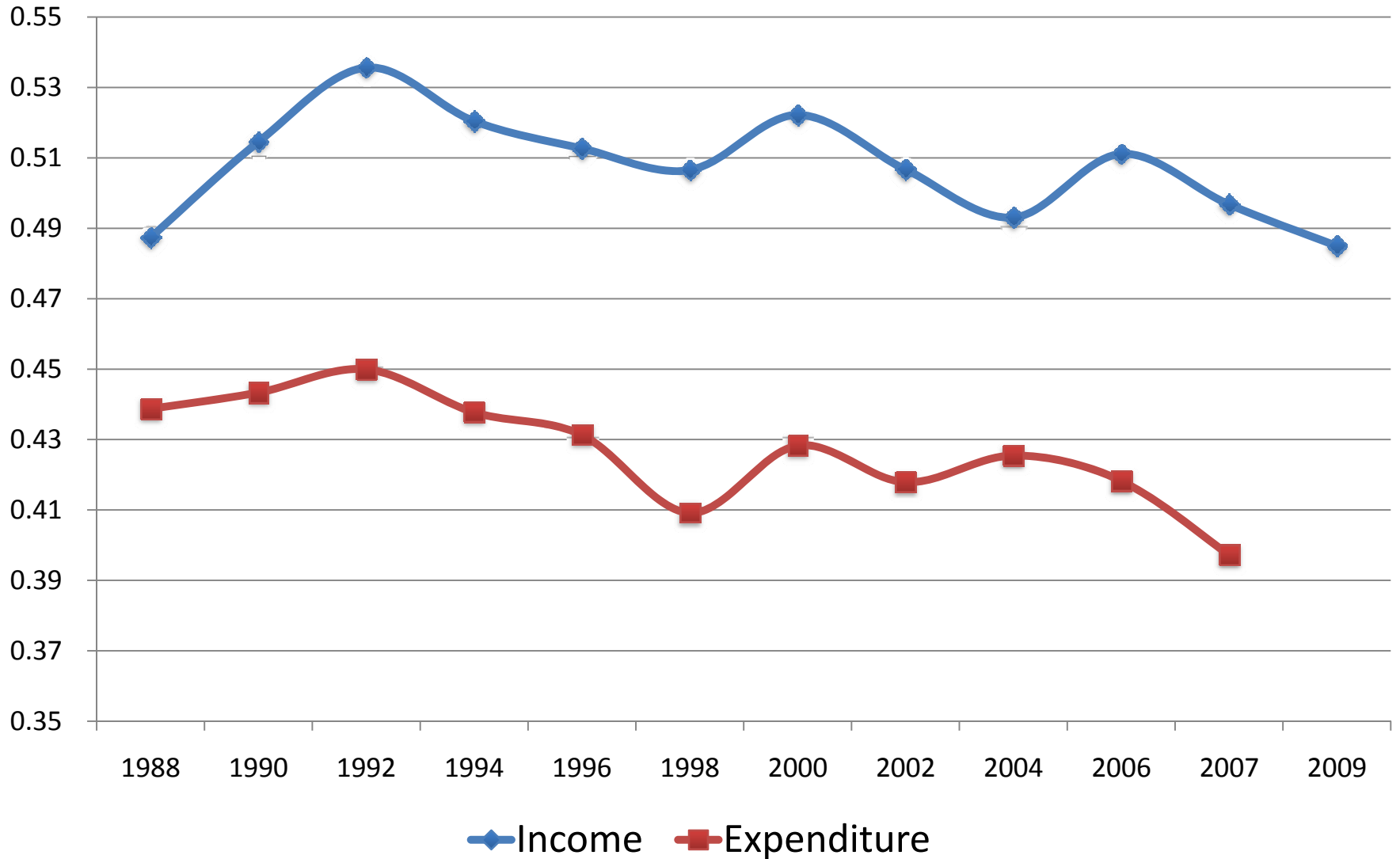
# Measurement errors

- Note that the measurements of inequality and poverty are based on estimated ***monetary*** income.
- Income inequality ***does not*** deal with the issue of ***quality of life, but*** income is the best available measure of poverty.
- **Non-monetary indicators** of poverty are: infant mortality, child and adult death, literacy, and school enrollment, life expectancy, availability of safe water and medical services, caloric and protein intake.

# What the Gini does not tell

- Income measures may not adequately capture informal sector income, value of food *grown and consumed* by the family, and other economic activity that goes unreported or unestimated (the underground economy)
- **The positive relationship between equality and growth (when per capita income is above the threshold level) does not imply that “soak the rich” policies will improve long-term growth.**
- **How about measuring inequality by expenditures rather than income?**

# Thailand's Gini Coefficients



# Should we tax the rich?

- Policies designed to decrease inequality may increase government consumption, and the cost of the greater government consumption *may outweigh* the benefits of greater equality.
- If per capita income is below the threshold level, a higher level of inequality is not a necessary precondition for growth.
- How did Korea and Taiwan manage their income equality so well?

# Has Thailand's economic development led to rising income inequality?

- The bottom/top 20% of income quintiles remained remarkably stable between 1975 and 2000.
- It is premature to say that Thailand's market friendly development policy has increased income inequality.
- Income inequality is related to **asset inequality**.

# Land holding inequality

- Ten percent of the population own more than 100 rai of land each
- While 90 % own less than one rai.
- The land and building tax bill will be put on parliamentary agenda before the meeting session ends on April 28.

# *Points to ponder*

- Beware of the danger from promoting a policy regime based on just one set of statistics and econometric evidence such as the Gini coefficient.
- Keynes' dictum: intellectual monopolization can have a negative impact. (Don't totally believe what the gurus or the experts say)
- Goodhart's law: "An indicator's measurement will be distorted if it is used as a target." ( like a target of 3.5 GPA)

# Past record: before and after the financial crisis in 1998

- **During the past three decades prior to the 1997 crisis, real per capita income had increased continuously.**
- **There was a significant decline in inequality between 1988 and 1998, the Gini coefficient dropped from 0.48 in 1988 to 0.41 in 1998.**
- **The increase in inequality in 1999 was the result of increasing level of poverty due to increased unemployment after the crisis.**

# Factors contributing to higher income inequality

- Higher poverty
- Slower economic growth
- Higher unemployment
- Higher social cost (including crime rates)

*Severe inequality can cause a vicious circle of slower economic growth*

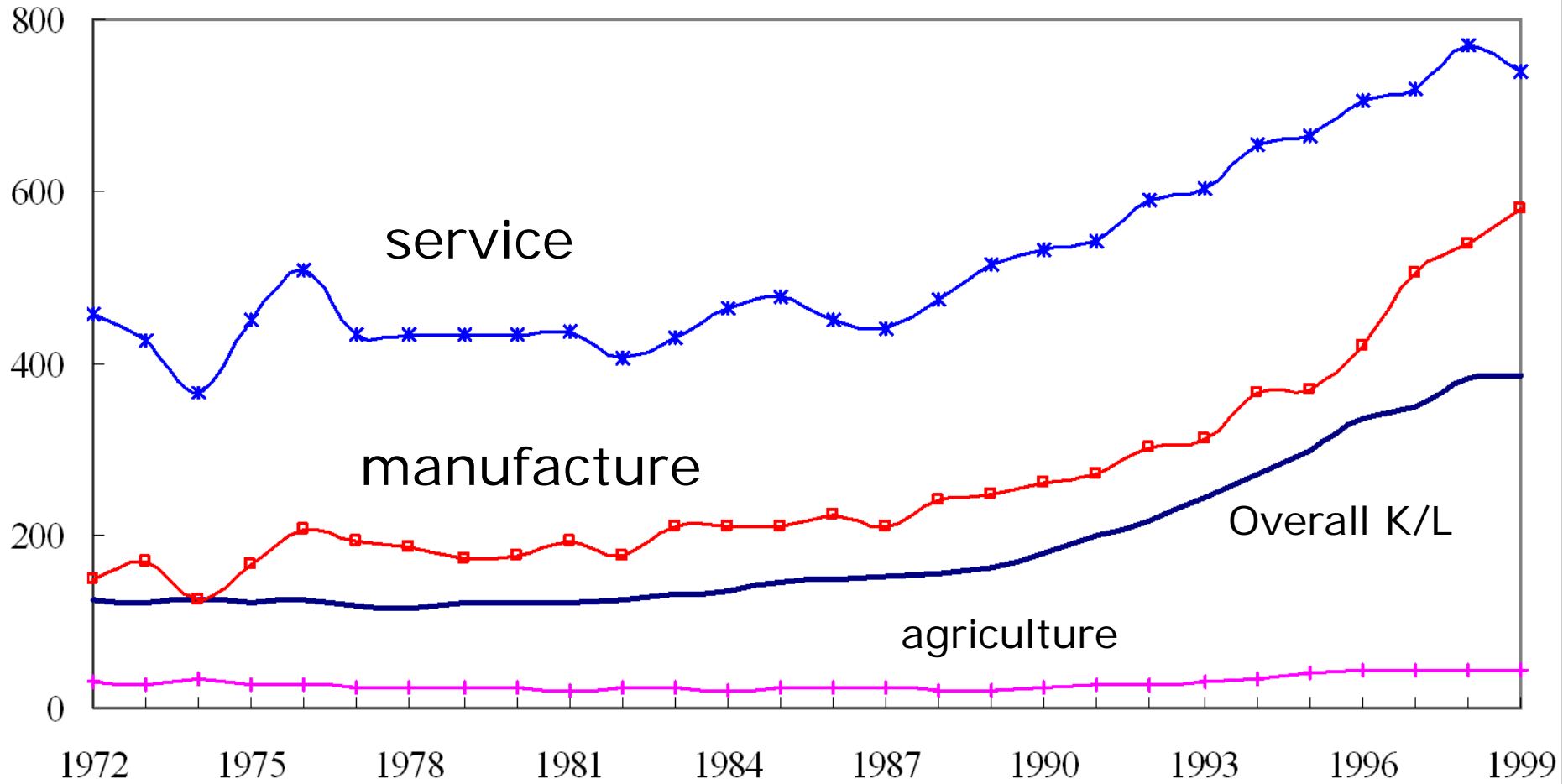
# Neoclassical theory of wage

- The wage rate is determined by the value of marginal product of labor in the competitive market.
- The demand for labor is the derived demand from the goods produced by the labor.
- The higher the marginal productivity of labor, the higher the real wage rate.

# Wages = MPL X Prices

- Income distribution between farmers in rural and labors in urban areas depends partly on relative marginal productivity as well as relative prices of the products they produce.
- Marginal productivity of each industry depends on the capital-labor ratio employed in each sector.
- The changing terms of trade among sectors also determine income distribution.

# Capital-labor ratio



# Impact of capital account liberalization

- **Capital liberalization led to capital concentration in the modern sector; thereby raising the capital-labor ratio in the manufacturing and non-traded sectors, including the FIRE (Finance, Insurance, Real Estates) sector.**
- **The agricultural sector is credit constrained with low level of capital accumulation.**
- **Productivity differentials grow together with wage differentials and income inequality.**

# Growth is good for the poor

- Bangkok and surrounding areas have been the places where the **poverty reduction** was the greatest.
- High degree of labor mobility contributes to a reduction in regional income disparity.
- Growth of urban wage rates is mitigated by migration of workers from rural areas, which in turn raises the agricultural wage rate; thereby, reducing wage differentials between the two sectors.

# Financial exclusion

- There is now a wealth of evidence from worldwide research that suggests financial inclusion plays a critically important role in poverty reduction, reducing income disparities and increasing economic growth.
- The cumulative effect of a large swathe of the population being effectively excluded from access to formal financial services carries both private and social costs, and ultimately undermines economic growth and development.
- The most important reason for being excluded appears to be either having incomplete documentation or lacking any collateral.

# Financial inclusion

- Bangkok has 100,000 registered taxicabs, and they are used by 200,000 drivers, working on 12-hour shifts.
- Each driver must earn at least 1,000 baht a day to meet the cost of petrol (300 baht) and 700 baht daily rent.
- The cars will never be their own as they only earn a minimum wage at best.
- Pracha-Wiwat micro-lending scheme through GSB, SME, and ABAC banks provide loans at 6% annual rate, rather than 7% month interest rate required by leasing companies.

# Pracha Wiwat microfinance

- Each motorbike taxi driver is entitled to 40,000 baht loans that must be repaid within 11 months.
- A 10-member groups are formed to secure loans of 400,000 baht providing mutual guarantees for one another.
- On the 85% of driver households carry average debt of 150,000 baht with average monthly payment of 7,500 baht.
- 58% is owned to banks and 42% to loan sharks.

# Gender inequality

- Source: Yoko Niimi (2009) “Gender equality and inclusive growth in developing Asia” Asian Development Bank, Economics Working Papers no. 186

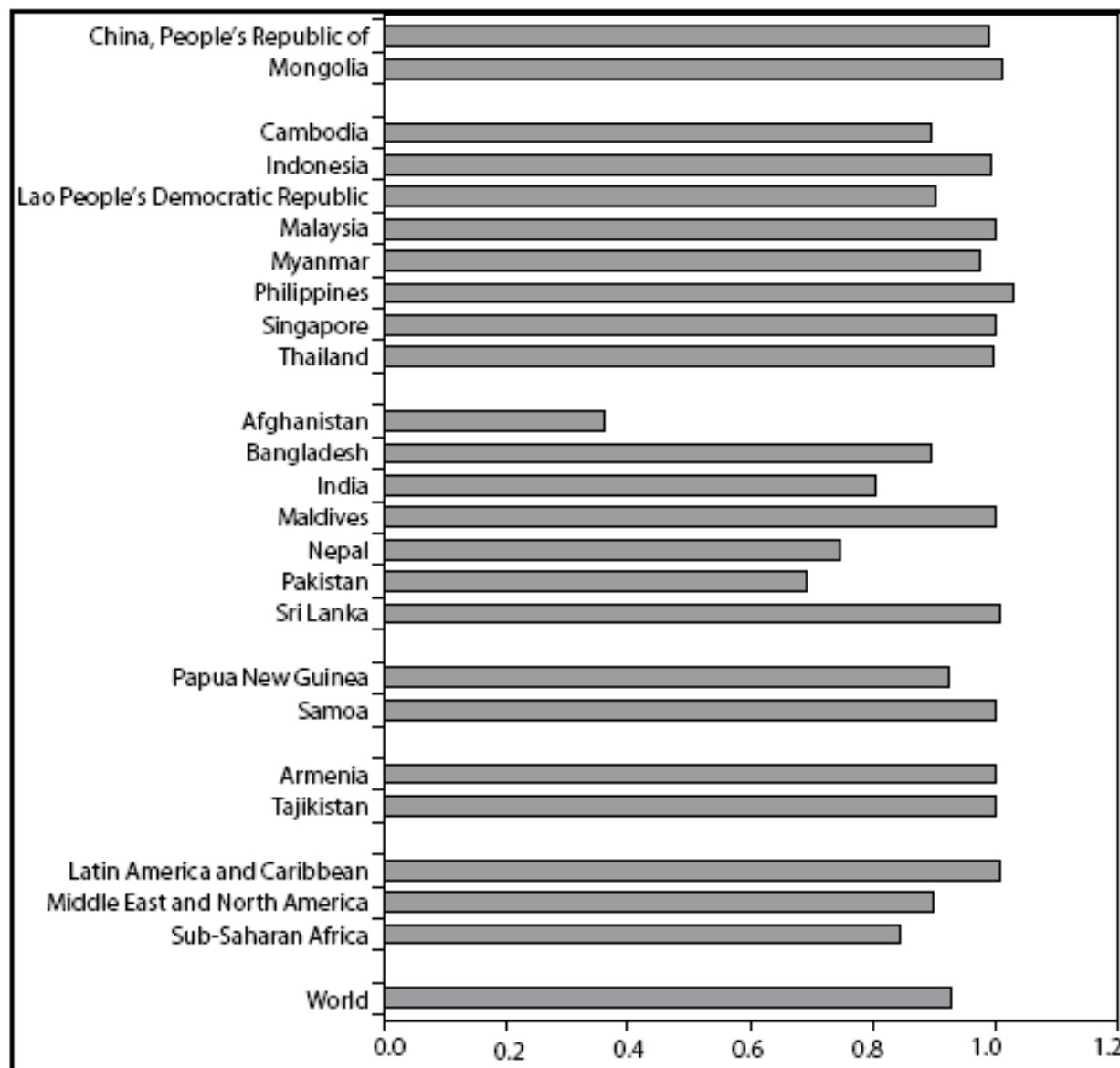
**Table 1: Indicators of Gender Equality under the MDG3 Plus Approach**

Domain	Indicators	Level of Aggregation
Capabilities		
Education	Ratio of girls' to boys' enrollment in primary, secondary, and tertiary education	Household
	Ratio of literate females to males among 15–24 years old	
Health	Primary completion rate of girls and boys	
	Under-five mortality rate for girls and boys	
	Percentage of reproductive-age women and their sexual partners using modern contraception	
	Percentage of girls aged 15–19 who are mothers or pregnant with their first child	
Access to resources and opportunities		
Employment	Share of women in nonagricultural wage employment	Economy and market
	Labor force participation rates among women aged 20–24 and 25–49	
	Ratio of female to male hourly earnings in primary, secondary, and tertiary sectors	
Political participation	Percentage of seats held by women in national parliaments	Society

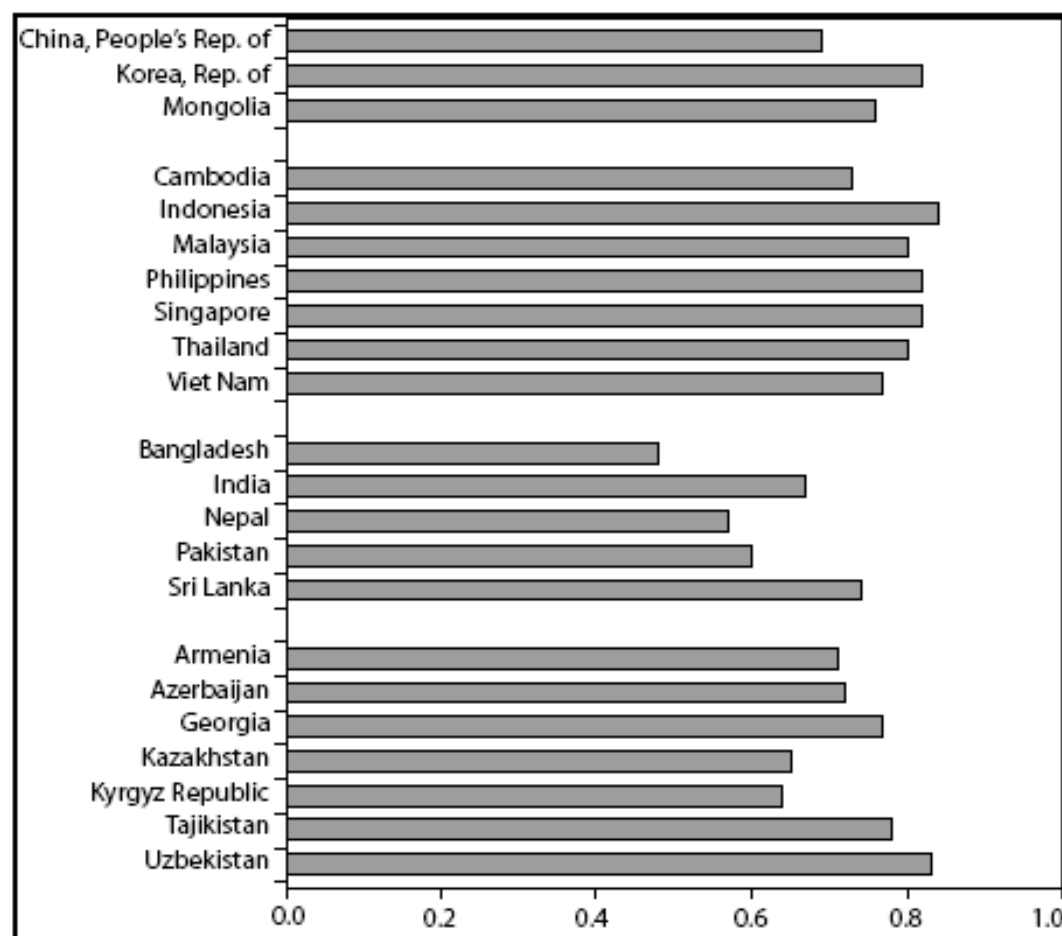
MDG3 = Third Millennium Development Goal.

Source: Morrison et al. (2008).

**Figure 6: Ratio of Literate Females to Males Aged 15–24, 2006**

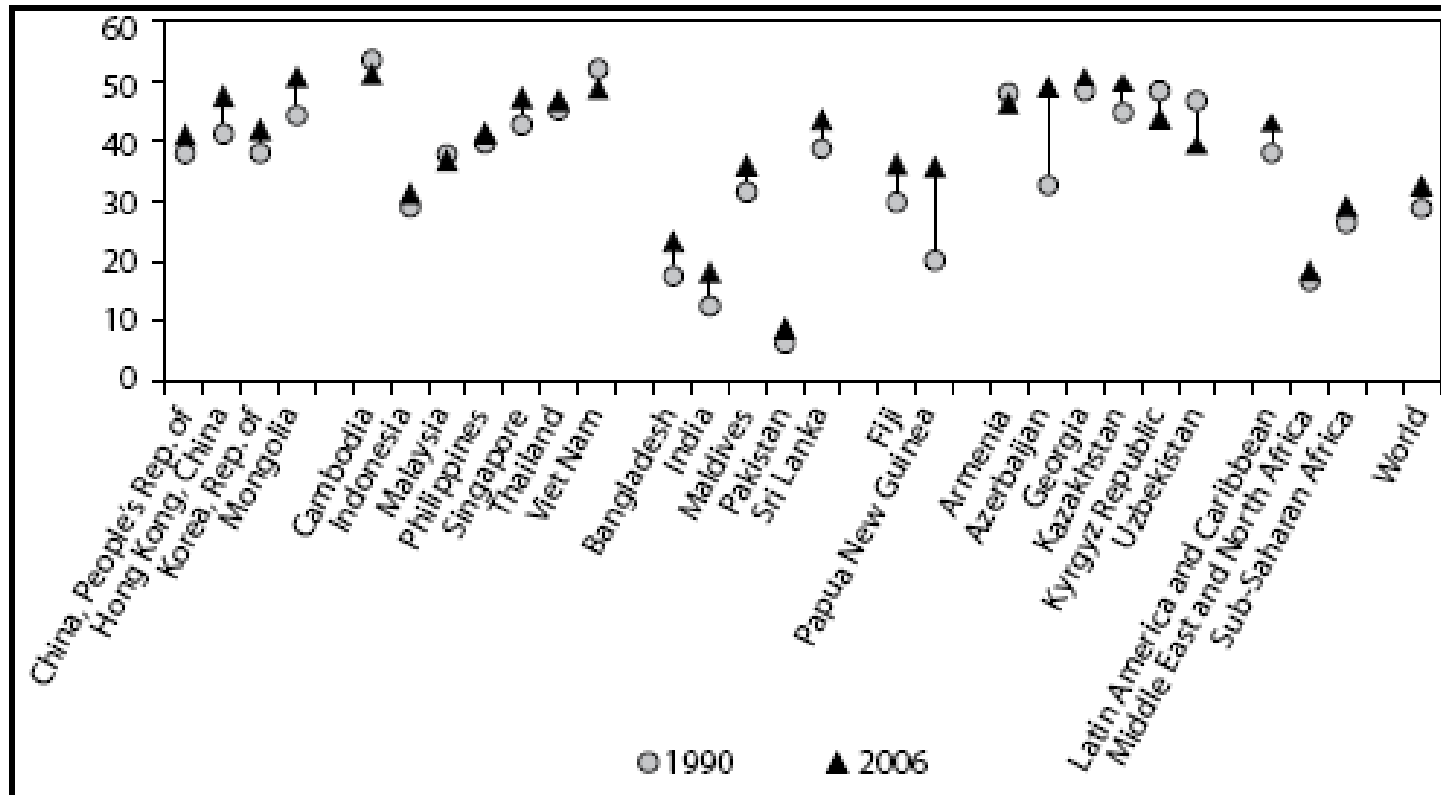


Note: The figure is based on the latest available data between 2000 and 2006 for each country and region.

**Figure 13: Ratio of Female to Male Wage for Similar Work, 2007**

Source: World Economic Forum (2007).

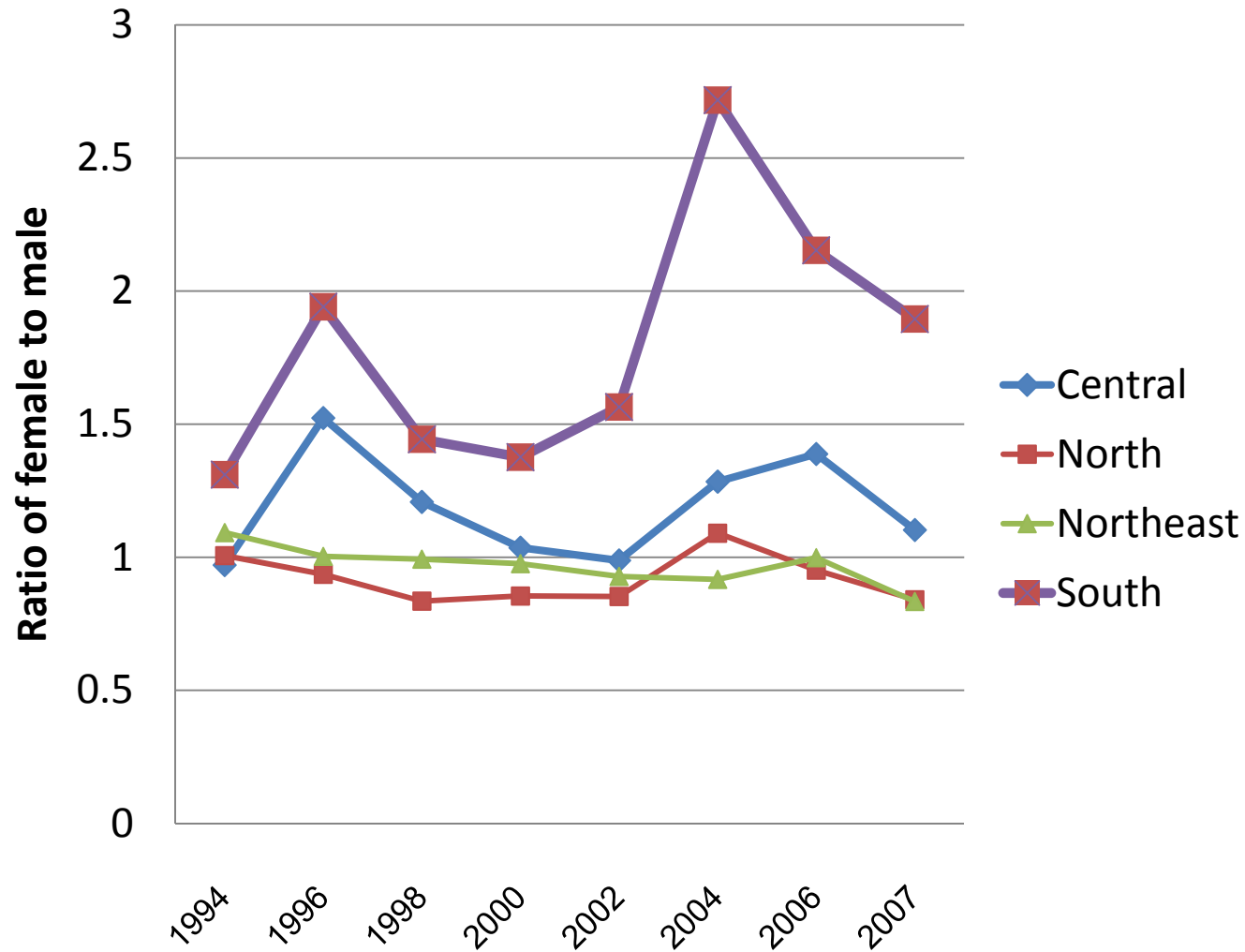
# Share of non-agricultural wage employment, 1990 and 2006 (%)



Note: The figure is based on the earliest available data between 1990 and 1995 and the latest available data between 2000 and 2006.

Source: Morisson et al. (2008).

## Gender inequality ratio (relative poverty)



# Summary

- Output growth of the service sector has more impact on poverty reduction than manufacturing and agricultural sectors.
- Capital liberalization led to rapid capital inflows, enhancing capital-labor ratio, and enlarging productivity differentials.
- When the terms of trade turns against farm prices and agricultural productivity lags behind other sectors, income inequality deteriorates.
- There are some flaws in using the Gini coefficient to measure inequality.

# Questions

- Explain how trade reform and capital control liberalization might affect income distribution.
- “Economic development in Thailand is a failure because income distribution has worsened” Discuss.
- What are major factors determining income distribution in Thailand?
- “A move toward free trade improves income distribution in Thailand” Discuss.
- Analyze the impact of oil price shocks and food price shocks on income distribution and poverty.
- What can Government Savings Bank and the Bank of Agriculture and Agricultural Cooperatives contribute to reduce income inequality?

# Previous final exam questions

1. "Quantitative easing policy conducted in the US would exert a negative impact on Thai exports in 2011" State whether you agree or disagree with the statement. Provide brief reasons to support your answer.
2. "The Bank of Thailand raised its key policy rate to 2% last week. Other things equal, the normalization of monetary policy that would continue into next year can subdue inflation in 2011". State whether you agree or disagree with the statement. Provide brief reasons to support your answer.

## Open book exam

Each question carries 10 points

3. With substantial extension of mass-transit routes of trains to provinces surrounding Bangkok, How would the rent gradient of Bangkok look like in 2020?
4. Discuss whether a ban on rice exports by China would have any impact on poverty and income distribution in Thailand.

# Answer all 10 questions

5. If Burma and Lao are accepted as a member of the WTO in 2025, how would Thailand's pattern of trade be affected?
6. If the government does not cut public consumption in the next fiscal year, the budget deficit will be worsen and raise the debt-to-GDP ratio further.

Make sure that your answers are as clear and concise as possible

7. Thailand was able to recover within a few years after the bailout by the IMF during the financial crisis in 1998. Do you envisage any similar pattern of recovery of the Irish economy in the near future?
8. Examine how various industries in Thailand can be affected if the baht appreciates to 28 baht to the dollar next year.