East Asia’s low spending model on welfare is no longer fit for tackling growing inequality

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During the late 1980s and the early 1990s, scholarly debates about East Asian miracle economies were about their secrets of success. Unlike most industrialised nations, they managed to grow without spending much on welfare. Some scholars pointed to East Asia’s unique cultural traits, particularly highlighting the role of family. Due to strong familial ties, it was argued, intra-family transfer more or less substituted the role of state welfare. Others saw this as lack of economic development. Despite their spectacular growth, they were still developing, and their welfare spending would eventually grow as the process of modernisation and industrialisation continued.

Neither of these accounts has been particularly convincing especially after a few decades of further development. Families are getting smaller and elderly populations are particularly vulnerable to poverty. Empirical evidence suggests that private transfer in East Asia plays a comparatively more important role than its Western counterparts, but it is not equivalent to public welfare and there are high levels of old-age poverty in the region. Contrary to the expectation that economic development would eventually push these countries to spend more on welfare, Japan remains the only economy in the region that spends around the comparable level to other member nations of the Organisation for Economic Co-operation and Development (OECD) on welfare, even though other East Asian economies have become as rich, if not more. Japan’s status as an early industrialiser in the region
and its ageing population may explain why Japan’s spending is much higher. Indeed, South Korea, Taiwan and Singapore, despite their ageing populations, are still relatively young compared with most OECD countries. But this structural account has little to say about why Hong Kong, the second oldest in the region, is the least committed to welfare in spending terms.

Instead of these rather deterministic accounts, a more convincing explanation points to the strategic use of social policy in order to speed up the process of economic development. One account under this broad theme sees social policy as subordinate to economic policy: social policy is largely understood secondary to economic policy and only those social policy sectors that are deemed useful for economic development take precedence. Another strand takes a more instrumental approach and highlights the utility of social policy not just in economic production but also in achieving socio-political objectives. A democratic deficit with strong authoritarian characteristics in East Asia pushed ruling elites to seek political legitimacy through socioeconomic development. What distinguishes the two is that whereas the former takes redistributive social policies—particularly in the form of cash transfers—as something that gets in the way of economic development, the latter can accept them so long as they serve the key goals of social stability and political legitimacy. With almost all public policies directed towards the goal of economic growth, East Asian economies managed to maintain the conservative ascendancy while the growth of labour power was kept in check by state elites and business interests.

How was this almost blind pursuit of growth-first strategy possible? As long as economic pies grew larger, people saw opportunities that could improve their life chances. A relatively equal distribution of income, particularly in the form of pre-transfer market income (i.e., income before taxes and cash transfers), was an important premise within which almost all aspects of social policy could be diverted to growth-related objectives. The lack of measures to equalise income distribution was not particularly concerning because income was not very unequal in the first place. Instead, greater efforts have been made to accumulate capital through promoting savings, and problematising and suppressing citizenship rights (e.g.,
strict eligibility rules for receiving income support and repressive labour laws). Direct cash transfer payments, particularly if paid regularly, were believed by conservatives to undermine individual responsibility and work incentives. Indeed, with the exception of Japan, most East Asian economies spend little on social protection whereas their spending on education, housing and healthcare sectors are often greater than their Western European counterparts; and even Scandinavian countries when expressed as a proportion of total government spending.

East Asia’s relatively strong emphasis on service provision rather than cash transfers was well aligned with the strong presence of idea of meritocracy: as far as the public perceive that they have a fair chance of upward mobility, they can accept a degree of inequality. At least in part, this explains why people are not necessarily concerned about growing inequality. The idea of meritocracy is prevalent in East Asia. In the early 2010s, the majority believed that ‘hard work usually brings a better life in the long run’. Even in societies where inequality appeared high, such as Singapore and Hong Kong, people believed that hard work would pay off. To put it another way, it was not the opportunities that were lacking but the willingness and effort to work.

Around 2018 and 2020, people’s view on meritocracy shifted in East Asian economies, with Korea recording the biggest drop from 53.7 to 30.4 percent, followed by Hong Kong and Taiwan from 60 to 48.6 and from 57.6 to 49 percent, respectively. Other economies in the region also experienced a reduction, albeit not as dramatic. Changes in people’s attitudes towards whether hard work will lead to success are also reflected in the fact that East Asia’s social mobility is not necessarily better than elsewhere. In the case of Japan and Korea, for instance, it is expected to take 4-5 generations for the offspring from a family at the bottom 10 percent to reach the mean income. In comparison, it is expected to take 2-3 generations for most Nordic countries. Singapore’s social mobility is not much better than in the UK and worse than Germany and France. Given that Singapore has long been considered as a society where meritocracy is the governing principle, this is now a big problem. In broader terms, if the paradox of inequality does exist, the drop in the belief in meritocracy is likely to result in the increasing concern about
inequality. In other words, when people begin to lose their faith in meritocracy, high inequality begins to bite, challenging the status quo and governing authorities.

Between 1980 and 2020, East Asian economies have experienced a shrinking of the bottom 50 percent share of pre-tax national income. Korea and Taiwan experienced a particularly dramatic reduction of more than seven percent. In the case of Korea, pre-tax national income of the top one percent grew by 5.18 percent. This is lower than USA’s 8.28 percent, but much higher than Japan’s 2.22 percent and Germany’s 2.93 percent. At the same time, the middle class in East Asia is growing smaller. Expressed as the middle 40 percent of national income, the proportion of the middle class in Japan, Korea and Singapore is now below 40 percent, lower than that of the USA, Germany and Sweden. Given that the middle class in these East Asian economies constituted nearly 45 percent in the early 1990s, this is a notable reduction. Globalisation, financial deepening and labour market imperfections are among the key drivers of growing income inequality. More than anything, however, the rise in income inequality in East Asia was closely associated with its almost blind pursuit of capital accumulation. In fact, early social programmes were deliberately designed to ensure the accumulation of capital and the building of markets, both of which are critical for economic growth, yet also contributing to rising income inequality. All of these economies have now reached GDP per capita of $US40,000, using purchasing power parity. For these rich economies, GDP per capita may not be the best indicator to measure their socioeconomic progress. Instead, the size of their middle class may be a better indicator.

Nevertheless, East Asian economies largely remain reluctant to allocate more money to welfare. In fact, according to Oxfam’s ‘Commitment to Reducing Inequality Index’, which measures not just spending but also taxation and labour rights, Korea, Singapore and Hong Kong ranked at 24th, 79th and 86th respectively (out of 161). Japan did much better, almost making the top five. For Korea, this was a notable improvement from a 2017 ranking of 51st out of 150 countries, recording the highest rise in the OECD. However, spending was the least impressive performer out of the
three measures between 2017 and 2022. A higher level of spending on welfare does not necessarily mean better welfare outcomes. In fact, welfare spending is often criticised as an inadequate and misleading indicator. But there seems to be a general pattern that big spenders tend to achieve greater equality. This does not mean that big spenders have more progressive cash programmes. In fact, one of the most influential OECD reports found that higher levels of spending are associated with lower progressivity (i.e., ‘how large a share of benefits is received by different income groups’). Nevertheless, what is famously known as the paradox of redistribution thesis points to the size of the budget as one of the important contributing factors to explain why countries with universal, earnings-related measures achieve greater redistribution of income. Within East Asia, Japan is a big spender by a large margin. The welfare spending levels of Korea and Taiwan are around half that of Japan and even smaller than China expressed in the form of percentage of GDP. Japan is not considered a target-efficient welfare state, but it spends more than the OECD average. Perhaps not surprisingly, what is known as relative fiscal redistribution which measures the ratio between pre-transfer (before tax and transfer) market income and disposable (post tax and transfer) income for Japan is around the same level as Sweden’s. In other words, about 34 percent of income inequality is reduced by tax and transfer system in Japan. For the rest of East Asia, this rate is less than half that, and much lower than the USA’s rate of 21.7 percent, which is one of the lowest in the Western world.

In relation to the question of whether higher levels of spending would result in better redistributive outcomes, Singapore can provide us with some useful insights. Singapore is one of the high performing and rich economies in the region. But it openly refuses to be recognised as a redistributive welfare state. Social security programmes are explicitly designed not to be adequate. There is neither unemployment benefits nor minimum wage in Singapore. Its social assistance programme, known as ComCare, targets the poorest of the poor on a temporary basis. Regular payments of any kind are deemed undesirable. Not surprisingly, Singapore’s low tax and transfer regime is identified as a leading contributory factor
to its smaller redistributive effects.

Around the time of Global Financial Crisis in 2007/8, Singapore experienced the peak of its income inequality. In the 2011 election, the ruling People’s Action Party gained the lowest share of popular vote since Singapore’s independence. The ruling party has never lost power and this result did not come close to a loss. Nevertheless, it was significant and in 2013 both the Prime Minister and the Finance Minister highlighted the greater need for collective responsibility ‘to share the risks through a stronger social safety net’. This acknowledgment itself is important given Singapore’s long-standing emphasis on family responsibility and self-help. Government transfers in Singapore continue to remain small, constituting less than 10 percent of total income. Most of these take the form of rebates and subsidies. Regular transfers constitute around 16 percent of all government transfers. Nevertheless, it is these regular transfers that tend to achieve much greater redistributive effects than rebates and subsidies. In fact, when there was a sizeable injection of government support in the midst of COVID-19 in 2020, Singapore reduced inequality by the biggest margin it has ever recorded, achieving the lowest income inequality since the government started tracking the data in 2000.

The same cannot be said about Hong Kong, which is often compared to Singapore for its residual welfare model. Hong Kong’s GDP per capita in purchasing power parity terms is the second highest in the region, below Singapore’s but its social expenditure also remains the lowest in the region. Given that inequality in Hong Kong in both pre- and post-transfer terms is also by far the worst, the weak redistributive effect is particularly concerning. Despite fading faith in meritocracy, Hong Kong’s effort to reduce inequality has been mediocre. Unlike other East Asian economies, Hong Kong tends to rely more heavily on social assistance which is a last resort safety net measure. Although it is officially called the Comprehensive Social Security Assistance (CSSA), it is not comprehensive in its coverage and generosity and has become smaller in size, coverage and effectiveness over time. Instead, a new scheme targeted at the elderly with special needs has grown bigger than the CSSA. Even with the increase in inequality and decline in meritocracy, social programmes
in Hong Kong continue to highlight the ‘innate local values of concern for the family, commitment to self-improvement, self-reliance, mutual support and generosity, [and] reluctance to be dependent on ‘welfare’.’

For both of these economies, the affordability of state welfare has become much less of an issue. After all, these are rich economies. In fact, it is now the least prosperous Japan that spends the most. The question of whether an increase in the amount of welfare spending will lead to better redistributive outcomes may remain contentious. But more than that, it is a matter of political commitment. People’s opinions have begun to change. Yet these changes are at an early stage. As seen in both cases of Singapore and Hong Kong, deep seated beliefs about the role of family and the ideal of self-reliance are difficult to change or abandon even if people have begun to see the cracks emerging. Nevertheless, if these beliefs continue to progress, albeit slowly, they will pressure political authorities to address and act on the inconsistencies created.

These changes are arguably more likely in societies where political authorities are regularly and frequently challenged. Indeed, both South Korea and Taiwan show greater financial commitments to welfare than Hong Kong and Singapore although they are still substantially lower than the OECD average. After decades of authoritarian rule, both have experienced arguably frequent occurrences of government turnover in recent history, more so than the long-standing democracy of Japan where the ruling Liberal Democratic Party has mostly been in power since its foundation in 1955. Government turnover can be seen negatively as it can indicate political instability. But more positively, it may also be a ‘favourable source of competition and institution-building.’ Both Korea and Taiwan have been much more dynamic. In their presidential elections, for instance, the opposition Democratic Progressive Party candidate won four times in 2000, 2004, 2016 and 2020 in Taiwan. Similarly, in Korea, the opposition left-wing candidate won presidential election three times in 1998, 2003 and 2017. Korea’s social expenditure has been growing at one of the fastest rates in the OECD, although its starting position was so low that it still remains low. With similar levels of social spending, its richer neighbour Taiwan
has maintained its steady pace of welfare spending in line with its economic growth rate. As its pre-transfer inequality remains substantially lower than most other industrialised economies, perhaps due to the stronger presence of small businesses with relatively smaller wage gaps between them, its rather weak redistributive effect of social transfer system seems less of a concern at least for now.

While stronger political commitment to higher levels of spending is likely to lead to greater redistributive effects in most East Asian economies, Japan seems to be in a difficult situation. As a welfare leader in the region, Japan looks closer to the standard model of welfare than the rest. But, unlike the rest where the present low level of spending can be an advantage as it leaves room for further spending growth, further spending growth to act on its ageing society is a big challenge for Japan, not least because it would necessitate sustained economic growth. Although Japan is still the third biggest economy in the world, its wage growth rate has been stagnant for some time. It therefore remains to be seen whether its higher-than-average welfare spending can be sustained in the future without losing momentum to keep the level of inequality in check.