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GLOBALIZATION, EXPORT-LED GROWTH AND INEQUALITY: THE EAST ASIAN STORY

Mah-Hui Lim

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ABSTRACT

Over the last three decades, several East Asian economies have grown by leaps and bounds. The success of their export-led growth model is regarded, and copied, by many emerging economies as a sure path to achieve high-income status. But with impressive growth came worsening inequality both in personal income and functional income distribution.

This paper looks at the export-led growth model of five East Asian economies - China (Peoples Republic of), Korea (Republic of), Taiwan (Province of China), Malaysia and Thailand – and identifies the global forces and national policies that led to rising inequality and falling wage share. Export-led growth has been one way to counteract falling domestic consumption and aggregate demand. However, inequality can constrain further grow as export markets, faced with strong global economic headwinds, falter. Some countries turn to domestic debt–led personal consumption to pick up the slack. This is unsustainable. If wage share of GDP has been falling and inequality rising, countries will not be able to depend on domestic market to drive growth unless they also restructure their distributive and redistributive regimes.

INTRODUCTION

This paper examines the relationship between inequality, globalization and the type of growth models pursued in five East Asian economies, namely, namely China (Peoples Republic of), Korea (Republic of), Taiwan (Province of China) [2], Malaysia and Thailand. Inequality is examined not simply from the point of personal income distribution, but more importantly from the perspective of functional income distribution, i.e., wage share versus capital share of national income. [3] We find that in all these economies, wage share has been declining over the past few decades. It is argued that the type of growth model pursued, in particular export-led growth, has had a significant impact on income distribution. In other words there is a strong relationship between the productive and the distributive regimes. This is particularly true for Malaysia, Thailand and China, where export competiveness based primarily on lowering unit labor cost represses wages and wage share of national income. Underlying this trend is a clear divergence between productivity growth and wage growth, with the latter falling behind the former, contributing to worsening inequality. Even in Korea where its export-led growth is less dependent on foreign investments and low wages, this divergence emerged since the 1990s due to financial and economic liberalization. In the case of Taiwan (PoC), it deviated from export-led growth based on technological competitiveness to low-wage policy after 1990s.

While export-led growth has resulted in rapid growth for these economies over the past few decades, it is facing strong headwinds and highly uncertain global conditions and markets. Some of these economies, in particular China, are attempting to turn to domestic markets for growth. In pursuing this path, they need to restructure not only their productive but also their distributive system. This means the link between the two that was taken for granted or ignored, has to be restored. This is the challenge facing these economies.

Part I presents some stylized facts on worsening inequality in five East Asian economies not just in personal income distribution but more fundamentally in functional income distribution. This is then related to the forces of globalization and national policies pursued by these countries. Part II examines in detail the trend of and reasons for worsening inequality in each of the five economies. Part III discusses the limits and challenges of export-led growth in a new global environment. Part IV sketches the new policies and strategies to meet these challenges; and Part V concludes.

I. THE ISSUE OF INEQUALITY

In the 1950s and 1960s, income inequality was an issue that occupied the attention of prominent economists (Kuznet, 1955; Lewis, 1954; Kaldor, 1955/56) and even mainstream establishment institutions like the World Bank. But by the late seventies this issue faded from economic literature, replaced by the notion that growth is necessary to reduce poverty and that

[2] Here after referred in short as Taiwan (PoC)
[3] Wage share and labor share will be used interchangeably.

accepting increases in inequality to promote private investment and risk-taking is unavoidable. Kuznet's famous inverted U-shaped growth trajectory postulated that with industrialization and growth, income inequality would initially rise and fall thereafter. For a while this was the case, but the recent record of rapidly worsening income distribution in the Anglo-American economies has extended an upward tail to the inverted U. Furthermore, Korea's and Taiwan's (PoC) growth did not follow the Kuznet's curve. Here income inequality measured in terms of the Gini coefficient declined from the high forties to the low thirties in the early phase of industrialization and growth.

Today, after four decades of rapid growth, the trickle-down effect of growth did not materialize. On the contrary, income inequality has returned with a vengeance, painfully exposed by the recent global financial crisis. Inequality is one of the most pressing global problems today, with serious political and social consequences. In 2012 and 2013, many international institutions like the ADB, World Bank, UNCTAD and ILO devoted special issues to the problem of income inequality. [4] The ADB Report (2012:45) revealed that 13 of 36 Asian economies had Gini coefficient of 40 and above, and 11 economies covering 82% of Asia's population experienced worsening inequality. However, most of these reports, with the exceptions of UNCTAD and ILO, display an obsessive focus on inequality in terms of personal income distribution determined by factors such as access to opportunities like education, health, and technology without reference to the larger context of growth models, and the social, political, and institutional processes influencing these indicators. [5]

In this paper, we emphasize that more than personal income distribution, it is distribution between labor incomes (wages and self-employment) and capital incomes (profits, dividends, rents and interest), i.e., functional income distribution that is crucial in determining inequality. Furthermore, this functional distribution of income between labor and capital is related to the types of growth models chosen.

I.1 Declining Wage Share of National Income

Some recent studies have highlighted the widespread decline in wage share of national income in many countries in the world. Chandrasekhar and Ghosh (2013), using UN data showed that for the world as a whole, the share of wages and mixed income of self-employed has been declining since 1980 but with regional and temporal differences. This decline is found both in the developed and the less developed countries, with South America as the only region bucking the trend. The wage share in the U.S., Europe and Japan are all falling with accentuated decline since the late 1990s, and more severe among export-oriented economies like Japan and Germany. The same trend is found in East Asian countries with the sharpest decline in China, Korea and Malaysia after the late 1990s. The ILO (2011) study also shows that since the early 1990s, three quarters of the 69 countries for which functional income distribution data are available experienced declining wage share of income. In Asia the wage share declined by almost 20 percent since 1994. In China, the wage share dropped 10% since 2000 (Ibid: 56).

[4] Even establishment organizations like the World Economic Forum and publications like the Economist have placed it on their top agenda.

[5] See Fischer (2012) who argues that poverty and inequality have been reduced to technical indicators and completely depoliticized in analysis.

Inequality and declining wage share is driven by global forces and national policies; the latter can either ameliorate or aggravate inequality. Both mainstream studies as well as heterodox political economy studies agree that globalization has had significant impact on functional income distribution, though their approach and conclusions are different.

Mainstream studies see globalization, mainly the increase in world trade, as pushing down wages in advanced countries, especially for the less skilled labor, and pulling up wages in less developed countries, mainly through relative factor pricing. Political economy studies, however, view functional income distribution and wage determination in the context of changes in bargaining power between capital and labor. Globalization forces that break down national barriers and increase mobility favor production factors that are more mobile, typically capital rather than labor. The change in functional income distribution is a result of redistribution of profit and rent rather than equalization of factor costs (Stockhammer, 2013).

Over the last few decades, advances in communication and transportation technology, and the breakdown of political and economic barriers in trade and capital flows meant that capital is able to freely flow to places where wages are low, putting pressure on the bargaining power of labor both in the rich and poorer countries. Contrary to mainstream belief that globalization has a positive effect on labor in less developed countries, many governments in these countries pursue policies that repress labor and wages in order to attract foreign investments. In other words, freer trade and foreign investments increase the mobility of capital over labor and put downward pressure on wages and wage share in many developing countries.

Beyond trade openness, heterodox economists argue that financial liberalization and deregulation is another major driver of declining wage share. Onaran (2007) writes that capital account openness is frequently accompanied by currency crises that generate lasting negative effects on wage share through currency depreciation, erosion of real wages, and economic recession. Furthermore, economic crises are often periods when capital and labor fight over distribution of income, as happened in Korea during the Asian financial crisis. Diwan characterized crises as episodes of distributional fight that leave distributional scars (cited in Onaran, 2007:14). Stockhammer (2013) identified indicators of financialization such as increased indebtedness, currency volatility, asset price inflation, short-termism in investments, and new corporate governance that skew distribution of profits in favor of shareholders over labor. All these factors reduce labor's bargaining power by increasing the geographical mobility and investment opportunities of capital. Firms can choose to invest in real estate and other forms of financial assets rather than in productive capital and/or move to wherever unit labor cost is cheaper. The idea of maximizing shareholders value has also taken root as a new form of corporate governance at the expense of labor share.

Over the past decades, internationalization of production has become more sophisticated involving many countries in the production of a single product. This phenomenon is termed global supply chain (GSC) or sometimes as international production network. Within a GSC, each producer imports inputs that are processed and exported either as finished product or as intermediate goods for further value addition in another country. Sometimes this product is re-imported for further value addition before re-export. Not all countries benefit equally in this GSC. Countries that participate in producing high value-added intermediate products stand to benefit more, while those that participate in production

of low-value added products using cheap labor benefit less. [6] Where and how these countries insert themselves and participate in the international production network affects their wage share and income distribution. Among the five East Asian economies, Korea is located at the high end of the value chain, China, Malaysia and Thailand at the lower end, and Taiwan (PoC) in the middle.

The next section examines in detail the trend of and reasons for worsening inequality in each of the five economies.

II. THE EAST ASIAN STORY [7]

Over the last four decades, several East Asian economies have grown by leaps and bounds, though some more successfully than others. A large part of their growth is export-led, though all of them started off with import-substitution industrialization.

Table 1 shows the GDP and gross exports growth rates of the five East Asian economies. While GDP growth rates were high, gross export growth rates were even higher for most periods. Korea and Taiwan (PoC) registered between 7.7% and 10.1% GDP growth in the 1970s and 1980s, slowing down slightly in 1990s, and further decelerating to around 4% and 5% in the first half of 2000s. China, Malaysia and Thailand enjoyed GDP growth of between 5.9% and 9.8%% in the 1970s and 1980s, picking up to between 8.6% and 10.7% in the first

Table 1: Gross Export and Real GDP Growth for 5 East Asian Economies

		1970s	1980s	1990-96	1997-99	2000-2007	2008-11
China	Exports	21.1	3.2	13.0	14.7	24.1	8.6
	GDP	7.4	9.8	10.7	8.2	10.5	9.6
Korea	Exports	9.8	7.0	8.7	11.7	6.7	3.1
	GDP	8.3	7.7	7.9	2.4	5.2	3.1
Taiwan(PoC)	Exports	19.9	11.6	7.5	7.6	9.4	5.6
	GDP	10.1	7.7	6.9	5.0	4.4	3.4
Malaysia	Exports	8.2	9.2	15.4	6.4	6.8	1.6
	GDP	7.7	5.9	9.5	2.0	5.6	3.9
Thailand	Exports	10.4	13.6	11.4	8.2	7.9	4.2
	GDP	7.5	7.3	8.6	-2.5	5.1	2.0

Sources: World Development Indicators; Directorate-General of Budget Accounting and Statistics Executive Yuan (DGBAS), (http://eng.stat.gov.tw)

[6] A study by Dedrick et al on the value-added composition of an Apple iPod shows that of the Chinese factory gate price of $144, only $4 maybe Chinese value added. Japan accounts for $100, the U.S. $15 and the reminder by Korea and other countries (cited in Koopman, et.al0:2)

[7] East Asia here refers to North East Asia and Southeast As

half of 1990s and dropping to between 5.1% and 10.5% in first half of 2000s.

Table 2 shows the net growth rates between GDP and gross exports. We define an economy as export-led when gross exports grow faster than GDP i.e., the net position is positive and shown in red); and domestic-led when gross exports grow slower than GDP (the net position is negative and shown in black). [8]

It is evident that all these five economies are export-led most of the time. [9] The only periods when they were domestic-led were in the 1980s for China and Korea, and after 2008 for China, Korea and Malaysia.

Table 2: Periods (in red) where Gross Exports Growth Exceeds GDP Growth

	1970s	1980s	1990-96	1997-99	2000-2007	2008-11
China	13.7	-6.5	2.3	6.4	13.5	-1.0
Korea	1.5	-0.7	0.8	9.3	1.6	-0.1
Malaysia	0.5	3.3	5.9	4.3	1.3	-2.3
Thailand	2.9	6.3	2.8	10.6	2.8	2.2
Taiwan (PoC)	9.9	3.9	0.6	2.6	5.0	2.1

Sources: World Development Indicators; Directorate-General of Budget Accounting and Statistics Executive Yuan (DGBAS), (http://eng.stat.gov.tw)

A distinction should be made between exports as part of growth and export-led growth. In an open economy, a country needs to export in order to earn foreign exchange to import goods and services; hence exports constitute a necessary part of growth. However, when a country adopts explicit industrial and/or trade policies to promote exports to drive growth, it becomes export-led. Such policies range from setting export performance targets or quotas for firms to achieve, as in Korea; providing generous tax, trade and other incentives for export-producing firms; repressing wages and labor to keep unit labor costs low and internationally competitive; and dumping goods in export markets.

High growth rates, however, do not translate into balanced and equitable growth. Inequality, both in terms of personal income distribution as well as functional income distribution, has worsened for these five East Asian economies particularly after the 1990s. Even though Korea and Taiwan (PoC) have lower levels inequality in personal income distribution, their Gini coefficient has deteriorated from low 0.3 to mid 0.3. On the other hand, China, Malaysia and Thailand are highly unequal with Gini indices in the mid to high 0.4, and climbing higher.

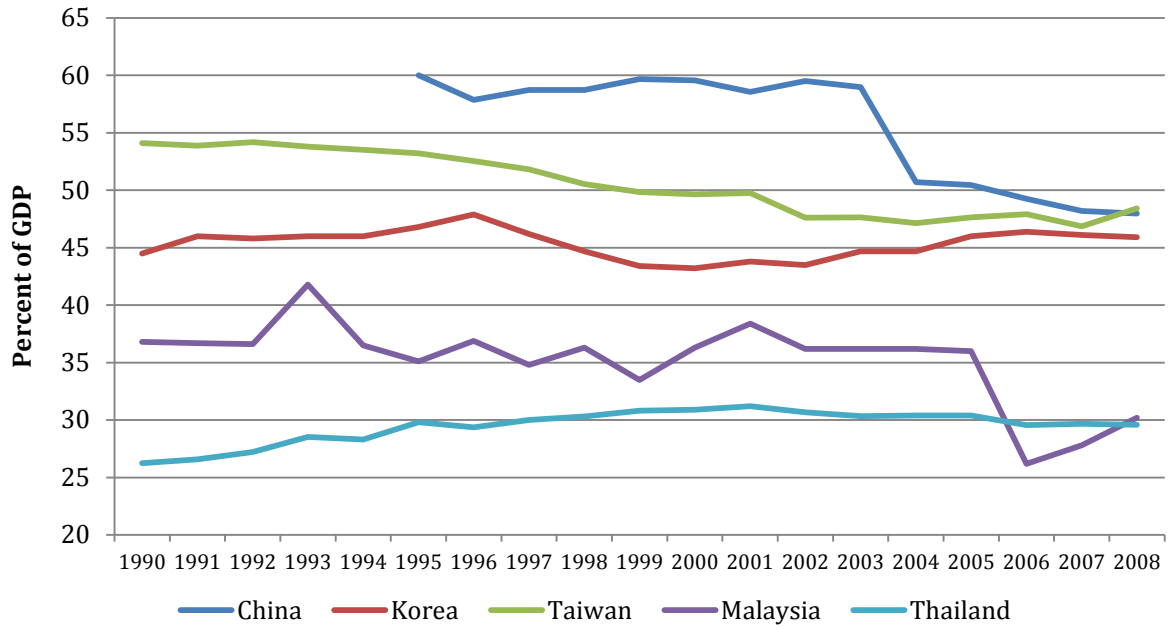
[8] Akyüz (2010) argues that using gross exports overstate, and using net exports understate the contribution of exports to growth. He adjusts for this by factoring in the import intensity of exports, of domestic consumption and of investments.

[9] It is not necessary for an export-led economy to have current account surplus; it can experience current account deficits and balance of payment problems when it imports large amount of capital and intermediate goods for export manufacture as in Korea in the 1980s.

The same worsening inequality is found in their functional income distribution.

Figure 1, shows that for all the five economies, the general trend is one of declining wage share of GDP since the 1990s with China having the largest drop. Three economies - China, Taiwan (PoC) and Malaysia -experience a clear downward trend in wage share. For China it dropped 12 points from 60% to 48% between 1995 and 2008. In the case of Taiwan (PoC) it declined from 54% to 48%; in Malaysia it slid from 37% to 30%. Korea's wage share rose slightly (from 45% to 48%) in the first half of 1990s and dropped after the Asian Financial Crisis in 1997, recovering slightly in the first half of 2000s and declined again with the recent global financial crisis. While Thailand's wage share is relatively stagnant, it is the lowest among the five economies, hovering around 30% of GDP.

Figure 1: Wage Share of GDP for Five East Asian Economies, 1990-2008



Sources: China – ILO; Korea- Bank of Korea; Taiwan (PoC)- Directorate General of Budget, Accounting and Statistics, Executive Yuan, R.O.C.; Malaysia – Department of Statistics; Nagaraj and Goh (n.d.); Thailand - National Income of Thailand (chain volume measures 1990-2010), National Economic and Development Board.

What is driving the decline in wage share?

The decline in wage share in these economies is mirrored in another trend, that is, the divergence between growth in labor productivity and growth in real wages. For all these economies, labor productivity has been growing faster than growth in wages. This means more of the increase in productivity is going to capital rather than to labor. This divergence is evident in Figures 2 to 7.

Under neo-classical economics, wages are determined by marginal productivity; increase in real wages should parallel increase in labor productivity over the long run, though

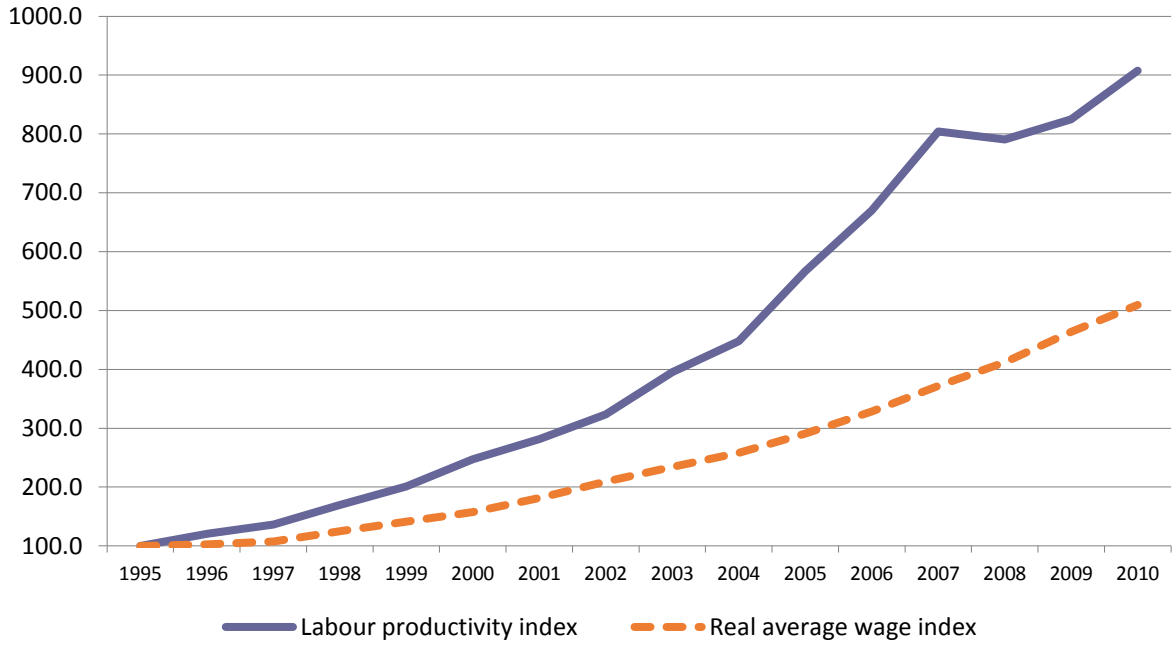
there may be occasional divergence. However, in all these economies, real wages have consistently lagged behind productivity growth most of the time due to national policies and/or global forces. Rather than marginal productivity, it is the interplay of political, economic and social forces, both global and national, that influence the bargaining power of labor versus capital over how income is distributed. We next examine the dynamics of these forces in each of these economies.

Lacking technological edge, China, Malaysia and Thailand's export-led growth model is based on wage-competitiveness. In this model, wages are seen purely as a cost component; hence the need to reduce unit labor cost to enhance global competitiveness, exports, and ultimately profits and investments (Stockhammer and Onaran, 2012:3). These countries practice labor policies that repress wages and labor activism in order to attract foreign investments.

II.1. China

China's second period of reform started in 1992 with the 12th Party Congress' decision to extend market economy from the agricultural sector to the whole economy. Private enterprises, including foreign investments, were encouraged. Overseas Chinese investments from Taiwan (PoC) and from Southeast Asia started to flow in for the first time taking advantage of cheap labor supplied by millions of peasants who drifted into cities. State owned enterprises were restructured into profit-making enterprises resulting in massive labor retrenchment. Labor productivity surged but wages were kept low by the large supply of rural labor and discriminatory national policies towards migrant workers in cities who were denied social and economic services. The government prohibited trade unions except those that are state sponsored. After four decades of industrialization, average hourly wage in China's

Figure 2: China, Labor Productivity vs. Real Wages in Industry, 1995-2010



Source: National Bureau of Statistics of China, *China statistical yearbooks (various years).*

manufacturing industry in 2002 was only 3% of that in the U.S. (Roach, 2009:184). Between 1996 and 2007, China's labor productivity in industry grew annually twice as fast (19.1%) as real wages (11.6%) (National Bureau of Statistics, China). The decline in wage share and the divergence between productivity and wage growth was particularly steep after China joined the WTO in 2000; exports became the main driver of growth. Exports surged from 23% of GDP in 2000 to 38% in 2007. In the same period, China's GDP grew at annual average of 10% while exports rose by 24% annually (refer to Table 1). China's development is an extreme case of export-led growth predicated on wage competitiveness that cannot be adequately explained by its controlled exchange rate policies or even huge surplus of rural labor. Hung (2009:11-14) argues it is a consequence of the government's fiscal, financial, and agricultural policies that are biased against the countryside and transferred financial and human resources from its rural-agricultural sector to the urban-industrial sector. [10]

II.2 Malaysia and Thailand

Malaysia's and Thailand's export-led model, like China, is also driven largely by cheap labor, keeping wages behind productivity growth, and falling unit labor costs. Even though Malaysia and Thailand started export-led growth earlier (beginning in the 1970s) they never achieved the export growth rate of China. Exports grew at average annual rate of 11% and 15% for Thailand and Malaysia in 1990s prior to the Asian Financial Crisis (1997). See Table 1.

Both countries implemented similar export-led policies that are quite different from that of Korea's and Taiwan's (PoC). First, its export industries were highly reliant on foreign participation - both as a source of investments and a destination for markets. Among the five economies, Malaysia's and Thailand's dependence on foreign direct investments are highest at 12% and 14% of gross fixed capital formation in the 2000s (see Table 3). In Malaysia, one time the world's largest producer and exporter of semi-conductor chips, most of the electronics firms are dominated by multinational corporations producing for their parent companies. Production is heavily reliant on foreign markets as a source of demand and growth, with high import content so that the net value added is minimal. There are little backward or forward linkages with industries in both countries (Rasiah, 1995; Siriprachai, 2012). The state offered a range of incentives to attract foreign investments including tax holidays, low import duties, provision of physical infrastructure, and most of all repressive labor laws to keep wages low and competitive.

Table 3: Net Inflow of FDI as Percent of Gross Fixed Capital Formation

	AVG 1980s	AVG 1990s	AVG 2000s	AVG 2010-2012
China	1.6	11.1	7.7	4.0
Taiwan (PoC)	2.2	2.4	4.9	0.3
Korea	0.9	1.9	3.3	3.4
Malaysia	8.9	15.9	12.1	17.8
Thailand	3.2	9.0	13.8	9.9

Sources: UNCTAD and UN, DESA

[10] See also the work of Huang, Rozelle and Wang (2006); and Chen and Wu (2006) for an anthropological study of exploitation of the peasantry.

In Malaysia and Thailand, the dependence on low-cost, labor-intensive manufacturing for export meant the government enacted laws that strictly controlled labor activities and wages in order to attract foreign investments. The manufacturing export sector was the main targets of these policies. In Malaysia, industries in the export processing zones were exempted from existing labor laws that were already weak in the first place. Trade unionism was banned in export industries, and only partially lifted in 1988 after intense international pressure.[11] The right to strike was banned in Thailand in 1976 and employers maintained a black list of "troublesome" workers.[12] Labor organizations continued to be restricted, controlled (in-house unions) and weak. Between 1980 and 2000, trade union density in Malaysia declined from 11.25% to 6.94% (Kumar, et al., 2013).[13] For a long time, both governments resisted the introduction of minimum wage law until its introduction in 2012/13; but its implementation remains weak and is often circumvented. [14]

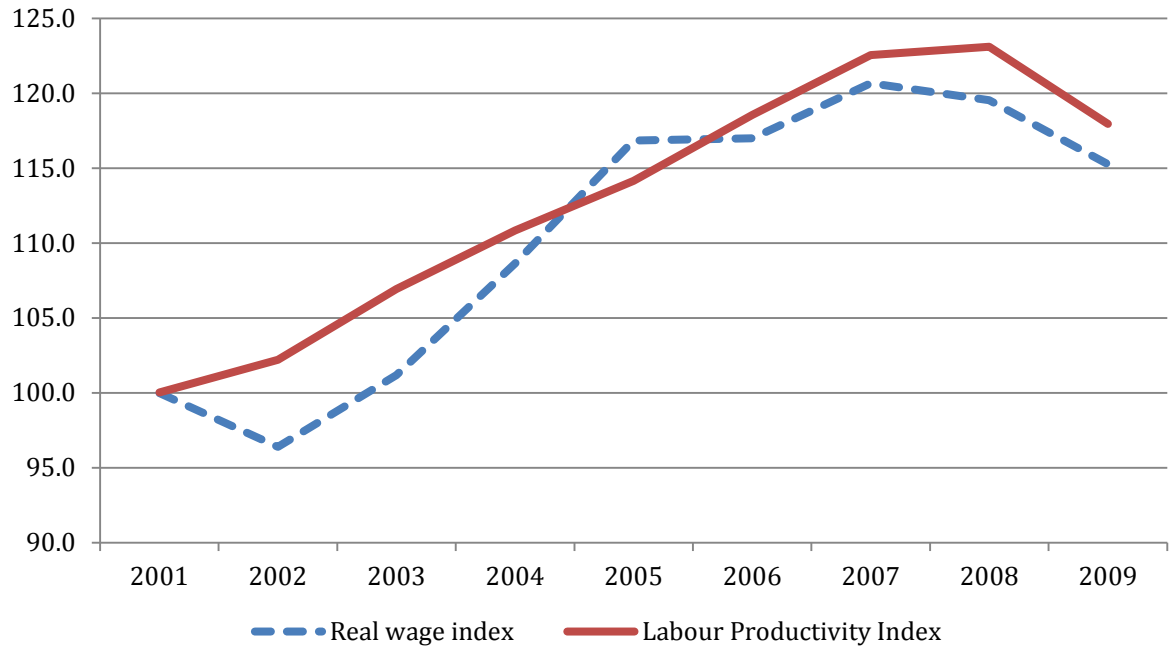
Lacking in domestic technological capability, reliant on foreign direct investment that is closely linked to international production structures dominated by foreign multinational corporations, these countries participate at the low end of the global supply chain. The strategy and policy of keeping productivity high but wages low is the main reason for falling wage share of GDP and falling unit labor costs. These are captured in figures 3 and 4 that show wages falling behind productivity growth, though the divergence is more pronounced in Malaysian than Thailand.

Figure 3: Malaysia, Productivity vs. Wage Indices in Manufacturing Industry

Source: Department of Statistics, Malaysia

[11] For detailed analysis, see Kuruvilla, 1995.
[12] See Phongpaichit and Baker, 1999:199-200.
[13] By comparison, the weighted average trade union density in 18 advanced countries is 38% (Nationmaster.com).
[14] The minimum wage in Thailand is Baht 350 (US$11) per day and in Malaysia Ringgit 900 (US$270) per month.

Figure 4: Thailand: Productivity vs. Wage Indices



Sources: Bank of Thailand, NEDB, Statistics Office.

II.3 Taiwan (PoC) [15]

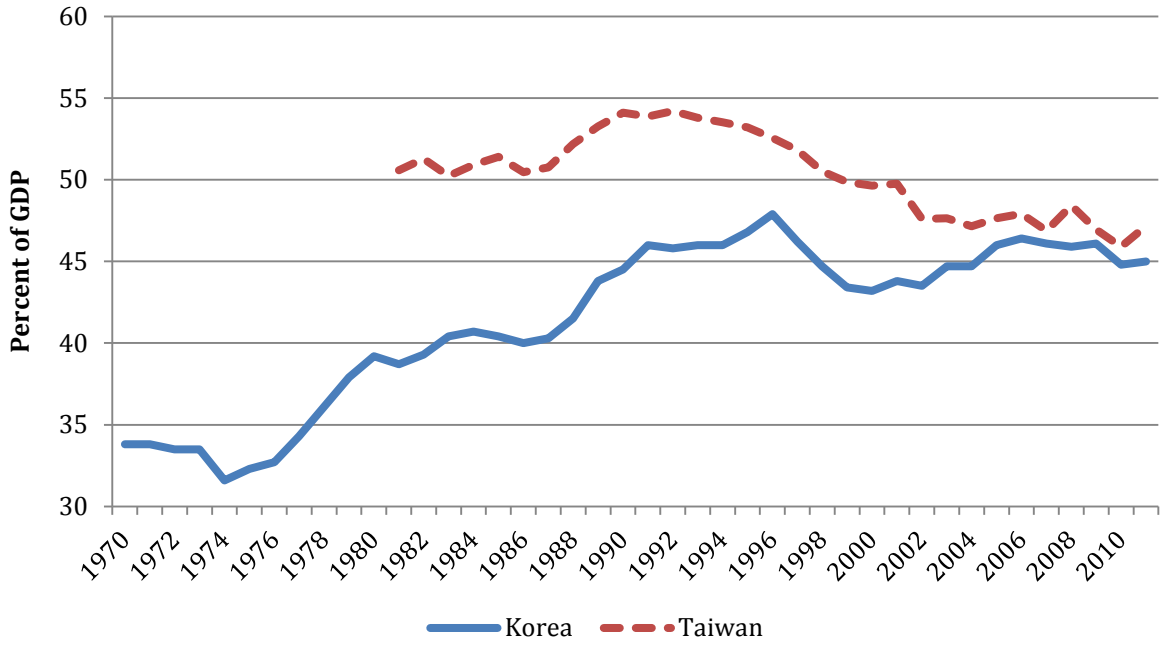
Taiwan's (PoC) growth story is slightly different, falling somewhere in between Korea on the one hand, and the three other economies of China, Malaysia and Thailand, on the other hand. Taiwan (PoC), like Korea, started off as an early industrializer in the 1960s with strong import substitution industrialization followed by export oriented industrialization in the 1970s. Because both these economies introduced comprehensive and radical agrarian reforms that included land redistribution, its economic growth was broad-based, egalitarian, and balanced between agriculture and industry. A strong agricultural sector contributed to industrial growth by providing labor, capital, agricultural products to industry, as well as a market for industrial products. Hence and its growth was supported by a healthy domestic market as well as a strong domestic class of entrepreneurs. When they embarked on export-oriented industrialization, they used foreign direct investment but more for technological development rather than as an assembly plant for foreign firms or to access capital. Inflow of foreign direct investments was regulated and they varied only between 1% and 5% of gross domestic capital formation (see Table 3). The governments paid attention and gave incentives to nourishing national firms – chaebols in Korea, state enterprises and small medium enterprises in Taiwan (PoC). They encouraged exports as a way to gain productivity and to upgrade technology rather than simply as a source of market. Foreign firms accounted for only 20% of the country's total exports and 17% of employment in Taiwan's (PoC) manufacturing (Mao and Schive, 1995:47).

During the early period of growth up to 1990s, labor reaped a large part of productivity gains. Wages were rising and personal as well as functional income distribution improved. In Taiwan (PoC), the Gini index for personal income plunged from the high 0.4 in

[15] The author personally interviewed the following persons who provided valuable insights on Taiwan (PoC): Po-chih Chen, Dennis Engbarth, Minn-Tsong Lin, Shang-Kai Lin, Cheng-Dong Tso, Chi-Jen Wu, Jiann-Fa Yan.

1950s to 0.31 in 1990s. Its wage share of GDP rose from 50% to 54% (1980-1994); see Figure 5. Wages kept up with productivity gains. The real wage index for non-agricultural workers doubled from 100 to 191 in 15 years (1970-1984) (Amsden, 1989:196).

Figure 5: Wage Share as Percent of GDP for Korea and Taiwan (PoC)



Sources: Bank of Korea; Directorate General of Budget, Taiwan

Things began to change starting in the 1990s. Taiwan's (PoC) democratic transition began in the late 1980s and accelerated after the death of Chang Ching Kuo. As the economy grew, land prices rose, environmental regulations were tightened and with democratic liberalization, wage demands also increased. At the same time, China liberalized its economy, adopting market reforms in industry and opening up its borders to overseas Chinese investments in the early 1990s. Taiwan (PoC) took this opportunity to invest heavily into China. Taiwanese firms, instead of building up capital investments and upgrading technology, took this opportunity to move much of their operations to China. In contrast to Korea, Taiwanese firms adopted a "cost-down" strategy to meet rising domestic challenges. Taiwan's (PoC) outward approved investments into China rose from almost nothing in 1990 to $3 billion in 1993 involving 9,300 projects. They further accelerated to an annual average of $7 billion in the 2000s and over $10 billion yearly in 2010s (Taiwan Statistical Data Book, 2013).[16] Approved investments totaled $124 billion involving 40,000 projects (1991-2012). In its electronics industry, it is estimated 90% of production is done in China. Some have called this the hollowing out of Taiwan's (PoC) industries.

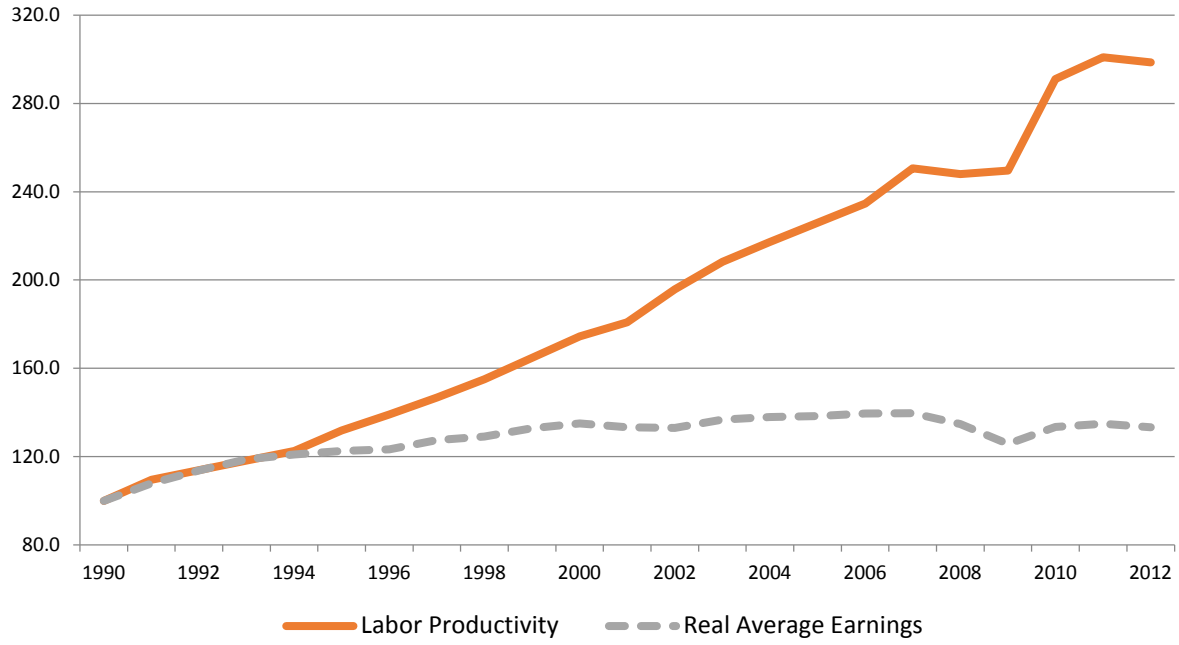
The movement of capital into China was accompanied by a brain drain. There are now over 1 million skilled workers and professionals from Taiwan (PoC) working in China with

[16] According to an interview with Prof. Poh-Chi Chen, former Chairman of Council of Economic Planning and Development, this is a gross understatement as one U.S. estimate puts it at $200 billion ten years ago.

wages that are higher than their counterparts in Taiwan (PoC). Meanwhile, foreign cheap labor is imported to make up for its labor shortage. With the supply of cheap foreign labor to run its industries, there is little incentive for Taiwanese firms to upgrade their technology. Thirty years ago, Taiwan's (PoC) car and electronics industries were technologically at par with Korea. Today they are trailing far behind Korea. While Korea regulates its foreign outward investments, continues to encourage and support technology upgrading, and emphasizes building in-house technological capability, Taiwanese firms take the easy way out by buying technology or using cheap labor.

This pincer movement – Taiwanese firms moving their operations abroad to reduce costs and importing cheap labor into the country to run its economy – puts pressure on wages. Hence after the mid 1990s, its wage share has been trending down and wages have stagnated; there exists a clear divergence between wage and productivity growth. See Figure 6. Today, the average wage of a full professor in a Taiwan (PoC) public university is less than that of his/her counterpart in Malaysia.

Figure 6: Taiwan (PoC), Labor Productivity vs. Wage Growth



Source: Taiwan Statistical Data Book, 2013

II.4 Korea

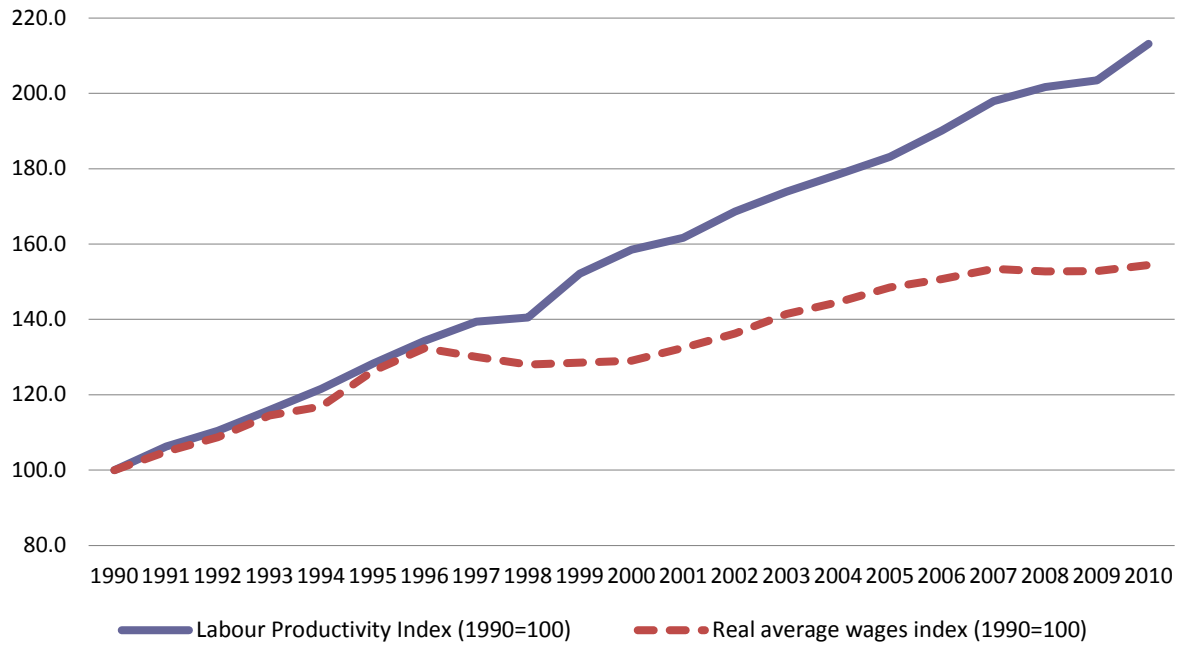
Korea is the only country that has joined the ranks of OECD countries. As described earlier, Korea shared similar characteristics with Taiwan (PoC) in its early stages of development – balanced growth between agriculture and industry and equitable income distribution. Its export industrialization was not dependent on foreign capital averaging only between 1% and 3% of gross capital formation. Korea managed to purchase technology transfer due to its close relationship with the U.S. during the Cold War. Export competitiveness was based on technology rather than low wages. Real wages rose with productivity, and real wage index for non-agricultural sector tripled from 110 to 276 between 1970 and 1984 (Amsden,

1989:196). Real wage share of GDP rose steadily from 33% in 1970 to peak at 49% in 1996 and then declined thereafter (refer to Figure 5).

The turning point was the Asian Financial Crisis. Prior to the early 1990s, Korea practiced strategic integration to the world economy by promoting export-led industrialization while regulating imports, foreign investments, capital flows and foreign exchange rates (Lee, K.K. 2013:4). However, the success of its growth and the rising dominance of big domestic capital (chaebols) undermined the role of the developmental state. By early 1990s pressure from domestic capital together with the U.S. government and international agencies forced the state to undertake financial and capital account liberalization that resulted in huge capital inflow. Foreign debt, much of it short-term, rose threefold from $44 billion to $120 billion between 1992 and 1997 (Ibid: 5). Korea's financial system collapsed when banks refused to roll over their short-term loans during the Asian Financial Crisis. Korea had to be rescued by the IMF.

The restructuring following the bailout of financial institutions marked the turning point for Korea's economy. Restrictions on capital flows were further liberalized and labor laws relaxed. After the crisis, foreign ownership of financial institutions rose dramatically and some of Korea's biggest banks became majority foreign-owned. As stated earlier, financial and economic crises are episodes for the distribution of profits and rents between capital and labor. The crisis also provided a perfect opportunity for capital and the state to extract further concessions from workers. The state legalized lay-offs and the number of temporary and irregular employees as well as unemployment shot up, and labor's bargaining power weakened. This is reflected in Figure 7 that shows that up until mid-1990s, wages and productivity grew in tandem. But this trend clearly diverged after 1996 with wage growth falling behind productivity growth.

Figure 7: Korea, Labor Productivity vs. Wage Growth 1990-2010



Source: OECD

II.5 Summary

In this section, we showed that five East Asian economies registered impressive GDP growth over the last few decades, driven by export-led growth policies. Growth, however, has been accompanied by higher levels of inequality especially after 1990s – both in terms of personal and functional distribution. The wage share of GDP of all these economies dropped, with China registering the steepest decline of 12%. This decline is mirrored in the divergence between labor productivity and real wage growth. Real wages have lagged behind productivity growth. Rather than invoking marginal productivity, we analyze the political, economic and social forces and national policies, particularly the export-led strategy based on repressing wages and unit labor costs that shape the bargaining power of labor versus capital over the distribution of profits and rents to explain rising inequality. China, Malaysia and Thailand follow an export-led growth policy that is labor-intensive and based on repressing labor and pushing down unit labor costs to attract foreign investments. Whilst Korea's export-led model is based more on technology rather than wage-competitiveness, its wage share nevertheless has started to decline after the Asian Financial Crisis due to globalization and financial liberalization. Taiwan (PoC) falls in between the two groups, following the Korean model in its earlier phase of growth but succumbing to a cost-down strategy after the opening up of China.

III. Limits and Challenges of Export-Led Growth

Export-led growth has served many East Asian countries well over the last four decades, lifted large segments of population out of absolute poverty, and even propelled some economies to high-income nation status. To what extent can they continue on this growth path and do the external as well as domestic conditions support such growth? What were the international conditions that fostered the earlier spurts of export-oriented industrialization in East Asia and do they exist today? What are the consequences of such growth on inequality?

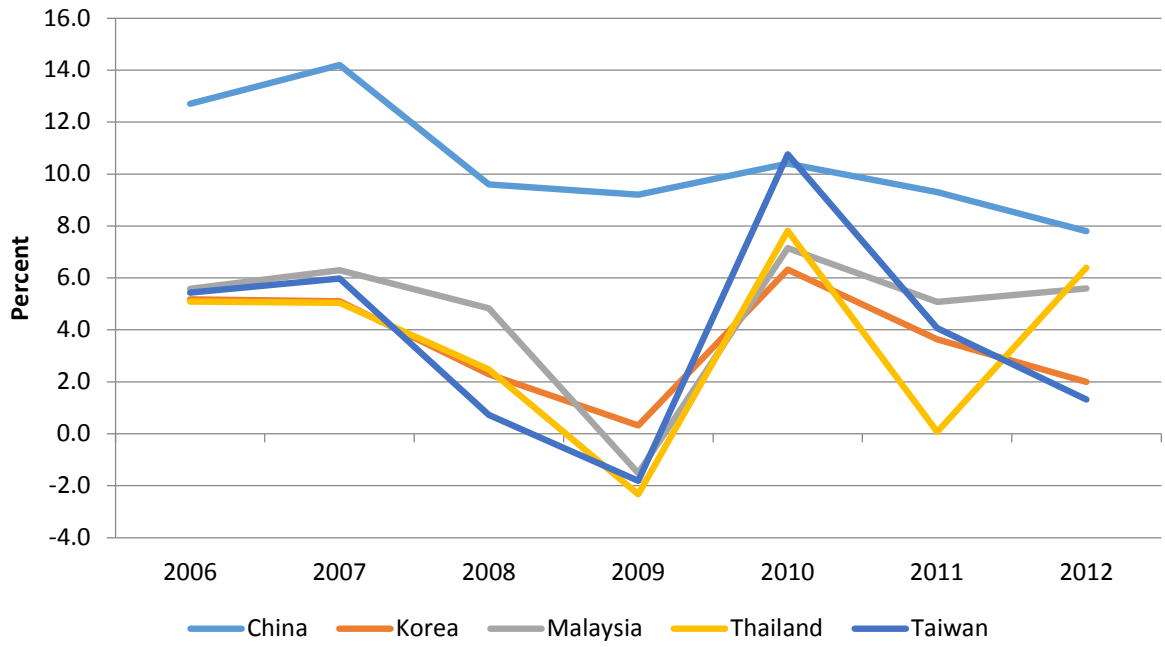
Excluding Japan, the first wave of export-oriented industrialization started in the late 1960s and early 1970s with the emergence of a new international division of labor and production structure where large corporations from advanced economies spread their wings to relocate production overseas in search of cheaper labor. This was especially true of the electrical and electronics industries that were assembled abroad and the products shipped back to home countries. Korea and Taiwan (PoC), because of their strategic relationship to the U.S. in the era of Cold War, benefitted from this process and were able to gain access to technology through licensing and franchise without heavy dependence on foreign direct investments. The second wave of export-oriented industrialization was due to the large inflow of Japanese outward investments into Southeast Asian following the 1985 Plaza Accord. The yen's appreciation pushed Japanese corporations to relocate their production abroad mainly into Malaysia, Thailand and Indonesia. The third wave of exports into the advanced economies occurred after the dotcom bust. To resuscitate its economy, the U.S. lowered interest rates that fueled a debt-boom consumption. This eventually led to the deepest financial and economic crisis in 2007 since the Great Depression.

The crisis exposed the vulnerability of Asian economies' dependence on global markets and exports as the driver of growth. Unlike the Asian Financial Crisis where the financial system of many Asian countries collapsed, this time the impact was on Asia's trade and investment. Asia's financial system remained sound but there was a sudden collapse of exports and with it growth.

Fortunately, there was a quick rebound in exports and growth in 2010 due to massive world-wide fiscal stimulus and monetary loosening. Nevertheless, five years after the Great Financial Crisis and Recession, instead of economies picking up, the world economy is slowing down again with Eurozone, U.K. and Japan going into double-dip recession with direct impact on Asian economies. Olivier Blanchard, IMF chief economists, said, "It's not yet a lost decade… But it will surely take at least a decade from the beginning of the crisis for the world economy to get back to decent shape" (cited in Akyüz, 2013:5).

Though the GDP growth of the five economies is stronger than that of G3, there was clear drop in their growth rates in 2011 and 2012. [17] See Figure 8.

Figure 8: GDP Growth in Five East Asian Economies, 2006-2012



Source: World Development Indicators

Clearly the international economic conditions today are very different from the days when these economies embarked on export-led growth and could depend on the advanced economies to absorb their exports. In light of lower global growth potential and sluggish global demand these economies will face severe headwinds for their export markets.

On top of trade dependence, they are equally vulnerable to erratic capital flows

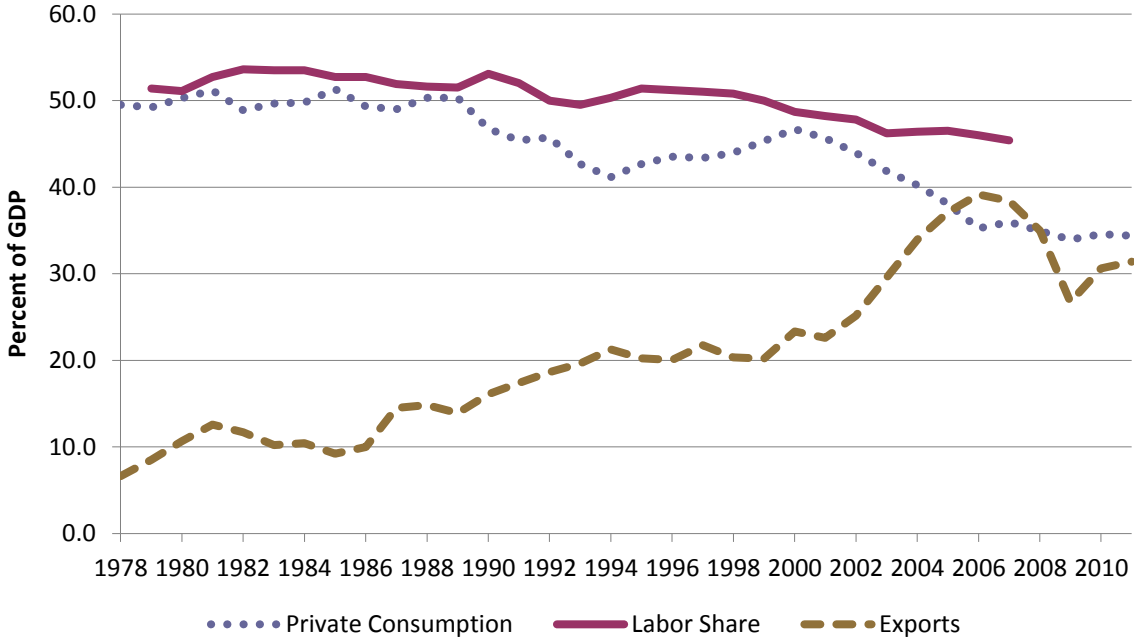
[17] Thailand's 2011 growth plunged to 0.1% because of the severe floods that disrupted production and rebound in 2012 to 6.45%, still below the 7.8% in 2010.

causing currency volatility as well as financial and macro-economic instability. The flood of cheap money into Asia led to a stock and property bubble that collapsed when capital flows reversed in 2008 and 2009. Global monetary loosening, particularly quantitative easing by the U.S. and U.K., and historic low interest rates, led to massive international liquidity. This has once again pushed asset prices in Asia beyond their pre-crisis level. In May and June of 2013, the mere mention of possible tapering of quantitative easing by the Federal Reserve Bank sent the stock and bond markets tumbling. The countries most seriously affected in Asia were India and Indonesia. They suffered huge capital outflows, worsening current account deficits, and significant currency depreciation (Crabtree, 2013; Bland, 2013).

In the first decade of the new millennium, developing economies grew much faster than the advanced economies prompting the decoupling thesis that has been challenged by Akyüz (2012). It is unlikely this can continue as their high growth rates were the result of a particular set of conditions in the advanced economies, particularly in the US, where strong consumption and import were driven by rising household debt ending with the Great Financial Crisis. The U.S. debt and current account deficits were partly financed by the current account surpluses of many East Asian countries.

Viewed in another way, the current account surplus of East Asia and the current deficit of the U.S. are two sides of the same coin related to rising inequality in these societies (Lim and Khor, 2011; Goda, 2013; 2014). Take the case of China; its declining wage share from 54% to 45% (1984-2007) was accompanied by fall in private consumption from 50% to 36%. [18] See Figure 9. A drop in wage share impacts negatively domestic consumption and

Figure 9: Private Consumption, Labor Share, and Exports in China



Sources: World Development Indicators; Simarro (2011)

[18] Another source estimated China's labor share of GDP fell from 56.5% to 36.7% between 1983 and 2005 (China News, 2010).

aggregate demand. This is because in the macroeconomic sphere, wages are not simply a cost factor. Wages play two functions. Wage bill is a cost item in production but it is also a source of aggregate demand. A decline in wage share of national income will suppress private consumption and demand as the marginal propensity to consume out of wages is higher than out of profits. Hence in a domestic-demand led economy, unless wage share of national income rises or remain stable, growth will be negatively affected. Yet many economies have been able to sustain growth despite stagnating or decline wage share of national income. Generating net export surplus is one way to externalize and overcome the domestic demand deficit problem.

The current account surplus of one country has to show up as current account deficit in other countries. In this case, much of the current account surplus of China goes to finance the current account deficit of U.S.[19] However, unlike China, despite rising inequality and falling wage share, the U.S. personal consumption did not drop. The opposite happened. Personal consumption rose to a high of 72% of GDP supported by ballooning household debt reaching 100% of GDP. Hence, increasing personal debt is the other way of circumventing demand deficit (Lim and Lim, 2010: chapter 4).

In short, there are two ways of counteracting declining personal consumption and aggregate demand arising from falling wage share. One is through export-led growth, and the other is debt-led growth, both of which show up as current account imbalances in the world economy. Mainstream economists point to global trade imbalance as a fundamental cause of the recent financial crisis but fail to go beyond trade figures to relate them to the underlying cause of imbalance in functional income distribution. As we now know, this model of imbalanced growth is unstable and not sustainable in the long run.

While these economies have achieved significant growth based on strong exports in the past, the limits to such growth are now evident. Global economic conditions have changed. In the early phases of export-oriented industrialization, there was a ready global market for East Asian exports. Early industrializers and export-led economies did not face as much competition and pressure to lower unit labor cost. Today with economic crisis and sluggish growth in the advanced countries, East Asia will face strong head winds for their exports.

Massive fiscal stimulus and aggressive loose monetary policies helped to avert a long and deep recession. But as the U.S. and other advanced economies deleverage, domestic demand and growth have dropped. Sluggish demand and persistently high unemployment will put a drag on the advanced economies. Furthermore, the U.S. is attempting to fire up its export engine to spur growth. All these plus the need and attempt to rebalance current account imbalances among the major trading partners imply East Asia cannot continue to look to exports as the main engine of growth.

Guo and N'Diaye (2009) assessed the sustainability of China's export-oriented growth and suggested conventional ways of keeping China's 20% global export market share through measures like increasing productivity, lowering prices and profits, diversification, increasing domestic value-added for exports, and moving up the value chain. Even with these measures, they caution there are limits to the global market share a country can occupy and recommend

[19] In China as the domestic financial system was relatively undeveloped and household borrowing accounted for 18% of total loans in 2008. The excess of savings over investments in China instead was recycled through the international financial system and lent to the U.S. (Lim and Khor, 2011).

rebalancing growth toward private domestic consumption as a way to sustain growth. They call for policies to reduce precautionary savings such as reforming the healthcare, education and pension systems. [20] While these redistributive policies are helpful to raise private consumption, they fail to address the distributive consequences of export-driven growth based on lowering unit labor cost. As indicated earlier China's wage growth has lagged behind productivity and the declining wage share of GDP is reflected in the fall in private consumption. Hence any attempt to turn to domestic private demand to spur growth must change the distributive structure in society. There should be a mutually supportive relationship between the productive and distributive structure.

In recent years market forces have worked to slightly correct the wage imbalance. The supply of rural labor has been dwindling due in part to China's one-child policy. This has increased the bargaining power of labor. In 2010 demand for higher wages led to strikes and lockout in various foreign owned factories in the coastal cities (Ramzy, 2010; Tabuchi, 2010). Has the Lewis turning point – drying up of rural surplus labor and rise in wages - arrived in China and will this signal the start of a secular trend toward higher real wages in China in line with productivity growth and a rising share of labor in the economic output?

Recent data tentatively point to some changing trends in China's economy. China's current account surplus averaging 7.1% of GDP (2004-07) dropped to 3.0% (2010-12). Domestic demand growth for 2010-12 at 10.0% is higher than GDP growth at 9.2% compared to the earlier period when domestic demand growth (10.3%) lagged behind GDP growth (12.1%) signaling a move towards domestic demand-led growth (Akyüz, 2013: Table 4).

What about Korea and Malaysia? Parallel to the fall in wage share, Korea's household savings rate which at 26% in 1988 was the highest among the OECD countries plunged to 0.4% by 2002 at the height of Korea's credit card crisis, and hovers in the 2-3 percent range in recent years (Yonghap News, 2011).[21] Personal consumption was supported by rising household debt. For the past twelve years, household debt rose at an annual average of 13.3%, twice the nominal GDP growth rate of 6.2% to reach 89% of GDP in 2011 (Park, 2012); its household debt to disposable income touched 164% in 2012 making it one of the highest in the world (Munday and Ock, 2012).

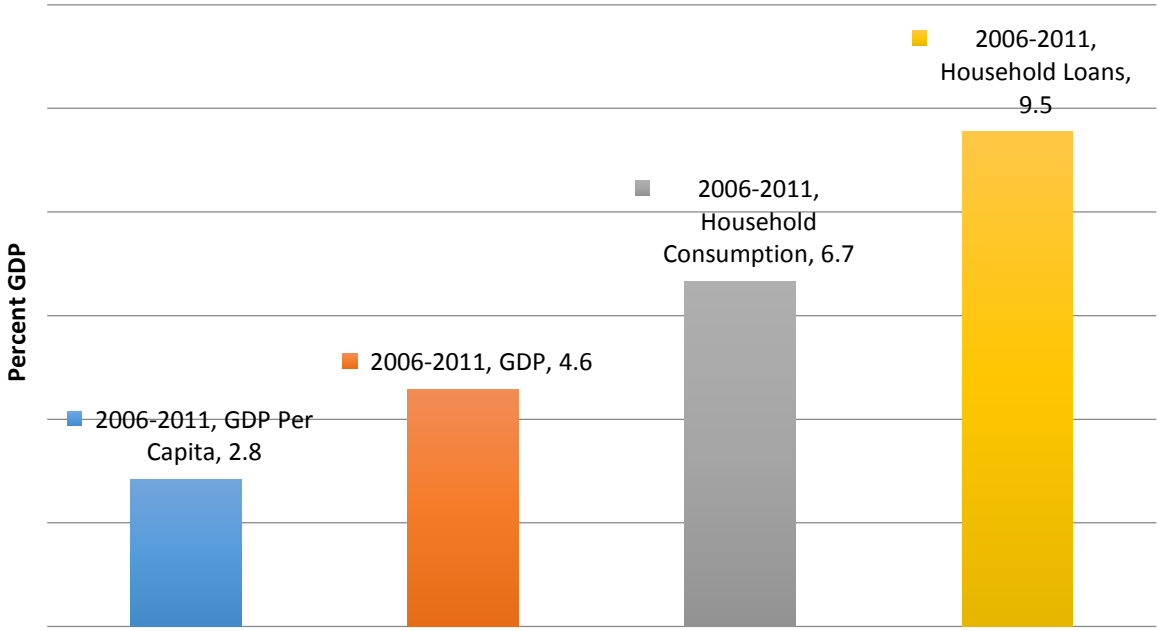
A similar story unfolds in Malaysia where wages have lagged behind productivity in the manufacturing sector (refer to Figure 3) and compensation share of GDP dropped from 47% in 1970s to 30% in 2008 (refer to Figure 1).

Not surprisingly private consumption has been supported by debt rather than healthy income growth especially after 2000. This trend accelerated after the financial crisis of 2007. [22] Between 2006 and 2011 Malaysia's GDP grew at annual average of 4.6%, while household consumption and household debt grew at 6.7% and 9.5% (see Figure 10). This deteriorated in 2012 when its household debt to GDP ratio hit 83% and its household debt to disposable income 140% (Goh, 2013:21; Lee, S.I., 2013) putting it among the highest among

[20] Private savings level in China is not much higher than in other Asian countries. It is corporate profits and savings that are rising and account for the high saving and investment rates (Akyüz, 2010:27).
[21] Korea's national savings rate remains high at about 30% of GDP, much of it consisting of corporate savings. In fact, the government is considering taxing corporate savings to incentivise firms to invest.
[22] While the Bank Negara (Central Bank of Malaysia) is concerned about rising household debt, the Second Minister of Finance of Malaysia is more sanguine. He said he would like to see private consumption rise from 51% to 70% of GDP (cited in Lim and Lim, 2010:99).

developing countries.

Figure 10: Average Annual Growth of Selected Indicators, Malaysia 2006-11



Sources: World Development Indicators; Bank Negara, Monthly Statistical Bulletin

Malaysia's development is more worrisome because, unlike Korea, productivity growth in manufacturing sector has declined significantly from an annual average of 6% (1988-1997) to negative 1.5% (2001-05), slightly improving to 1.7% (2005-10) (Rasiah, forthcoming: Table 11). According to Rasiah, Malaysia is experiencing early deindustrialization beginning from 2000 onward. Rich in natural resources, much of Malaysia's exports and growth has been propelled by commodities such as palm oil, timber, rubber, petroleum and natural gas. The problem is compounded by the rise in public deficit and debt as the government pump primed the economy in 2008/9, dithered on fiscal reforms on subsidies and taxes, and gave a 20% salary raise for government employees in 2013 to gain political support in the general elections prompting a downgrade of the country's credit rating outlook from stable to negative (Star, July 31, 2013).

Mainstream economists continue to push for reform agenda in the form of greater domestic financial liberalization, flexible exchange rates, freer capital flows, privatization of state owned enterprises, and more flexible labor policies as the way to drive growth. But it is exactly the deregulation of the financial sector and liberalization of capital flows that exacerbated financial instability and crisis, and caused greater frequency of boom and bust cycles. It is the repression of domestic wages to gain international competitiveness that depresses domestic private demand. In an economy where the financial sector is not well developed and aggregate demand is constrained by low wages, exports offers a way out of the problem, as in the case of China. However, this wage-demand constraint became less important with financialization of the economy, as in the case of the U.S. As finance becomes more dominant and debt more widespread, the traditional wage constraint on aggregate demand can be mitigated by rising household debt. Nevertheless this process

cannot continue indefinitely; sooner or later the economy will face a balance sheet constraint as has happened in the U.S. in 2007, and will be faced by Korea and Malaysia if household debt level continues to rise. The relationship between financial deepening and growth is mixed. Some argue there exists a positive relationship between the two (Goldsmith, 1969; Greenwood and Jovanoivch, 1990; King and Levine, 1993); others see no relationship (Demetriades and Hussein, 1996); still others demonstrate a mixed relationship (de la Torres et al., 2001). A recent IMF study shows that beyond a certain threshold, financial development no longer has a positive effect on output growth because the marginal costs (greater financial instability and crisis) generated by financial deepening outweigh the marginal benefits. According to them that threshold level is reached when credit to the private sector rises to 100% of GDP (Arcand, Berkes and Panizza, 2012).

IV. NEW POLICIES AND STRATEGIES

The limits of export-driven growth are evident not only in terms of its vulnerability to external conditions but also in the domestic social and economic costs of rising inequality and other forms of imbalances. [23] Policy makers seem to be aware of such limitations and challenges and are attempting to redress them. Faced with unfavorable global conditions, countries are seeking to re-orientate production and turning to domestic, rather than just export markets, as another route to stimulate growth. However, to achieve this, they need to restructure not only their distributive and redistributive regimes but also their production structure.

Declining wage share and rising inequality impose wage constraints on domestic private demand, and pumping up consumption through debt will eventually come up against balance sheet constraint. If a country wants to increase domestic private consumption as a driver of growth, it has to allow wage growth to keep up with productivity increases and to reverse the imbalance between wage and capital share of GDP. Currently, to attract foreign direct investments and to promote exports, many countries are competing with one another and racing to the bottom by offering low wage as an incentive, or undervaluing their exchange rates – both of which are counterproductive. The former strategy depresses domestic private consumption, while the latter creates global trade imbalances and tensions as all countries cannot simultaneously enjoy current account surplus. Any competitive gains tend to cancel out as global competition to cut wage leads to decline in global demand (ILO, 2012/13:60). An alternative would be for countries to establish institutional arrangements to align wage growth to productivity growth rather than to have most of the gains captured by capital in the form of higher profits or by external consumers in the form of lower prices (UNCTAD, 2012:155-167). [24] This requires an income policy where average nominal wages rise at the same rate as average productivity plus an inflation target. [25]To be more effective these policies should be coordinated among developing countries that are attracting FDI. All

[23] One critical imbalance is ecological – export-led growth tends to be excessively plundering of nature, with very adverse consequences on quality of life. China at present is a prime example, but Thailand too shows the effects.

[24] Rising rent, the reward to property owners, is another form of distribution to capital and is rampant in these Asian economies, causing major problems for small businesses who struggle with exorbitant rentals.

[25] The average productivity trend can be calculated over medium term, say five years, rather than yearly.

countries can simultaneously boost productivity and wages to improve their overall welfare, but not all can simultaneously boost exports and achieve current account surpluses by wage cuts and cheap currencies.

On the redistributive side, countries should also restructure their fiscal system towards a more progressive tax structure, correcting the imbalance between taxes on capital and on wages, and improving social services like education, health, social security and other social safety nets. In the case of China, this would reduce both corporate and private savings rate and channel the funds to raise its private consumption rate that is lingering at about 36% (Guo and P'Diaye, 2009:16). Increase in capital gains tax, especially for short-term capital gains, would be another effective way to reduce gains to capital.

Over the last few decades, China has emerged as the leader of a global production network in Asia where other East Asian countries specialize in the production of specific components that are then shipped to China for final assembly and for export to the advanced economies. In this production network, a country's productive structure is vertically specialized, with low backward and forward linkages, and heavily geared to export markets. A shift from a vertically specialized, export-oriented production system to domestic-led consumption requires significant industrial restructuring as skills, capital equipment and organizational structures are often industry and product specific (Akyüz, 2011:11-13). For example, the demand for products ranging from sophisticated computer chips to simple products like Barbie dolls may not fit well with the demand structure of developing economies and hence the production system needs to be restructured.

Smaller East Asian countries with limited domestic market may not be able to absorb the export slack and need to look to intra-regional trade to sustain growth. Presently, a large part of Asia's intra-regional trade is linked to the Sino-centric production network that serves the export markets of advanced economies. This makes the exporting economies both directly and indirectly through China, vulnerable to the vicissitudes of the latter. Asian economies should redouble their effort to rebalance and restructure their intra-regional trade away from vertical specialization to horizontal specialization and to intra-regional trade in final goods. China can play a pivotal role in this process by increasing its imports of final goods and also of its import content (Akyüz, 2011:12-13). ASEAN as a regional trading bloc should refocus their effort on streamlining and coordinating their production and trade structures.

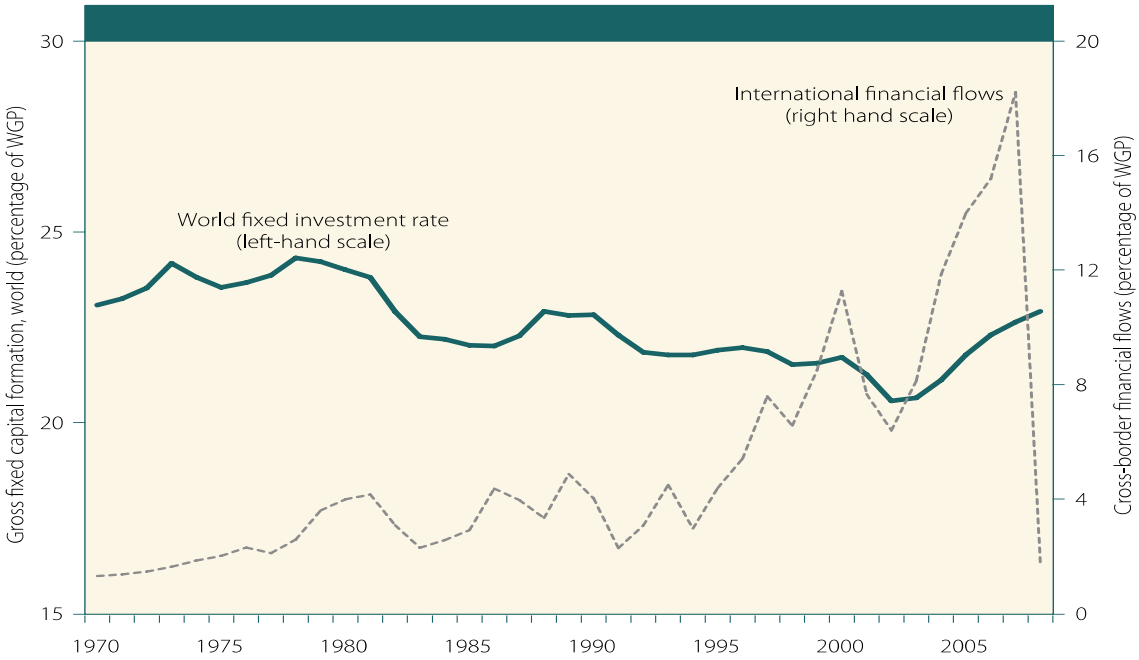
While China has an exceptionally high investment rate of about 50%, Southeast Asian economies, like Malaysia and Thailand suffer from low investment rate of about 20%. China needs to either reallocate its investment rate, away from physical and property infrastructure, toward social infrastructure like education and health, or lower its investment rate and expand its domestic consumption. On the other hand, Malaysia and Thailand need to raise their investment and productivity rates to generate growth and to distribute the gains more equitably between wages and profit to support effective domestic demand. China's aggressive policies to attract foreign direct investments with generous incentives partially account for the redirection of FDI from these other countries to China. [26] There is a need to redistribute aggregate investments within East Asia away from China to the other countries (Akyüz, 2010:32).

The financial sector occupies an important position in modern economy and credit is

[26] Domestic factors also play a role in the drop in investment rates; in the case of Malaysia, it is ethnic politics and quotas, and for Thailand, it is political infighting and instability.

an important driver of growth. However, the recent global financial crisis also exposes the dangers of too much debt, and too much financial innovation geared toward speculation rather than investment. A U.N. study showed that despite rapid financial growth, world fixed investment rate stagnated around 20% for forty years (see Figure 11). Greater financial liberalization and capital movement deregulation increase the vulnerability of East Asian economies to volatile capital flows and decrease their policy space to maintain currency and macro-economic stability as was experienced during the Asian Financial Crisis. Parallel to enhancing regional trade integration, Asian countries should cooperate more in financial integration, not by indiscriminate financial and capital flows deregulation, but by coordinating policies on exchange rate and on capital flows movement (Lim and Lim, 2012:12-19). Countries acting individually to regulate capital movements such as Thailand did in December of 2006 faced severe market obstacles and they suggest that perhaps the results could be different if all the ASEAN+3 members acted as a bloc and had more coordination on say the URR policy on portfolio inflows (Ibid:19). [27] UNCTAD's report suggests changes in nominal exchange rates to reflect fundamentals, i.e., differential inflation rates or the rise of unit labor costs across countries (2012:164).

Figure 11: Financial Flows and World Fixed Investment Rate, 1970-2009



Source: United Nations, DESA, 2010.

Another critical area for financial cooperation is how to mobilize the vast foreign reserves of Asian countries. Lim and Lim (2012) argue that in mainstream literature, too much emphasis has been placed on development of bond markets as the key to Asian financial integration without considering the attendant risks and costs on recipient countries

[27] Malaysia is one case where it successfully imposed controls on capital outflow in 1998 and together with other fiscal measures, that ran counter to IMF type of policies, enabled the economy to recover quickly from the recession.

of extreme volatility of free capital movements that come with capital markets. Instead, they suggest that a third leg of the financial system in the form of national and regional long term credit and development banks should be encouraged operating on principles of steady, long-term, inclusive and more anti-cyclical type of lending (Lim and Lim, 2012:44-46).

V. CONCLUSION

Inequality has been rising in many Asian countries. Most studies focus on personal income distribution attributed to inequality of opportunities and outcomes. In this paper, the emphasis is on analyzing inequality in terms of functional income distribution and relating it to global forces and national policies particularly the export-led growth model pursued by five East Asian economies.

Since the 1990s, all the five East Asian economies experienced increasing inequality and declining wage share of national income despite impressive growth rates. This was the result of real wages rising slower than productivity, reflecting the declining bargaining power of labor. China, Malaysia and Thailand pursue an export-led growth model based on inviting foreign direct investments into labor-intensive industries supported by state policies that repress wages and labor activities in order to push down unit labor costs to remain competitive. Korea's export led-growth was less dependent on foreign direct investments; it very quickly moved out of labor-intensive industries into higher value added industries, and growth is based on technological rather than wage competitiveness. Nevertheless, after Korea liberalized its economy, particularly the financial sector, it experienced the Asian Financial Crisis. This marked the turning point for the decline in labor's bargaining power and the fall in wage share. Taiwan (PoC) started off pursuing the same export-led growth model as Korea, but with the opening up of China, it adopted a cost-down strategy, moved its industries into China putting pressure on domestic wages and this led to declining wage share.

Normally, declining wage share leads to falling private consumption and aggregate demand. In East Asia, net export surplus offered one way to counteract falling aggregate demand. The U.S. current account deficit was financed by Asia's current account surplus. The U.S. over-consumption by households was made possible by an increase in household debt. The strategies of export-led growth in East Asia and debt-led growth in the U.S. have resulted in global imbalances, economic crisis and are unsustainable.

After the recent global financial crisis, East Asia's export-led growth is facing severe headwinds and slowing global demand. It is unlikely that these economies can continue to depend on exports as the main driver of growth. In seeking new sources of growth, China and other economies are turning to domestic and regional demand. However, these economies need to restructure their distributive (functional income distribution), redistributive (fiscal), and productive systems to meet these challenges.

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