

# **GROWTH, INEQUALITY, AND POVERTY REDUCTION IN DEVELOPING COUNTRIES**

by

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Why is the distribution of income being more unequal in Third World countries? The economist Simon Kuznets developed a hypothesis to explain why developing nations tend to have a more unequal distribution of income. Income inequality is inherent during the early period of a nation's industrial growth. However, according to Kuznets, the income gap will narrow after a certain level of per capita income is achieved. Reasons for the initial income disparity include the fact that the profits of industrial growth go directly to business owners, who represent a small percentage of the population.

At the same time, the existence of "surplus labor" on the low end of the economic scale serves to keep wages down for the poorer members of the society. In addition, the upper classes tend to possess the skills and education that enable them to profit from the early stages of industrial development. This hypothesis has since been used as a justification for government policies in developing nations that emphasize the attainment of rapid industrial growth, regardless of the immediate effects on income distribution, based on the view that such inequalities will automatically self-correct as growth continues.

However, recent research has indicated that Kuznets hypothesis fails to adequately explain the reasons for income inequality in the Third World. Therefore, other factors must contribute to this situation.

One such factor is the distribution of the ownership of property, or land. In the Third World, labor being relatively abundant and land and capital relatively scarce, the property share of agricultural income is higher. Where land distribution is quite unequal,

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<sup>1</sup> The views and opinions expressed herein are those of the author and do not necessarily reflect the views of MIER.

income inequality may grow over time because the larger farmers absorb technical progress faster than the smaller farmers. In other words, more wealthy farmers are able to invest in the technologies and materials that enable them to derive higher incomes from their land. By contrast, it has been found that land reform, where undertaken, has had a powerful equalizing effect on income distribution. An example peculiar to Malaysia is the FELDA scheme.

Another factor is the lack of educational opportunities for the poorer members of societies. In developing nations only, the higher-income groups are able to attain the levels of education that are required for obtaining high-income occupations. Thus, as a result, the educational system tends to perpetuate inequality of income from generation to generation, rather than acting as an avenue for social mobility.

There is also the problem of the "entrenchment of elites" in these societies. The rich elite have greater access to educational opportunities and are thus able to obtain the professional skills that are required for maintaining their high levels of income. These skills are increased in value by virtue of the fact that people with wealth and education often have the option of emigrating to other countries where income levels are even higher.

Another unfair advantage of these elite classes is that they tend to pay lower taxes than the poor (progressive taxation policy). For example, in the 1980s in a certain South American country –those who earn less than the minimum wage pays 37.3% of their earnings in taxes. In contrast, those with incomes a hundred times as large pay only 13%. What results is a skewed class structure, in which the established elites have enormous clout in political and social matters.

The unequal distribution of income can also be attributed to the failures of government policies in the Third World nations. During the early stages of growth, national governments tend to place too much emphasis on the attainment of wealth and too little on finding ways to solve domestic economic problems. Actually "welfare measures and infrastructure improvements" are needed for overcoming the conditions of inequality. A better strategy would involve tolerating a higher deficit while creating jobs.

Therefore, increasing income equality in the world will require a change in the policies of many Third World governments. Issues such as land reform and fair taxation will have

to be addressed. These governments will also have to increase investments in educational programs. In addition, beyond education is a whole range of ancillary activities whose effects are similar in improving the quality of labor: nutrition, health, and other social investments. By focusing on efforts such as these, the governments of the Third World nations can take steps toward the attainment of greater income equality. This, in turn, will mark a step toward the attainment of increased equality in comparison with the other nations of the world.

In the case of Malaysia –the primary objectives of economic policy can be encapsulated in the phrase ‘growth with equity’—that is to ensure a growing economy in which all benefit. The goal of improving equity in income and wealth distribution has been at the apex of Malaysia’s national development agenda.