

Growth with equity primary goal

By **Samirul Ariff Othman** - August 19, 2023 @ 7:15am



Land reform has a powerful equalising effect on income distribution. One example is the Felda scheme. BERNAMA PIC

Malaysia is on the verge of a second economic take-off as the New Industrial Master Plan 2030 will be launched this month. The plan will serve as a framework for us to work on improving our local manufacturing scene, with the goal of creating better jobs with better pay for all Malaysians.

In the case of Malaysia, the primary objective 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 the national development agenda. But what about other emerging markets and rapidly developing countries? Perhaps taking a closer look at them will help us to better understand what we underwent.

INCOME INEQUALITY IN THE THIRD WORLD

Why is the distribution of income more unequal in third world countries? 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 labour" on the low end of the economic scale serves to keep wages down for the poorer members of 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 explain the reasons for income inequality in third world countries. Therefore, other factors must have contributed to this situation.

One such factor is the distribution of the ownership of property, or land. In third world countries, labour being relatively abundant and land and capital relatively scarce, the property share of agricultural income is higher. Where land distribution is quite unequal, income inequality may grow over time because large farmers absorb technical progress faster than small farmers.

In other words, richer farmers are able to invest in technologies and materials that enable them to derive higher income from their land. By contrast, land reform has a powerful equalising effect on income distribution. An example would be the Felda scheme.

Another factor is the lack of educational opportunities for the poorer members of society. In developing nations, only the higher-income groups can attain the levels of education that are required for obtaining high-income occupations. Thus, as a result, the education system tends to perpetuate inequality of income from generation to generation, rather than acting as an avenue for social mobility. This is because, education is supposed to boost social mobility by contributing to social selection based on achieved rather than ascribed characteristics of individuals. According to the Madani Vision, Malaysia aspires to be among the Top 25 in the Human Development Index.

This can be achieved by offering the best facilities in health and education, as well as a conducive environment for people to develop and realise their full potential. While, at the same time, ensuring that there is full financial inclusion.

'ENTRENCHMENT OF ELITES'

There is also the problem of the "entrenchment of elites" in the third world. The rich elites have greater access to education and are thus able to obtain professional skills that are required for maintaining their high income. People with wealth and education often have the option of emigrating to other countries where income levels are even higher. Award winning economist Thomas Piketty demonstrated that in a free-market economy, inequality inevitably rises faster than growth.

Another unfair advantage of the 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 pay 37.3 per cent of their earnings in taxes.

In contrast, those who make 100 times more pay only 13 per cent. This results in a skewed class structure, in which the established elites have enormous clout in political and social matters. Thus, the case for fair and simple taxation. While Malaysia has a low tax to gross domestic product ratio (around 12 per cent), alternative sources of revenues are still needed. At present non-tax revenues are around 23 per cent.

CHANGE IN GOVERNMENT POLICIES

The unequal distribution of income can also be attributed to the failures of government policies in third world nations. During the early stages of growth, 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 boost investments in educational programmes.

In addition, beyond education is a whole range of ancillary activities whose effects are similar in improving the quality of labour: nutrition, health, and other social investments. By focusing on them, third world governments can obtain greater income equality.

Malaysia seems to have addressed most of these issues, this in large part due to the far sightedness of our earlier leaders. They prioritised bread and butter over guns and bullets, houses rather barracks. We are in the final lap of transforming into a high income and developed country.