

Growth and distribution: Policy Lessons

COMMENT

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IN Malaysia, economic growth has effectively reduced poverty rates to a large extent for all ethnic groups. The number of households below the poverty line has reduced from 65% in 1970 to 12% in 2000 for bumiputras, declined from 26% to 1% for the Chinese and dropped from 39% to 3% for the Indians.

However, the growth itself has little effect in reducing the income gap among ethnic groups. The Gini index, which is a common measure for income inequality, declined by only 7% between 1970 and 2000 for bumiputras, 5% for the Chinese and 11% for the Indians. The gap in real per capita income between 1970 and 2000 is almost constant for bumiputra-Chinese and increased by 7% for bumiputra-Indians.

This article provides a summary of research findings that had been carried out by Universiti Putra Malaysia and University of Groningen. The principle aim of the research is to analyse the extent to which economic growth and structural changes between 1970 and 2000 have implications on income inequality across ethnic groups. The full article on the research findings has been published in the World Development Report (Volume 76, 2015).

Expansion of exports and the changes in structures of the factor market (labour and capital) are found to be the main determinants for a change in income inequality. While the expansion of exports has a positive impact on income, the changes in the structures of factor market have a large negative impact on all ethnic groups.

There are two causes that may explain the negative impact of factor market. First, import substitution effects are driven by offshoring activities (outsourcings). These activities rely heavily on imported

inputs, which substitute domestic value-added exports.

Second, skill-biased technological change effects. Due to skill-biased technological change, the changes in the structure of factor inputs led to large decreases in the labour incomes for all unskilled workers to modest decreases for skilled workers. Export growth led to large income increases for unskilled workers and modest increases for skilled workers. The combination of these two forces had a positive effect on the incomes of skilled workers but a negative effect for the unskilled workers.

For the three major ethnic groups, the export growth and changes in the structure of factor market had relatively small percentage effects on income growth of the Malays when compared with the Indians and the Chinese.

The underlying reason is that a large percentage of the Malays are employed in the public sector, with its focus on the domestic market and is thus rather insensitive to changes in export demand. This was a clear result of the policy to restructure the society through an expansion of the public services sectors where priority had been given to skilled Malay workers and through the promotion of exports of labour-intensive products (which rely on unskilled workers).

All unskilled workers benefited greatly from export growth but suffered more from the changes in the structure of factor market. The Chinese and Indian skilled workers suffered slightly from the changes in structure of factor market but benefited more from export growth. The Malay skilled workers benefited slightly from both types of changes.

Altogether, the policy reforms through expansion of the public services sector and export promotion for the private sector, have had limited effect in terms of reducing income inequality across ethnic groups.