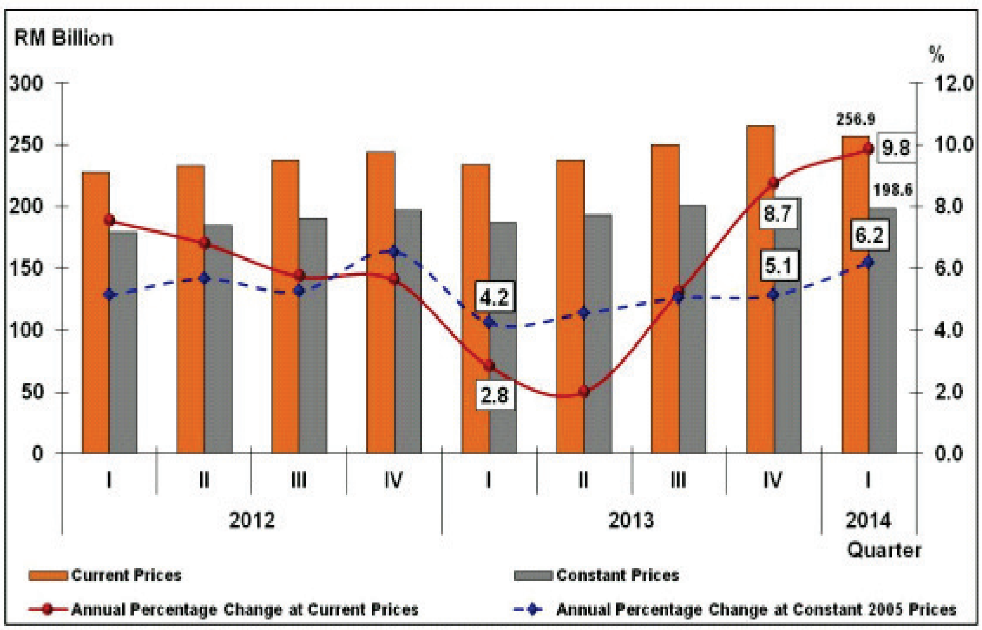
Malaysia has experienced strong economic growth over the past decades, but income inequality has not significantly lowered and many people are still left behind. What economic policies can Malaysia implement to reduce income inequality without sacrificing its rapid growth?

There are strong evidences proving that Malaysia is indeed experiencing a strong economic growth for the past few years. Malaysia has continue to grow at an astonishing rate and this is shown by the Gross Domestic Product(GDP). According to the Department of Statistics Malaysia, The actual GDP in Malaysia expanded 0.8% in the first quarter of 2014 over the previous quarter. GDP growth rate in Malaysia averaged 1.28% from 2000 to 2014 on a quarterly basis. In first quarter of 2014, the GDP in current terms amounted to RM256.9 billion and the GNI stood at RM250.5 billion.

Chart 1: GDP and Annual Percentage Change



1

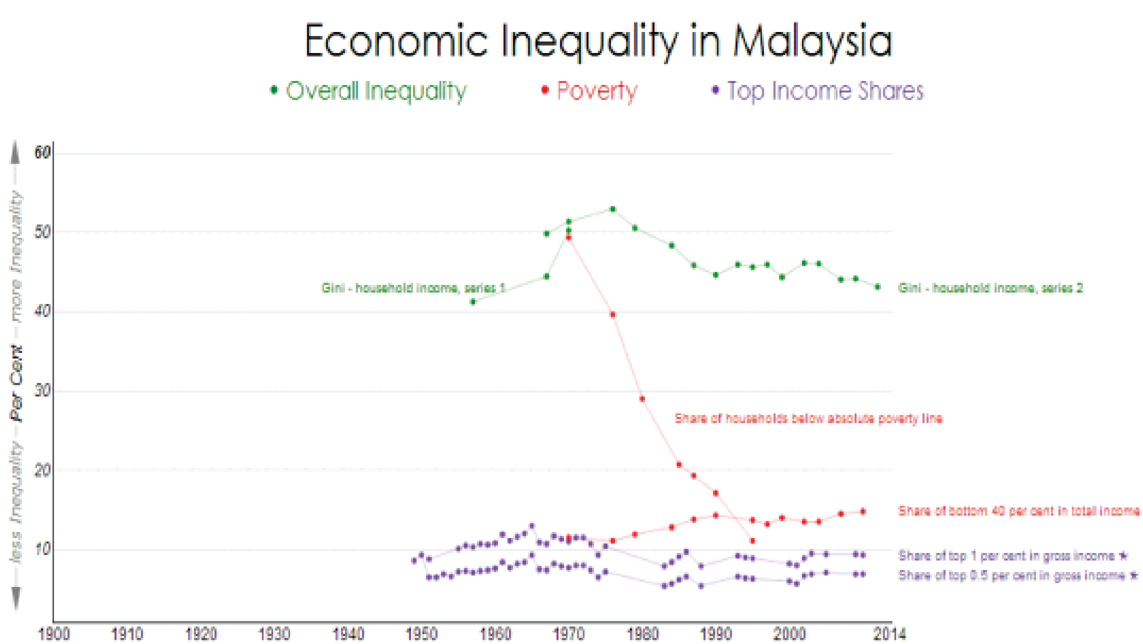
Strong economic growth in Malaysia is largely dependent upon the export-led growth and the growing tertiary sectors in Malaysia such as tourism and hospitality services. The ability of Malaysia to attract more tourists from overseas has led to a significant increase in the annual GDP growth in this country. Undeniably, this is a good news as it increases the job opportunities for local people, decreases unemployment, increases households income, increases consumer spending and investments and eventually results in high growth with the evidences of high annual GDP and GNI.

However, despite the growing economies, there are many other economics problems left untackled. One of it is that the income inequality is still spiking, leaving the people who are rich getting richer and the poor ones getting poorer. Governments should not ignore this economic problem as it involves the welfare of the people in this country as well as the well-being of a country.

Income inequality refers to the extent to which income and wealth is distributed in an uneven manner among a country's population. It is one of the macro-objectives that economists wish to tackle to ensure economic sustainability and continuous development. This is clearly a problem where economists take it serious because income inequality not only happens in developing countries like Malaysia but also in highly-developed countries like the UK and the USA.

"Mean monthly income for households is on the rise for the nation's poor. In 1970, mean monthly income was at RM76 per household, rising to RM693 by 1995. Household income for the poor is estimated to hit RM2,007 last year, with a target of RM2,300 by 2015."

Above shows an extract from an article on the The Star paper business news on Monday June 9, 2014,stating that the monthly income of Malaysia has risen years over years. This seems to be a great tendancy towards higher living standards of people in Malaysia but it is not necessarily true. One of the reason could be that the gross income is growing rapidly than the real income. Higher growth leads to higher inflation. When there is high inflation in a country, the purchasing power of people will decline significantly. For instance, a same pair of shoes can be bought at RM10 back in 10 years ago whilst now it only can be bought at RM50. The value of money is getting smaller and smaller and the currency of the country is dropping.



Based upon the graphs above, the overall income inequality has declined then remained almost stable from the past decades. On the other hand, the absolute poverty line slopes downwards drastically from years to years. Although people living in absolute poverty have been decreased, the overall inequality doesn't seem to be improving at the same time. Hence, this suggests that many people are still left behind even though with the fast pace global economic growth.

The Gini coefficient measures the inequality among values of a frequency distribution of income. A Gini coefficient of zero expresses perfect equality, where all values are the same, for example, where everyone has the same income. A Gini coefficient of one (or 100%) expresses maximal inequality among values, for example where only one person has all the income. According to study, Malaysia still remains the highest Gini coefficient amongst other countries in Asia, which is around 0.45.

High inequality in income will have negative effects on economic growth. One study done by economist Andrew Berg and Jonathan Ostry of the IMF recently found that the countries with higher inequality of income tends to have a shorter spell of economic growth than those that with more equality.

Income inequality in Malaysia is caused by several reasons. Firstly, elasticity of demand for labour would influence its wage rate and hence the income. When demand for labour is inelastic, i.e when other factors cannot easily be substituted for it, the labours tend to have higher income. When labour only forms a small percentage of the cost of production in an industry, the labours will receive lower income which results in a disparity of income in Malaysia.

Secondly, income differentials arrives because there are different types of labour supply. Some industries face a limited supply of labour which is relatively low compared to the demand for it. Thus, this results in higher wages for that group of labour. For instance, such labours could be celebrities, musicians and football players.

Furthermore, differentials in wages are linked with the basic human characteristics. If jobs require specific qualification, such as highly-skilled and experienced workers, supply of labour will be restricted. This leads to higher income for this group of people, such as surgeons, actuarists and financial planners.

While income inequality seems to be very unavoidable due to the volatility of the labour market and nature of the jobs, there are some macroeconomic policies that the governments and economists can adopt to tackle the problem of income inequality without sacrificing its rapid growth.

The biggest solution that majority of countries are trying to adopt to reduce income inequality in an economy is the Supply Sides Policies (SSPs). They are policies to influence the movement of aggregate supply in an economy by increasing the productive/ potential capacity of an economy without having to sacrifice rapid growth. To increase the aggregate supply of a country beyond its limit, we need to increase the quantity or/ and quality of factors of production such as human capital and equipment.

In these policies, governments try to improve the education and provide more training for people. In order to increase the quality of labour, it is vital for the government to continuously spend onto education and training. Besides, more funds should be allocated towards setting up training institutions that provide courses like language proficiency, computer and IT skills, vocational skills like cooking, bakery, carpentry and others. These are meant to train those workers who lose their job in an old industry and to improve their occupational mobility.

Besides that, Malaysia governments could lower the income tax and corporate tax in order to create a larger incentive for business people to keep themselves and their businesses more innovative and creative. When people are allowed to keep larger proportion of their income, they would have higher incentive to produce more and hence increases its productivity which eventually leads to an increase in total output and national income.

Provision of better medical services is also able to reduce income inequality. Malaysia governments grant its people to better healthcare service to ensure people in the country have access to better health and it extends their span of life, especially for the poor ones. Once this policy is adopted, poor people who tends to have lower standards of living can be avoided from paying a large proportion of income on healthcare and that this reduces the opportunity cost of the money spent on medical services. Building more state hospitals and offering medical services at low cost could have a good impact on solving income inequality in Malaysia.

Moreover, deregulation is one of the solution. This economic policy can increase output without causing an inflationary fear. Deregulation can be understood as opening up the market for greater competition .When there are more firms joining the industry, the level of output will increase. Also, to maintain their customer base, they are unlikely to charge high price. That means cost efficiency must be present. Lower cost and higher productivity can result in an increase in national income, alongside with a positive multiplier effect, the governments would now have more resources to be rechanneled into tackling the problem of high inequality.

Apart from all of these, governments should also focus on the problems causing inequalities. One of the factor could be misallocation of resources. Without a proper detailed plan, the scarce resources every economy has could be easily misuse on things that are less important. For instance, if governments spent too much on catalyzing a faster growth while the money can actually be spent on projects that are more benefiting for the people such as financial assistance under Amanah Ikhtiar Malaysia

(AIM), a misallocation of resources occurs. Hence, before any implementation of large projects, governments have to be extra cautious to protect the welfare of people and also the sustainability economy.

Based on the study, the Malaysia Government invests heavily into Technical and Vocational Education and Training to shore up supply for the 46% high income jobs out of 3.3 million jobs to be created under the Economic Transformation Programme. Last year alone, the Government spent RM3.61bil. We can see a huge amount of money is needed to ensure a successful macroeconomic policies. However, where to get the financial assistance and the uncertainties in the world economy seems to be stumbling rocks throughout the pathway to achieving higher income equality without sacrificing its rapid growth.

Economists are still divided about the relationship between growth and income inequality, which has spiked around the world as economies struggle in the wake of the 2007-2009 financial crisis. Income redistribution rather than inequality was responsible for hurting growth. Some argued that inequality prompted governments to transfer money to the poor, which reduced incentives to work. Subsequently, it leads to social problems and the ultimate aim of governments to reduce income inequality seems to be ruined.

Thus, income inequality can no longer be ignored and relegated to the background of policy determination during periods of economic prosperity. We have seen in several crisis-hit countries that poverty incidence fell because the average income of the people increased through increased employment brought about mainly by economic growth that resulted from well-directed government interventions and sound macroeconomic policies. But, often, this economic growth also came as a result of inappropriate and unsustainable economic activities associated with a bubble economy.

Reducing income inequality is never an easy task because it is very time-consuming, costly and contradicting. Governments always wanted to experience high growth but it will lead to inflation. To reduce inflation, contractionary fiscals/monetary policies are used. When income tax, corporate tax and GST tax are high, people who live in poor will never get to live a better life while the rich ones are getting better each day, causing a higher income inequality. The major conflicts in achieving macroeconomic objectives of stable growth, low inflation, low unemployment, higher living standards and less income inequality are always exist.

In crux, despite of all the conflicts, an economy has always wanted to achieve a sustainable growth and development. Supply Sides Policies (SSPs) mentioned above which aim to reskill workers, deregulation, privatization and encouraging higher investment through tax rebates and relieve are all long term solutions to solve economic problems. Although it has a high opportunity cost and limitations, the only way to shift the PPF (production possibility frontier) outwards to increase scare resources is through such long term solution. In the fast pace world with more advanced technologies and sophisticated research, an economy can still achieve its macro-objectives without making any big loss.

References:

http://en.wikipedia.org/wiki/Income_disparity_in_Malaysia

http://www.thestar.com.my/Business/Business-News/2014/06/09/Tackling-income-inequality-Malaysia-is-on-the-right-track-but-we-must-have-the-gumption-to-keep-goin/

http://www.themalaymailonline.com/malaysia/article/world-bank-malaysias-economic-growth-to-pick-up-in-2014-household-debt-at-r

http://www.thestar.com.my/Business/Business-News/2014/04/08/World-Bank-Malaysia-GDP-to-grow-49/

http://en.wikipedia.org/wiki/Economy_of_Malaysia

http://www.worldbank.org/en/country/malaysia/overview

http://www.tradingeconomics.com/malaysia/gdp

http://www.statistics.gov.my/portal/images/stories/files/LatestReleases/gdp/2014/GDP_PRESS_RELEASE_Q1_2014.pdf