

CHAPTER 1 – INTRODUCTION

1.1 INTRODUCTION

Over the past few decades, one of the great debates was whether economic growth is an effective device in eliminating poverty (Gallaway, 1973). ‘Trickle Down Theory’, which was the dominant development thinking in the early 1960s, proclaimed that benefits of economic growth will automatically filter down to the poorer segment of the population though the proportional benefits of the poor is always lesser. However, ‘Trade Off Theory,’ which is the equity-efficiency development thinking from the late 1950s argued that rapid growth will result in the poor being bypassed and marginalised by the structural changes of modern growth.

Ahluwalia (1971) of the World Bank in an early analysis observed that ‘Less Developed Countries’ (LDCs) with a low-level of real income usually would have a high level of absolute poverty. Bergman’s (1979) study on growth and equity in 16 ‘Semi-Industrialised Countries’ (SICs) realised that (absolute) poverty remained low due to the impact of continuous economic growth. Most of the empirical studies supported the argument of ‘Trickle Down Theory’, that rapid growth is very good at reducing poverty.

Does economic growth reduces poverty in Malaysia? Past experiences has shown that growth in Malaysia rises along with improvement in poverty reduction. This is especially obvious during the implementation of ‘New Economic Policy’ (NEP). In 1970, ‘Incidence of Poverty’ (IP)¹ was high at 52.4 per cent while the amount of real ‘Gross Domestic Product’ (GDP) was at RM26,815 million. Over the years, IP has

¹ ‘Incidence of Poverty’ (IP) is an indicator used by the Malaysian’s government to measure the percentage of poor households in Malaysia. See: Malaysia. 1986. *Fifth Malaysia Plan, 1986-1990*. Kuala Lumpur: National Printing Department, p.81-83.

reduced and reached 16.5 per cent² in 1990 while real GDP rose up to RM105, 977 million. From this observation, economic growth is an effective element in reducing poverty.

However, economic growth can be achieved along with poverty reduction even when there is hardly any relationship between the both. Other factors such as income distribution can play an active role in reducing poverty during the period of rapid growth. In such a case, economic growth cannot be considered as an effective element for poverty reduction. Growth is not 'pro-poor'³ (biased in favour of the poor) where the poor are benefiting from growth proportionally more than the rich. Therefore, the relationship between growth and poverty should be examined in order to ascertain the effectiveness of growth in reducing poverty.

Previous studies of economic growth and poverty in Malaysia examine little on the (statistical) relationship between the two variables. Recent works by Ragayah (2000), Roslan (2004)⁴ and Khan (2002) drew conclusions on the link between growth and poverty in Malaysia based on comparison of real GDP and IP data. Basic econometrics modelling method, which would give some insight into the relationship between growth and poverty, has not been used for examination. Earlier studies that examine the growth-poverty relationship in more detailed by Hirshman (1974) and Muniappan (1985) confined their study only to Peninsular Malaysia due to non-availability of data. Overall, the relationship between economic growth and poverty in Malaysia has not been explored thoroughly using the statistical methods.

² Based on incidence of poverty in 1989. See Malaysia. 1996. *Seventh Malaysia Plan, 1996-2000*. Kuala Lumpur: National Printing Department, p.72.

³ According to Kakwani and Pernia *et al.* (2000), 'Pro-poor growth' can be defined as one that enables the poor to actively participate in and significantly benefit from economic activity. See: Kakwani, Nanak and Pernia, Ernesto M. 2002. *Pro-poor Growth and Income Inequality*: with the assistance of Hyun Son. Economics and Development Resource Center: Asian Development Bank (ADB), October.

⁴ Year 2004 is not the published year of Roslan's paper entitled "*Income Inequality, Poverty and Development Policy in Malaysia*", but is the year where the paper is available online.

Therefore, it is important to examine in detailed relationship between growth and poverty in Malaysia by using statistical analysis. It will enable us to identify the progress of poverty reduction in achieving economic growth. It will also tell us whether poverty varies in large magnitude with respect to changes in growth. The variation of the strength of the growth-poverty relationship through decades could be identified. Meanwhile, the impact of time trend and economic crisis on the growth-poverty relationship could also be determined.

According to Todaro (2003), the magnitude and extent of poverty in any country relied upon the degree of inequality in its distribution besides the average level of national per capita income. Clearly, for any given level of national income, the extent of poverty reduction depends on how the distribution of income changes with growth. Therefore, the importance of income distribution could not be neglected in the examination of growth-poverty relationship. What will the impact of income distribution be, in affecting the ability of growth to reduce poverty? Does the role of income distribution outweigh the role of growth on poverty reduction in Malaysia?

Meanwhile, 'how' or 'in what ways' can economic growth benefit the poor in Malaysia? Is it through the translation of growth into rapid progress of social and economic sectors that gradually raises average income level, or purchasing power of the poor? What would be the role of several mechanisms such as aggregate demand, government expenditure, job opportunities, government redistribution strategy, and so forth in helping the poor to obtain benefits of growth? Understandings, therefore, should be drawn beyond analysing the statistical relationship between growth and poverty. Consequently, effective ways could be determined and promoted in order to achieve rapid growth along with poverty reduction.

As proclaimed by Juan Somavia (1995), “The unfinished business in the 21st century is poverty eradication”.⁵ Malaysia, in the process of transition to a more complex and perhaps more controlled patterns of development, undeniably, still faces the problem of poverty. Understanding the exact linkage between poverty and economic growth will enable Malaysia to consider the effectiveness in promoting growth as a crucial alternative to reduce poverty.

1.2 SCOPE OF THE STUDY

The scope of this study is confined to Malaysia and covers the period from 1970 to 2002. The year 1970 is an appropriate starting year to assess the relationship between economic growth and poverty since the government began to emphasise on oriented policies with distribution through the establishment of NEP. Previous researches on poverty, which covered period before the 1970s, are basically confined to Peninsular Malaysia only due to the unavailability of data in East Malaysia. This study focuses on the period after the 1970s where poverty data are available for East Malaysia. With more adequate data, this research will give a better picture of the economic growth and poverty trends as well as conditions in Malaysia.

1.3 OBJECTIVES OF THE STUDY

The general objective of this study is to examine the impact of economic growth on poverty in Malaysia during the period of 1970 to 2002. The specific objectives are as follows: -

- (1) Examining the statistical relationship between economic growth and poverty in Malaysia during the period of 1970-2002.

⁵ See paper presented by Juan Somavia in the *United Nations World Summit for Social Development*, 1995.

- (2) Identifying the impact of income inequality on the ability of economic growth to reduce poverty.
- (3) Determining “how” or “in what ways” economic growth benefits the poor in Malaysia.

1.4 LIMITATIONS

One of the limitations in this study is the problem of obtaining time-series data on poverty and income inequality for the period of 1970 to 2002. Statistical method of estimation based on calculation of yearly average changes, is used to construct the unavailable data between two-actual data points. The possible fluctuations of data, which might exist within the period of two-actual data points, were neglected. Therefore, data of poverty and income inequality used in this study represent similarly but not exactly the actual context of poverty and income inequality in Malaysia. Meanwhile, due to the shortcomings of estimation method, a relatively more precise and reliable time-series data could not be produced.

Lack of measurements of poverty and income inequality in Malaysia is another limitation of the study. The IP and ‘Gini coefficient’ (GC)⁶ used in this study were not able to capture the different aspects of poverty and income inequality respectively. The IP, which measures poverty in absolute term, fails to measure the extent to which the incomes of the poor fall below the poverty line. The GC is limited in its ability to capture changes in income distribution among income quintiles. Therefore, analysis using these single measurements, fail to provide complete and thorough understanding of the context of poverty and income inequality in Malaysia.

⁶ ‘Gini Coefficient’ (GC) is an indicator used by the Malaysian’s government to measure the ratio of income inequality in Malaysia.

The problem of 'Poverty Line Income' (PLI) is also a limitation to this study. The PLI only considered three components, food items, non-food items and clothing and footwear, which are inadequate to give a comprehensive picture of the quality of life, that determines the level of poverty in Malaysia. The computation of PLI also failed to consider the differences of urban and rural living costs and differences in household size. The changes in PLI over time, which is only adjusted using 'Consumer Price Index' (CPI), failed to allow for changes in consumption patterns, which occurred over the decades as income grows. Thus, the poverty level in Malaysia used for this analysis could have been underestimated or overestimated by the PLI.⁷

1.5 ORGANISATION OF THE STUDY

This study is organised as follows; Chapter 1 states the problems of research, objectives, and limitations of the study; Chapter 2 reviews the concepts and measurements of economic growth and poverty. It also surveys previous theoretical and empirical studies that examine the impact of economic growth on poverty in Malaysia and other countries; Chapter 3 discusses the data, sources of data and definitions of economic growth, poverty and income inequality. It also presents the hypothesis and the methodology to be adopted in the study; Chapter 4 examines the statistical relationship between economic growth and poverty during the period of 1970-2002; Chapter 5 analyses the impact of income inequality on the relationship between economic growth and poverty; Chapter 6 examines the ways growth have been beneficial to the poor in Malaysia; Chapter 7 summarises the research findings and presents some concluding remarks and suggestions for future research.

⁷ For the readings of the problems of PLI, see: Hashim, Shireen M. 1998. *Income Inequality and Poverty in Malaysia*. United States of America: Rowman and Littlefield Publishers, Inc.