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Effects of Markets on Poverty and Economic Inequality: Evolutionary and Ethical Perspectives

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ABSTRACT

Taking into account Kuznet’s hypothesis, considers the general relationship between the evolution and extension of market systems and the incidence of poverty and economic inequality. It suggests that a re-evaluation of the Kuznet’s curve is needed because income inequality has been rising in many countries, with growing economic liberalisation, expansion of globalisation and greater reliance on markets. Nevertheless, societies that experience a rapid transition from traditional, centrally controlled, or social welfare economic systems to market-based ones often experience a substantial rise in their incidence of poverty and income inequality, at least initially. Some of the reasons for this and the processes mentioned are outlined. The recent upward trend in economic inequality, particularly in more developed countries, seems to have a different genesis to the initial phase of rising inequality indicated by the Kuznet’s curve. Its basis seems to be the combined effect of the growing importance of inequality in human capital, especially resulting from educational differences, and market extension. The increased adoption of the user-pays approach to education could magnify social stratification and cement social inequalities. The essay concludes with a discussion of ethical issues. These issues include whether or not the payments of income based upon market competition are just, arguments for redistribution of income such as those of some utilitarians and of Rawls, and the relevance of critiques of these redistribution proposals, especially as they apply to the poor. Critiques include that of Richard Musgrave, and those based on the assumption on that the poor have a high preference for leisure, exhibit backward-bending labour supply curves at very low levels of income, and are likely to spend their extra income on non-essential commodities, such as gambling and alcohol, expenditure disapproved of by many in society when the poor engage in it. Some consideration is also given to A K Sen’s view that lack of social entitlements is a major source of poverty.
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1. Introduction
In recent times, extension of markets and greater freedom in marketing have been increasingly seen as keys to economic growth and development. Growing economic globalisation involves both factors (Tisdell, 2005; Tisdell and Sen, 2004). Advocates of greater economic globalisation stress its anticipated contribution to global economic growth, even though doubts have been raised about whether such growth would be sustainable (Tisdell et al., 2004; Tisdell, 2001). Less attention has been given to the possible impacts of market extension and freer markets on economic inequality and the occurrence of poverty. However, the mainstream economic view at present is that such changes are likely to reduce the incidence of poverty, most likely will ‘improve’ the distribution of income, and might even result in everyone being better off in the long run than they otherwise would be. The latter proposition implies that these economic changes are likely to bring about a Paretian improvement for society.

The purpose of this article is to discuss this optimistic view critically. The ready acceptance of this hypothesis may blind its advocates to other points of view. It may also become a basis for not adopting or for relinquishing targeted government policies to assist the poor and the socially disadvantaged because it may be automatically accepted that they will all benefit if economic growth can be achieved. In turn, this can be expected to result in the demise of the Welfare State, with responsibility for assisting the poor and disadvantaged being progressively transferred to private charity.

In this article, alternative views about the relationship between income inequality and economic growth are outlined first, then the relationship between economic growth, market extension and freedom, and the occurrence of poverty is considered. Finally ethical arguments for redistributing income to the poor and the needy are discussed.

2. Income Inequality and Economic Growth
Views about how economic growth might affect the distribution of income and the occurrence of poverty differ considerably. Some writers believe that inequality is likely to be
reduced by economic growth, a negative mathematical relationship exists, where as others, possibly influenced by Karl Marx (1956), believe that economic growth based on the capitalist market system can be expected to increase income inequality; the mathematical relationship is positive. However, Kuznets (1963, 1973), relying on empirical evidence, reached the conclusion that neither of these hypotheses appears to be correct. He argued that the relationship between income inequality and per capita income is likely to assume a reverse-U-shape. His reversed U-hypothesis implies that as less developed countries experience economic growth and their per capita income rise, income inequality increases at first but if economic growth continues and per capita incomes continue to rise, income inequality begins to fall and continues to do so. The type of relationship that Kuznets had in mind is illustrated in Figure 1 by the curve ABC.

![Graph illustrating Kuznets' hypothesis](image)

**Figure 1** Income inequality and the level of economic development is of a reversed-U shape according to the Kuznets’ hypothesis.

Kuznets’ theory provides a relatively optimistic outlook from a long-term perspective, even though in the early stages of development, income inequality, and possibly the incidence of poverty increases. At what stage economic growth might reduce the incidence and severity of poverty is unclear although Kuznets did try to predict at what levels of per capita income the turning points in the Kuznets curve would occur.
Nevertheless, doubts have now arisen about whether the Kuznets’ U-shaped relationship continues to hold. In more developed countries, such as the USA, income inequality has been rising since about the mid-1970s. A widening income gap has been observed between those with greater education (more skills) and the less skilled. As economic globalisation has proceeded, in recent decades income inequality has risen in countries like the USA. Hence a reclining S-type relationship seems to have emerged between rising per capita incomes as illustrated in Figure 2 for a more developed country by curve ABCD (Tisdell and Svizzero, 2004).

![Figure 2](image_url)

**Figure 2** Recent experiences in some developed countries suggest that the relationship between income inequality and per capita income levels may be of a reclining-S shape rather than a reverse U-shape.

Different reasons have been suggested for the emergence of this relationship. One view is that it is due to technological advances that have reduced the demand for labour of the unskilled and those with limited skills. Another view is that freer international trade has reduced the demand for unskilled or low-skilled labour in more developed countries because importation from less developed countries of commodities dependent on the use of such labour has become easier as international trade restrictions have been reduced. It is possible that both factors have played a role (Svizzero and Tisdell, 2002).
It is also possible that skill-based income inequality has increased in less developed countries (compare Ghose, 2004). There may be several reasons for this. First, the market for skilled labour tends to be global one. Secondly, economic production involving a high intensity of use of unskilled labour may need the input of some skilled labour if it is to be efficient. The demand for such labour in less developed countries may, therefore, be relatively inelastic and if supply of such labour is short, this will inflate the salaries of the skilled. Given the process of economic globalisation, it is possible that a developing country initially on the upward section of the Kuznets curve could change it trajectory. This is illustrated in Figure 3. In this case, instead of following the Kuznets path AFBC at point F the path FGH might be followed because of the growing openness of the economy in the neighbourhood of F and beyond.

![Figure 3](image-url)

**Figure 3** Some less developed countries may be deflected from a Kuznets’-type trajectory by their increased openness and technological change. For example, they may follow the path AFGH rather than AFBC.

The relationship in Figure 3 implies that with growing openness of its economy, this less developed country experiences an increase in its income inequality at a rising rate, and then subsequently, at a declining rate. Whether or not income inequality in such a country would eventually decline with its continuing economic growth is unclear. Furthermore, this is also unclear for the case illustrated in Figure 2 for a more developed country.
A limitation of the analysis of the distribution of income is its failure to take account of distribution of leisure-time and the general availability of leisure-time. While it might often be the case that as income rises, leisure-time also does likewise, this is not a universal pattern (Tisdell, 2006, Ch.1). The amount of leisure-time taken by individuals in modern societies appears to be less than in many hunter-and-gatherer societies (Sahlins, 1974). There is also evidence to suggest that the available amount of leisure-time of higher income earners, such as the skilled, may have fallen in recent times whereas for the less skilled this has not occurred (Costa, 1998). To some extent, the higher incomes of the skilled appear to have been purchased by a reduction in their available leisure-time. Furthermore, in developed countries, it has become more common for both husbands and wives (or partners) to work, and, therefore, higher household income appears to have been purchased by reduced leisure for parents and household partners. When loss of leisure-time is taken into account, higher incomes for the skilled and for households may not result in as much increase in their welfare as may appear at first sight (see, for example, Tisdell, Vol. I, Pt. III, 2006).

3. Poverty, Markets and Economic Growth

Just as views differ about the influence of markets and of economic growth on the distribution of income, varied views exist about the influence of these factors on the occurrence of poverty. The optimistic view is that economic growth, particularly if market driven, will result in trickle down ‘economic’ benefits to the poor. Economic growth is seen as a very effective means of reducing the occurrence of poverty. On the other hand, Karl Marx (1956) was convinced that economic growth obtained in the market capitalist system would lead to increasing ‘immiserisation’ of workers, the bulk of the population, and consequently, to the growing incidence of poverty in market systems based on capitalism. So far, however, there is no strong evidence to support Marx’s point of view. Nevertheless, new sources of poverty can arise with the development of the market system.

For example, the development of the market system tends to undermine the family, particularly the extended family, and kinship groups. This is because the market system is impersonal, based as a rule on individual self-interest and on individualism. It often calls for geographical mobility of individuals which reduces family ties. Traditionally, in many societies, families’ kinship groups have assumed the social responsibility of providing support for their needy members. The market system tends to undermine charity of this type. Therefore, those who are unable to benefit effectively from the market system, such as the
mentally or physically handicapped may be disadvantaged by the evolution of the market systems. This is so unless other institutions develop that can effectively fill the gap in social assistance resulting from the demise of the role of the family and of kinship groups. Voluntary charitable organizations (not based on kinship) may develop and/or the state may increasingly provide support for the needy, as in the Welfare State. These interventions are of a non-market type. They highlight the limitations of markets for addressing some forms of economic deprivation.

Rapid transition of economies from ones with no or limited reliance on free markets to ones that are free market-oriented may also create pockets of poverty, as has been observed in Russia. How long such new pockets of poverty will persist is not clear. Since China has joined the WTO, imports of soybeans (Xue et al., 2004) and maize have created economic problems for many of its farmers in its Northeast because of the lower prices of the American imports. The economic survival of many Chinese farmers in these areas is likely to depend on structural adjustment, such as switching to other crops and the amalgamation of farms for greater efficiency. Significant changes in market conditions increase the likely incidence of poverty amongst such groups (Tisdell, 2003).

In such cases, exposure to the free market begins a sorting out process in which the economically fittest survive as farmers, and may even prosper, and the least fit suffer. The least ‘fit’ are likely to be forced to migrate and seek employment in urban areas. To do this is by no means a simple task. In many countries, those displaced from agriculture join the urban poor often living in squalid conditions and may face the constant possibility of unemployment. Now not having land, they have no possibility of obtaining subsistence income and are completely dependent on market conditions for their survival.

The market system is often believed to operate smoothly and almost effortlessly. However, the market system in reality is very complex and does not operate in a costless manner. In transitional economies, citizens have to learn about how the institution of the market works. In particular, entrepreneurs and farmers have to make market predictions or forecasts and assume market risks. Those who do it poorly may become impoverished. Furthermore, adjustment of economic activities to altering market conditions is not costless. For example, if the farmers of Northeast China decide to switch to crops other than maize and soybeans,
they may have to undertake new investments specific to the new crops and the switch is likely to take some time.

Furthermore, farmers will have to learn how to grow these new crops in the most economic manner. Some farmers may fail and others may succeed. Some may be unable to adjust because they lack the initial capital needed for the adjustment or cannot withstand economic mistakes likely to be made during the adjustment process. They may become impoverished and be forced off their land. They become, at least in the short-term, casualties of the extension of the market systems. In the long-term, it is possible, however, that they and their offspring will be better off if the extension of the market system promotes economic growth.

4. Ethics, Poverty and Income Redistribution

A decision to assist those in poverty or need is basically an ethical one. Furthermore, it has been common in the past to distinguish between the supposedly deserving poor and the undeserving poor; the former being deserving of charity and the latter not.

In the West, as a rule, the less deserving or the undeserving poor are considered to be those who are poor because of their own choices, such as excessive spending on non-necessities, for instance, as alcohol, careless planning or a high preference for leisure rather than work. The deserving poor, on the other hand, are mostly believed to those who are poor due to circumstances beyond their own control, for example, born with a serious handicap, or injured as a result of an accident.

The distinction, however, between these groups depends on the assumption that the former groups is able to exercise free will and choose rationally. There may be some inherited factors or experiences that lock individuals into particular negative behaviours from which they find it impossible or difficult to escape. Hence, the distinction between the deserving and the undeserving poor is not as clearcut as may seem to be the case at first sight. Furthermore, even when individuals fall into poverty and severe hardship as a result of their own actions or foolhardiness, the moral question still arises of whether they should be assisted. The story of the prodigal son in the Christian Bible suggests that they should be.

The philosopher John Rawls (1971) developed a very strong equality principle, namely that the income of all should be equal unless inequality is in the interest of all. He argued that if
individuals could prior to birth communicate, they would opt for a social contract or agreement based on this rule because they would not know where, when and in what condition they would be born. However, Rawls may attribute too much to one’s initial conditions of birth and may not give enough consideration to the exercise of free will after birth by individuals. Nonetheless, his theory strongly supports the provision of charity for the poor.

In its simplest form, utilitarianism also supports the redistribution of income in favour of the poor. It implies that if the income distribution in society is to be made more equal, the greatest increase in total utility will be achieved if income is initially redistributed from the richest members of society to the poorest. That, however, assumes that the utility functions of all are similar and increase at a decreasing rate as their levels of income rise. In addition, the utility function is assumed not to be path-dependent, that is not to depend on previous income levels obtained by individuals. Also redistribution is supposed not to bring about a significant reduction in national income due, for example, to a disincentive effect on the economic effort of the richer members of society.

This raises the question of what is the impact of income inequality on national income and economic growth. Some economists are of the view that income inequality is associated with economic growth and that measures to promote equality of income may reduce economic growth. However, there have been many economies in which income inequality has been considerable and economic growth absent or minimal. The Philippines and some Latin American countries have displayed this pattern recently. Much of the inequality in such cases may arise from rents rather than profits from entrepreneurship.

Neither a very high degree of income equality nor a very unequal distribution of income (involving a high incidence of poverty) may be favourable to economic growth. The former situation may create considerable disincentive to economic effort and entrepreneurship. The latter situation may result in the human capital of a large section of the population being much below levels that would promote maximum economic growth. The poorer members of society may be deprived of adequate education, health care and means of personal development because of their lack of resources. Consequently, the productive potential of the economy is not achieved.
A typical relationship between income inequality in a society might be like that shown by the inverted-U relationship in Figure 4. High levels of income equality and considerable equality of income may not be favourable to economic growth and to the maximisation of national income.

![Figure 4](image_url)

**Figure 4** In the case shown, considerable inequality of income, such as at 0, and a high degree of equality of income, such as at E, are not favourable to economic growth. Income inequality corresponding to point D is most favourable.

A major issue in assessing income inequality is how to measure income. Earned income, for example, in a recent year, may not be representative of life-time earnings. Furthermore, some individuals have stronger preferences for leisure than other. For instance, two individuals may have exactly the same potential for earning income but one may have a much higher preference for leisure than the other. The latter, therefore, works for fewer hours and earns less income. No ethical case for transferring income for the higher to the lower income-earner exists.

This case is illustrated by Figure 5. The line MN represents the trade-off between leisure-time and income available to individuals A and B. The indifference curve marked $I^A_i I^A_i$ is representative of individual A’s income-leisure preferences and that marked $I^B_i I^B_i$ is indicative of B’s income-leisure preferences. Therefore, individual A maximises his/her utility for combination E, and B achieves this for combination F. A earns an income of $M_1$.
and B a lower income of $M_0$. Since both have equal income-leisure opportunities, no case exists for transferring income from A to B even if B may be near the poverty line. Musgrave (1974) points out that Rawls’ principle of justices does not give adequate consideration to such cases.

![Figure 5](image.png)

**Figure 5** Differences in leisure-income preferences complicate the assessment of income inequality

However, there may be cases where individuals have had identical opportunities but one ‘decides’ to squander his/her opportunity early in life. For example, two individuals might have equal intellectual ability but one does not apply himself or herself to learning early in life and obtains only a comparatively low income later in life, and regrets this. To what extent should such an individual be held responsible for a poor decision made early in life?

Mathias (1979) has argued that sometimes economic theories are used for social propaganda. He points out that the theory of the backward sloping demand curve of labour was used by many British writers in the eighteenth century to justify low wages, and to suggest that it would be a folly to redistribute income to the poor because they would engage in less work and might spend their extra leisure-time drinking alcohol and gambling. Such theorising was not backed up by empirical evidence. In general, given the prevalence of the Protestant ethic in the 18th and 19th centuries, a reduction in hours of work amongst the less well off members of society met with social and moral disapproval. However, according to Veblen (1934) a
different code of ethics applied to the leisure class. In this respect, Mathias (1979) points out that the British ruling class was hypocritical.

There are many reasons why individuals may be poor. It may, for example, be due to their poor personal endowment at birth, such as a physical handicap or lower than average intelligence, or due to deterioration in their initial endowment due to the exigencies of life and ageing. However, as stressed by Sen (1977, 1981), social or institutional entitlements may also restrict individuals’ economic possibilities and can contribute to their impoverishment. For example, in many societies in the past, and in some today, females are impoverished within families due to male dominance. This appears to be common, for example, in northern India (Tisdell et al, 2003) and in parts of Africa (Kiriti and Tisdell, 2004). Furthermore, in India, there is evidence that as economic growth has occurred, that discrimination against females has increased (Tisdell et al., 2003). In rural areas, discrimination against wives seems to increase when wives are working (Tisdell et al., 2001). It cannot be assumed, as is sometimes done, that greater participation of women in the workforce will necessarily reduce social discrimination against them.

5. Concluding Comments
The development and extension of market systems are seen by many as an effective means of reducing the incidence of poverty and increasing economic equality. Nevertheless, there are limitations to this view, as indicated in this article. Because of these limitations charity, either public or private, is needed to target poverty and redress gross economic inequalities. Social structures are altered by the development of the market systems. In particular, the social bonds of kinship appear to be weakened. Therefore, with the development of the market systems, charitable behaviour associated with kinship seems to be undermined. New institutions are needed to fill this social gap. As the market system evolved, non-profit organizations (not based on kinship) developed in many Western countries to help fill this role and the state became a major provider of social services. By the end of World War II, there was widespread public support in the West for the concept of the Welfare State. However, by the 1970s the pendulum began to swing as laissez-faire economics became more popular and the Washington Consensus in favour of small government and maximum reliance on markets emerged.
Depending on how persistent this social philosophy becomes, the extent of economic inequality and the incidence of poverty in more developed countries can be expected to increase, as has occurred in the United States. This pattern may also flow over to less developed countries. If such policies result in considerable economic inequality, apart from any moral objection to such policies, they are likely to reduce potential economic growth. They can impact negatively on the distribution of investment in human capital. A society in which only the richer individuals are able to develop their human potential and the poor are deprived of such opportunities, usually forgoes economic benefits because marginal returns on investment in human capital are not equalised for all. Such a society fails to promote equality of opportunity, and this failure has an economic cost. It would be socially unfortunate if the zeal of market advocates should blind them to possible (actual) social and economic efficiency failures of markets. The price mechanism is a valuable means for managing the use of scarce resources, but it is by no means a perfect one and without need of public intervention. Professor Lakshman states in discussing the process of economic globalisation, that we must be careful of claims that the laissez-faire market system, particularly if extended globally, is “the pinnacle of human achievement as well as the guaranteed cure for most (if not all) economic and social ills” (Lakshman, 2004, p.25).

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