

Income Distribution From Outward-Looking Development Policies

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Income distribution has become a central concern in developing market economies, now that breakthroughs are being achieved in expanding output. Severe inequalities in the distribution of the benefits of development are practically universal and appear to be growing.¹

Will these inequalities be reduced or cured by the outward-looking policies now being recommended to developing countries? This paper analyses these policies and arrives at a generally negative answer. In most developing countries, inequalities cannot be expected to cure themselves under outward-looking policies, no matter how desirable these policies may be for other reasons.² Inequalities may even increase unless major efforts are made to redistribute income.

The paper starts with a brief description of the policies now being recommended. There follow sections dealing with inequality-producing influences associated with this development strategy. These influences are discussed under the following headings:

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¹The available evidence suggests, as one writer has put it, "that large groups of people have experienced little or no broad based improvement in standard of living during the recent development period and may even have become worse off." See [12, p.3].

²For the present author's own views supporting these policies, see Keesing [6 Pp. 330-320].

Prices, savings, and the division of labour;
Technological influences;
Vicious circles and the limitations of education;
Provision of markets;
Employment from exports;
Taxation and public expenditures;
Reinforcement from political influences; and
Influences over the very long run.

No attempt is made to review the relevant literature or the empirical evidence.³ Influences are discussed in terms of their roles in promoting rapid output growth under the recommended strategy. The paper ends by noting important qualifications and implications for policy.

The Outward-Looking Strategy for Promoting Growth

The recent acceleration of output growth in developing market economies reflects in part an accumulation of experience in recognizing needs and mastering efficient techniques of government intervention in scores of specific tasks through-out an economy.

The other basic influence has been the widespread acceptance and increasing implementation of a handful of rather conservative principles, namely that the government should:

- (1) rely wherever possible on the allocative guidance of a market price system in which international and local prices are linked through a realistic exchange rate, although selected price signals may be deliberately modified through government intervention;
- (2) harness the energies of private enterprises within a division of labour between the public and private sectors in which each sector concentrates on activities that it can do relatively best, with the government spurring the private sector where necessary by complementary activities and special inducements;
- (3) pay careful attention to economic activities that increase and conserve the supply of foreign exchange, including agriculture and exports as well as the manufacture of import substitutes; and
- (4) make continuing efforts to mobilize the country's full investment potential and channel both private savings and tax revenues into investments that have a high social rate of return—but without exceeding the limitations set by import and savings capacity, so that the price mechanism does not break down.

As part of this approach, foreign investors are generally encouraged to take part, usually in restricted ways.⁴

³Relevant studies include, for example, Atkinson [2 Pp. 244-263]; Adelman [1 Pp. 24-37]; Turnham [13]; Kravis [7 Pp. 61-80]; Jain [5]; Oshima [10 Pp. 7-41]; and Unidas, [15]. There is also a rapidly growing empirical literature on trends in particular countries.

⁴For earlier comparisons among the strategies and their results, see, for example, Balassa [3 pp. 24-47]; Little [9].

This strategy has important political corollaries, for it envisages optimal results from a dictatorship or at least a powerful one-party government, highly committed to economic development, stable enough to take (and induce private enterprise to take) a long-range view, unified enough to carry out consistent policies, and strong enough not only to make its policies effective but also to keep control in the face of the unrest and dissent created by rapid socio-economic change.

Prices, Savings, and the Division of Labour

Under this strategy, factors of production, including workers of different types, are paid, as a rule, roughly according to their scarcity value in contributing to the growth of desired output. This has immense advantages in economising, mobilising and adding to scarce resources. Scarce resources are drawn toward their most productive uses while investments and incentive payments are allocated on the basis of high rates of return in output and output growth. Prices guide economic choices by the public and private sectors alike. It is, therefore, important that costs fairly reflect the scarcity value of the resources used relative to the objective of rapid growth. Hence, for example, little cost should be placed on the use of unskilled labour when there is an incipient labour surplus.

Reliance on the price system frees the government from a need to make routine allocative decisions in relation to the private sector. This, in turn, frees the private sector from concern over such allocations. Both sectors can concentrate more of their limited managerial capacities on actions that directly promote development.

Resources whose scarcity value (opportunity costs) are pushed up by the pursuit of rapid output growth almost inevitably include foreign exchange and capacity to produce it, savings and financial resources (particularly the ability to put together large blocks of funds, since many attractive investments are large and indivisible), managerial and entrepreneurial skills, the skills of trained professional workers (for example, engineers), technological know-how, existing productive capacity (such as modern-sector plants and equipment), and effective institutions and organizations. There may be shortages of people who can operate effectively in the modern sector at all levels; but for reasons to be discussed, unskilled labour and traditional skills will have little scarcity value in the pursuit of rapid growth.

In view of their nature, and as a result of existing inequalities in developing countries, valuable growth-linked resources—except, perhaps, for arable land—are almost certain to be concentrated in the hands of a small fraction of the population. Government actions that accelerate output growth should serve to increase the scarcity value of these growth-linked resources, and increase their potential rates of return. Pressures are set up at the same time to reduce the share of income going to the mass of ordinary workers, in order to reward the scarce growth-linked resources and also in order to diminish consumption to make room for investment. Recommended tax systems will be discussed later, but it can immediately be seen that if the goal is promoting output growth, there are strong reasons not to allow taxes to counteract growth-inducing effects of the price system.

Besides promoting static allocative efficiency, these high returns help to motivate people to add to their own and the nation's scarce resources through processes of accumulation. The rewards induce people, for example, to obtain professional training, master new technology, set up needed business organizations, gather together funds for investments, and expand export earnings. Links between local and international prices help to create pressures to achieve technical efficiency and improve products up to international standards, thus promoting the adoption of innovations and best-practice methods from abroad. The returns offered to such growth-linked private efforts can be greatly increased by diverting the bulk of the income stream away from unskilled labour and traditional economic activities (unless the effective market is shrunk as a result).

High rates of return lead directly to private wealth accumulation. People who start with control of scarce factors of production are permitted and encouraged to save, invest, and multiply their private holdings of scarce factors. Thus, possession of wealth leads to acquisition of more wealth.

Rates of return and savings rates both tend to be higher (tax rates and other things being equal) for large concentrations of wealth than for smaller concentrations. High rates of return are all the more likely to the extent that material wealth holdings become concentrated in the hands of people with personal characteristics (such as ability) that also contribute to economic success; and this association is likely when wealth holdings have been newly generated by the growth process. Higher, more certain rates of return can be expected from large wealth holdings than from small holdings, as a reflection of economies of scale of various types, advantages of market power, lack of well-organized capital markets, the ability to avoid costs of bringing large numbers of participants together, diversification of risks, and learning effects from involvement in a succession of modern-sector enterprises. Moreover, since a family's basic consumption needs are limited, a higher proportion of income can be saved and invested out of high income than out of low income.

Another source of inequality can also be readily justified on grounds of efficiency. In striking a division of labour between the public and private sectors, it is efficient to economize on public resources and exploit to the full dynamism of the private sector by allocating private opportunities on a competitive basis. This principle makes maximum use of available private resources while minimising public budgetary and information costs. Numerous industries and developmental tasks are left to the private sector in which enterprises compete with few restraints. Where subsidies or licenses are necessary they are given out to applicants with low-cost bids or those quickest to grasp the need. The same principle is extended to many other allocative decisions, for example, in allocating admissions to professional schools. By not discriminating against "haves" in these competitions the government reduces its own costs and passes many costs on to private individuals. People who win and profit from these competitions are almost invariably those who started with significant advantages based on advantage cultural backgrounds, prior experience, and ability to afford the requisite costs and investments.

Technological Influences

Turning next to technological influences, a rapid growth of output comes about in practice mainly through the expansion of activities using modern technology. To say by official definitions that a country is still "developing" means as a practical matter that a large proportion of the labour force has not yet been absorbed into high productivity, modern-sector activities. As long as a large pool of labour remains outside these activities the social opportunity costs of employing unskilled workers—and those who only possess traditional know-how—are bound to remain low.

Low incomes outside the modern sector reflect the low physical productivity of non-modern methods of production. Output per worker is much higher in modern-sector activities than in the rest of the economy. As a result, the modern sector provides a much larger proportion of the nation's output than its employment. People working in each economic activity are paid out of the proceeds of that activity. This leads to sharp contrasts between mean incomes in the modern sector and those in the rest of the economy.

Incomes within the modern sector tend to be highly unequal in turn. This is partly a matter of relative scarcities of different factors of production including different types of labour. It is also a reflection of the indirect effects of administered wages and prices, different degrees of market power, and economies from large-scale production. Balance sheets of modern, large-scale enterprises frequently leave large residuals of income in the hands of owners and managers, rewarding very generously the scarce inputs that these people provide. In any case, a large part of the nation's output goes to a small fraction of its households—those of people who own modern sector enterprises, and employees who are able to bargain successfully with them.

The much higher average labour productivity in the modern sector, compared to the rest of the economy, reflects the use of imported machinery, borrowed technology, new forms of organization and highly skilled personnel. Expansion of this sector depends on the growth of the market—to be discussed shortly—together with increases in the supply of scarce factors of production that the modern sector requires, such as capital, skills and foreign exchange. The growth of modern-sector employment often takes place only slowly for lack of sufficient rates of expansion of markets and complementary inputs. Employment growth is slowed because labour productivity ordinarily increases as a result of learning effects and economics of scale.

The whole situation is systematically worsened, from the point of view of the poorer classes, by the impact of modern labour-saving technology. Throughout the economy the scarcity values of both unskilled labour and traditional know-how are initially diminished in the early phases of modernization. Machinery is introduced that can substitute for unskilled labour in a great many traditional activities. Hence there is a fall in the scarcity value of the services commanded by the broad masses of the population. Trade in mass industrial goods displaces numerous artisans and traditional specialists whose skills become outdated and unmarketable. Meanwhile, modern public health measures increase rates of population growth and thus expand the supply of labour. As a result the scarcity value of unskilled labour is pushed down further.

These initial effects are compounded by a continual inflow of new labour-saving techniques. New designs of machinery and equipment are continually being offered that embody superior technical characteristics but that are designed to save on labour inputs, being built for the economic conditions of an advanced industrial country in which unskilled labour costs are very high compared to other costs (by standards of a poor country). A possible alternative is to use older machinery designed for an advanced country perhaps a generation earlier; but machinery built for factor supply conditions like those of developing countries would be hundreds of years old and hopelessly obsolete. Moreover, whether old or new equipment is purchased, in the course of time increases in production capacity are bound to reflect advances that have been made in automation. Thus, for still another reason the modern sector of a developing country experiences rising trends in labour productivity that limit its ability to absorb additional labour. Meanwhile, declines in the costs of replacing unskilled workers tend to depress further their scarcity value (social opportunity costs).

Possibilities of substituting unskilled labour for capital are limited not only by the inflexibility of the borrowed technology, but also by the circumstance that few researchers or engineers are working on the relevant possibilities anywhere in the world. Like other research and development (R&D) that would benefit many developing countries at once, this sort of research has the character of a public good for each country individually. Since international collaborative research is almost nil in this field, the stock of applicable techniques for replacing capital with unskilled labour grows only slowly, and information on these possibilities is not made systematically available to the same extent as information on labour-saving equipment.

Even to approach full employment under these conditions usually calls for extremely low real wages, inducing use of local labour in place of capital in scores of operations where there is a choice. Enforcement of higher minimum wages may create widespread unemployment. If the market-clearing wage would be intolerably low so that no attainable wage leads to full employment, then it may be economically justified to pay subsidies to employment or to projects that create employment. But output maximization under these conditions requires paying the lowest tolerable unskilled wages and, thus, creating the greatest tolerable inequalities that are consistent with full employment.

Regional Influences

The problem of severe inequality also has a regional dimension. Public as well as private investments are channeled toward the modern sector and the advantaged groups, because rates of return on investments are ordinarily highest in and around the modern sector where people and physical facilities are already partly modernized. Urban "poles of growth" offer numerous locational advantages and favourable externalities, based on such influences as economies of scale in the provision of social overhead facilities, low information costs, the presence of a suitable work force, interindustry links, opportunities to exchange ideas, learning that has already taken place, and access to centres of decision-making. Investments generally yield greater rates of return when concentrated selectively on these "poles of growth." Other areas are left behind.

Vicious Circles and the Limitations of Education

Another side of the picture is the influence of vicious circles that perpetuate glaring inequalities almost regardless of the pace and timing of development. Much has been written about ways in which backward areas, unfortunate families, and lower classes stay poor. These vicious circles are too numerous to discuss here. Most alarming are the circles by which parents unwittingly inflict permanent damage on their young children from protein deficiency, general malnutrition, disease, and child-care methods that inhibit learning. Even when children do not fall victim to these hazards they typically acquire their parents' characteristics and are caught in the same pressures including discrimination. Thus, handicaps may be passed on from one generation to the next.

The seriousness of these vicious circles must be gauged by the strength of the inequalities created *before* recent development efforts, under colonial rule and open economic policies, prior to any major impact of deliberate policies to promote import substitution. To some extent these older inequalities may have been due to discriminatory treatment of different groups, but in large measure they sprang from people's unequal preparation to participate in a complex economy, a problem that is still serious in a majority of developing countries. Different groups—such as tribal peoples, inhabitants of partly monetized regions, and immigrants—come to a modernizing economy with very different levels of technology and commercial sophistication. As a result, even without artificial favouritism or distorted prices, inequalities may tend to grow, with some groups doing much better than others. This is *not* a problem that can be solved readily by correcting prices through outward-looking policies.

Of course, disadvantages based mainly on inherited class characteristics are not economically desirable in themselves. Countries following an outward-looking strategy would prefer social mobility and a wide talent base. But inequalities already exist, and the strategy exploits them in ways already explained.

Another way to describe this problem is in terms of a perpetuation of unequal advantages in the distribution of "human capital." Here only one aspect will be given special attention. This is the inability of education by itself to overcome the problem of inequality efficiently.

Education as a rule is a more attractive and successful investment for "haves" than for "have nots." Thus, in practically all countries, children from wealthy, high status, managerial and professional families usually do far better and go much further in school than children of unskilled manual workers. Youths from advantaged families are better prepared culturally. They can better afford the out-of-pocket costs of schooling and the opportunity costs, such as earnings foregone. These advantaged youths are better nourished and less likely to fail through illness. They receive greater approval from teachers, are more likely to enjoy the school experience and are more certain to receive approval from their parents, elders and peers when they succeed in school and go on to jobs based on schooling. Easily justified expectations of success become a self-fulfilling prophecy. Moreover, earnings as a result of schooling tend to increase with a person's complementary assets. Thus, returns are generally greater for people who have (or share with their parents) profitable business enterprises, wealth, access to credit, friends in important places, "social polish" and other special advantages.

Prospects are very different for a youth from a lower class, or from poor or rural family. If he lives in a village he would have to move to continue in school past a low level, then perhaps move again to take advantage of his schooling. Unless he gets an exceptional amount of education, most jobs to which he has access involve only manual labour. The odds of continuing to a high level of schooling may be so unfavourable and the rewards so uncertain that even making an effort seems a poor investment. As a result, advantaged groups ordinarily gain a disproportionate share of the benefits from public education, and even good school systems serve to perpetuate the existing class structure.

There are also notable problems in the design of educational policies for economic development. If the government chooses to concentrate attention on basic primary education—which seems a reasonable approach early in development—the resulting schooling saturates the demand for people with primary education and drives down the market value of this education. Meanwhile, relative inattention to higher levels of schooling leads to a rise in the market value of middle and higher education. Incomes become unequal as a result. Conversely, if the government lavishes heavy attention on middle and higher education at the expense of the primary schools, rates of return to higher levels of education are driven down, so that the income distribution is flattened; but the educational programme is costly and ill-suited to the needs of development.

The answer might seem to be to saturate the demand for education at every level—a large supply of educated people would reduce the returns (in the sense of diminishing income differentials based on education) and at the same time meet all the human resource needs of development. But this solution, besides being costly, may only be effective if the culture already places or can be made to place a high non-monetary value on education. After all, this saturation approach not only requires heavy public educational outlays; it also requires that young people be willing to continue in school for long periods at low private rates of return. In a society where the traditional appeal of education is weak, high rates of return, and, thus, highly unequal incomes based on education may be essential to persuade people to continue in school beyond the basic primary grades. In other words, income differentials based on continued education are inversely related to the strength of local cultural pressures for getting such education.

Provision of Markets

Another part of the explanation of severe inequalities is that the powerful mechanisms already described are not offset in the pursuit of growth by a need for measures that redistribute income. Perhaps the most commonly cited argument for leveling income is the effect in expanding the market. This argument turns out to be weak and practically untenable, particularly as a case for helping the very poor.

Smallness of the market is certainly a problem in most developing countries. But the small size of the “pie” and the large slice required for investment do not permit much of a mass market for industrial goods under any income distribution. The effective size of the market would be diminished by a

redistribution of income toward the poor, if the result were to reduce either people's motivation to produce, or the efficiency of the system of resource allocation.

As part of the recommended development strategy today, the problem of market size is solved in some combination of three basic ways. The first is to orient production, particularly increases in production involving new types of goods, toward export markets to the extent possible. If this effort is to be successful, it becomes essential to have low wages together with prices that realistically reflect social opportunity costs to be able to compete with foreign producers.

The second method is to let the modern sector provide its own market demand. Income of this sector grows rapidly, and the sector provides a market not unlike those of the advanced industrial countries.

The third method is for the government to provide a market through its public sector investments and subsidies. This is not unlike the basic approach in socialist countries, but it can also be justified by Keynesian ideas. Government action to provide a market becomes essential early in the development process when the market is still minuscule and producers lack optimism. As development gains momentum, the private sector increasingly provides the requisite demand, so that the government can step back and reduce its role.

It can be seen that not one of these methods depends on a redistribution of income in favour of the poor. Indeed, the type of goods required to meet an increment in demand by the poor might prove harder to produce than the goods demanded by people in higher income brackets. After all, increasing the production of consumer durables is a straightforward task that is usually left to the private sector. Unit costs generally fall as output expands. Increasing the output of staple foods is quite another matter.

This is not to say that optimal policies from the point of view of creating a market would leave income distribution unaffected. Tax and wage policies that may not appear wise on other grounds, including high wages for industrial workers in the modern sector, may well be justified in terms of their effects in enlarging the market for industrial goods. But if output growth is valued in itself with little concern for its social implications or welfare effects, there is no obvious reason to favour the poorer classes. It could be argued that redistribution ought to favour the middle classes instead, to create a market that could readily be served using technology borrowed from advanced countries.

Employment from Exports⁵

Another part of the picture is that there are strict limits to the jobs and incomes that most developing countries can expect to create by exporting the simplest manufactured goods.

⁵This third approach runs a risk of providing little addition to useful consumption unless the government concentrates its efforts on expanding the output of goods useful to the mass of potential consumers while rechanneling income in their direction at the same time. This has almost never occurred on a large scale in market economies, and it is not even common in socialist countries.

In small economies under exceptionally favourable conditions, manufactured exports have had a significant positive effect on employment, and probably on income distribution as well. This appears to have occurred, for example, in Taiwan, South Korea and Singapore. But these successes cannot be imitated widely because the total world market for labour-intensive, standardized manufactured goods is rather small—probably only enough to generate a few hundred thousand jobs in developing countries around the world in industries such as textiles, footwear, leather products, toys, sporting goods, the simplest types of metal and plastic products, and the most tradeable types of clothing, furniture, wood products, and pottery.

Competition in such lines of production is intense. Profit margins are narrow; wages are very low; and industrial countries have been quick to invoke protectionist measures.

Thus, there is only a narrow niche in the international division of labour for export industries based on labour-intensive manufactured goods. This niche is regularly filled by industries from exceptional developing countries, i.e., those with high per capita skills and education, highly disciplined labour, and extremely low wages. In practice, these requisites can scarcely be met except in countries with unusually heavy pressures of population on natural resources, together with a considerable degree of prior modernization. Even in these countries, export success has been partly an indirect reflection of serious neglect of manufactured exports by some of the larger developing countries, notably India.

It is simply not realistic to expect to see large-scale, low-skilled manufactured exports from other developing countries unless they can compete head on with places such as Hong Kong and South Korea. For the exceptional small economy that does succeed in this competition, however, exports may solve the problem of employment and thus help to set a floor on incomes. These will be low incomes at first, but in time they can rise as skills are improved and manufactured exports become diversified.

Taxation and Public Expenditures

Another reason why inequalities are not reduced is that little effort is made to reduce them through government tax and expenditure policies. Powerful income and inheritance tax schemes are not part of the strategy and can scarcely be found in developing market economies. Welfare measures aimed at the lower classes are slight, compared to other public expenditures that tend to have opposite effects.

The outward-looking strategy makes two main recommendations in relation to taxes. Neither calls for a redistribution of income in favour of the poor. The first and most important point is that public expenditures must be financed through taxation and savings in order to avoid inflationary pressures that would otherwise undermine the price system, beginning by wrecking the balance of payments. The second point is that tax exemptions and subsidies should be used in moderation to promote investment, savings, entrepreneurship, and other actions that contribute to development.

In addition, developing countries are encouraged to build up existing tax systems to give them a quasi-progressive character, so that revenues will automatically grow slightly faster than incomes. This is important because, in the course of development, government expenditures typically grow slightly faster than total output. After all, public investments are essentially complementary to private investments; public intervenient activities are needed to promote development; and public goods and services are desired as part of the mix of output as incomes rise.

In practice, however, in most developing countries, even when quasi-progressive results are achieved, the tax system is not conspicuously progressive in its net effects. Typically, tax burdens turn out to be proportionally heaviest on people in the middle and upper middle of the income distribution. These middle groups are hit heavily by excise and import duties on consumption, and their incomes and assets are easily observed for purposes of direct taxation. In terms of tax effects alone, therefore, there is a slight redistribution toward the richest and (less often) the poorest classes.⁶

Progressive income taxes help to reduce contrasts in income, but they are usually implemented with loopholes for the rich, and, in any case, their effect can easily be exaggerated. Even if they are effective, they only partially offset the inequality-creating mechanisms already discussed.

Turning to public expenditures, it is not conceptually easy to separate, let alone measure, the distribution of the benefits of public expenditures among different classes and income groups; but a strong case could be made that rising public expenditures serve especially the needs of people who live in favoured regions (capitals and urban "poles of growth") and enable people throughout the country to make more money on the basis of the scarce resources that they control. Some of the public services that expand as incomes rise contribute mainly to the living standards of the middle classes. For reasons such as these, advantaged groups may gain an even larger share of the benefits than of the taxes they pay.

Some expenditures that directly benefit the poorer classes can be expected to be undertaken because of favourable effects on the growth of output. For example, a country may foster improvements in small-scale agriculture. It may supply credit to poor farmers. Investments may be made in the poorest regions to improve roads, schools, and health with an eye to indirect effects on output, migration, and the quality of the labour force. Scholarships may be given to bright students and loans may be given to small businesses to widen access to paths of upward economic mobility and thereby to infuse the middle classes with people of talent from the poorest classes.

In the aggregate, these programmes may increase somewhat the absolute living standards of the poor together with their health and socio-economic mobility, but there may be little favourable effect on the income share going to the poor. A fundamental problem is that, except for increases in subsistence output, most of the benefits cannot be captured by the poor themselves because

⁶For some of the empirical evidence and further theoretical discussions of taxation in developing countries, see, for example, Bird [4] papers of the Rice University Program of Development Studies series.

competition among them eliminates most of their gains by depressing the market value of their added agricultural output and improved labour characteristics. If everyone gets a primary education, the private market value of having such an education becomes greatly reduced. If grain becomes plentiful through improved technology, its price falls so that the farmer whose marketed output has increased may have no greater purchasing power than before. Through the effects of competition which may be greatest among the poor, the bulk of the gains in the productivity of the "have-nots" tend to be captured by the "haves." For example, expanded grain output allows money wages to fall and increases the economy's capacity to import producer goods. As a net result, the income of the "haves" may grow faster than ever relative to that of the "have-nots".

Reinforcement from Political Influences

In the absence of clear leadership in the opposite direction, political mechanisms reinforce the inequalities that result from the economic influences just outlined.

First, as noted already, the most effective political system for accelerating growth is a dictatorship or one-party system that can clamp down on tensions created by the growth process, including political demands by the lower classes. "Losers" as a result of development, and those who fail to share the gains, tend to be systematically deprived of power to take action to persuade the government to redistribute income in their favour. "Haves" who benefit from rapid growth are left relatively free to try to exert pressures in favour of their interests.⁷

Second, the preferences, training and self-interest of most political decision-makers tend to favour the "haves," and favour institutions that lead to growing inequalities. Government leaders and officials tend to be conscious of, and responsive to, the needs of social classes most like themselves and interest groups well represented among their neighbours, families and friends. Acting in their own self-interest, government officials typically lavish attention on the capital city, allocate themselves comfortable salaries, and advocate intervenient policy instruments—such as controls and licensing—that increase their own importance while affording them opportunities to accept bribes and favours. The more highly paid officials benefit substantially from private property rights, low taxes on income and wealth, unequal wages and profitable opportunities for investment.

Fortunately, many people who have already reached the pinnacles of power care little for further material wealth and are concerned instead with their political images and their roles in history. Many high and not a few lower officials are actively or latently motivated to improve poor people's living conditions. Strong leadership can turn this into a major theme of government action.

⁷This does not mean, however, that "haves" are as secure and sure to farewell in a dictatorship as in a representative democracy. In an absence of institutional or political-military restraints against government action, wealth can be redistributed by the people in power as they see fit. But attention to the interests of the "have-nots" depends on the motives of the leaders, plus whatever credible threats remain.

Another problem that is partly political is that officials' selfinterest and social-psychological limitations hold back programmes that could help the poor. Most of these programmes are relatively unpleasant and unrewarding for the officials involved. Working among poor people, government personnel are exposed to poverty and other disadvantages of the poor, and are forced to share some of these disadvantages. Ordinarily the work lacks social and psychological compensations. It is hard to get personnel of appropriate quality to do these jobs; and too frequently officials—administrators, teachers, social workers, technical advisers—behave in ways that attack or undermine people they are supposed to be helping. As a result, such programmes are vulnerable to breakdowns and failures from poor staffing, they are expensive to staff; and they tend to become unpopular among government personnel and poor people alike.

Finally, the influences of outside advisers, local development experts, and prestigious techniques of choice and measurement tend to be thrown in favour of output growth to the neglect of distribution. Excessive importance is still being attached to measures of gross national product, despite their known biases and their exclusive concern for the volume of output as against its distribution and content. A nearly exclusive concern for output maximization is also built into the actual application of decision-making tools and choice criteria, such as cost-benefit analysis and rate-of-return calculations, that have become every-day guides for decisions at a lower level. More generally, at present economists, engineers and other development specialists are trained to look right past distributional effects without seeing them. Expert recommendations are made on "technical" criteria in which distributional preferences are usually impartial, implicit and well-hidden. In the usual case, technical recommendations are based implicitly on the "ideal bribe criterion" by which one course of action is judged superior to another if the people who gain could compensate those who lose even though no such compensation is required to take place.⁸

Influences Over the Very Long Run

Disregard of income distribution in development policy has been based in part on a widespread expectation that, in the long run, inequalities will automatically diminish as a result of the development process itself. This expectation is grounded, first, in the circumstance that inequalities are not nearly as glaring and poverty is not as widespread in the advanced industrial countries as in the poor countries, and, second, in models of development in which inequalities decrease as labour becomes scarce.

Historically, there is some reason to believe that inequalities grew in most industrial countries during the middle stages of their industrial transformation and then narrowed at a later stage in the process.⁹ This pattern can be attributed mainly to at least three mechanisms in addition to the responsible altruism of elite leaders.

⁸Much of the time, this expert advice leads to widening inequalities. When it does not, powerful interest groups get a second chance through the political process.

⁹See, for example, two monographs, Simon Kuznets [8 Pp. 1-80], Williamson [16 Pp. 1-84].

The most important mechanism has been the emergence of labour shortages in the course of the growth process so that employers are required to seek out unskilled workers and pay them attractive wages. A second mechanism has been political and fiscal. Redistributive measures of varying intensity have been enacted with an eye to strengthening lower class support, especially in countries that have strong democratic traditions. In some countries powerful social welfare measures and highly progressive income and inheritance taxes have been adopted. The third mechanism involves increasing competition for the attractive roles in the economy as a result of increased social mobility. But to the extent that the other mechanisms are ineffective, this competition is also held back, since the poor cannot compete on equal terms.¹⁰

A fundamental question is, will these mechanisms be as effective in the future as they have been in the past?

Labour scarcities are being avoided today by means of labour-saving trends in technology. Advances in the world's technology are guided principally by the business and national objectives of the "haves" in the richest countries. These people pay for almost all of the world's research, new products, machinery and equipment. In response, the powerful capabilities of modern scientific research and engineering are deployed mainly to increase these people's profits and well-being.

For business enterprises in the richer countries, the single most pressing problem is to find ways to do without labour inputs. Reflecting this pressure, the capabilities of the world's machine builders are continually directed toward reducing the need to employ labour. Since unskilled and manual labour are relatively expensive both directly and indirectly in advanced countries, research is devoted in effect to finding ways to make the skilled labour and capital of the few into a better and better substitute for the unskilled labour of the many. As a result, long-term trends in modern technology lead, other things being equal, toward higher productivity (and rising opportunity costs) for management and skilled labour together with falling opportunity costs and diminished employment for unskilled labour. These trends make it difficult for more than a few small countries to reach full employment by exporting labour-intensive manufactured goods.¹¹

Long-run trends in politics have also undermined the political and fiscal mechanisms for reducing inequalities. Military dictatorships flourish more than ever. Faith in representative democratic institutions has waned.

¹⁰Inheritance systems may also exert a significant influence on the division of wealth in the long run. See especially Pryor, [11, Pp. 50-72].

¹¹Scientific research and engineering are also geared to the needs of "haves" in other respects as well. For example, a significant part of the world's R&D effort searches for ways to reduce the need for inputs of land and natural raw materials, which, along with unskilled labour and raw talent, constitute the main resources controlled in large part by the poorer countries. To the extent that R&D efforts are directed to promote national power, military prestige and profits, the basic objective may be viewed as an increase in the ascendancy of the rich country doing the research at the expense of some or all of the rest of the world. When R&D are poured into health, education, or goods for consumption, the usual aim is to improve life for the world's "haves" rather than its "have-nots". Meanwhile, for reasons that include the public-good character of most R&D, very little research is devoted to the needs of the world's "have-nots" in general and the developing countries in particular.

Techniques have been perfected in relation to party and government organization that make it difficult to capture control or exercise unwanted influence from below. Totalitarian methods and modern armaments can be used to prevent or counteract collective pressures by the poor. New communications media offer unprecedented opportunities for government influences on opinion formation.

Modern development policies also provide means to "defuse" poor people's discontent, without really giving them much in exchange. For example, leaders often put on an ostentatious display of concern for the lower classes in the spreading of schools and teachers, roads, public health measures, new farm techniques, irrigation and electric power. Yet the investments made in these programmes may only be those that would be desirable in any case in terms of the interests of the middle and upper income groups.

The net result is that today's political systems can tolerate the great inequalities inherent in recent trends in technology and development policy; and there is little built-in political pressure to make taxes strongly progressive.

If this interpretation is correct, the observed historical trends in income distribution in advanced and developing countries alike can be understood as a result of two influences or currents. The first is a long term cycle in the development process by which, other things being equal, disparities in income and opportunities tend to widen over a large portion of the process but eventually narrow, as labour becomes a bottleneck and workers gain greater sophistication and political influence. The second influence is a one-way trend toward greater inequality of income over time, arising from long-run trends in technology and politics, particularly advances in automation. According to this view, the rapid widening of income inequalities in the poorer developing countries is largely a result of both influences operating together in the same direction. Present trends in income distribution in "developed" countries and in the most advanced of the developing countries are a result of the second influence struggling against the first.

Some Qualifications

The arguments put forward here do not mean that inequalities necessarily become larger as a result of following outward-looking policies. Inequalities may even be reduced, notably in the short run, depending, among other things, on local export possibilities, the previous distribution of income (which may have been very unequal), and the way in which inequalities are measured for purposes of comparison.

Even if large groups of people lose or fail to gain at all, there is likely to be a rise in the proportion of people who enjoy middle or high incomes, together with an increase in socio-economic mobility and other favourable results. It may be no simple matter to define and ascertain what has happened to inequality.

Moreover—and this should be emphasized—inward-looking industrialization policies may be worse than outward-looking policies in their inequality-producing effects, so that outward-looking policies may be superior in terms of distribution as well as output growth. Enormous windfall profits and high

incomes for government officials tend to be created by policies involving overvalued exchange rates, rationing of underpriced import licenses, high levels of effective protection, and loans at negative real interest rates, such as one typically finds in countries pursuing import-substituting industrialization policies. Effects include increased urban unemployment and depressed conditions in agriculture and export activities. The resulting unequal distribution of income is all the more disturbing because, in contrast to the situation under outward-looking policies, redistributions of income do not promote economic efficiency, nor do they reflect the social value of people's contributions to the economy.

In a number of countries, there may be room to raise growth rates, reduce inequalities, and increase what anyone would call social justice, by switching to outward-looking policies. This paper has tried to look beyond these desirable changes, to the long-term distributional consequences of outward-looking policies, in the absence of major measures of redistribution.

CONCLUSIONS AND POLICY IMPLICATIONS

The analysis suggests that under outward-looking policies, severe inequalities will not generally cure themselves. Except in a few relatively advanced, small countries, income redistribution in favour of the poor will not occur automatically, even in the long run, as a side effect of the development policies that are now being recommended. Inequalities may in some ways increase, and meanwhile, inequality is effectively exploited to promote output growth.

These findings do not necessarily mean that current policy recommendations should be drastically modified. That depends on the goals that a society sets for itself. It also depends on the answer to the question: what is the most effective way to achieve massive income redistribution at low costs in terms of other objectives in a developing market economy? This question is only beginning to be systematically explored.

Possibly what is needed is to incorporate systematic measures of redistribution into the outward-looking strategy. For example, it may prove wise to try to maintain factor prices that reflect the social opportunity costs of different resources in production but correct the resulting incomes systematically on the basis of taxes and transfers. It may also prove effective in some places to change relative prices and the mix of output, including public sector demand, in order to generate a more intensive demand for unskilled labour. Possibly, depending on choices among conflicting values and objectives, the answer may lie in a socialist system in which income can be more equally shared, as in China; or, possibly, a massive redistribution of property rights can equalize returns from property without turning to public ownership. These questions lie beyond the scope of the present analysis, which only suggests the urgency of facing them.

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