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The Economic growth and income inequality: Verification of the Kuznets curve for socialist Asian countries

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Abstract

In recent years the problem of economic inequalities has become one of the most often discussed problems in economics. Even though from neoclassical perspective inequalities should not have negative impact on economy, still the relation between inequalities and economic growth is not obvious. Traditionally, the starting point in this discussion is Simon Kuznets concept, according to which inequality rises in the early phases of economic development and decreases as the growth takes place. The empirical verification of this concept has been investigated, but the evidence is ambiguous. In this context, re-examining Kuznets theory for socialist countries in Asian (i.e. China, Vietnam and Lao) is especially interesting because of the rapid economic growth yet still keeping authoritarian regime. Therefore the main aim of the study is to verify the relation between economic growth and income inequality in China, Lao and Vietnam in years 1990–2022 and assess whether the relation takes shape of so-called Kuznets curve. In order to achieve the goal the data analysis and basic econometric methods are used. The results generally support relations indicated by Kuznets except for Lao for which obtained result were not statistically significant. The findings keep the door open to further analyses aimed at the identification and exploration of more significant determinants that could conclusively verify the relation between inequalities and economic development. Most promising would be incorporating some institutional determinants as it was proposed in Acemoglu and Robinson works.

Keywords: Kuznets curve; inequalities; economic transformation; economic growth; economic development

JEL classification: O1, O43, O53, P2, P3

1. Introduction

The problem of economic inequalities in recent years has become one of the most discussed topic in economic research. Even though economic inequalities are an obvious and immanent feature of every society, the fundamental question concerns their optimal level and possible impact on other macroeconomic variables and social cohesion. Therefore the question is what extent income inequalities are beneficial for the economy, promoting resourcefulness and entrepreneurial attitudes, and to what extent it negatively affects the country, leading to the emergence of interest groups and, in the extreme case, plutocracy.

Over last thirty years, Asian socialist countries, i.e. China, Lao and Vietnam have experienced significant growth of GDP which led to increase in income and largely contributed to a significant reduction in poverty. As a result the emergence of a modern middle class. This also meant significant changes in inequalities. The situation is paradoxical because all those countries are nominally socialist countries, declaratively emphasizing equality and emancipation of certain social groups.

The aim of this article is to investigate the relation between economic growth and income inequality in China, Lao and Vietnam over the last 30 years. Based on this aim, the work is divided into three parts. The first one presents the problem of inequality in economic theory, the second part briefly presents the post-socialist transformation in Asia the last part examines the impact of income growth (as GDP per capita) on inequality. In order to achieve the goal the data analysis and basic econometric methods are used. The research period covers the period from 1990 to 2022, the last year for which aggregated statistical data are available.

2. Literature Review

From a theoretical point of view, the level of inequality is of secondary importance for the efficiency of the economy. The optimal distribution of income should be linked to so-called Pareto optimality which can be achieved both in case of high and low inequality in certain society. In this context redistributive policies would be beneficial to the economy only if the current allocation structure is not Pareto-efficient as the policies would improve the situation of certain market participants without worsening the situation of others. Income inequalities, at least in theoretical regard, should favour the accumulation of capital which (when transformed into investments) should result in a higher rate of economic growth (Woźniak, 2014). In this sense, inequalities are a justified and necessary cost of modernization and development (see Figure 1).

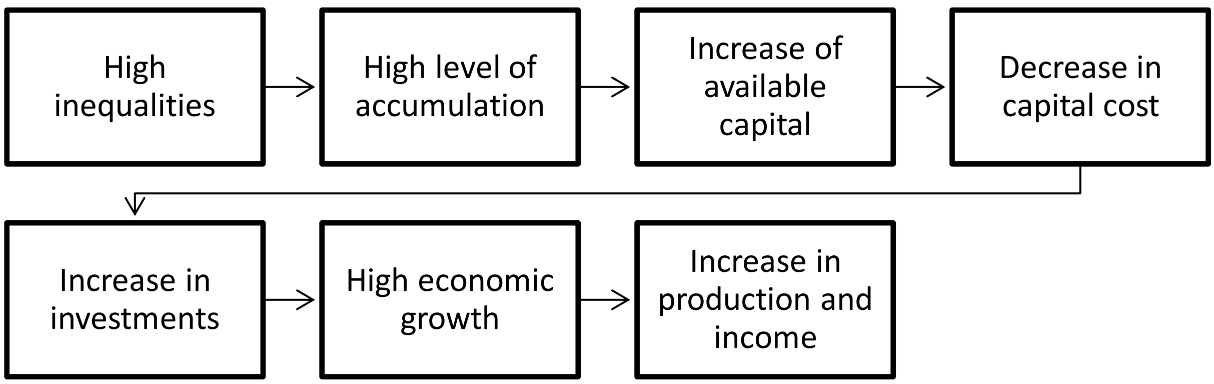

Figure 1: Theoretical relations between inequalities and development
Source: Author

A possible decline in inequality may occur in a later period along with increasing labor productivity as a result of the increase in the capital-labour ratio. This approach was first presented and popularized in the work Economic growth and income inequality by S. Kuznets (1955) who examined the impact of economic growth on inequality, taking into account data from three highly developed countries: Great Britain, the USA and Germany for which appropriately long time series were available.

According to Kuznets the economic growth in the initial phase leads to increased inequality which will decline later. Once a certain level of prosperity is achieved, the middle class begins to grow and accumulate wealth, and the lower class should receive higher wages along with structural changes and an increase in the productivity of the entire economy. According to Kuznets (1955), the main role in the decrease of inequalities was played by the gradual development of the industrial sector, contributing to the growth of the domestic product and offering higher salaries to employees. The change in the economic structure would later stimulate the increase in wages (income) in agriculture but also decrease wage growth rate in industry. Those changes would led to a slowdown in the pace of employee movement between the two sectors and decrease differences in income (salaries) in agriculture and industry. As a result inequalities in the economy would decrease.

The generalized form of this approach is known as bell-shaped Kuznets curve (Figure 2.). Even though the empirical data available to Kuznets can hardly be considered extensive or reliable and the research took place in the mid-1950s during the so-called the golden age of capitalism, the observed regularity became the basis for discussions about income distribution and inequality.

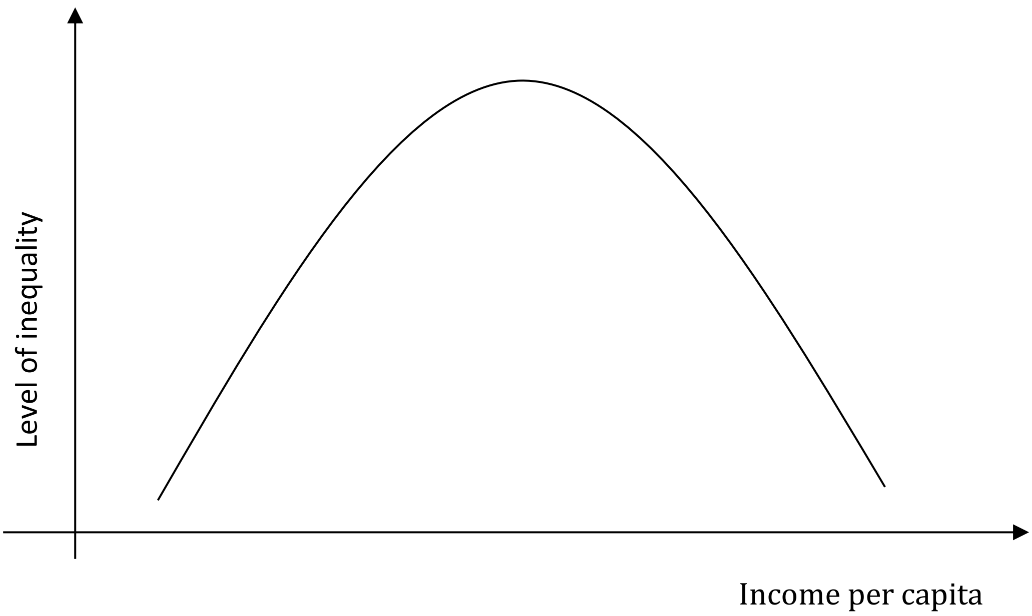

Figure 2: S. Kuznets U-curve
Source: Author

In the mid-1970s the first attempts to empirically verify Kuznets' hypothesis were made by Ahluwalia (1976), who conducted econometric research using cross-sectional data for industrialized economies. Income inequality was represented by the share of the poorest 40% of the population in the national income. His research confirmed the existence of a parabolic relationship between economic level and inequality.

Subsequent studies of the relationship between growth and inequality, based on larger and more complete data, questioned Kuznets' thesis (Kuznets, 1955). A systematic study of these relationships was the subject of research by Deninger and Squire (1998), and the results obtained were very non-obvious:

- only five of the 48 countries surveyed had an inverted U-shaped Gini coefficient;
- in four countries the Gini coefficient varied according to the letter U;
- in most of the countries surveyed, there was no statistical relationship between the Gini coefficient and national income.

Other studies also did not provide enough evidence for formulating generalized conclusions. Studies by Deininger and Squire (1996), Chen and Ravallion (1997), Easterly (1999), and Dollar and Kraay (2002) indicate that periods of accelerated economic growth do not coincide with changes in inequality. As rightly noted by H.G. Ferreira (1999) this means that changes in the rate of economic growth generally do not affect inequality. The reverse relationship, i.e. the impact of inequality on growth, also does not lead to clear conclusions.

Research by A. Alesina and D. Rodrik (1994) and R. Perotti (1996) indicate the negative impact of inequality on the rate of economic growth. In turn, H. Li and H. Zou (1998) and K. Forbes (2000) showed a positive relationship between inequality and economic growth. Research by J.H. Lopez (2004) showed a weak relationship between inequality and economic growth. According to this research, reducing the Gini index by 1% leads to a reduction in the economic growth rate by only 0.007%.

The lack of impact of inequality on economic growth also results from the research of R.J. Barro (2000). This all suggests that there is no generalized model according to which inequalities are shaped and how they affect other macroeconomic variables (see Table 1). It is also worth noted that Higgins and Williamson (2002) and Cogneau, Guénard (2002) pointed that many cross-sectional studies were conducted on the basis of "questionable quality" data on income inequality.

Higgins and Williamson underlined the existence of methodological differences in the measurement of income, definitions of units (residents, employees, households) that was used to calculate income inequality, and the varying degree of completeness of information about the surveyed population obtained from different countries.

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Table 1: Growth and redistribution in chosen economies (the years in which the study was conducted are given in brackets).

	High growth	Low growth
Distribution worsening	Brazil (1960s to early 1990s); Pakistan (1970–1985); China (1980s); Thailand (1970s and 1980s); Botswana (1970s).	Post-Soviet Russia; most eastern European countries (1980s); Mexico (1980s); Kenya (1980s); Ethiopia (1980s); Guatemala (1970s and 1980s).
Distribution improving	Indonesia (1973–1993); Malaysia (1970–1990); Taiwan Province of China (1950–1980); Republic of Korea (1950–1980); Mauritius (1980s and 1990s).	Sri Lanka (1960–1970); Cuba; Colombia (1980s); Morocco (1970–1984); Trinidad and Tobago (1970s and 1980s).

Source: (Stewart, 2000).

To sum up, the debate on inequality and its impact on the economy is neither settled nor closed. Their impact on the economy and the rate of economic growth is not obvious, and the discussion is complicated by ideological factors and personal beliefs that influence the discussion. However, it can be assumed that while artificial and excessive reduction of inequalities will be unfavourable for the economy, too high a level will also have an unfavourable impact on it.

3. Remarks on post-socialist transformation in Asia

Reforms in socialist Asian economies started in the late 1970s and early 1980s. (Winckler, 1999) as a result of impossibility of real socialist system to maintain high growth rates in long run and successes of so-called Asian Tigers which built their economic success on export and high competitiveness. The reforms emphasized the agriculture and industrial competitiveness and also initially introduced some superficial and limited liberalization. Conducted reforms had a positive impact on economy, making them more competitive and efficient. Most important and similar economic reforms took place in China and Vietnam, as well as in Lao.

The gradual establishment a market economy in China began in the late 1970s, while in Vietnam the *Doi Moi* reforms were initiated in the mid-1980s. Agriculture reforms in Vietnam, unlike in China, took place in parallel to liberalization reforms in the state-owned enterprises. On contrary, in China in the second half of the 1990s rapid privatization and marketization of the economy took place, while in Vietnam these processes slowed down. In Laos the economic transformation was similar to Vietnamese.

Reforms began with the liberalization of the agrarian sector in the late 1970s (only a few years after the introduction of socialism) and after the introduction of the "New Economic Mechanism" in 1986, the industrial sector was liberalized. On contrary to China or Vietnam reforms did not pose many problems as the country's level of industrialization was small and agriculture was poorly collectivized. In fact in case of Lao external factors played more significant role than in China or Vietnam – the inefficient industrial sector could not cope with Thai products, and farmers could easily emigrate to neighbouring

Thailand in search of better life. Stuart-Fox (1997) estimates that Laos initially reformed the socialist economy faster than Vietnam.

The reforms overall might be called post-socialist transformation, as mentioned previously, central planning would be almost completely replaced with market mechanisms and more general "economic strategies" with significant role of communist elites and communist party. Asian model of post-socialist transformation would be characterized by gradual changes and general lack of shock therapy. Also Asian socialist countries would not liberalize political environment nor fully accept Western human rights system, also regarding workers' rights as it would have negative impact on competitiveness and therefore very high growth rates. Planning still remains as an important element of the economic policy.

China has been preparing and implementing Five-Years Plans since 1953, with the current 14th Five-Year Plan lasting until 2025. Laos has been using economic development plans as the main documents defining sectoral directions of development and reforms since the 1970s. The eighth one is currently being implemented (2016-2020). Vietnam has been implementing five-year plans intermittently since 1961, approving its 2021-2025 five-year plan in February 2021.

In all surveyed countries central planning agencies prepare and oversee the development processes. In China that is National Development and Reform Commission – NDRC, in Lao and Vietnam Ministry for Planning and Investment. Taking into account their current role in the economy they might be compared to the Economic Planning Council under Park Chun Hee regime in South Korea, the Economic Planning and Development Council in Taiwan, Economic Development Council in Singapore and, to some extent, to the famous Ministry of International Trade and Industry (MITI) in Japan (Bolesta, 2017).

What is very characteristic, neither the Communist Party of China nor the Communist Party of Vietnam would introduce any revolutionary political changes – any changes in political system were rather adaptation to the changes in the socio-economic sphere (Bolesta, 2017). In case of Lao Evans (2012) argues that we may talk about "the Leninist road to capitalism" as during the fifth congress in 1991, the communist party recalled its leading role as the only political force in the country.

The most visible effect of post-socialist transformation is impressive and high development dynamics, despite the fact that economic liberalization was gradual, communist political elites-maintained power and control the economy making business environment less transparent and vulnerable to corruption. According to World Bank data, the average economic growth of China was almost 9%, Vietnam's 6,6% and Laos' 6,37%. It is worth noting that in the period 1979-2015 China (as the pioneer of the transformation) noted economic growth dynamics at 9.7% on average per year (Fig. 3).

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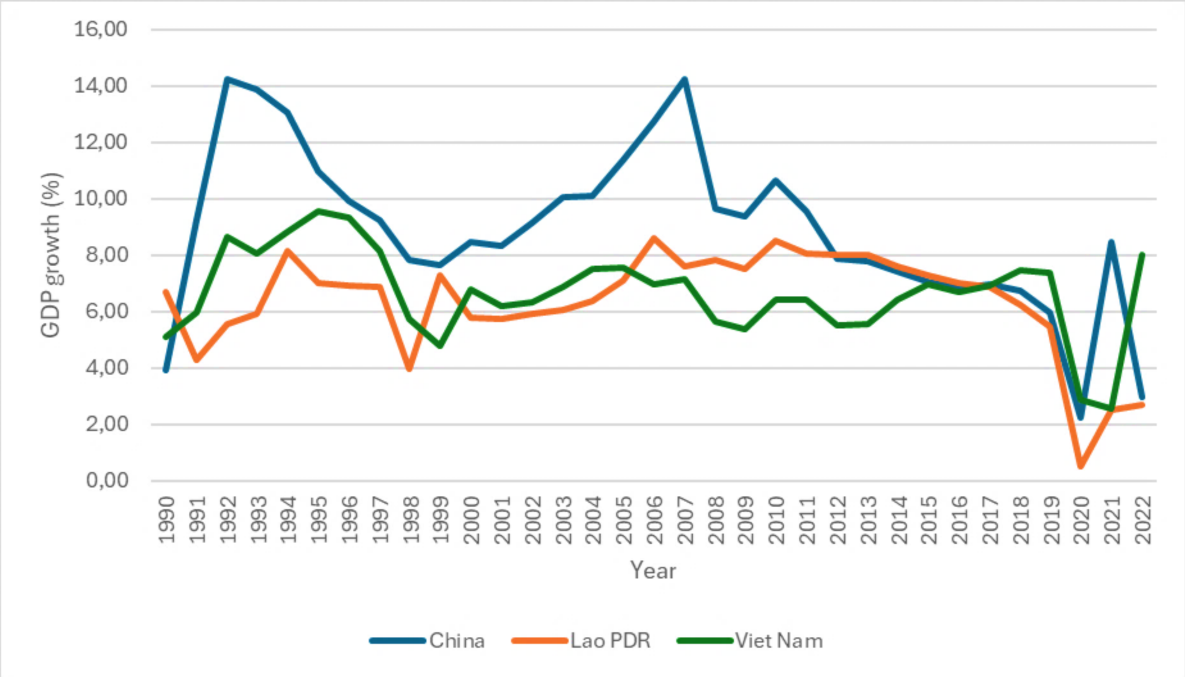

Figure 3: S. Kuznets U-curve
Source: Author based on World Bank Database (2024)

In all analysed countries industrial policy is be associated with attempts to enter and expand in the foreign markets as it was necessary in case of low development of internal market, poverty and limited purchasing power of society.

Another problem was low level of technological advancement which could endanger the economic growth processes in the long run. As remedy economic growth has been supported not only the development of foreign trade but also inflow of foreign direct investment (FDI), which were encouraged by improving physical infrastructure, low labour costs, and preferential access to market and political stability assured by political regime (Banomyong 2010).

As a result China, has become the centre of global production. As the country moves today towards more technologically advanced industries and focuses more on internal market, investments in labour-intensive sectors are moving to other Southeast Asian countries. According to the World Investment Report, Vietnam maintains a cost advantage over China, however, Laos maintains a cost advantage over Vietnam (UNCTAD, 2015).

While USD 16.3 billion of foreign direct investment flowed into Laos in 1989-2014, and the value of FDI for Vietnam only in 2016 amounted to USD 15.8 billion. USD (Table 2).

Table 2: Foreign direct investment, net inflows in China, Vietnam and Lao in chosen years (current USD).

Country Year	China	Lao	Vietnam
1990	3 487 000 000,00	6 000 000,00	180 000 000,00
1995	35 849 200 000,00	95 100 000,00	1 780 400 000,00
2000	42 095 300 000,00	33 890 000,00	1 298 000 000,00
2005	104 108 693 867,09	27 720 000,00	1 954 000 000,00
2010	243 703 434 558,18	278 805 903,12	8 000 000 000,00
2015	242 489 331 627,40	1 077 759 914,59	11 800 000 000,00
2020	253 095 616 058,58	967 706 086,20	15 800 000 000,00

Source: Author's own elaboration based on Word Bank Data (2024).

Importantly, one of the fundamental effects of reforms in socialist Asian countries was a significant reduction in extreme poverty.

According to World Bank data (2024), the percentage of the population living below USD 1.90 per day (according to PPP) has decreased from 72% of population in China, 45,1% in Vietnam and 23,7% in Lao to 01% in China, 1% in Vietnam and 7% in Lao, which is a unique achievement on a global scale (Table 3.). This also means the practical elimination of hunger, which affected Asians up to the 1970s.

Table 3: Poverty headcount ratio at $2.15 a day (2017 USD at PPP) (% of population).

Country	China	Lao	Vietnam
1990	72		
1992		23,7	45,1
1993	62,7		
1996	48,1		
1997		43,2	24,4
1999	46		
2002	36,5	25,4	29,9
2004			20,1
2005	22,1		
2006			14,9
2007		19,5	
2008	18		11,1
2010	13,9		2,9
2011	10,2		
2012	8,5	10,9	1,7
2013	2,9		
2014	2,1		1,9
2015	1,2		

2016	0,8		1,3
2017	0,7		
2018	0,4	7,1	1,2
2019	0,1		
2020	0,1		0,7
2022			1

Source: Author's own elaboration based on Word Bank Data (2024).

Together with economic growth and poverty reduction, the increase in inequality could be observed, especially in China, whereas in Vietnam and Laos this increase is less seen. This process is not surprising – when the economies moved these from a "pure" centrally planned system to a market economy, and the ruling party finally abandoned its policies of nationalization, collectivization and expropriation, a series of changes inevitably led to an increase in income inequality. Incomes began to better reflect the market demand for labour and the value of education and skills, with the greatest benefits for better educated individuals. Also, the opening of the economy and increasing its competitiveness opened up new opportunities to earn money and made income largely dependent on the initial input.

Table 4: Gini coefficient for China, Vietnam and Lao (1990-2022).

Year	Gini coefficient (adults) in Vietnam	Gini coefficient (adults) in China	Gini coefficient (adults) in Lao
1990	57,89%	43,23%	57,40%
1991	57,89%	44,78%	57,40%
1992	57,89%	46,26%	57,40%
1993	57,92%	47,76%	57,65%
1994	58,06%	48,35%	57,99%
1995	58,11%	47,74%	58,23%
1996	58,08%	47,13%	58,37%
1997	58,10%	47,10%	58,54%
1998	58,09%	47,20%	58,21%
1999	58,38%	48,13%	57,87%
2000	59,09%	49,80%	58,01%
2001	59,56%	50,72%	57,96%
2002	59,69%	53,46%	57,55%
2003	59,16%	54,28%	57,62%
2004	58,97%	54,60%	58,01%
2005	58,03%	55,77%	58,17%
2006	57,06%	55,90%	58,25%
2007	57,16%	56,20%	58,42%
2008	57,27%	56,22%	58,25%
2009	59,06%	56,27%	58,31%
2010	60,44%	56,65%	58,20%
2011	58,54%	56,46%	57,99%
2012	56,69%	55,31%	57,69%
2013	56,22%	56,21%	58,19%

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2014	55,94%	55,46%	58,78%
2015	56,09%	55,55%	59,17%
2016	56,31%	55,37%	59,57%
2017	56,25%	56,14%	59,88%
2018	56,16%	55,92%	60,13%
2019	56,16%	55,79%	60,13%
2020	56,16%	56,41%	60,13%
2021	57,89%	56,52%	57,40%
2022	57,89%	56,52%	57,40%

Source: Author's own elaboration based on World Inequality Database (2024).

As a consequence of these processes, the relative and absolute income differences have increased, and national inequalities – both in terms of income and wealth – have increased (Table 4.). This process in especially seen in China, whereas in Vietnam and Lao the level of income inequality remained almost the same – despite years of communist policies towards greater equality in economy (Table 5 & Table 6).

Table 5: Share of top 10% and bottom 50% in pre-tax national income in China, Vietnam and Lao in chosen years

Year	**China**		**Vietnam**		**Lao**	
	Pre-tax share in national income of top 10%	**Pre-tax share in national income of bottom 50%**	**Pre-tax share in national income of top 10%**	**Pre-tax share in national income of bottom 50%**	**Pre-tax share in national income of top 10%**	**Pre-tax share in national income of bottom 50%**
1990	30,85%	20,73%	45,82%	13,37%	45,68%	13,72%
1995	33,90%	17,82%	46,27%	13,35%	46,85%	13,53%
2000	35,87%	16,71%	47,06%	12,76%	46,44%	13,56%
2005	42,16%	13,85%	45,37%	12,98%	46,60%	13,48%
2010	42,83%	13,24%	48,26%	12,09%	46,33%	13,33%
2015	41,66%	13,77%	43,65%	14,08%	47,26%	12,83%
2020	43,20%	13,13%	43,75%	14,05%	48,30%	12,38%

Source: Author's own elaboration based on World Inequality Database (2024).

A similar situation occurs in the case of accumulated wealth, which is also concentrated in the hands of a small group – the top 1% owns almost 70% of national wealth in China and approximately 60% in Lao and Vietnam. At the same time, the share of the bottom 50% of the population in national wealth has fallen from 15% in China to less than 6% and almost remained the same in Vietnam and Lao (see Table 6.).

Table 6: Share of top 10% and bottom 50% in national wealth in China, Vietnam and Lao in chosen years

Year	China		Vietnam		Lao	
	Share in national wealth of top 10%	Share in national wealth of bottom 50%	Share in national wealth of top 10%	Share in national wealth of bottom 50%	Share in national wealth of top 10%	Share in national wealth of bottom 50%
1995	41,29%	15,17%	59,60%	4,30%	60,00%	4,24%
2000	48,02%	13,39%	60,00%	4,24%	59,69%	4,30%
2005	56,90%	9,46%	59,09%	4,35%	59,85%	4,28%
2010	62,69%	6,73%	60,55%	4,14%	60,04%	4,24%
2015	67,35%	6,19%	58,63%	4,42%	60,04%	4,24%
2020	68,59%	6,01%	59,24%	4,35%	60,07%	4,24%

Source: Author's own elaboration based on World Inequality Database (2024).

While the changes in income inequality itself seems to be a typical and obvious cost of liberal economic reforms, the level is surprising. It seems that high inequality was not the result of stagnation or decline in the incomes of the poorer sections of society, but of a faster increase in the incomes of the richer ones. It is clear that the fruits of the reforms were not and are not evenly distributed throughout society, which is a definitive rejection of communist egalitarianism. The countries studied have become not only some of the most dynamically developing economies, but also economies with huge inequalities. This is paradoxical because they are still officially socialist countries, emphasizing equality and emancipation of individual social groups.

4. Income and growth. Literature review

Most of the empirical studies aimed at the verification of existence of the original Kuznets Curve used the GDP per capita indicator (GDPpc) in logarithmic form as the measure of economic development – for example Barro (2000). Therefore For verification of the relation between economic growth and in¬equalities, the following basic model has been used:

$$I_t = \alpha_0 + \alpha_1 \log GDPpc_t + \alpha_2 (\log GDPpc_t)^2 + \varepsilon_t$$

for t=1,...,T, I_t is the income inequality at time t, which is expressed by the Gini coefficient. $GDPpc_t$ is the the logarithm of Gross Domestic Product per capita, and εt is the error term. The variable $(\log GDPpc_t)^2$ is intended to verify whether the change in income inequality follows an inverted U-shape. If α_1 is statistically significant and positive and α_2 is negative, it will suggest an inverted U-shaped path of income inequality over time. The model is based on the time series for the years 1985-2022. The obtained results are presented in Table 7.

Table 7: Economic growth and income inequality in China, Vietnam and Lao: results of estimation.

	Coefficient	Standard error	Student's t distribution	P value	Statistical significance at the 1% level
China					
const	−0,654278	0,0989835	−6,610	<0,0001	***
lnGDPpc	0,279107	0,0268268	10,40	<0,0001	***
$(\log GDPpc_t)^2$	−0,0159781	0,00177234	−9,015	<0,0001	***
R^2	0,946512		Adjusted R^2	0,943455	
Vietnam					
const	0,456288	0,0557396	8,186	<0,0001	***
lnGDPpc	0,0428805	0,0172390	2,487	0,0178	**
$(\log GDPpc_t)^2$	−0,00360448	0,00130310	−2,766	0,0090	***
R^2	0,366710		Adjusted R^2	0,330522	
Lao					
const	0,637194	0,0712484	8,943	<0,0001	***
lnGDPpc	−0,0229073	0,0219614	−1,043	0,3041	
$(\log GDPpc_t)^2$	0,00217689	0,00166295	1,309	0,1990	
R^2	0,454819		Adjusted R^2	0,423666	

Source: Author's own elaboration.

As mentioned previously, the parameters α_1 and α_2 should be statistically significant, and their values should comply with the following conditions $\alpha_1>0$ and $\alpha_2<0$ ($|\alpha_1|>|\alpha_2|$) in order to confirm the inverted U-shape relation hypothesis.

The obtained results indicate that in case of China and Vietnam such conditions have been fulfilled. In case of Lao results are not statistically significant. Also in case of Vietnam the R^2 value was rather low. Nevertheless in case of China and Vietnam the results confirm the assumption that the key factor determining the increase in the level of inequality was the uneven increase in income. This is not surprising, although it once again confirms that the fruits of economic growth have not been and are not evenly distributed throughout society. Other factors determining the level of inequality probably included the level of accumulated wealth and the level of human and social capital. The results suggest the existence of a Kuznets curve, but this relationship is weak and does not allow drawing clear conclusions.

A possible decline in inequality in China and Vietnam seems to be possible primarily through appropriate economic policy, especially increasing fiscal transfers to less developed areas and excluded groups. Therefore, the priority should be the development of education system, access to public services and social security, including financial assistance. Tax policy could potentially play a huge role by increasing tax regression in both income and wealth taxes.

5. Conclusions

Asian socalist countries, i.e. China, Vietnam and Lao have been experiencing a period of rapid economic growth since the implementation of market reforms and final abandonment of “pure” central planning. The rapid economic growth led to a significant increase in living standards and a sharp reduction in poverty.

The so-called Kuznets curve, despite the years, still remains one of the main tools used by researchers to analyze the relationship between economic development and inequality. Nevertheles there is no hard or empirical proof that an inverse-U relationship between inequality and development exists.

In this paper, relation between economic growth and income inequality level in China, Vietnam and Lao have been analyzed. The results generally support this relations except for Lao for which obtained result were not statistically significant. Also the R^2 coefficient is rather low in case of Vietnam.

The findings keep the door open to further analyses aimed at the identification and exploration of more significant determinants that could conclusively verify the relation between inequalities and economic development. Most promising would be incorporating some institutional determinants as it was proposed in Acemoglu and Robinson (2000; 2002) works.

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