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**“KUZNETS CURVE” AND CORRELATION BETWEEN WEALTH
AND POVERTY**

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Abstract

The relationship between wealth and poverty is a common issue both worldwide and in Russia. Many famous scientists have tried to explain the reasons why wealth distributes so unevenly and the gap between the poor and the rich is getting only wider. In this article, we have emphasized the scientific activity of Simon Kuznets. Although “Kuznets curve” has caused much discussion, tests and even rebuttals, it appeared to us that it could help to move forward in understanding possible changes in the relationship between wealth and poverty during market modernization in the countries of the former socialist bloc. We analyzed the “Kuznets curve” from a historical perspective and draw parallels with the current socio-economic situation in Russia. More than that the article describes “trickle-down economics” and considers the negative impact of excessively active redistribution of the government. The development of human capital has been mentioned in this paper as well as the role of education in the labor force. The article includes the opinion of the well-known economist Jan Tinbergen on the topic of skilled and unskilled workers. We have also clarified the influence of small businesses on the economy and their positive and negative qualities that can be discovered in the process of economic transformation.

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1. Introduction

The relationship between wealth and poverty had become a relevant problem both worldwide and in Russia. The improvement of material living conditions as a result of the free market economy development does not mean the benefits for all sectors of society. Wealth can be distributed very unevenly, and most of it can be concentrated in the upper strata of society. At the same time, the well-being of the lower strata may not increase and may even fall. As a result, the gap between the poor and the rich is going to get wider. This picture is very similar to what has been happening to Russian society for the last three decades since it embarked on a process of modernization the economy on a free-market basis. It seems to us that so called “Kuznets curve” can help people to move forward in understanding possible changes in the relationship between wealth and poverty during market modernization in the countries of the former socialist bloc. Kuznets, American economist and winner of the Nobel Prize for Economics, proposed the mentioned regularity in his statement to the members of the American Economic Association in 1955. The American economist established a statistical dependence, which was later called the “Kuznets curve”, based on the statistics of countries at various stages of industrialization and market economy development (Kuznets, 1955). According to this dependence, firstly inequality in income distribution dramatically increases during the process of “capitalist modernization” but then it tends to decline and sets at an almost constant level. This regularity is true not only for the developed countries but also for traditional ones that are getting in the way of modernization. “Kuznets curve” has caused much discussion, tests and even rebuttals (Berger, 1986; Decker, 1996; Tinbergen, 1975). It is therefore only logical as this regularity sheds light on several important economic, sociological and political problems. It is now widely regarded that Simon Kuznets’s dependence is well-established and has sufficient empirical confirmation from a historical perspective as well as from comparison the relationship between the modernization stages and the income distribution trends in different countries.

Before going further with the analysis, we would like to make an aside and talk briefly about Kuznets. Meanwhile, in Russia his scientific activities have not attracted sufficient attention, his name is widely known in world economic community, along with the name of another American economist of Russian origin –Leontief. However, Leontief’s (1986) scientific achievements are widely recognized, as his research papers have been published since the late 1950s and the basic principles of cross-sectoral analysis were used by domestic economists. Kuznets is rarely mentioned. There is still no appropriate number of translations into Russian of his classical works. At the same time, the fate of the scientist as well as the fate of his ideas is one of the striking examples of Russian and the world economic science's destiny in the XX century. Kuznets (1901-1985) was born in Pinsk, the county town of the Brest region in current Belarus. This is where he spent his school years. After entering the Faculty of Law of Kharkov University in 1918 Kuznets immersed himself in learning statistics and economics. For some time he worked in the Statistics Division of the Southern Bureau of the All-Russian Central Council of Trade Unions. He studied the development of wage forms of factory employees in Kharkov in his first article (Kuznets, 1921). Kuznets' scientific interest in the professional structure of income in a broader context emerged in the late 1940s.

It is worth mentioning that our former compatriot was well aware that the roots of his scientific interests go to the Russian economic and statistical school. Having moved to the United States, he wrote

about Russian economic science, reviewed and translated relatively unknown international level works of Kondratiev (1935), Slutsky (1937), Pervushin (1926), Weinstein (1925). Kuznets became known primarily for his research works about national income. He had set standards in macroeconomic statistics due to the depth and thoroughness of his works. He proposed a calculation methodology of the national product by three approaches – at production, distribution and consumption stages. And this helped Kuznets to revolutionize in a way economic statistic. The 1971 Nobel Prize in Economics was awarded to Kuznets for his work on economic growth. In this work he identified a new economic era, called by him “modern economic growth”. Specific empirical studies enabled Kuznets to outline the main elements of the overall concept of development. He showed that the “new type” of economic growth spread from the late XVIII century to the south and east from Western Europe, and reached Russia and Japan in the late XIX century. The indicator of such changes, according to the modern economist, was an increase in average per capita income, on average of 15% per decade, that was not seen in earlier historical periods.

2. Problem Statement

Kuznets' main scientific achievement is that his activities have made a very significant contribution to transforming the economy from sufficiently speculative and qualitative to empirical one. His writings also served as a model for further econometric research and quantitative economic history. It should be noted that the American economist has studied the income differentiation dynamics during the modernization in over 30 countries. And the transition to industrial capitalism has been accompanied by a sharp and sustained increase in inequality in all of them. The intensity and durability of the process varied from country to country, but the general pattern described above was widespread. In comparison, Kuznets studied the process from a historical perspective. He found that in the XIX century income inequality increased in all industrializing European countries. It was most visible in England and exceeded even the indicators that are observed nowadays in the “third world” countries. The income differentiation curve reached the peak in Europe at the turn of the XIX and XX centuries, there was a notable equalization of income in Western countries from 1920 to 1950, after that the situation has stabilized and has remained practically unchanged ever since.

3. Research Questions

The research questions for this paper were: What conclusion can be drawn from Kuznets' reasoning to assess our current situation? Why is there firstly an equalization of income and then its reduction? What are the main reasons for income inequality? What is understood by “trickle-down economics”? What is the impact of population education on economic growth? To what can redistributive State policies lead? What are the positive factors for small businesses?

4. Purpose of the Study

There are several purposes of this paper:

- to analyze the “Kuznets curve” from a historical perspective;
- to draw parallels between Kuznets' reasoning and the current socio-economic situation in Russia;

- to compare the relationship between the modernization stages and the income distribution trends in different countries;
- to study the role of small businesses in economic growth;
- to understand the positive and negative qualities of small businesses;
- to explore the relationship between education and the labor force.

5. Research Methods

Empirical and basic research methods were used in this work. Much attention has been given to qualitative methods. Qualitative methods include observations described in words and literature reviews exploring concepts and theories. With the help of these methods, we studied the economy of various countries by analyzing and synthesizing the past and current processes of modernization and liberalization. It is worth mentioning that qualitative analysis tends to be quite flexible and relies on the researchers' judgment. That is why we had to reflect carefully on our assumptions. This type of research enabled us to gather in-depth insights on the topic.

6. Findings

The modernization and liberalization of the economic and social system required paying a price. For example, the inevitable stratification of society by level of income and, as a result, the emergence of poor people layer. The period during which income differentials remain high cannot be too short and take decades. The usual explanation for the initial jump in income inequality is that it is a necessary precondition for output growth. This inequality favors the accumulation of capital, without which there can be no further economic recovery. That ultimately increases the incomes of all population segments, including the poorest ones (Sorochaikin & Sorochaikin, 2019).

To the question, why there is firstly the equalization of income and then a reduction in its differentials, neo-liberal economists respond that it is at the expense of market forces themselves and does not require special state intervention. In substantiation, they refer to the fact that the "Kuznets curve" takes into account mainly income received before tax payments and does not consider the various distribution measures of the government. The key is that economic growth should be sufficiently high and lasting. The resulting wealth is beginning to spread to all segments of society including the poorest ones. This vision was called "trickle-down economics", which means that the benefits of growth are gradually trickling down, and a wave of wealth ultimately raises the well-being of the poor. Several economists believe that the equalization of living standards is the result of technological and demographic changes, in which both the structure of the main industries and the available labor forces are changing. Thus, the well-known economist Tinbergen claimed that the most important cause of inequality is the existence of a pay gap between skilled and unskilled workers. If that is true, then the supply and demand for unskilled workers can be an important equalization factor, which applies as the transition from "saving labor" to "using labor" technologies (Tinbergen, 1975).

The reasons for the alignment are also related to the development of human capital. The improvement of labor force quality in society during the modernization process is primarily influenced by education improvement. Therefore, the supporters of this view say, the most appropriate policy for the

government is not the direct redistribution of income from the rich to the poor through high taxes but providing the lowest population strata with opportunities for education, access to quality health care and other social services related to the “quality of life” (Sorochaikin, 2005).

At the same time, economic liberalism proponents warn that excessively active redistributive state policy to equalize income and eliminate poverty can have the opposite effect. High taxes and strong state intervention in the economy reduce entrepreneurial initiative, negatively affect productivity and thereby block economic growth. As a result, the action of the “Kuznets effect” is delayed or may not occur at all. The emergence of “administrative capitalism” during economic modernization can be also called a barrier to the processes of “wealth trickling” and poverty elimination. This means that government officials are actively included in the business sphere and have better access to resources than the rest of population. They create local enclaves of the market economy, which monopolize economic life and exclude the majority of people from the benefits of economic growth. This situation is very common in many developing countries of the “third world”, this is also noticeable in post-socialist states, including Russia (Sorochaikin, 2011).

The role of small businesses in income equalization processes is sometimes highlighted but without sufficient clarity. In our view, this is a very important mechanism, so it is useful to specifically refer to it. World experience has shown that small businesses are of paramount importance for the success of the market system. If small businesses in the country are not developed, it reduces the flexibility of the economy and its sensitivity to innovation. Moreover, small enterprises have great social significance. Their representatives largely form the middle class and thus leave the lower strata of society. It is worth considering that any enterprise wishing to succeed in a modern competitive environment must work towards integration of economic efficiency, management and interpersonal culture. Nowadays attention to corporate culture and “corporate identity” indicates that there is a need for “cultivation” of the enterprise’s internal life beyond the production function (Sorochaikina, 2012).

Small businesses are discovering a number of important positive qualities in the process of economic transformation. They are characterized by considerable freedom and rapid adaptation to the changing conditions of the economy. Equally important is the fact that it also contains rather low costs related to the organization and conduct of business, which allows involving a wide range of individuals in entrepreneurship. Small businesses also make better use of local material and labor resources; therefore, they can be successfully developed away from industrial and financial centers. This enables to equalize the distribution of wealth across regions, which is essential for Russia (Sorochaikin, 2011). The government of Russia focused on the creation of large-scale industries during the Soviet period. As a result, monopolism was growing everywhere with all its negative consequences. In this respect, the role of small businesses in the transformation of the Russian economy is particularly important.

7. Conclusion

According to the regularity established based on the large empirical material by Kuznets, firstly the inequality of wealth dramatically increases, and then, assuming that economic growth is long-lasting and steady, begins to decrease. Finally, it reaches a relatively stable level that can vary from country to country. This is not so much due to redistributive state policies, but due to certain spontaneous mechanisms that help

to “trickle” wealth into the lower layers of society. It seems that the state can help to speed up the process by adding to it some effective measures, for example, by helping to educate the low-income citizens. The improvement of labor force quality is primarily influenced by education improvement. However, the excessively active redistribution, for instant, through high taxation of entrepreneurs can have a negative impact on economic growth. And as a result, it can lead to a drop in the average standard of living of all social strata, including the poor ones.

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