INEQUALITY & GROWTH : LET'S NOT LEAVE THE POOR BEHIND

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When a country's economy grows, there is potential for the growth to uplift all individuals in that economy. However, when economic growth is accompanied by inequality, it offsets the positive effects of growth and as a result the poor are left stuck at the bottom. This calls for sound policies which can emancipate the poorest quintile through achieving a kind of growth which also mitigates inequality. Income inequality among individuals of the world today is very high. Branko Milanovic finds that the global Gini coefficient is currently 0.62 (Milanovic, 2018), which is approximately the Gini coefficient of South Africa, the fourth most unequal country in the world (hdr.undp.org, 2018).

This astonishingly wide gap between the world's richest and poorest has existed for a while now. A broad quantitative historical view of world inequality is presented in, "Inequality Among World Citizens", 1820–1990 (Bourguignon and Morrisson, 2002). This seminal paper extends other work done in the field of inequality all the way back to the 1820's, and finds that income inequality has in fact worsened over time: the Gini coefficient has increased by 30% and the Theil index[1] has increased by 60% from the early nineteenth until the mid-twentieth century. In the late twentieth century, however, in "Inequality Convergence", Martin Ravallion (2003) finds another interesting phenomenon taking place: there has recently been a convergence in intra-country inequality among nations, but in the direction of a more "equal inequality", towards a Gini of 0.4. Most of this convergence was due to previously egalitarian nations becoming less so. Ravallion hypothesizes that the reason behind this could be the widespread transition to a more market-oriented economy, that is, policies across the globe started to become more and more similar around that time. But since the underlying conditions of these countries were different (in terms of endowments like skill, natural resources, etc), the policies did not reduce inequality much in the countries that were already very unequal, and had an adverse effect on inequality in countries that were egalitarian.

This is why it is a key for policy makers to study the complexity of the problem of inequality before deciding on policies to tackle it. Plus, such policies are imperative since inequality can hinder the development of nations through numerous channels. Firstly, an unequal income distribution denies poorer sections of the population access to basic necessities like healthcare and education. This in turn increases the number of unhealthy and under-skilled citizens in society, and ultimately it is the entire country that pays the price of slow economic growth. Secondly, an unequal society is more likely to be an unhappy society (Powdthavee and Neve, 2017), and therefore less motivated and productive (Oswald, Proto and Sgroi, 2015). In addition to this, as Richard Wilkinson's, "Unhealthy Societies, The Afflictions of Inequality", (Kawachi and Kennedy, 1997) explains, a wider income gap has been found to cause frustration, stress, and family disruption, which then increase the rates of crime, violence, and homicide.

One solution proposed to abate inequality was the Kuznet's inverted U-curve hypothesis. Perhaps the most popular model in the inequality literature, the U-curve predicts that innovations first benefit few individuals, and then trickle down to the masses (Banerjee, Bénabou and Mookherjee, 2011). This rather optimistic perspective of development implies that as developing countries grow; there will be a rise in inequality initially, which can be ignored because the benefits of growth will eventually trickle-down to the masses. However, this view has been widely contested. Thomas Piketty in ,"The Kuznets' Curve, Yesterday and Tomorrow", (Banerjee, Bénabou and Mookherjee, 2011) puts forward the argument that Kuznets misidentified the causes behind the fall in inequality in the first half of the 20th century. Apart from Kuznet's missing pieces of evidence (since his data ended in 1948, he could not consider the fact that inequality decline stopped from World War II onwards), he could not decompose inequality into labour-income and capital income components. Piketty posits that there is empirical evidence to confirm that in developed nations, during the years of great depression, inequality fell because of capital

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[1] The Theil index is an index similar to the Gini index, but it decomposes inequality into a within-region and across-region component.

income shocks, rather than due to increase in wage incomes of the poor; and shocks like wars are unlikely to occur to developing countries in the future, making the Kuznet's curve inapplicable to countries undergoing development currently.

On the other hand, Dollar and Kraay in, "Growth is Good for the Poor", (2002) provide evidence of the trickle-down effect on a global scale over the 1950-99 period. Upon measuring how the share of incomes accruing to the poorest quintile varies with average incomes, across a sample of 92 countries, they find that they cannot reject the null hypothesis that incomes of the poor rise equi-proportionately with average incomes. They conclude that poverty reducing strategies can be successful even if countries focus solely on growth of average income, because the trickle-down effect of growth will raise incomes of the poor along with rest of the society.

However, basing policy decisions on this conclusion alone may not always be advisable. As Ravallion, in "Growth, Inequality and Poverty: Looking Beyond Averages", (2001) explains, while designing policies it is important to look beyond averages for a variety of reasons. Firstly, cross-country correlations are complicated by data problems, and can hide welfare impacts. So conclusions from such data can be deceptive. Secondly, there is the issue of the effect of gainers and losers cancelling out, leading to the conclusion of "no effect"[2]. As Ravallion puts it, "people are often hurting behind averages" (Ravallion 2001). Another, more noteworthy reason why Dollar and Kraay found no systematic effects on the poor is the fact that starting conditions vary among developing countries, and averaging across them hides systematic effects. Using household survey data for the 1990's for around 50 developing countries, Ravallion tries to uncover the effect of growth on inequality, controlling for initial level of inequality. He finds a negative interaction effect between growth and initial inequality, implying that growth reduces high inequality, but increases inequality where it is initially low. So although growth oriented policies can provide opportunities for the poor, it can happen only if conditions are in place for them to take advantage of those opportunities. Only such growth may be considered "pro-poor". Evidence of pro-poor growth from countries across the world can shed light on what exactly these conditions are.

Ravallion and Datt in, "Why has Economic Growth been more Pro-Poor in Some States of India than Others", (2001) examine pro-poor growth in India and try to determine how much initial conditions really matter when it comes to the differing poverty-reducing impacts of economic growth between states. They first regress growth (measured by the indicators: higher farm yields, higher state development spending, higher urban-and-rural non-farm output and lower inflation) on poverty, and find all of the measures to be poverty reducing in all states. However, the elasticity of poverty[3] to non-farm output varied significantly across states. For example, in West Bengal, a 1% reduction in the headcount index increased non-farm output by 1.24%, while in Bihar it increased output by only 0.26%. They find that the reason for this disparity is the difference in initial conditions across states. Non-farm growth is more pro-poor in states with higher initial farm yields, higher initial female literacy rates, lower infant mortality, lower urban– rural disparities in consumption levels and lower initial landlessness. Literacy rates seemed to be especially important: using simulations, the authors show how if Bihar had Kerala's literacy rate, then the elasticity of the headcount index to non-farm output per person in Bihar would have risen about three-fold, from 0.26% to 0.79%. Therefore policy makers must focus on rural and human resource development and a more egalitarian distribution of land in order to achieve growth that especially benefits the poor. Case studies from Indonesia and Vietnam also support this claim.

P.C. Timmer in, "The Road to Pro-Poor Growth: The Indonesian Experience in Regional Perspective", (2008), analyses Indonesia's growth in the second half of the twentieth century. Since the mid-1960's, the Indonesian government developed a strategy for economic growth with a strong focus on connecting the poor to economic growth. Their pro-poor strategy included three basic levels. First, there was lowering of transactions costs in the economy (especially between rural and urban areas) through government investment in infrastructure - roads, communications networks, market infrastructure and ports, and irrigation and water systems. Lower transaction costs meant easier access for the poor to markets, thereby connecting them to economic growth. Secondly, these were built as labour-intensive public works, which made millions of jobs available to unskilled labourers. Thirdly, investments in human capital— education, public health clinics and family planning centres— further helped connect the poor to economic growth. As a result of these efforts, growth in Indonesia was both rapid and pro-poor. Between 1987 and 1990, the average growth per capita was 5.7% per year and at the same time, incomes of the

[2] He gives the example of the Russian financial crisis: panel data on household surveys reveal a small increase in the poverty rate of 2%, however this was the result of a large portion of the population falling into poverty and a slightly smaller fraction escaping poverty over the period of the study.

[3] The measures of poverty considered by the authors are: headcount index, poverty gap index, and squared poverty gap index.

bottom quintile grew by 10.8% per year.

While Indonesia focused on the rural and human resource development aspect of pro-poor growth, they stressed little on land redistribution[4]. In Vietnam however, land redistribution was seen to have resulted pro-poor growth, as found in, "Pro-Poor Growth: Concepts and Measurement with Country Case Studies", (Kakwani and Son, 2003). Vietnam's agricultural sector during the late 1980's accounted for roughly 40% of GDP and 70% of total employment. Reforms in this sector around this time focused on dismantling of collective farms and the redistribution of land to peasant households through long-term leases. Growth in this period was pro-poor because it was accompanied by a reduction of inequality, the rural Gini coefficient declined to 26.42% in 1997-98, from 28.86% in 1992-93. In conclusion, while studying solutions to the problem of inequality it is important to keep in mind the averages, but at the same time one must not forget that there is movement behind these averages. Initial conditions (in terms of human and rural resources and land distribution) vary across nations, which is why policies targeted at growth attenuate inequality in some countries and exacerbate it in others. There are also initial conditions other than the ones studied in this paper, such as inclusive institutions, access to credit, etc., which possibly matter just as much in determining the poor's access to growth. There is a need for further in-depth research, at the country level, in order to find the perfect blend of growth enhancing policies which uplift the poor, rather than leave them behind.

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[4] Timmer says this was because during 1966-67, around 80% of Indonesia was in absolute poverty, and there was effectively nothing to redistribute.