Rising Inequality: Global Experiences and Policy Lessons

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Introduction (1)

Has the concern over income inequality increased in the last ten years?

- Increased a lot: 0.7%
- Increased: 13.0%
- Stayed the same: 26.3%
- Decreased: 2.9%
- Decreased a lot: 57.1%
Would you agree with the statement that higher income inequality is acceptable so long as poverty is declining?

- Strongly agree: 46.3%
- Agree: 37.2%
- Disagree: 6.2%
- Strongly disagree: 5.5%
- Don't know: 4.8%
How important do you think it is to have policies in place to prevent rises in inequality in order to maintain stability and sustain growth in your country?

- Very important: 57.0%
- Important: 38.1%
- Not important: 1.9%
- Not important at all: 0.5%
- Don't know: 2.4%
Introduction (4)

• These results are from a survey of Asian policy makers.
• To gauge the extent of the rising concerns over inequality among Asian policy makers, ADB carried out a web-based survey.
• The survey targeted officials of ministries of finance, planning authorities and other government agencies, and lawmaking officials in developing member countries (DMCs) of the Asian Development Bank (ADB).
• The results cover 504 respondents from key government agencies of 25 Asian developing countries.
Introduction (5)

• So, what’s going on in Asia?
• Answer: Inequality is rising. 83% of Asia’s population live in countries with rising inequality. Not just China and India. Other countries like Bangladesh, Sri Lanka, Korea, Viet Nam etc.
Introduction (6)

• Inequality is rising in other parts of the world, too.
• BUT, in some parts of the world it is falling.
Introduction (7)
Introduction (8)

• The object of this talk—to give a narrative of inequality evolution through eight case studies from around the world.

• Draw lessons from the commonalities and from the particularities of the experiences.

• No more numbers! Method used will be that of a narrative. Details in referenced papers.
Some Basic Analytics (1): Assets and Returns

- Income can be thought of assets times rates of return on assets:
  - Physical capital
  - Labor and Human Capital
- Inequality in income is then a combination of inequality of assets and inequality of rates of returns to assets
  - Example, wage income inequality; education inequality and education premium (or skill premium)
Some Basic Analytics (2): Structural Inequalities and Market Outcomes

- Initial conditions and structural inequalities in physical and human assets.
- Interaction with market processes—rates of return on physical and human assets.
- Market Outcomes.
- Government intervention and redistribution.
- Next generation of structural inequalities.
Some Basic Analytics (3): Why Does Inequality Matter?

• Inequality matters directly in the social objective function.
• Only poverty matters, but high inequality means high poverty.
• Inequality matters because it is detrimental to stability, investment and growth.
Some Basic Analytics (4): Mean, Inequality and Poverty
Some Basic Analytics(4) Contd.

• Mean $\uparrow$ and Inequality $\leftrightarrow$
  – Poverty $\downarrow$

• Mean $\leftrightarrow$ and Inequality $\uparrow$
  – Poverty $\uparrow$

• Mean $\uparrow$ and Inequality $\downarrow$
  – Poverty $\downarrow$ (East Asia in 1960s and 19070s)

• Mean $\downarrow$ and Inequality $\uparrow$
  – Poverty $\uparrow$ (East Europe in 1990s)

• Mean $\uparrow$ and Inequality $\uparrow$
  – Poverty $\uparrow$ (Asia in 1990s and 2000s).
Some Basic Analytics (5): Group Inequality

- Inequality between persons, interpersonal inequality, is the dominant perspective on inequality in economics.
- But in policy and political domains another perspective is very important—inequality between groups:
  - Provinces/states/regions
  - Caste
  - Ethnicity
  - Religion
  - Language
Eight Country Studies (1)

• South Korea (and Taiwan) in the 1960s and 1970s: The “Growth with Equity Miracle.”
• Work of Irma Adelman and others. Interaction of initial conditions with pattern and nature of global integration.
• Initial conditions:
  – Land redistribution imposed by occupying American forces.
  – Wide spread of basic education in the 1940s and 1950s
• Combined with exports of light manufactures which increased demand for basic educated labor.
• Consequence: Growth with Equity.
Eight Country Studies (2)

- Eastern Europe and Russia in the decade or so after the fall of the Berlin Wall.
- A distributional catastrophe. Fall in mean, rise in inequality, rise in poverty (fall in life expectancy etc etc). Why?
- Botched privatizations; driven by ideology; created huge inequalities (Russian oligarchs etc). Initial conditions for the next generation—contrast with East Asia land redistribution in the 1940s!
Eight Country Studies (3)

• USA in 1940s-1970s
  – Approximating a closed economy
  – Expansion of high school and college education; narrowing gap between more educated and less educated labor; this wins the race with skilled bias technical progress; narrowing wage premium; lower market inequality; progressive tax and transfers. Net result, declining inequality-the “great compression.”

• USA since the 1980s
  – Much greater openness; competition from cheap labor, downward pressure on unskilled wages.
  – Acceleration of skill biased technical progress.
  – Stalling of reduced inequality in education.
  – Combined effect, increasing market inequality.
  – Further, reduction in progressivity of tax and transfer systems.

• Importance of skilled biased technical progress for rest of the world.
Eight Country Studies (4)

• East Asia in the 1990s and 2000s—growth and poverty reduction (except for crises), but sharply rising inequality.
• For Asia as a whole, 83% of population live in countries with rising inequality and growth had been distribution neutral, 240 million MORE would have been lifted out of poverty.
• Why the increase in inequality? Some explanatory power in urbanization (some way to go still in some countries). But a major explanation is the growing gap between returns to skilled and unskilled labor, and between capital and labor. In other words, skilled labor and capital biased technical progress that is being imported from the global trend.
• The policy implications of this will be taken up later in the talk.
Eight Country Studies (5)

- Ghana in 1990s and 2000s. Growth, falling poverty, but rising inequality.
- In particular, inequality between north and south—politically explosive.
- Issue has become sharper with discovery of oil in the south.
- Government is well aware of these divides and tensions and has regional balance as one of its key policies. Perhaps not efficient in the traditional economic sense, but it has kept the peace and avoided civil war (unlike in neighboring countries).
- So structural divides other than simple ones of capital/labor or skilled/unskilled workers are sometimes crucial.
Eight Country Studies (6)

• South Africa. Strong spatial pattern to racial apartheid. Townships and location of industry. Also, strong racial patterns to spatial provision—health and education etc.

• Post apartheid—equalization of racial inequalities in health, education and housing. BUT rising income inequality, with high unemployment among blacks, especially in the townships.

• Two hypotheses on high levels of unemployment—labor market rigidities and spatial pattern of infrastructure. Both are difficult to address, for different reasons.
Eight Country Studies (7)

• China. Distributional facts are well known. Remarkable growth, remarkable poverty reduction, but also remarkable rise in inequality. The Gini coefficient rose from 32% to 42% from the 1990s to the 2000s.

• But spatial inequality, inequality between rural-urban and between provinces, also rose, particularly from the 1990s onwards.

• In the early 2000s the government changed tack and began a massive investment program in lagging areas. Some effects are now showing through.

• Chinese government’s responses in the 2000s are consistent with Berkeley historian Bin Wong’s assessment of the “DNA” of Chinese policy making over the very long run. Perhaps the 25 years after 1978 were the exception!
Eight Country Studies (8)

- Latin America from the late 1990s onwards. From being a poster child for growth with inequity in the 1960s and 1970s,” and after the “lost decade” of the 1980s, the late 1990s and especially 2000s have seen a strong pattern of growth with equity in the major Latin American economies—Brazil, Mexico, Argentina, Chile etc.
- In Brazil for example, to achieve the same degree of poverty reduction without the decrease in inequality would have taken a growth rate of 4 percentage points higher.
- What explains the fall in inequality? Country specific explanations, of course. BUT, some of it is fall in education (skill inequality), some of it is fall in skill premium, some of it is redistribution of market incomes with tax and transfers.
- Central role of conditional cash transfers (CCTs). Started in Mexico in the mid 1990s (Progressa-Oportunidades) and have now spread across Latin America eg Bolsa Famila in Brazil. They are large, expenditure accounts for several percentage points of GDP. Rigorous evaluations have shown them to be effective in raising education levels, thus holding down the wage premium from the demand side.
Implications for Asia (1)

• Structural inequalities, and how they interact with the current market processes, matter.

• Throughout the world, a major global force is technical progress that is raising the returns to capital and to skilled labor. This is now and will be a major driving force of rising inequality of market outcomes in Asia and elsewhere. Thus the key structural inequality is in the ownership of physical and human capital.

• There are other structural inequalities, of course, but this factor seems to run across all or most countries.
Implications for Asia (2)

• It would be unwise and in any case probably infeasible to switch off the technical change tap which is giving us both unprecedented growth and unprecedented inequality.

• If inequality is a concern, then, an appropriate response is to work vigorously to equalize the distribution of human capital and physical capital, and also to do some redistribution of the market outcomes through tax and transfers.
Implications for Asia (3)

• In this context, the success of CCTs in Latin America must hold important lessons for Asian policy makers.

• At the same time, CCTs must be paid for in a fiscally prudent manner. For this reason, policy makers should consider a range of instruments depending on country level feasibility, including taxation of incomes from large holdings of land and capital.
Conclusion (1)

• Asia is no longer the home of Growth with Equity. In the last two decades, growth has come with rising inequality.
• Policy makers, and populations, seem to be concerned about this rising inequality.
• Global experience on inequality is varied, but there are common threads.
• In a nutshell, the basic lesson is that current structural inequalities interact with market forces to determine inequality of outcomes which can then become the structural inequalities of the next generation.
Conclusion (2)

• Addressing structural inequalities requires purposive action. Experience shows that it can be done, as shown by the experience of East Asia in the 1940s and 1950s, and by Latin America in the 1990s and 2000s. Experience also shows that structural inequalities can just as easily be created, as in East Europe in the 1990s and in apartheid South Africa.

• If Asia in general, and East Asia in particular is to avoid crystallizing inequalities for a generation, it will need purposive policy action to build up physical and human capital in lagging individuals and lagging groups and regions. CCTs are only one possible instrument to achieve this objective, but they deserve a closer scrutiny by Asian policy makers, along with more general instruments of taxation and expenditure.
• Thank You!