Growing inequality as we grow economically?

By Lilli Loveday

'Extreme disparities in income are slowing the pace of poverty reduction and hampering the development of broad-based economic growth.'

Kofi Annan, Africa Progress Panel, 2012

The issue of inequality is on the table – for all the wrong reasons. As the body of evidence pointing to the increasing gap between the world's richest and the world's poorest grows, along with evidence highlighting the negative ramifications, both socially and economically, of high levels of inequality, so too does the need to question the idea that economic growth will bring shared prosperity.

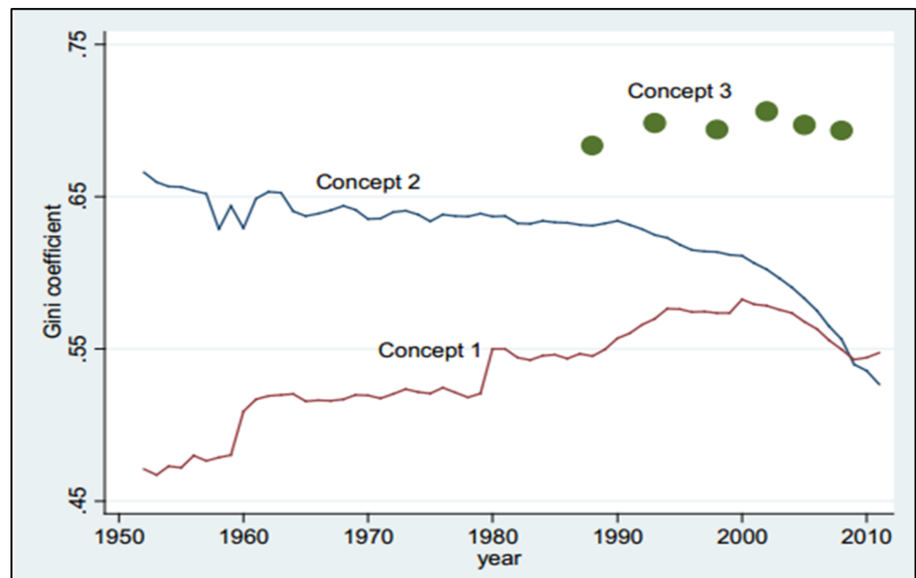
At Mokoro's Quarterly Meeting (QM) in January, consultants and staff gathered to discuss the problems and drivers of inequality, as well as to add their perspective to the debate on possible solutions. This article brings an overview of the issue, prepared by Lilli Loveday, and a series of opinion pieces from Kit Nicholson, Bev Jones, Ray Purcell and Adam Leach.

The scale of inequality is shocking. Globally, we are experiencing the highest levels of relative and absolute inequality at any point in history. Figures indicate that the world's 85 richest people own the same wealth as the 3.5 billion poorest people and that the top 1 per cent of the world's population have 65 times the wealth of the bottom 50 per cent of the population. Economic growth has not been distributionally neutral, with the proportion of 'additional' global GDP going to the poorest 20 per cent of the population declining from 0.9 per cent to 0.7 per cent between 1999 and 2010 (UNCTAD, 2013). In other words, during that period for every $100 dollars of global income, only 70 cents went to the poorest quintile. Meanwhile, during a time of global financial crisis, the number of billionaires has increased by almost a third (from 8.5 million to 12 million). The problem does not only exist between developed and developing countries, it is also increasingly apparent within countries (and notably within developed countries). Between 2007 and 2010, OECD countries saw a greater rise in inequality than in the previous 12 years and it is estimated that almost one in ten working households across Europe are living in poverty. Inequality in Britain has recently come under scrutiny from Oxfam. At a time when over 500,000 people in Britain are believed to be reliant on food banks, it is entirely unsavoury and uncomfortable to learn that the single richest Brit is reported to own the same wealth as the bottom 10 per cent of the UK population (6.8 million people).

Despite growing consensus that inequality is an issue, it has taken time for the debate to catch up with the scale and urgency of the problem. At the recent World Economic Forum in Davos, rising income inequality was tipped as being amongst the biggest risks for the coming decade. But this is in sharp contrast to statements made just over a decade ago. The 2000 World Development Report stated that rising inequality should 'not be seen as negative', so long as incomes at the bottom did not fall and the number of people in poverty did not rise. As such, halving the number of people living in extreme poverty (defined as anyone living below the conventional poverty line of $1.25/day) has been the focus of the development agenda for the past 14 years. But $1.25/day is a low and unambitious standard and with inequality soaring, many of the world's poorest face more challenges than ever before.

How inequality is measured is significant and the trend identified is dependent on various factors including the measure of inequality (e.g. Gini coefficient / Palma Index / Thiel Index); the unit of inequality (countries weighted equally or by population / individuals weighted equally); the income conversion rate used (purchasing power parity / market exchange rate); and the source of data (household income surveys / national income accounts). In a paper on the history of global income inequality, Branko Milanovic discusses three concepts of inequality:

Note. The Gini coefficient measures deviation of income or consumption among individuals or households within an economy from a perfectly equal distribution (represented as 0). An index of 1 represents perfect inequality.



Source: Milanovic, 2012, p.6

Concept 1) un-weighted international inequality, measured by inequality in per capita incomes amongst countries in the world;

Concept 2) population-weighted international inequality (between-country inequality), measured by per capita income per person against their place of residence;

Concept 3) global interpersonal inequality, measured by calculating difference between actual individual incomes.

The distinctions are significant as the graph above highlights. Measured by concept 1, international inequality has increased between 1950 and 2010. However, measured by concept 2, the world appears to have become a more equal place. But concept 2 not only ignores within-country inequality, it is also skewed by the inclusion of China (and, more recently, India). China's large population and rapid growth have offset slow growth elsewhere, thus distorting the figures. Measured by concept 3, where individual incomes are taken into account, there is a much higher overall level of inequality with a global Gini coefficient of around 0.70. However, lack of data from the poorest countries distorts the Gini coefficient down meaning that the true extent of global inequality may not be captured fully. This may explain the slight drop observed in the trend (which Milanovic describes as 'a tiny drop, a kink' (page 8)).

The associated issues of inequality are great, not least as a moral and ethical injustice. In an interconnected world, where we have greater dependence on nations, as well as greater awareness of 'the other' (including of the 'haves' and the 'have nots'), inequality impacts not only on financial and political stability but also on social stability. Furthermore, evidence indicates that no country has transited beyond middle-income status while maintaining high inequality, demonstrating how inequality inhibits development efforts. Recent reports by Oxfam highlight that economic inequality, if not addressed, could cost an additional $300bn in bringing an end to poverty. And, if inequality is accompanied by lack of publicly funded health and education services, there is an increased risk to people's lives – especially the poorest – and exacerbation of social inequalities (such as gendered divisions in access to education) because these services becomes completely unaffordable. In a TED Talk, 'How economic inequality harms societies', Richard Wilkinson (author of The Spirit Level) draws attention to the 'divisive and socially corrosive' impacts of inequality. Focusing on the significance of within-country inequality, Wilkinson indicates that in countries where there is a greater level of inequality life expectancy rates are lower; there is worse social mobility and higher rates of homicide. Inequality brings higher rates of mental health problems and lower levels of trust, with Wilkinson referring to the psycho-social impacts of inequality – of feeling valued or de-valued, superior or inferior and secure or insecure. But as both Wilkinson and Oxfam point out, inequality isn't just bad for the poorest in society (although arguably, its effects are felt most amongst this group), it affects everybody negatively – including the rich.

Addressing the issue is complex. Some argue that there should be a redistribution of wealth – with Oxfam claiming, for example, that if the income share of the richest quintile were to be reduced by just 1 per cent, an estimated 90,000 infants' lives would be saved each year. The Brookings Institute further supports the potential of redistribution, indicating that it would only take a 0.25 per cent reduction of the top 10 per cent's income to lift 154 million people from poverty over the next 10 years. Others promote economic growth and argue that if global inequality is primarily between populations in rich and poor countries, remedies should be focused on getting poor countries to grow faster. Milanovic makes a claim for increased migration and the need to 'facilitate immigration in rich countries'. Other possible solutions include, improving taxation and the international tax system, ensuring delivery of free public services and devising progressive taxes for companies and individuals.

But for those who argue that inequality, instability and lack of cohesion are the mutually reinforcing by-products of finance-led globalisation, a far more drastic restructuring of the underlying economic system is called for.

Kit Nicholson *is an Economist and Principal Consultant with Mokoro, with expertise covering economics, agriculture and climate change. Kit's recent work includes preparing Indonesia's strategy for green planning and budgeting.*

Thanks to Lilli for capturing the essence of the problem and some of the wide range of issues discussed at the QM in January. The scale of inequality is, indeed, truly shocking. But what is even more shocking is that it is getting worse in many countries.

People talk about progressive tax regimes and social policies for redistributing wealth and providing social services to the poor. But this deals mainly with the symptoms and not the cause. It seems to me that the problem lies deep at the heart of our economic system, as Lilli hints in her concluding sentence. It lies in the fact that ownership of the means of production is becoming ever more concentrated, affecting capital, property, land and companies, which are not quite the same thing as capital.

History tells us clearly that revolutionary distribution of wealth is not effective. But I think Corporate Social Responsibility (CSR) offers some hope as a radical but voluntary approach, based on a company's reliance on customer loyalty. CSR is still a bit of a messy catch-all, covering issues ranging from water use to greenhouse gas emissions to relations with doubtful political regimes. There are great risks that CSR could be undermined if it is broadened too much and expected to cover a huge range of worthy but unrealistic causes. But I believe it should be possible to build on the existing progress in using CSR to expose exploitative pay and working conditions. What is needed is the emergence of some sort of consensus across society on acceptable norms on wage spreads and on the diversity of corporate ownership. This needs public debate and it may also require some changes in corporate law. I think this may happen slowly, by itself, but it would be greatly helped by courageous government support and leadership.

Bev Jones *is a Social Accountability and Governance expert. She is team leader for the design and start-up of a five-year, multi-donor, demand-side Civil Society Support Programme in Ethiopia and recently wrote a brief on equitable service delivery for the Government of Ethiopia.*

The article rightly acknowledges the complexity of addressing equity within countries, and cites the argument, among others, for some form of redistribution of wealth. But does increasing money for the bottom quintiles always close the gap? Can it, in some instances, lift some of the existing excluded group out of poverty and powerlessness, while pushing the remaining women, men and children into deeper exclusion?

An interesting dilemma appears to have occurred in the Ethiopian context. A recent World Bank study shows that the Government is indeed underpinning its policy commitment to broad and even development with resources to match – favouring the bottom two quintiles. These investments are leading to more service outputs in health and education, and clear benefits for more, poorer people. Yet, at the same time, some of the hardest to reach women, men and children are finding it even harder to access the services that they need. For them, the gap is growing rather than closing. This appears to be because services provided tend to follow models that work for the majority of the population; they are insufficiently customised to the diverse needs of individuals who, for one or more reasons, cannot access mainstream services. For example, children of gold-mining families need schools which accommodate the role that the children play in supporting the livelihoods of their parents. Informal prejudices in the civil service about the capabilities of women, occupational caste or disabled people affect access to services. Proper customisation and fair implementation therefore relies upon much deeper understanding about how the most marginalised people see the world, and how they make decisions and how their agency is affected by informal rules.

This dilemma for Ethiopia is an entirely normal position to have reached in a country's quest for equitable services: the broad base needs to come first to establish the service delivery architecture. However, if there is reluctance to go the extra mile to customise services for the hardest to reach people, it is likely that the low take-up by the poorest will lead decision-makers (and perhaps also tax payers) to question the value of investing resources in the bottom quintile. This feeds the idea that the very poorest are worthy only of welfare hand outs, and charity. For these reasons then, wealth redistribution alone is not enough.

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For a development specialist with an Africa bias, the recent focus on increasing global (especially income) inequality is a depressing counter to the goodish economic news of the last decade. During 2000–10, six African countries were amongst the top ten global fastest GDP growers and progress was made on the MDGs. But now it seems I have spent my professional life in vain!?!

The current debate highlights global trends and impacts rather than dynamics and causalities. In terms of our ability to have an impact through our professional work, the dynamics and causalities at the country level are of most interest to me. To find solutions, we need to move towards a better understanding of the interactions and attributions of increased inequality. These are quite hard to find in the literature. The OECD provides some depth but its analysis is restricted to the 30 or so advanced OECD economies, and is somewhat inconclusive on both drivers (globalisation, technology, policy and regulation) and solutions. Milanovic, who has been a recent prompter of the inequality discourse in the last decade, touches on causalities and solutions to global inequality in recent work but only in his conclusions section (see Milanovic, 2012).

The seminal work on inequality by Kuznets was able to convey the dynamic he observed in the 1950s (mainly based on South American data) in terms of labour market fundamentals. This ascribed income gains by the skilled in the early stages of development to scarce skills-based technological change. This was followed by catch-up by larger sections of the population as political institutions and the economy matured, and democratisation and social welfare allowed for the redistributive trickle down of benefits from rapid growth. Empirically this has not stood up well to the test of time, but at least there was an attempt to probe and explain the causal logics, something lacking in the recent more polemic style literature.

Future efforts at causal inequality analysis at the country level need to differentiate between rich and poor countries and successful and failing experiences at different stages of development, and between the "before" and "after" scenarios around the 2007–08 global financial crisis. Ultimately, what we want is achievable solutions based on an understanding of the problems, dynamics and interactions.

To take up Lilli's pointer to the restructuring of the "underlying economic system", what and how should this be done? Radical transformation of economic systems historically is associated with political revolution and popular uprising e.g. in the 20th century through the Bolshevik revolution and the introduction of communism, and 70 years later in the more gentle flower and colour counter-revolutions marking the breakup of the Soviet Union.

And now into dangerous territory. Most modern economic change at the global and country levels has been fairly non-radical, associated with gradualism and incrementalism, e.g. the shift from Keynesianism to monetarism and free markets, took place over several decades from the 1960s; morphing, in a developing country context, into the discredited liberalisation and structural adjustment of the Washington Consensus. And now in developed countries we have shifts at the margin through austerism to who knows what! But it's all pretty gradual.

Currently in the UK, the political debate is not of pre-distribution (a radical solution based on confronting political and economic power structures) or even of redistribution. The political oppositions emphasise a cost of living crisis or an immigration crisis, not an inequality crisis. Even these don't seem to have huge traction, maybe because they have been sussed out as pre-electioneering. Despite the income and employment deprivations caused by the financial crisis, all political parties seem to see the social welfare system, a main tool in recent decades of addressing inequality, as a means to incentivising people to get back into work rather than as the traditional redistribution mechanism.

Spurred on by the media, bankers' millions have come in for a clobbering, but there is little public outcry about the obscenity of payments made to the new gods of popular culture, the leaders of IT and finance, entrepreneurs, pop stars etc. The Premier League – where average weekly salaries are around £15k reaching £300k for the Rooneys (I kid you not – per week) – causes little consternation. I feel for the players with a short shelf-life in my community-owned team on £30–40k per year. But they appear to be grateful for the psychic income of having a job, a wage and, if they are lucky, doing what they enjoy. This probably goes for the squeezed many in general.

Just thinkin'.

Adam Leach is Chief Executive of Y Care International, which works with YMCAs and other youth focused organisations to empower young people with skills for work and enterprise development.

Inequality is now recognised as a serious problem with damaging effects for all, especially the poorest. The Mokoro review is a helpful summary and provides crucial, accessible analysis of the critical global aspects of inequality, distribution and conditions for sustainable growth. These are causes – or should be – for prevailing concern amongst all politicians, economists, corporates, and social agents.

In an increasingly unequal world, preoccupation with aggregate analysis that does not recognise the disempowerment of more than a third of the world's most vulnerable people will, at the very least, make the problems more complex.

The most meaningful – and revealing – measure of inequality, described by Milanovic is the hardest to assess but emphasises that there is a major, urgent, and growing problem. Yet, the lasting well-being of the majority of people is buried beneath aggregates, such as per capita GDP. Given its importance and impact the analysis of inequality needs more demographic depth. With 1.2 billion people under the age of 25 years, we face the largest cohort of young people in modern history; 90 per cent of this cohort live in poorer countries, nearly 50 per cent of whom live on less than US$ 2 per day. This youth bulge presents massive challenges for employment, inclusion, and recognition. Each year, there are now some 11 million new entrants to the job market in Africa alone.

With this additional complexity, analysis must not replace vital action. Like many seemingly intractable issues that beset decision-makers and practitioners, hope of change demands action over time, on multiple levels, from many actors. Structural, 'root-and-branch' solutions are likely to take too long. Multiple, concerted, 'both and' approaches are now imperative – not single, partial, 'magic bullet' solutions.

Recognising that sustainability is most likely in more equal societies, policy must focus on a combination of tax on capital wealth (the source of gross social polarisation) and incentives for those with wealth to invest in (and give to) social change and transformation.

Recognising that sustainability, however, is impeded by so large a preponderance of vulnerable and disempowered young people aged 15–24, action must focus on empowering this group, including those who are most vulnerable. Empowerment means access to assets, opportunity for economic productivity, social responsibility and involvement in the political processes that govern their lives. Attention to the individual productive, social, and personal capabilities of young people is needed at policy and practice levels. Local initiatives that deliver technical, psycho-social, and economic solutions and thereby bring greater income and social equality are needed to underpin and secure advances in equality.

The resulting impact on inequality could be very different – if young people really were given the chance.