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Inequality in Emerging Countries: Trends, Interpretations, and Implications for Development and Poverty Reduction

While the other contributions in this Forum have focused on inequality and its consequences in Europe, it is important to also take a wider perspective and examine how inequality trends and their impacts are developing in other parts of the world. This contribution will focus on the three emerging economies Brazil, India and China (the BIC in the often-used BRIC grouping) whose rapid economic development over the past two decades has also led to a sharply rising prominence of these countries in global economic and political affairs. I will first briefly describe trends in (income) inequality in these three countries and briefly comment on the determinants of these trends. I will also specifically examine the link between this inequality and overall development and poverty reduction in these countries to ask whether (rising) inequality has helped promote development or poverty reduction. My central arguments are four: First, although income inequality has increased in many developing countries including these three in the 1980s and 1990s, the considerable decline in inequality in Brazil since the mid-1990s shows that there is nothing inevitable about these trends. Second, the countries show that there is considerable scope for policy to successfully affect inequality trends. Third, the rise in inequality has a strong negative welfare impact and poses threats to future well-being and social cohesion. Lastly, the preponderance of evidence suggests that rising inequality has had a neutral or negative impact on economic growth, and a sharply negative impact on (absolute) poverty reduction. In sum, rising inequality is preventable, and doing so would not necessarily harm growth, but help with poverty reduction.

Inequality Trends in Developing Countries and the BIC

After a long period of stability with a very slight declining trend in the 1970s, inequality in developing countries started to show an upward trend in many countries in the early 1980s.[1] The major reasons appear to have been increasing regional inequality in many countries, rising returns to education, inequality-enhancing policy reforms and the failure in many countries to develop the lagging agricultural sector, in which the majority of the poor are (still) to be found. The countries of focus here, India, China, and Brazil, fit nicely into this overall trend. As shown in Figure 1, inequality has risen very strongly in China (from a very low level), considerably in India (from a moderate level), and moderately in Brazil (from a very high level) since the 1980s. As shown in many studies,[2] the rise in inequality in China is, to a large extent, due to the rise in inequality between urban and rural areas, linked partly to rising inter-provincial inequality and to China's progressive integration into the world economy. Also in India, the inequality increase was driven by faster than average growth in the richer states and rising rural-urban disparities.[3] In Brazil, the rise in inequality in the 1980s was driven more by rising educational inequality and the anti-poor bias of high inflation.[4]

But while inequality continues to show an upward trend in China, and increasingly so in India, we see a significant decline in inequality since the mid-1990s in Brazil, to levels that prevailed in the early 1980s. While Figure 1 clearly shows that Brazil's inequality, despite this decline, is still much larger than that in China or India, a reduction of the Gini coefficient by 5 points (from about 0.62 to about 0.57) very rarely happened anywhere in the developing world between 1960 and 1990. A similar pace of decline could be observed in the industrialised countries between 1920 and 1960, where inequality fell significantly over a very long time-horizon, reaching the Gini coefficients in the low 30s that characterised Europe in the 1960s and 1970s. While Brazil is particularly noteworthy for this decline, mainly because it started relatively early and was sustained over a rather long time-period, we now have ev-

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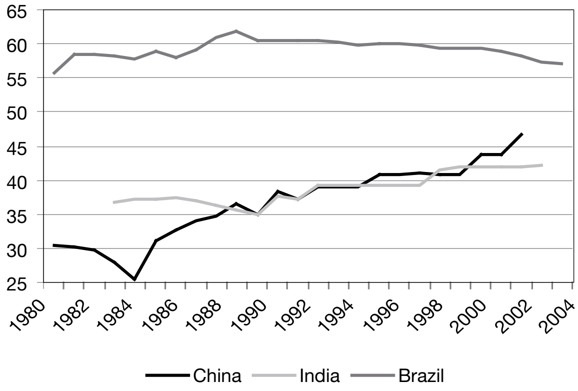
[1] C. Gruen, S. Klasen: Growth, inequality and well-being in transition countries, in: Economics of Transition, Vol. 9, 2001, pp. 359-394.

[2] For example, G. Wan: Understanding regional poverty and inequality trends in China: Methodological issues and empirical findings, in: Review of Income and Wealth, Vol. 53, No. 1, 2007, pp. 25-34.

[3] G. Datt, M. Ravallion: Is India's Economic Growth leaving the Poor behind?, in: Journal of Economic Perspectives, Vol. 16, 2002, pp. 89-108.

[4] F. Ferreira, P. Leite, J. Litchfield: The rise and fall of Brazilian inequality, 1981-2004, in: World Bank Policy Research Working Paper No. 3867, 2006.

Figure 1
Gini Coefficients for China, India, and Brazil, 1980-2005



Note: These Gini coefficients (multiplied by 100) are drawn from the WIDER World Income Inequality Database, usually drawing on the same source (where possible) and adjusting for differences in the income concept using the approach of Gruen and Klasen; cf. C. Gruen, S. Klasen: Growth, inequality and well-being in transition countries, in: Economics of Transition, Vol. 9, 2001, pp. 359-394; the figures here have been standardised to gross income per person. Where there were gaps in the series (as is particularly the case in India and China for some years in the 1990s), numbers were interpolated using the average of the previous and next observation.

idence that in the majority of countries in Latin America a significant decline in inequality has occurred since the early 2000s.[5]

What drives this surprising decline in inequality? It appears that in Brazil's case (as well as in the case of many other Latin American countries) the decline was helped by macroeconomic stability, which particularly helped the poor, by higher overall economic growth, declining educational inequality and strong programmes of pro-poor redistribution through more progressive government transfer programmes. In particular, the spread of conditional cash transfer programmes such as Brazil's Bolsa Familia programme, under which substantial transfers are made to poor households provided children attend school and participate in health programmes, have played an important role in this pro-poor redistribution.[6] These programmes were possible without endangering macro stability because the government was able to significantly increase its tax revenue as a share of GDP, thereby bringing the tax to GDP ratio closer to the level of developed countries.[7] The Brazilian story, which appears to be have been emulated elsewhere in Latin America, thus shows that rising inequality is not inevitable in emerging countries, and that government policies can play a significant role in bringing about a significant reduction in inequality.

If Brazil was able to achieve declining inequality, why not China and India, whose governments also profess to be concerned about rising inequality? In practice, government policies in these countries, on balance, promote *rising* inequality as they favour those regions in which the export sectors are concentrated through undervalued exchange rates, cheap credit, and strong state support for the building of infrastructure. In contrast, government support for agricultural development, including investments in productivity improvements, rural infrastructure and land reforms, has lagged behind in these countries and this has contributed to the sharply rising rural-urban disparities, the main driver of rising overall inequality. In the case of China, it is interesting to note that the early rural reforms of the late 1970s and early 1980s, which effectively gave back control over land and production decisions to peasant families, served to dramatically increase agricultural growth, kept inequality low and sharply reduced poverty. As soon as growth shifted to export-oriented urban-based production, concentrated largely in the coastal provinces, however, the rise in inequality got under way.[8] Lastly, redistributive programmes of the type now *en vogue* in Latin America do not exist or are slowly being built up, albeit from a very low level.

Consequences for Welfare, Growth and Poverty Reduction

When evaluating this rising inequality, one can examine its intrinsic welfare consequences or study its impact on growth and poverty reduction. Turning to the first issue, there is a sizable literature in theoretical welfare economics, experimental economics, and on subjective well-being. The literature on the latter has documented the negative consequences for well-being of rising inequality.[9] A series of papers by Gruen

[5] G. A. Cornia, B. Martorano: What explains the recent decline in income inequality in Latin America? Paper presented at 2009 PEGNet Conference, The Hague, September 2009.

[6] L. Lopez-Calva, N. Lustig: The recent decline in inequality in Latin America: Argentina, Brazil, Mexico and Peru, Paper presented at 20th Economia Panel, Universidad Torcuato di Tella, Buenos Aires 2009; F. Ferreira, P. Leite, J. Litchfield, op cit.; G. A. Cornia, B. Martorano, op. cit.

[7] G. A. Cornia, B. Martorano, op. cit.

[8] M. Ravallion, S. Chen: China's (uneven) progress against poverty, in: Journal of Development Economics, Vol. 82, No. 1, 2007, pp. 1-42.

[9] For a survey cf. S. Klasen: The efficiency of equity, in: Review of Political Economy, Vol. 20, 2008, pp. 257-274.

and Klasen[10] have used welfare measures that combine growth and inequality and have shown the empirical implications of these measures for intertemporal and global welfare comparisons. Using one of these measures (the so-called Sen measure in which well-being is defined as mean income multiplied by 1 minus the Gini coefficient), it is found that the growth in well-being in China between 1980 and 2004 was 90 percentage points lower than per capita income growth in the same period, due to the effect of sharply rising inequality. Thus the welfare consequences of rising inequality are quite severe and it seems hard to imagine that continued increases of the type observed in China (or India) will not lead to serious social and economic disruptions.

On the other hand, the question arises whether the rise in inequality in these emerging economies is a necessary condition for higher growth and development. Moreover, does it help or hinder poverty reduction there? I will treat these two issues in turn. Regarding the impact of initial inequality on subsequent growth, the preponderance of empirical evidence from across the world suggests that high initial inequality serves to reduce subsequent growth.[11] And it is indeed likely that Brazil's growth experience since World War II has been negatively affected by its high level of inequality, while many East Asian countries benefited from low initial inequality, which facilitated their rapid growth and development since the 1960s. Also, within China and India it is actually the places with lower initial inequality which have been able to boost economic growth more than other regions.[12] It is somewhat less clear, however, whether *redistribution* promotes or hinders growth. Here the empirical literature is rather divided on the subject.[13] Clearly, it is likely that some forms of redistribution will hurt growth (e.g. arbitrary asset confiscations) while others will promote it (e.g. pro-poor education spending financed by taxation). This is the reason why the experiences of Brazil (and some other Latin American countries) are now so interesting. Clearly, Brazil's growth has (so far) not been hurt by its redistributive policies. In fact, those redistributive policies that focused on achieving macro stability and reducing educational inequality have surely helped promote economic growth (and enabled Brazil to weather the current economic crisis relatively well so far); there is also no evidence that the expansion of redistributive social programmes has adversely affected economic performance, although this is too early to tell. Looking beyond Brazil, it is quite clear, however, that not all of the redistributive policies adopted by Latin American governments will be beneficial to growth, and many may harm it. While the policies to sharply increase the taxation of rents of commodity producers helped fund the expansion of social programmes in many countries, it is likely that some governments, including those of Venezuela and Bolivia, have taken matters too far by effectively expropriating key commodity producing sectors, with negative repercussions for future investments and growth in these countries.

Given the fact that redistribution does not invariably lead to lower growth (and low initial inequality actually promotes it), the implications of inequality and redistribution for absolute poverty reduction are rather clear. This is due to the precise mathematical relationship between growth, inequality, and (absolute) poverty reduction. As has been shown by Bourguignon[14] and Klasen and Misselhorn,[15] under the assumption that incomes are log-normally distributed (which is roughly correct in most countries), two clear relationships between growth, inequality, and poverty reduction can be deduced. First, any redistribution will automatically reduce absolute poverty immediately. Secondly, the impact of growth on the pace of poverty reduction is larger, the lower initial inequality is. This is due to the fact that in less unequal countries, the distance of the poor to the poverty line is lower and (distribution-neutral) growth is more easily able to lift the poor over the poverty line. If it is then the case that redistribution does not negatively affect growth (and might even promote it), it is quite clear that pro-poor redistribution will accelerate absolute poverty reduction due to the effects described above. As a result, it is not surprising that the pace of poverty reduction has accelerated

[10] C. Gruen, S. Klasen: Growth, inequality and well-being ..., op. cit.; C. Gruen, S. Klasen: Growth, Income Distribution, and Well-being: Intertemporal and Global Comparisons, in: CESifo Economic Studies, Vol. 49, No. 4, 2003, pp. 617-659; in: C. Gruen, S. Klasen: Growth, inequality, and welfare: comparisons across space and time, in: Oxford Economic Papers, Vol. 60, 2008, pp. 212-236.

[11] E.g. K. Deininger, L. Squire: New Ways of Looking at Old Issues: Inequality and Growth, in: Journal of Development Economics, Vol. 57, No. 2, 1998, pp. 259–287; S. Klasen: In Search of the Holy Grail: How to Achieve Pro Poor Growth?, in: B. Tungodden, N. Stern, I. Kolstad (eds.): Toward Pro Poor Policies: Aid, Institutions, and Globalization, New York 2004, Oxford University Press, pp. 63-94.

[12] M. Ravallion, S. Chen, op. cit.; G. Datt, M. Ravallion, op. cit.

[13] E.g. K. J. Forbes: A Reassessment of the Relationship between Inequality and Growth, in: American Economic Review, Vol. 90, No. 4, 2000, pp. 869-887, vs. A. V. Banerjee, E. Duflo: Inequality and Growth: What Can the Data Say? In: Journal of Economic Growth, Vol. 8, No. 3, 2003, pp. 267-299.

[14] F. Bourguignon: The Growth Elasticity of Poverty Reduction, in: T. Eicher, S. Turnovsky (eds.): Inequality and Growth, Cambridge 2003, MIT Press.

[15] S. Klasen, M. Misselhorn: Determinants of the Growth Semi-Elasticity of Poverty Reduction, Ibero America Institute Discussion Paper No. 176, 2007.

in Brazil since the 1990s, while it has actually slowed down in China and India as rising inequality is making poverty reduction more difficult and reduces the poverty impact of growth.[16]

Some Conclusions

This brief discussion has highlighted that high and rising inequality is not only an issue of great concern in OECD countries. It is one of the central questions of developing countries, including particularly rapidly growing ones.[17] Rising inequality, as observed in Brazil in the 1980s, and in China and India since the 1980s, can seriously reduce welfare, slow down poverty reduction, undermine social stability, and may ultimately undermine economic growth. The example of Brazil shows that policy can make a difference and inequality need not rise inexorably in today's globalised world. The lessons from Brazil and other Latin American countries in reducing inequality are well worth examining further.

[16] Cf. M. Ravallion, S. Chen, op. cit.; G. Datt, M. Ravallion, op. cit.

[17] M. Grimm, S. Klasen, A. McKay: Determinants of Pro-Poor Growth: Analytical issues and findings from country cases, London 2007, Palgrave Macmillan; T. Besley, L. Cord: Delivering on the Promise of Pro-Poor Growth, London 2006, Palgrave-Macmillan.