

## »» Rising inequality in developing countries: what can be done?

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Inequality is attracting a growing amount of attention in international discussions. Piketty's work has contributed to this phenomenon, as have more recent studies conducted by the OECD and the IMF, which see inequality as an impediment to growth. In developing countries the debate has partly been fuelled by a sharp increase in inequality since the 1980s, which is leading to growing social tensions. Consequently reducing inequality was defined as a new global goal within the SDG framework. But what does this goal mean and how can inequality be reduced? What is the role to be played by development cooperation, if any, in this process? These questions are examined in a recent study for the Federal Ministry for Economic Cooperation and Development (Klasen et al. 2016), and a selection of key issues are presented here.

### The confusing SDG 10

SDG 10 states that (income) inequality within and between countries should be reduced. These are two very different areas calling for improvement. Inequality between countries declines when poorer countries grow faster than their more wealthy counterparts. The success of bids to reduce inequality depends on the growth policy pursued by a country, but also on the global growth environment for developing countries. Inequality within countries depends on the allocation of resources like education and physical capital, the returns on these goods and the government's redistribution policy. A very broad range of policy areas are involved. This, in turn, also makes the targets and indicators confusing. Some focus on domestic inequality (growth of the poorest 40%, equal opportunities and the expansion of social security

systems). Other factors that may influence international inequality comprising, for example, financial market regulation, effectively-managed migration and more development assistance for poor countries, tend to impact inequality between countries. In addition, targets like the improved political representation of developing countries in international organisations, for example, were formulated that bear no direct relation to (income) inequality between and within countries. Since the topic of growth and improving growth conditions for poor countries is also considered by other SDGs, I would make a case for primarily devoting SDG 10 to the topic of national inequality. Even so, the related agenda still remains very large. The rest of this article will focus on this topic.

### National inequality: a few facts

National (income) inequality has actually increased in many regions since the 1980s. The most dramatic increases were seen in some Asian countries (like China and India, for example) and in several transition countries (like Ukraine), but inequality also rose in most of the countries of Africa and Latin America in the 1980s. Since the mid-1990s the picture has become far more heterogeneous. Inequality has fallen in Latin America, while trends are inconsistent in Africa and developments are also heterogeneous in Asia. This cannot primarily be attributed to the influence of economic growth on inequality. In fact, the development of inequality in these countries tended to depend more heavily on government policy, whereby both direct redistribution measures and structural policy like education and health policy played a role.

There is also no clear proof of any relation between inequality and economic growth. While it is true that countries with a historically low level of inequality also showed higher growth, countries that reduce inequality are not necessarily rewarded with higher growth rates.

There is, however, clear evidence that a reduction in inequality leads to lower absolute poverty, and that the poverty-reducing impact of growth is enhanced at the same time. Even if there is no growth bonus, there are still good economic (and political) reasons for championing lower inequality.

### Policies for lowering inequality

To develop policies for overcoming inequality, it is first essential to identify the drivers of inequality in a given country. Does inequality result from the unequal distribution of resources (land, capital and human capital)? Or is it due to

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the unequal returns on these resources if, for example, farmers receive little for their harvest in remote areas? Or is it due to government redistribution policy, which is either not very progressive or merely too small-scale? The direct policy measures required to address inequality depend on which of these factors are most important for achieving a greater redistribution effect, ranging from land reform and investment in education for the poor to rural infrastructure and restructuring government taxes and expenditure. Increasing the overall tax ratio (via resource taxes, for example, or progressive value-added tax and improvements in fiscal administration) can also play a key role in many countries and has helped to reduce inequality in Latin America, for example, especially as these policies were accompanied by the setup of progressive transfer systems.

### **What can the international community and development cooperation do?**

National inequality is a difficult political topic in many countries and therefore has to be approached with the requisite sensitivity. It is also clear that such a major topic can only be selectively influenced with the modest means of bilateral development cooperation, as the government policy pursued by developing countries is crucial in such cases. A good deal can nevertheless be achieved. At an international level, above all, governments can commit to curbing capital flight by rich individuals and tax avoidance by multilateral companies. Promising processes are already in the pipeline at the OECD and the IMF level. It is important, however, to ensure that developing countries are fully integrated in the design and implementation of such initiatives, as well as

being their beneficiaries. This is the only way for developing countries to secure the resources required to pursue a stronger redistribution policy.

At a bilateral level, it is primarily possible to support government policies by providing advisory services. This can begin with analytical topics such as an inequality diagnosis, via the implementation of tax reforms, education and social protection policies that respectively benefit the poor. Financial Cooperation can subsequently advance policy measures to reduce inequality. One option would be to support multi-sectoral initiatives as a whole via policy-based lending or budget support. However, Financial Cooperation can also be applied selectively by funding insurance and cash transfer systems, for example, or expanding basic infrastructure (education, healthcare, streets) in disadvantaged regions and/or for disadvantaged target groups.

It is important to bear in mind that this requires patience. Inequality is deeply-rooted economically, politically and socially, and can only be influenced very slowly and by pursuing a consistent policy. Experiences from Latin America since the mid-1990s, however, show that such a consistent policy approach can definitely prove effective. ■

### **Literature**

Klasen, S., N. Scholl, R. Lahoti, S. Ochmann, and S. Vollmer: Inequality: Worldwide Trends and Current Debates. Courant Research Center Discussion Paper No. 209 (2016).