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››› Extreme inequality is an assault on democracy

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By Kaushik Basu

Kaushik Basu
is Senior Vice President and Chief Economist, World Bank. He is on leave from Cornell University where he is Professor of Economics and the C. Marks Professor of International Studies.

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Extreme inequality, be it measured in terms of income or opportunity, is undesirable. Some inequality in an economy is natural and creates incentives and efficiency and may even be a driver of enterprise and growth. Some inequality is also a matter of choice: Some may prefer to write poetry and be poorer than others who sacrifice their love of poetry to do what they hate, play the stock-market. But on these grounds we would not have the extent of inequality that prevails in the world today, which is unfair and destructive of the social fabric, and a fuel for political and social conflict.

Income inequality across all individuals in the world, measured in terms of the Gini coefficient, is around 0.7 – and this has remained persistently high over the last two decades.[1] Income inequality across countries has declined somewhat because of higher growth rates in several emerging economies, such as China and then India, and more recently many other developing countries, including Ethiopia and Rwanda. But even in the light of these recent improvements in reducing inequality between countries, the level of inequality we have in the world today still is unconscionably high. In a world as rich as ours, when you have people barely making a living, and all their time and effort spent on trying to survive, they face not just economic deprivation but societal marginalization. In that sense, extreme inequality is an assault on democracy.

To address inequality of opportunity is vital but not enough: Inequality of outcome matters as well

Our primary concern has to be with equality of opportunity but attention must not be confined to that alone. First of all, what constitutes inequality of opportunity is not always clear. If you place two pots of money at the top of a staircase and give two persons the opportunity to walk up and get them, is this equal opportunity? What if one of those persons has a handicap from birth and cannot climb up the stairway without special help? Is providing that help a part of equal opportunity? It is possible to differ how we answer these questions concerning equal opportunity. Given these inherent difficulties, in my view, it is also important to look at differences in outcome.

But there is no real need to go into intricate, philosophical debates because one look around at the world should tell you that in today's world the inequality is huge no matter how you measure it; not just in terms of income but also opportunity. We have today babies being born into enormous wealth and, at the same time, hundreds of thousands of babies being born in total poverty. Since babies do not choose to be hard working or lazy, this is a case of having your chances blighted right at the start of your life for no fault of yours. And this can have no moral justification.

It is for this reason that we, for the first time, made the mitigation of inequality and the sharing of prosperity a mission goal of the World Bank. There was a lot of opposition to this in the beginning; but it is heartening to see the entire World Bank Group getting together behind this goal, to collect data, educate policymakers, and design and implement policy, to take on this huge challenge.

Globalization is a positive force, but we need to mitigate its negative effects on equality

The connection between globalization and poverty and inequality is interesting. Overall, I treat globalization as a positive force. It breaks down boundaries, socially and culturally, and is as such desirable. It also creates greater economic opportunity and allows for more specialization and yields high returns to scale. In brief, globalization typically expands global GDP. Today a person can sit in Addis Ababa or Port Louis or Cairo and work for a company in Bonn, London or Los Angeles. This is the great opportunity that globalization creates.

But there can be no denial that globalization can also marginalize some individuals and groups. It can cause

[1] See Lakner and Milanovic (2016). The period covered is 1988-2008

certain kinds of work in certain countries to vanish, leaving people poor and destitute, and exacerbating inequality. This calls for not trying to stop globalization but have complementary government policies to compensate and retrain those who lose out. This is a good strategy for many reasons but the most important is that globalization is not something that anybody deliberately created. It is a natural outcome of natural processes; as such, it is inevitable. To spend time lamenting globalization is similar to spending time feeling sad about the existence of gravity.

How to reduce global and within-country inequality?

Within-country inequality can be addressed in a variety of ways. One might think of two different sources of income disparity: short-run shocks and longer term differences in human capital. At any point in time, there is a group of people with low incomes (or virtually no "market" income) because they have lost their jobs or have suffered illness or disability. During the course of a year, it will not always be the same people, but there will always be a group of people in this situation. Social safety nets that provide income transfers to this group of people raise that group's income levels and help reduce inequality.

Over the longer term, it is about reducing differences in the skills – or human capital – that people deploy in labor market or bring to their entrepreneurial activities. This really gets back to the notion of inequality of opportunity: programs to provide education, health, and training to everyone bridge gaps in the opportunities that people have to develop their human capital and earn income.

Global inequality is much harder to address than within-country inequality. This is because we do not have enough global political institutions, let alone a global government, for addressing this problem. Indeed, one of the big challenges of today's world is that it is seeing increased economic globalization; but socially and politically the world remains balkanized. For this reason, when it comes to global inequality, there is a big responsibility with multilateral organizations such as the World Bank and the IMF; and also institutions, such as G-20, carry a special responsibility.

Some aspects of the problems are more manageable. Since a large share of global inequality is due to differences in average incomes across countries, it seems pretty clear that promoting growth in poor countries is one key component of a strategy to reduce global inequality. How that growth is promoted in those countries will have an impact on the degree of inequality within those countries. Enclave growth in natural resource sectors can lead to highly inequitable growth with increasing within-country inequality. In an ideal world there would be some effort to tax the rich to help the poor across the world. In the meantime, foreign aid remains an important instrument.

Tax-and-Transfer redistribution to compensate negative distributional effects of technological change and growth

Both theory and the experience of the last 200 years tell us that the driving force for rising incomes is technological change. Usually that technological change brings extraordinary benefits to the leaders of that change: whether we think of the firms and entrepreneurs within the country, or the lead countries themselves on a global scale. As a result, technological change can lead to increases in national and global inequality. A first question is whether all people in the country have access to the goods and services they need to become one of the leaders in technological change. That said, even if the opportunity question is addressed, there will be some people left behind and some form of tax-and-transfer redistribution is necessary. All advanced economies have put in places programs of this kind. But much more is needed. A challenge may be that there might be a growing share of people left behind as automation proceeds. In addition, globalization itself can complicate the policy space, since it may limit the degree of national autonomy in tax policy.

From a developing country perspective, the continued rise of automation in manufacturing has led to a debate on development strategies and the role of manufacturing versus services. As developing countries approach the productivity frontier in manufacturing, they will find that the frontier technologies are labor-saving. Jobs will have to also come from modern service sectors. Finally, I believe, we will also have to think in terms of some universal support, ideally, some fraction of profit to be shared with workers, both those in and out of work.

Development Cooperation and international policy coordination are key to reduce extreme inequality

Development agencies and development banks have an important role to play in financing programs and investments that are well targeted to the less fortunate. Even if not all their interventions can be directly focused on the extreme poor, they should carefully analyze and monitor the distributional effects of their activities and transparently address trade-offs with other developmental goals like growth, climate and peace.

In addition, as I already mentioned, policy coordination is increasingly important and multilateral cooperation is key. One example is coordinating tax policy. There is an increasing tendency for big corporations and even professional individuals to arbitrage tax rates across nations. Nations in turn often use corporate tax rates to game the global economy. Development agencies have an important role to play to curb some of these excesses.

Finally, money is important, but equally importantly is the role of ideas. As John Maynard Keynes had reminded us, ideas are the bigger stumbling block to progress than vested interests. Development agencies can play an important role in developing, promoting and arbitraging knowledge and ideas.■