

# Inequality and Development:

## An Overview<sup>1</sup>

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### Abstract

Inequality is one of the most important issues in development. Not only is it unjust according to most philosophical perspectives, but evidence indicates that it is deleterious to well-being generally, social stability, economic growth, and prosperity. Inequality may be among individuals, groups, or nations. The main focus here is on vertical (individual) and horizontal (group) inequality. Inequality may be defined in different “spaces” or dimensions, including income, assets, capabilities, happiness, or opportunities, with the appropriate space depending on the objective. This chapter briefly reviews measurement issues and explores recent trends. Despite its negative effects, inequality, broadly, seems to be increasing in many countries, and policies aimed at reducing it tend to be weak. There are more ambiguous conclusions with respect to inter-country income inequality, income inequality among global citizens, and inequality among groups. The range of policies relevant to reducing inequality is well known,

but does not form part of much of the current policy agenda, largely because of a lack of political support.

**Keywords:** Inequality; horizontal inequalities; poverty; growth; capabilities; Kuznets curve; Gini coefficient.

“Whichever way we look at it, we always return to the same conclusion: namely that the social pact establishes equality among the citizens in that they all pledge themselves under the same conditions and all enjoy the same rights.”

(Rousseau 1968 [first edition 1762]: 76)

“It is precisely because the force of circumstances tends continually to destroy equality that the force of legislation should always tend to its maintenance.”

(Rousseau 1968: 97)

## **Introduction**

This chapter analyzes inequality—why it matters, how it is defined, how it has been changing, and how it might be reduced. It considers inequality among people and among social groups, and the issues associated with each. While many countries have succeeded in raising their growth rates in the 2000s compared with the previous two decades, in the majority of cases this has been accompanied by rising income inequality—and inequalities among groups are a key source of unrest and conflict. The issue of inequality is consequently becoming increasingly central to development, because it has many deleterious effects on society and is intrinsically unjust. Moreover, without redistribution, the position of poor

individuals and groups can only be improved by economic growth, which generally involves adverse environmental consequences.

## **Defining inequality**

Several issues have to be considered in defining inequality. Important aspects are:

- Inequality among whom;
- Inequality in what space or dimension; and
- Inequality over what time.

### ***Inequality among whom***

Inequality may be measured among individuals within a particular society, or in a region or in the world as a whole. Inequality among individuals (or households) is most commonly measured within a particular country, but there are some efforts to measure inequality among all citizens of the world. We shall term inequality among individuals (or households) *vertical inequality*.

Alternatively, inequality may be measured across groups of people within a society—for example, ethnic or religious groups, or people grouped by region, age, or gender. We shall term this type of inequality *horizontal inequality*. Inequality is also often measured among countries or groups of countries (like developed and developing countries), which is a type of horizontal inequality.

Each of these types of inequality is relevant in particular contexts. For example, to find out how a particular level of gross domestic product (GDP) per capita translates into poverty, vertical inequality measures are appropriate. Horizontal inequalities (within a nation) are relevant as a source of the type of injustice that can lead to societal conflict. And inequalities among nations are relevant to issues of global justice and global redistribution policies, such as aid flows.

### ***Inequality in what space***

Although traditionally inequality is measured in income space, and this or inequality in consumption is still dominant in measures of vertical inequality, income has been widely criticized as an unsatisfactory indicator of welfare or development. Sen has been a leading critic (Sen 1977): he argues that development is about advancing freedoms or capabilities, defined as what people can do or be, and consequently that inequality should be assessed in

the space of capabilities (Sen 1980; Sen 1999). This suggests a multidimensional concept. Inequality may then be measured independently in relation to each important capability (such as the ability to be well nourished or healthy), or in the resources needed to achieve each important capability (such as access to food or health services), or through a multidimensional index. Nonetheless, income distribution remains important in helping to determine access to various freedoms. But because the correlation between the distribution of income and that of various capabilities is not very strong, one cannot simply substitute one for the others (Samman et al. 2011).

Some capabilities seem to be of greater importance than others, either because they seem intrinsically important or because they are essential for the realization of other capabilities. For example, living a long life represents an important capability in itself, and being alive is, of course, essential for all other capabilities. Consequently, it is essential to separate out the important dimensions, sometimes known as basic capabilities (Sen 1999; Nussbaum 2000), and to measure inequality in the distribution of each one, paying particular attention to the capabilities that affect other capabilities.

### ***Inequality over what time***

Clearly, if inequality fluctuates a lot, then one needs to measure it over several years to get a true picture of the distribution of capabilities among individuals. The nature and extent of injustice and the societal consequences of inequality are very different if particular individuals move in and out of poverty or riches, that is, if there is social mobility. Panel data would be necessary (and desirable) to inform us about whether a stable overall distribution is indicative of stability in the placement of particular individuals. The limited evidence available indicates considerable movement among individuals in and out of income poverty: for example, one study showed that in the Central and Western Regions of Uganda, nearly a quarter of households moved out of poverty over a twenty-five-year period (Krishna 2005).

Horizontal inequality (notably between ethnic and racial groups, and between men and women) often (but not always) persists over decades and even centuries (Stewart and Langer 2008; Thorp and Paredes 2010). Tilly defined such “durable” inequality as *categorical inequality* and provided an explanation of why such inequality tends to persist in terms of opportunity, exploitation, and imitation—i.e., a group that gets an initial advantage (opportunity) exploits and sustains this advantage in whatever way it can (e.g., by exclusion and discrimination), and this is widely imitated (Tilly 1998). In addition, an initial advantage can become cumulative (e.g., extra income enables better health and education in the next

generation, which in turn leads to additional incomes). While this applies to individuals, among groups the forces of persistence tend to be greater as they lead to asymmetries of social capital (groups having more contacts with other members of the same group than with outsiders), and this is compounded by overt discrimination (Stewart and Langer 2008). Panel studies have shown that upward mobility among individuals is greater for people in more advantaged groups (Devine, Plunkett, and Wright 1992; Corcoran 1995).

It follows that inequality (and mobility) needs to be measured over different time periods to understand its full welfare implications.

## **Is high and growing inequality undesirable?**

There are many ways of approaching the complex question of whether inequality (both vertical and horizontal) is undesirable. Two sets of reasons can be distinguished: first, those which relate to the *intrinsic* merits or demerits of inequality; second, *instrumental* reasons, in which inequality is assessed for its consequences for other objectives. For both, the argument depends partly on the “among whom” question, since different considerations apply to horizontal and vertical inequality; and partly on the dimension or space being considered, since both the intrinsic merits of equality and the instrumental consequences of equality or inequality vary according to the space.



### ***Intrinsic reasons***

Philosophers have reached different conclusions about the intrinsic desirability of equality.

One (humanist) approach is based on the premise that all humans share the right to be treated equally by virtue of being human (Kant 1949; Williams 1962). Kant interprets this as requiring “equality of respect,” which does not necessarily mean equality of material wealth, but would rule out gross inequalities. Williams argues that shared humanity implies that “for every difference in the way men are treated, a reason should be given; . . . further that the reasons should be relevant, and that they should be socially operative” (Williams 1962: 123). Here, much depends on how one defines “relevant reasons.”

A different approach starts from the premise of a social contract; Rousseau, as shown in the quotation that opens this chapter, concludes that the social contract implies equality as, he argues, people would not sign up to it if it involved inequality. Yet Rawls’ conclusion is that a social contract agreed under a “veil of ignorance” leads to *maximin*—i.e., inequality is justified so long as it means that the poorest person is better off than he/she would be with equality. This then justifies some inequality where it is instrumentally helpful in improving the position of the poorest.

The fundamental principle behind human rights approaches to development is the Kantian idea that every person is morally equal and therefore entitled to certain basic rights. A human rights approach implies universality in access to certain basic aspects of life (for example, adequate nutrition, housing, water, and education) and consequently limits inequality in these dimensions. An important difference between the “humanists” and the social contractarians is that the arguments of the former apply to the *whole* of humanity, irrespective of where people reside, while the social contract is argued to apply only to people who share a government, i.e., *not* across nations (Nagel 2005; Nussbaum 2004).

A very different approach is taken by libertarians, who argue that inequality is justified so long as the wealth was acquired legitimately (Locke 1773; Nozick 1974). Nozick argues that just outcomes are those that result from *legitimate* acquisition and transfer of goods and services. Since, according to Nozick, legitimate transfer includes bequests, any initial inequality, which may emerge even from an equal starting point, can lead to substantial and rising inequality over time—which is just, according to his theory. However, a major exception to this unconstrained situation arises from the principle of rectification, which justifies redistribution if resources are not obtained legitimately. As Nozick accepts, “some people steal from others, or defraud them, or enslave them” (Nozick 1974: 152). The principle of rectification would apply to horizontal inequality in particular, including much

North-South inequality, since the majority of group inequalities have their origins in historic injustices, such as colonialism, conquest, slavery, and discrimination.<sup>2</sup>

Economists' views of inequality have evolved historically, starting from an intrinsic perspective, but moving to an instrumental one. According to utilitarians, the optimum degree of inequality is that which maximizes utility. Pigou argued that this led to a highly egalitarian conclusion, assuming that a person's marginal utility would diminish as he/she acquired more of it (Pigou 1952); but this assumption was famously disputed by Robbins (1938, 1945), whose assertion that one cannot compare the utility gained by different individuals became the dominant view among economists.<sup>3</sup> Consequently, economists have tended to shy away from making judgments about the desirable degree of inequality except from an instrumental perspective.

However, in recent years, "happiness" economists, in line with utilitarians, have argued that the overriding objective should be maximization of the sum total of happiness. Measures of how much happiness people at different income levels derive from that income mainly seem to support the Pigou hypothesis that poorer people get more satisfaction/happiness from additional income than richer people (Krueger et al. 2006; Sacks, Stevenson, and Wolfers 2010). However, this has yet to inform economists' views broadly.

### ***Instrumental reasons***

Nonetheless, without making judgments about the intrinsic justice of a particular distribution, economists have accepted that instrumental reasons are relevant to determining the desirable extent of inequality. The prime justification for a particular income distribution rests on the effects on efficiency, with the desirable distribution being that which would maximize output. A certain amount of vertical inequality may be needed to encourage people to work hard, use their talents, and direct their energies in a way that exploits their comparative advantage and maximizes societal output.<sup>4</sup> But there is also an efficiency case *against* too much inequality, since it can reduce societal human capital (as poorer people are likely to be less well nourished and educated) and can also reduce the size of domestic markets, leading to underconsumption and unemployment, though there are ways of compensating for this. Thus there are instrumental efficiency arguments both for and against vertical inequality, and the power of these reasons depends on empirical relationships.

A number of studies have found that higher inequality leads to less growth, although this has been questioned.<sup>5</sup> Considerable evidence links a less equal income distribution to poorer outcomes in education (Mayer 2000) and health (Hildebrand and Van Kerm 2009, Kondo et al. 2009), which in turn reduce growth (Birdsall and Sabot 1994; Ranis, Stewart, and Ramirez 2000). It has also been argued to affect growth adversely through its impact on

political populism and political instability. Moreover, for any given level of per capita income, vertical income inequality increases poverty.<sup>6</sup> Research also consistently shows that it increases intentional homicides and robbery (Fajnzylber, Lederman, and Loayza 2002). Empirical evidence on the links between inequality and measures of happiness at the country level are more mixed, with studies pointing in both directions,<sup>7</sup> but suggesting that perceptions of fairness and mobility appear to be crucial (Alesina, Di Tella, and MacCulloch 2004; Bjornskov et al. 2009; Oishi, Kesebir, and Diener 2011), that reference groups matter (Luttmer 2004; Eggers, Gaddy, and Graham 2006), and that even within countries, interpretations of inequality can shift over time.<sup>8</sup>

One plausible conclusion from economists' instrumentalism is that the objective should not be *equality of outcomes* but *equality of opportunities*, since efficiency should, in principle, be maximized if everyone faces the same opportunities (Roemer 1998). Genuine equality of opportunities, defined as equality in all dimensions over which the individual has no control (which includes all inherited inequalities, including those due to social background, etc.) is likely to rule out much horizontal inequality, since differences in group outcomes are generally the result of historic or current discrimination. While inequality among individuals may be due to differences in efforts and talents, these should even out between groups consisting of large numbers of individuals, since a similar dispersion of effort and talents can be expected within each group, unless historic or current disadvantages have led to

differences—i.e., unless there is an absence of genuine equality of opportunity. However, in the short run this type of equality of opportunity - which goes beyond eliminating current discrimination – may not be output maximizing.

The bulk of empirical evidence on horizontal inequality has focused on conflict. This research generally finds a positive relationship (Gurr 1970; Stewart 2000; Mancini 2008), particularly where there are both economic and political inequalities simultaneously and in the same direction (Stewart 2008; Cederman, Weidmann, and Gleditsch 2011; Østby 2008). There is also evidence that horizontal inequalities are associated with other forms of group violence, including milder types such as riots (Blau and Blau 1982) and horrendous forms like genocide (Fein 1993; Harff 2003; Stewart 2011). As well, some work links gender inequality to domestic violence (Bailey and Peterson 1995; Yodanis 2004).

## **Measuring inequality**

In order to ascertain prevailing levels of inequality and changes over time, there is a need to have an effective means of displaying distributions and of comparing them to one another—ideally through a summary index. Deriving such an index is complex, as it involves comparing the incomes (or other attributes) of all individuals within a society and incorporates an implicit or explicit sensitivity to transfers among them. Further complexities

arise when incorporating group affiliation into measurement and when considering inequality along multiple dimensions.

### ***Vertical inequality***

Measures of vertical inequality seek to represent how income or another attribute (we refer here to income for simplicity) is distributed among individuals or households in a population. The simplest measures are ratios of the amount of a given good in the top versus the bottom of the population (e.g., the top quintile versus the bottom quintile). More sophisticated measures consider the whole of a distribution—most simply represented by ranking the members of a society from poorest to richest and then plotting their cumulative share in the population against their cumulative income, as in the well-known Lorenz curve (Lorenz 1905). To summarize distributions, researchers have devised measures either because they fulfill certain desirable properties or axioms which establish their robustness, or for more “ad hoc” reasons such as mathematical or graphical appeal (Lugo 2007).

Some basic properties which it is generally agreed that inequality measures should fulfill are anonymity or symmetry, population size and scale, independence, and transfer sensitivity (Shorrocks 1980, 1984; Cowell 2008).<sup>9</sup> The first three imply that inequality measurement should be invariant to any other characteristic of individuals (including population size) but

their incomes, or to any uniform, proportional changes in income. The property of transfer sensitivity (Pigou–Dalton “principle of transfers”) makes the important claim that any transfer from a poorer to a richer member of society must increase inequality. To these four properties is sometimes added that of *decomposability*: the measure of inequality for a population as a whole should be the (weighted) sum of inequality among its constituent parts. In other words, it should be possible to look at inequality overall and to divide it up by any subgroup characteristic, e.g., men and women.

The most popular measures of inequality are the Gini coefficient, general entropy measures (Theil 1967), and Atkinson class of indices (Atkinson 1970), all of which obey the first four properties just enumerated. But each measure has some distinct features—a key issue is their sensitivity to transfers that take place in different parts of the distribution.

The Gini coefficient is the most widely applied because it is intuitive and straightforward to compute. It is most sensitive to transfers occurring in the middle of the distribution. The family of general entropy measures derives from information theory, and represents the entropic “distance” of a population from full equality. The three general entropy measures—of which the Theil index is the best known—are not only decomposable, but also vary in terms of the weight they place on different parts of the distribution. Finally, the Atkinson class of measures explicitly considers the welfare loss associated with inequality according to



a normative “inequality aversion” parameter, higher values of which are more sensitive to changes at the lower part of the distribution.

Because all these measures have differing sensitivity to performance at different parts of their distributions, they may rank the same distributions in different ways; for this reason, researchers have devised alternative approaches to rank distributions (Litchfield 1999). In particular, stochastic dominance techniques apply certain preferences to generate partial if not complete orderings: for example, one distribution may be said to “Lorenz dominate” another if every point on its curve lies above that of a second curve.

### ***Horizontal inequality***

Many issues involved in measuring vertical inequality apply equally to measuring horizontal inequality. But here some additional problems arise. One is that groups differ in size, making it necessary to decide whether to weight any inequality by group size. Another is that there is generally inequality within each group, raising the question of whether to compare the distributions of each group with every other group as a whole, or simply take the mean—which is what is typically done. Yet it is desirable to take into account the distribution as a whole, as the political, economic and policy implications differ according to how the whole distributions compare. The “mean of means” approach (Foster, Lopez-Calva, and Székely

2003)—simply the mean of mean levels of different subcategories within each group—is one way of doing so (see Mancini, Stewart, and Brown 2008; Stewart, Brown, and Mancini 2010). One common approach to measuring group inequality is to decompose overall inequality in a society into inequality between groups (BG) and within groups (WG), and to take the ratio of BG/WG as the measure of group inequality (Kanbur and Zhang 1999). But this makes the value of the between-group (or horizontal inequality) element dependent on how much within-group inequality there is, with the value of BG (and of the ratio BG/WG) falling as WG rises. Yet for most purposes, what researchers and policy-makers need to know is the actual extent of inequality between groups, and not its relationship to within-group or total inequality.

### ***Multidimensionality issues***

The measurement of inequality in multiple dimensions of well-being is vital to incorporate a fuller range of outcomes, yet this poses additional issues. A key issue is the ordinal and bounded nature of many indicators of interest, in contrast to income which is continuous and unbounded. Researchers have approached the issue of ordinality by devising median-based measures (see Allison and Foster 2004), and by transforming ordinal data into cardinal indicators so that standard indices can be applied (see van Doorslaer and Jones 2003).

However, the resulting rankings display considerable sensitivity to which of, and how, these two approaches are applied (Madden 2010).

Challenges arise, too, in establishing dominance along multiple aspects of wellbeing (Kolm 1977; Atkinson and Bourguignon 1982) as well as the need to weight dimensions relative to one another and to consider the extent to which inequality in different dimensions is substitutable (Lugo 2007). Here too, an axiomatic approach to measurement is often taken (see Tsui 1999), but a key difference relates to how to establish transfer sensitivity along multiple dimensions (Kolm 1977; Tsui 1999). Given these complexities, which make interpretation of any single multidimensional measure difficult, there is much to be said for presenting measures of inequality of important dimensions separately.

## **Inequality and development: historical trends**

A key issue is whether inequality changes systematically as countries develop, as suggested by Kuznets (1955). Data limits are severe for investigation of this relationship, even where income is concerned; even so, there have been some efforts to bring non-income dimensions into the picture and these quite often significantly change our view of the extent and evolution of inequality.

***Does the Kuznets curve exist, and what explains it?***

In a seminal paper published in 1955, Simon Kuznets proposed that in the course of development, income inequality would first rise owing to a shift from the agriculture to non-agriculture and the countryside to city, and then fall, as the returns across sectors equalized—“the range first tends to widen and then to diminish” (Kuznets 1955: 15). Kuznets cautioned that this conjecture was “perhaps five percent empirical information and ninety-five percent speculation” (Kuznets 1955: 26). Since then a large body of scholarship has investigated whether this relationship holds, and has derived policy conclusions accordingly. Early study drew by necessity on cross-country data and compared the experiences of countries at different levels of development (Adelman and Morris 1973; Ahluwalia 1976). These studies found support for a Kuznets relationship, but later studies argued that “the use of cross-country data to analyze what are essentially dynamic processes can be strongly misleading” (World Bank 2006: 44), while empirically, the findings turned out to be very sensitive to the economic specification, sample size and time period adopted (Anand and Kanbur 1993; Fields 2001). Advances in data collection over time have made it possible to look at trends within countries—studies here gave little support to the Kuznets hypothesis (e.g., Bruno, Ravallion, and Squire 1998). The absence of a clear structural relationship is argued to point to the importance of policy in shaping distributions (Kanbur 2011).

***What trends do the data suggest?***

Nonetheless, at a country level, there is a general—though not universal—finding that inequality has been increasing, on average, in past decades, but with evidence of regional variation. Cornia and Kiiski (2001) found that the Gini coefficient rose in two-thirds of seventy-three countries they examined between 1980 and 2000. Ortiz and Cummins (2011), drawing on data for 141 countries over the past two decades, show that inequality increased most in Eastern Europe/former Soviet Union and Asia, that it declined significantly in Latin America after 2000, and that while sub-Saharan Africa remains highly unequal, its Gini index appeared to have fallen by almost five points, on average, since 1990. The fall in inequality in Latin America has attracted widespread attention: it has been so marked that inequality is now approaching pre-liberalization levels (Lustig, López-Calva, and Ortiz-Suarez 2011; Cornia 2012).

Limited information on the distribution of health and education over the past fifteen to twenty years suggests considerable reductions in inequality along both dimensions in six Latin American countries (Sahn and Younger 2006; Cruces, Domench, and Gasparini 2011) and little progress on health but some on education in twenty three sub-Saharan African countries (Sahn and Younger 2007).

The question of inequality within countries is of deep interest not least because it has strong implications for national policy. However, the evolution of inequality between countries and among global citizens has also attracted attention, especially since prevailing inequalities are so much larger. Between countries, patterns of inequality would seem to hinge on whether the focus is on income or on other dimensions, with the evidence suggesting some convergence in health or education but not income (UNDP 2010). However, if data are weighted by population size, the rapid growth of India and particularly China has brought about some modest convergence for incomes, starting perhaps around 1960 (Boltho and Toniolo 1999; Melchior, Telle, and Wiig 2000; and Firebaugh 2003).<sup>10</sup>

The vertical global income distribution (i.e., among the global population) again shows deep-seated inequality: the top quintile of the global population enjoys more than seventy percent of global income, and the bottom quintile just two percent (Ortiz and Cummins 2011). However, there is little consensus on the direction of shifts in global inequality in the last two to three decades (Anand and Segal 2008).

Finally, trends in horizontal inequality are harder to trace at an aggregate level because while there are some common markers of disadvantage (namely caste, race, ethnicity, language, religion, gender . . .), the specific groups that are disadvantaged and the nature of the disadvantage they face vary significantly from country to country. One analysis of

“intersecting inequalities” at a regional level with respect to the Millennium Development Goals cited a narrowing of disparities for some groups and deprivations, and the persistence or widening of others. But it found that “in almost every society and in almost every region of the world, certain groups of people face systematic social exclusion as the result of multiple inequalities that constrict their life chances” (Kabeer 2010: 1).

## **Policies toward inequality**

Given the widespread acknowledgment that high and rising inequality is undesirable, systematic policies to reduce inequality are needed. Below we provide a brief outline of policies likely to reduce inequality, first for vertical, then for horizontal inequality.

### ***Vertical inequality***

These may broadly be divided into policies likely to affect primary (pre-tax and benefits) distribution and those directed toward post-tax and expenditure distribution.

*Asset redistribution* is in the first category, and land reform is the most frequently advocated and adopted form. Historically, redistributive land reform has played an important part in improving primary redistribution, including in South Korea, Taiwan, and a number of Latin

American countries (El Ghonemy 1990; Lipton 2009). Nationalization of major industries reduced inequalities in asset ownership in a number of countries in the 1960s, while privatization contributed to increasing inequality from the 1980s. Without nationalizing assets, specific schemes aimed at wealth sharing from natural assets can improve the distribution of benefits from these resources. For example, the Alaskan Permanent Fund (APF) was established to ensure that the population at large would benefit from the discovery of oil and natural gas. A 1976 amendment to the constitution of the State of Alaska specified that “at least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue-sharing payments and bonuses received by the state shall be placed in a permanent fund.”<sup>1</sup>

*Income distribution from earnings.* Improving the distribution of labor earnings can be achieved by extending access to education at all levels; supporting rapid growth combined with labor-intensive patterns of development; and introducing minimum wages for unskilled employment. Extending education and raising minimum wages are believed to have contributed to the recent improvements in income distribution in some Latin American countries, in addition to cash transfers (Cornia and Martorano 2011). In contrast, the improved distribution achieved in some East Asian countries in the 1960s and 1970s was attributed to a combination of land reform and labor-intensive growth. Maximum incomes, in

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<sup>1</sup> <http://www.apfc.org/home/Content/aboutAPFC/constAndLaw.cfm>.



principle, could restrict the earned income of the rich. While this approach has never been adopted, the idea of putting pressure on companies to restrain payments to highest-earning employees is gaining ground. Atkinson (2000) has pointed out that incomes at the top are partly determined by convention and norms, and these have been moving in an inegalitarian direction.

*Policies towards secondary distribution* (post-tax and benefits). Progressive taxation can improve the distribution of both assets (through estate duties and capital taxes) and income. However, in recent decades there has been a tendency to move in a regressive direction, with lower marginal income tax rates, an increasing role for indirect taxation, and uniform rates of indirect taxation on all goods (via a value-added tax). In principle, there are ways of making both direct and indirect taxation more progressive. For many countries, evidence suggests that taxation is broadly proportionate with incomes (i.e., does not change the distribution) but that expenditure is mostly progressive, benefiting the poorer sections of the population more (in proportion to their original incomes) than the rich. Consequently, increasing both taxation and expenditure as a proportion of GDP reduces secondary inequality (Chu, Davoodi, and Gupta 2000; Cornia 2004). Public expenditure itself can be made more or less progressive according to the sectoral distribution, with social services generally benefitting poorer people more than others; and according to the distribution within sectors, with some sorts of expenditure being more progressive than others (for example, primary health as compared

with hospitals) (van de Walle and Nead 1995; Chu, Davoodi, and Gupta 2000). A range of benefits in kind or cash can also be targeted to poorer sections of the population. These include conditional and unconditional cash transfers, which can materially affect the secondary distribution (Barrientos and Hulme 2008). For example, conditional cash transfers in Brazil, Mexico, and Chile have reduced inequality by fifteen to twenty-one percent at a cost of less than one percent of GDP (Soares et al. 2007).

Globalization tends to constrain progressive taxation, since companies and individuals may move to other countries to escape such taxation. This tendency could be overcome by global (and regional) coordination on tax rates, or by changes in the basis of taxation (for example, by taxing individuals in their country of citizenship irrespective of where they live or where their incomes are earned).

### ***Horizontal inequality***

Here we can differentiate between direct and indirect policies. The former target particular groups (through quotas, etc.), while the latter aim to achieve a similar inequality-reducing effect through general policies, such as taxation (Stewart [ed.] 2008). The first type of policies are often described as affirmative action, and have been adopted quite extensively in multi-ethnic societies (Simms 1995; Brown, Langer, and Stewart 2012). They can be

effective in reducing inequalities, but have some undesirable effects in entrenching identity distinctions. Indirect policies are much the same as the policies noted for vertical distribution, although they include geographic targeting of expenditure in countries where groups are geographically concentrated. Like the policies toward vertical distribution, they tend to take more time than direct policies and to meet political resistance.

### ***Political economy of policy making***

Despite the accepted view that reducing inequality is generally desirable, by and large policy change in this direction has been limited. This, broadly, is not because of lack of knowledge about policies that would be effective, if adopted, but because of political constraints. Indeed, many policies being adopted are likely to increase inequality, such as the reduction of marginal rates of income tax, cutbacks in public expenditure, privatization of public services, and land entitlement schemes, while the unregulated market economy appears to be unequalizing. At the international level too, a lack of support for tackling inequalities is also apparent. Ultimately, the question of reducing inequality comes down to politics. Where there is strong political support for progressive policies—for example, as a result of social movements, workers' and peasants' associations, or powerful ethnic or religious groups—in the case of horizontal inequality, policies to correct inequalities have been adopted. But where poorer groups are badly organized, political parties are weak, and non-ideological and

corporate pressure groups are strong, progressive policy change is unlikely. However, in those societies which have succeeded in achieving full or near full employment, the relative bargaining and market position of poorer members of society is improved, and policy change to reduce inequality becomes much more feasible. This occurred in Europe after the Second World War, and in several developing countries in recent decades, including Taiwan and South Korea. Currently, China is approaching this situation. Thus a combination of organization of poorer groups and rapid employment growth appears to be most propitious for reducing inequality.

## **Conclusion**

Scholarly interest in inequality has grown over time. In the years immediately following the Second World War, the focus was on growth, which was thought to be both necessary and sufficient to eliminate poverty. Yet the supposed “trickle down” from growth was grossly inadequate, and the number of poor people grew. Consequently, in the 1970s development economists and policy-makers began to focus on poverty, and their concern grew with the prolonged deflation of the 1980s. It is only recently that inequality has been widely recognized as important in itself and for its effects on poverty and social stability. Vertical inequality came to the fore with the rising inequality that appeared to accompany the increased pace of globalization, while horizontal inequality was recognized as a major factor

behind the high numbers of civil wars and other social disturbances. While inequality has therefore gained a central role in analysis and measurement, less progress has been made in identifying equalizing policies, and even less in gaining political support for them.

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<sup>1</sup> We are grateful to participants in the workshop on “Evolving Conceptions of Development” for helpful comments and suggestions.

<sup>2</sup> Similarly, the concept of fair difference suggests that some present-day inequalities ought to be supported to redress long-standing inequalities – for instance, in the case of indigenous peoples.

<sup>3</sup> “In our hearts we do not regard different men’s satisfactions from similar means as equally valuable” (Robbins 1945: 156-7; 1938: 635-41).

<sup>4</sup> Galenson and Leibenstein (1955) argued that greater inequality would raise savings and thereby growth.

<sup>5</sup> Adelman and Morris (1973), Alesina and Perotti (1994), Alesina and Rodrik (1994), Bénabou (1996), Panizza (1999). Inequality may affect other characteristics of growth, reducing the duration of growth spells (Berg and Ostry 2011). For opposing findings, see Li and Zou (1998), Forbes (2000).

<sup>6</sup> See Datt and Ravallion (1992, 1998); Fosu (2009); Kalwij and Verschoor (2007).

<sup>7</sup> For the argument that inequality has either no effect or modest positive effects on happiness, see Bjornskov et al. (2009), Berg and Veenhoven (2010). For the counterargument, see Graham and Felton (2006), Knight and Gunatilaka (2011).

<sup>8</sup> In Poland, Grosfeld and Senik (2010) show that in the early stages of transition, people interpreted income inequality as a positive symbol of opportunity, while later on it came to be associated with dissatisfaction with the country’s economic situation, and perceptions of a flawed and corrupt income-generating process.

<sup>9</sup> Shorrocks (1980) also argued for two technical properties of indicators: that measures should have a norm of zero, and that they be continuous in nature. This raises issues for the measurement of inequality in other dimensions, as we discuss below.

<sup>10</sup> Also, because the Gini emphasizes changes around the middle of the distribution, it emphasizes the current experiences of China, a middle-income country (Wade 2001).

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