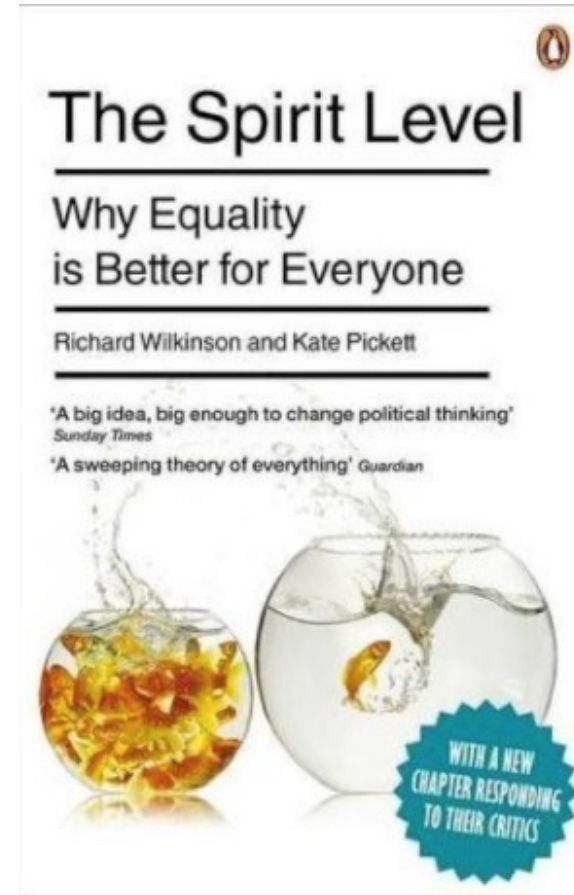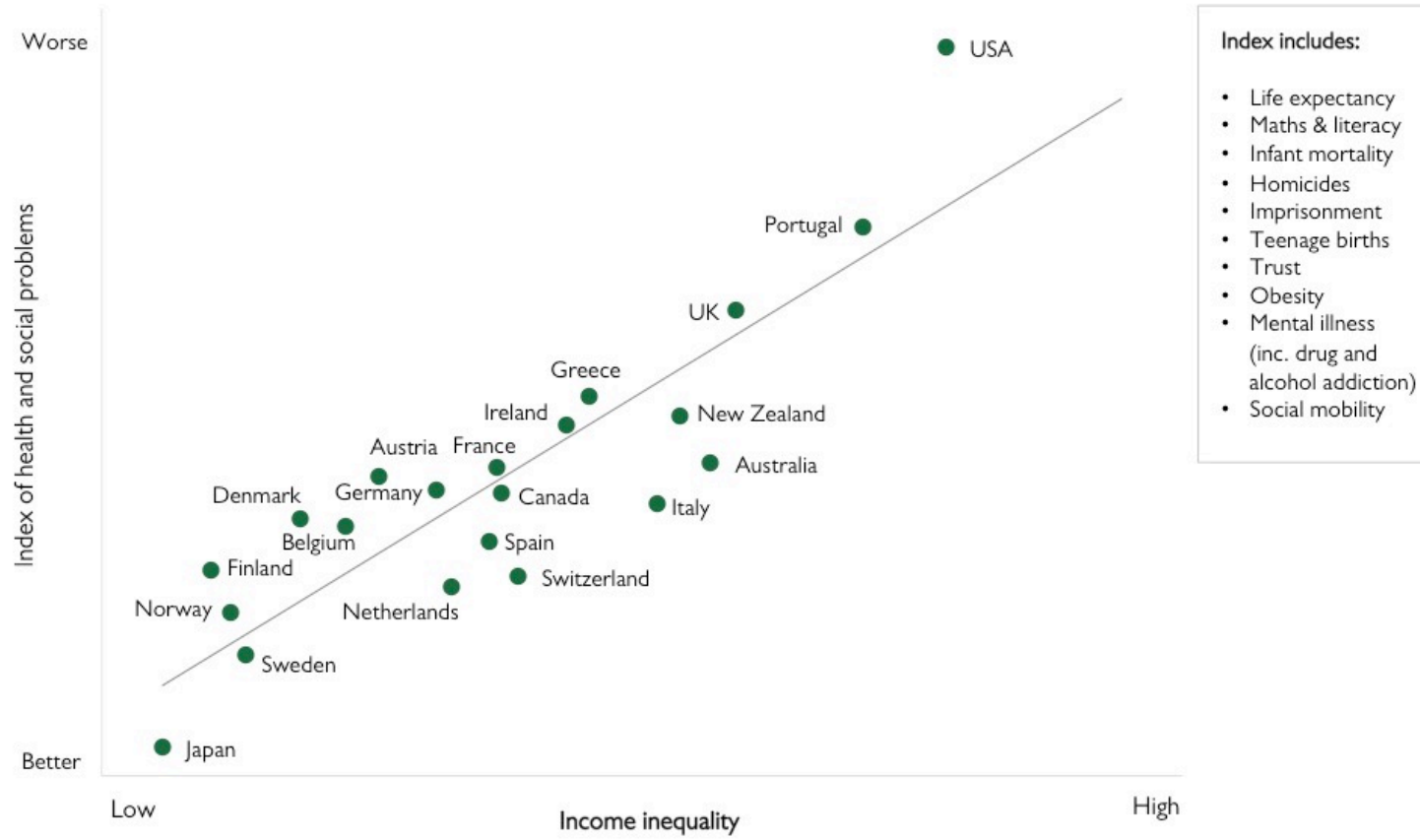# Development Policy

WITHIN-COUNTRY INEQUALITY

The Spirit Level by Richard Wilkinson and Kate Pickett (2009)

- Why we should care about rising levels of inequality

- Inequality associated with a range of pathologies in health, education, violence, drug abuse, and teenage pregnancy.

- Impact of inequality on trust, social cohesion and sense of citizenship
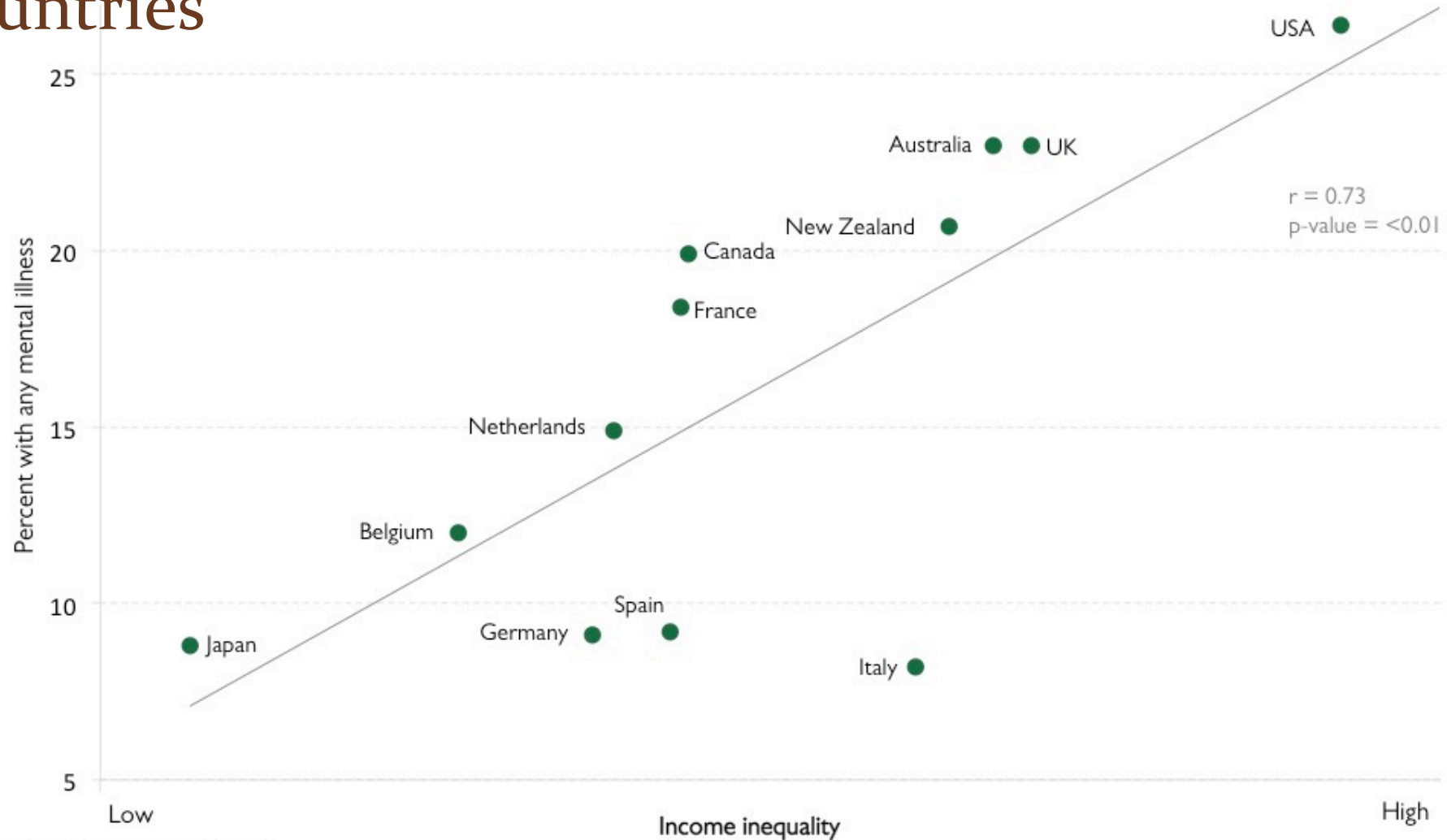
# Health problems are worse in more unequal rich countries

Index includes:
- Life expectancy
- Maths & literacy
- Infant mortality
- Homicides
- Imprisonment
- Teenage births
- Trust
- Obesity
- Mental illness (inc. drug and alcohol addiction)
- Social mobility

Y-axis: Index of health and social problems (Better to Worse)
X-axis: Income inequality (Low to High)

Countries plotted: USA, Portugal, UK, Greece, New Zealand, Ireland, Australia, France, Austria, Italy, Germany, Canada, Denmark, Spain, Belgium, Switzerland, Finland, Netherlands, Norway, Sweden, Japan

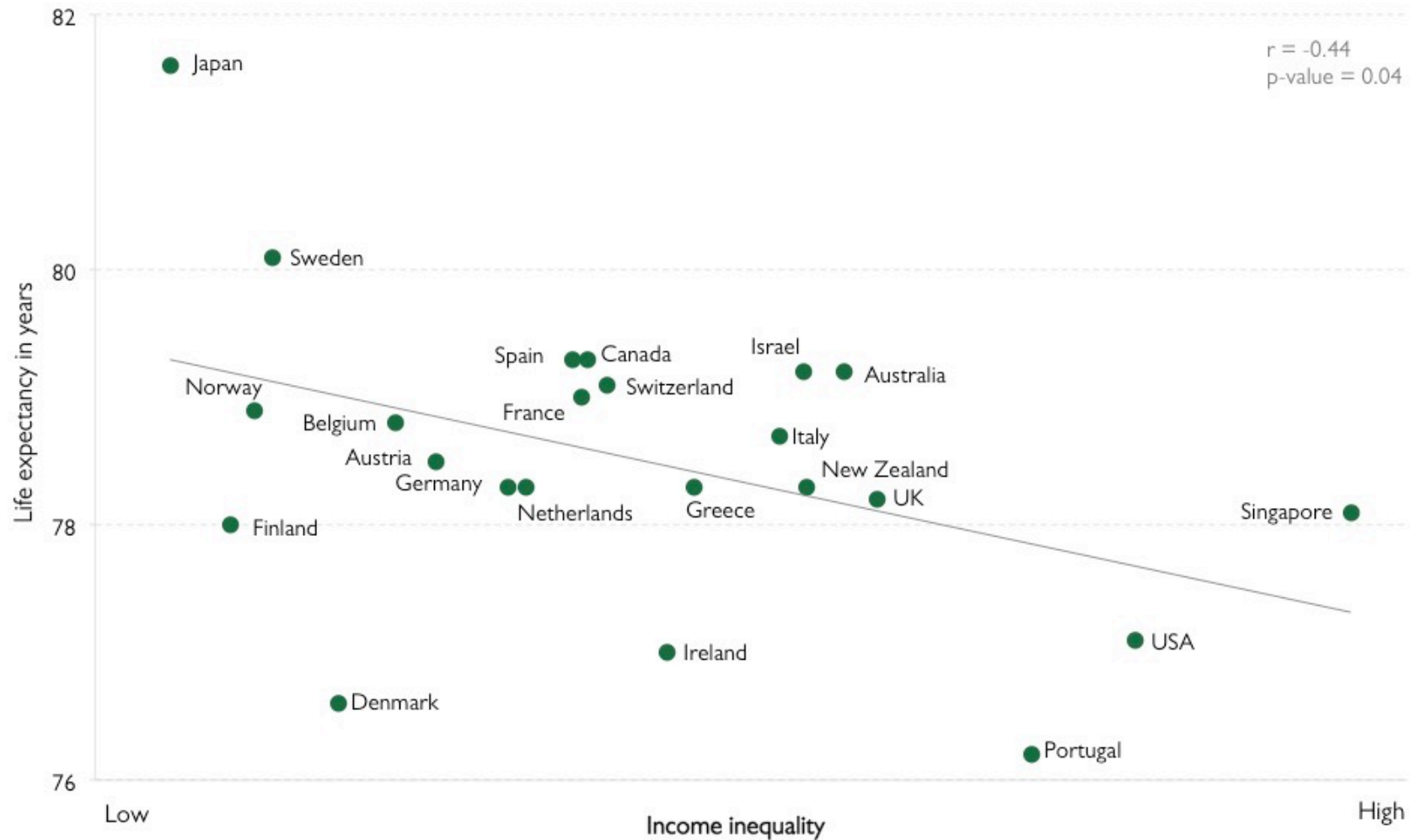# Mental illness incidence is higher in more inequal rich countries

Source: Wilkinson & Pickett, The Spirit Level (2009)

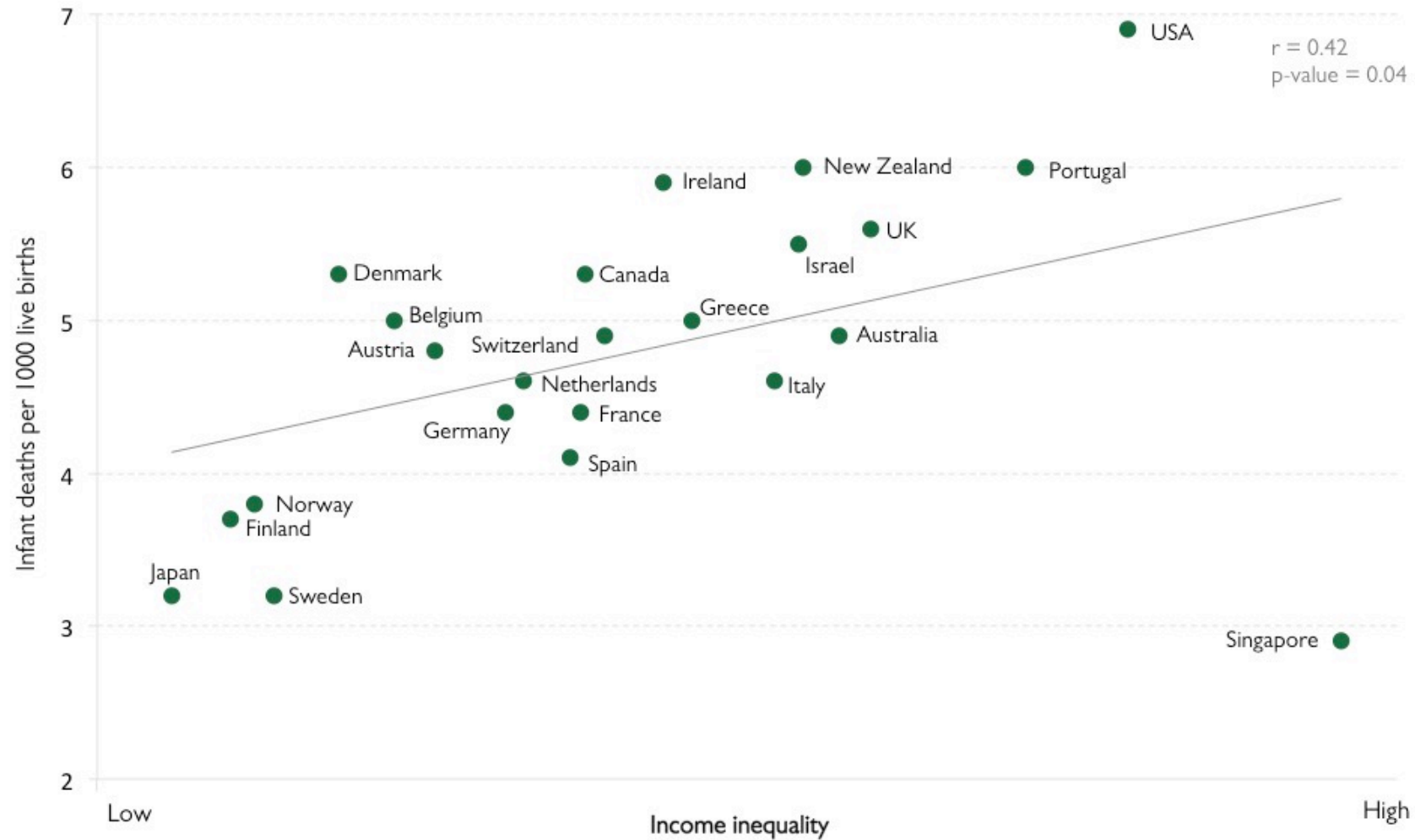# Drug abuse is more common in more unequal rich countries
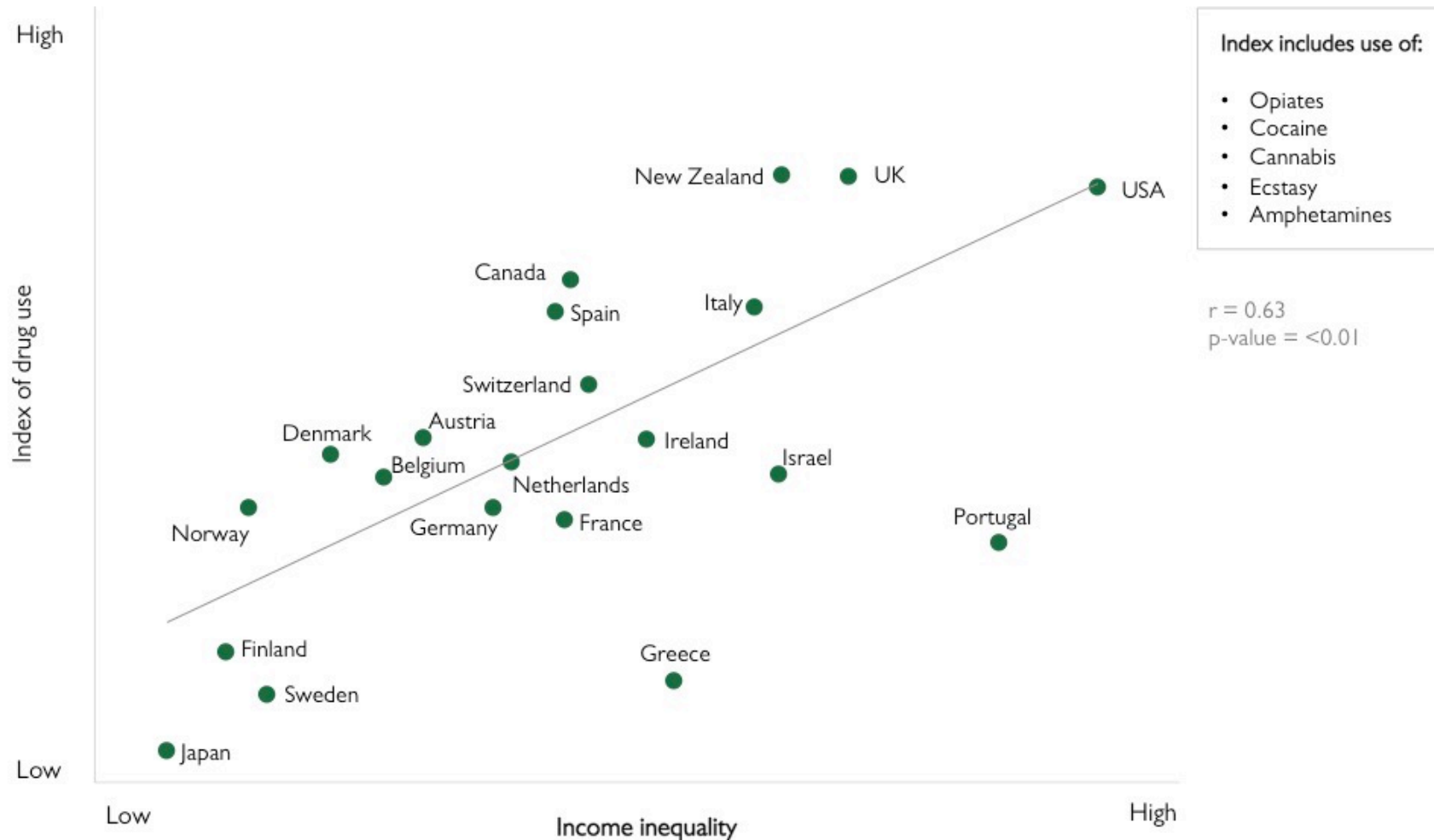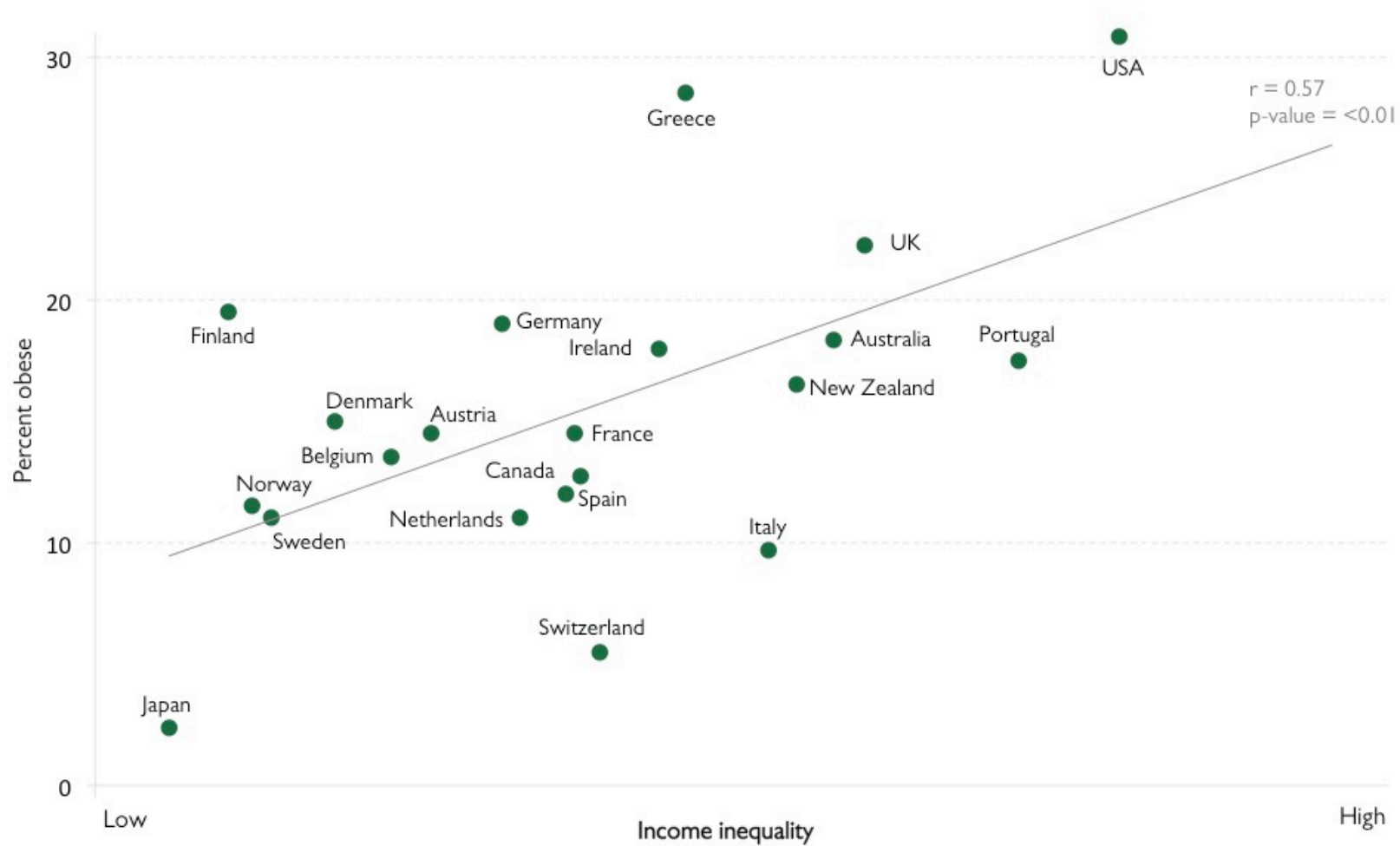

Source: Wilkinson & Pickett, The Spirit Level (2009)

People live longer in more equal rich countries
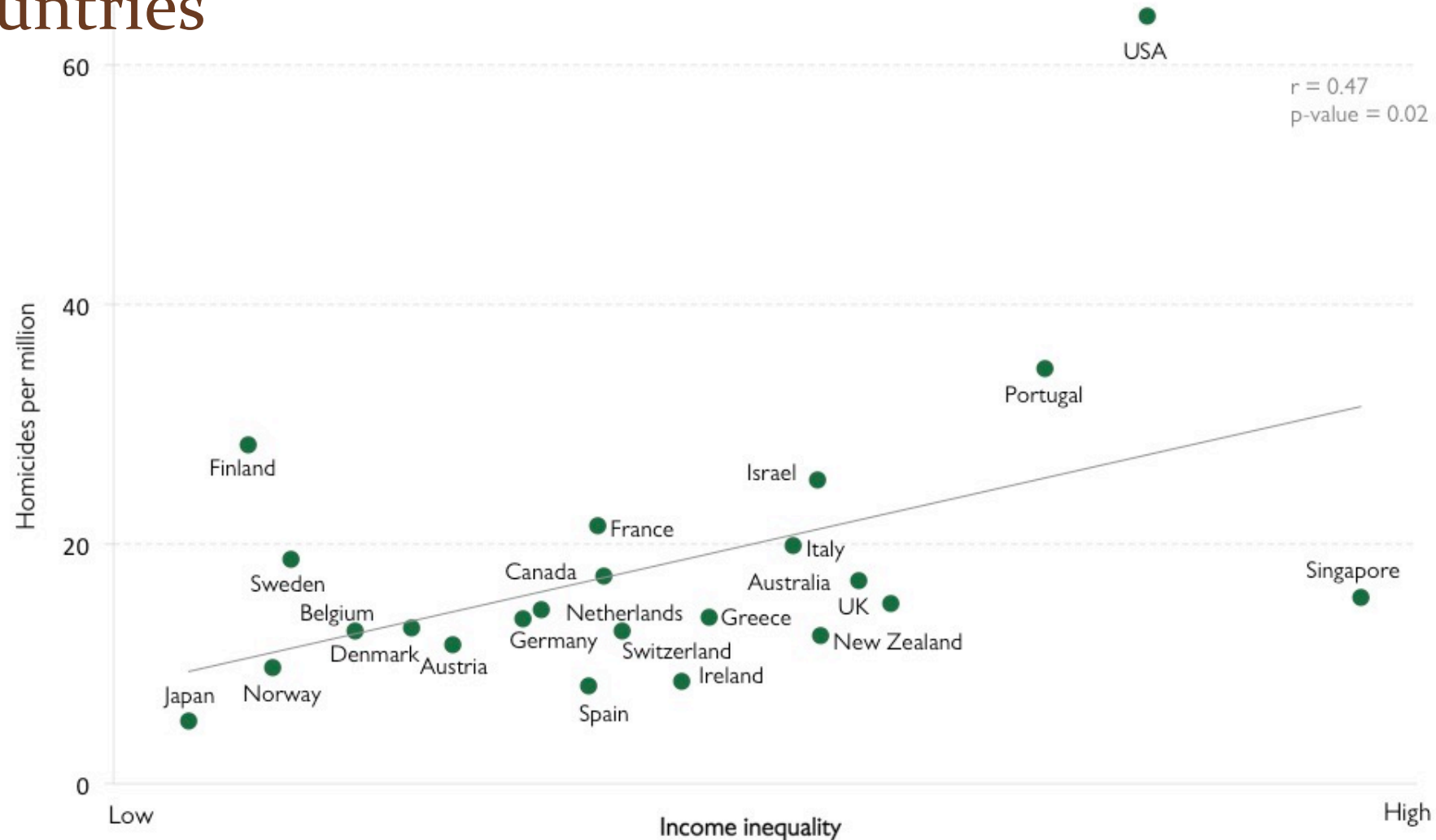
More babies dies in unequal rich countries

People are fatter in unequal rich countries

# Children learn better in school in more equal rich countries

Homicide rates are higher in more unequal rich countries

Measuring inequality

- Inequality is usually measured using the gini coefficient, which is the area between the Lorenz curve and a 45 degree line from the origin

- The Lorenz Curve is the line drawn by plotting the proportion of total income (y-axis) against the proportion of the total population (x-axis).

- The gini gives more weight to groups in the middle of the income distribution
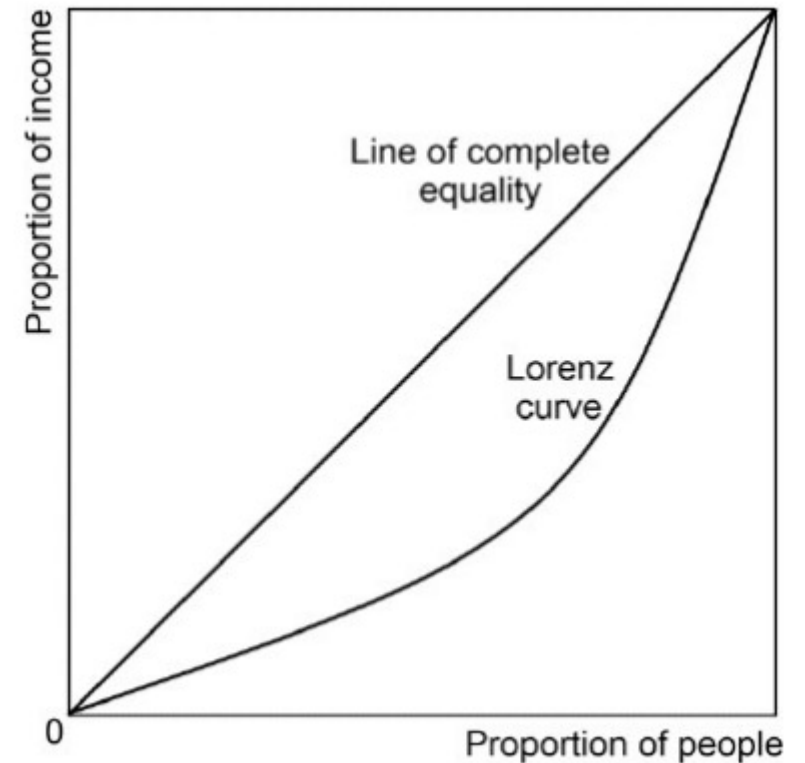
Gini coefficients around the world
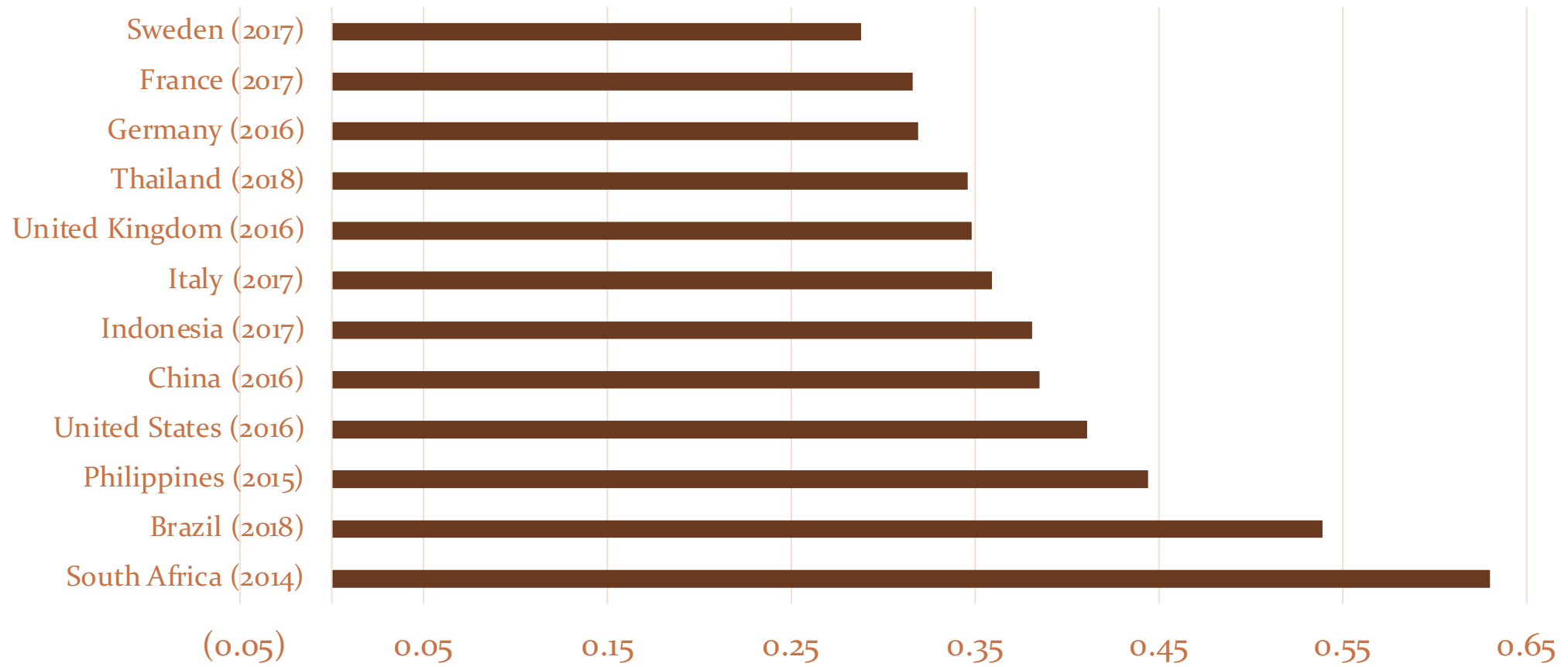
Problems comparing inequality statistics between countries

- Differences in methods: Tax and payroll data (individuals, income) vs surveys (expenditure, households)

- Purchasing power parity (PPP) exchange rates: consumption baskets differ across countries depending on culture and prices

- Coverage:
  - Over-representation of urban residents
  - Undercounting of migrants and people without a fixed residence
  - Undercounting of the rich
  - Sampling with and without replacement

Vietnam Household Living Standards Survey

- Systematically underestimates urban poverty because migrants are excluded (they are not registered households and so they do not enter the sampling frame)

- Migrants live in dormitories and rented accommodation and are poorer than residents

- Excludes rural to rural migrants (for example, daily labor on coffee farms in the Central Highlands and vegetable farms in Dalat)

- If they were included would Vietnam's gini be higher?

The Palma Ratio

- J.G. Palma found that most of the differences in income distribution between countries occurs at the top and bottom.

- The 5th to 9th deciles of the population tend to receive about the same share of national income.

- The big differences between countries are a result of the share of the top 10% and the bottom 40%. So the Palma ratio is:

$$\frac{Income\ share\ of\ the\ richest\ 10\%}{Income\ share\ of\ the\ poorest\ 40\%}$$
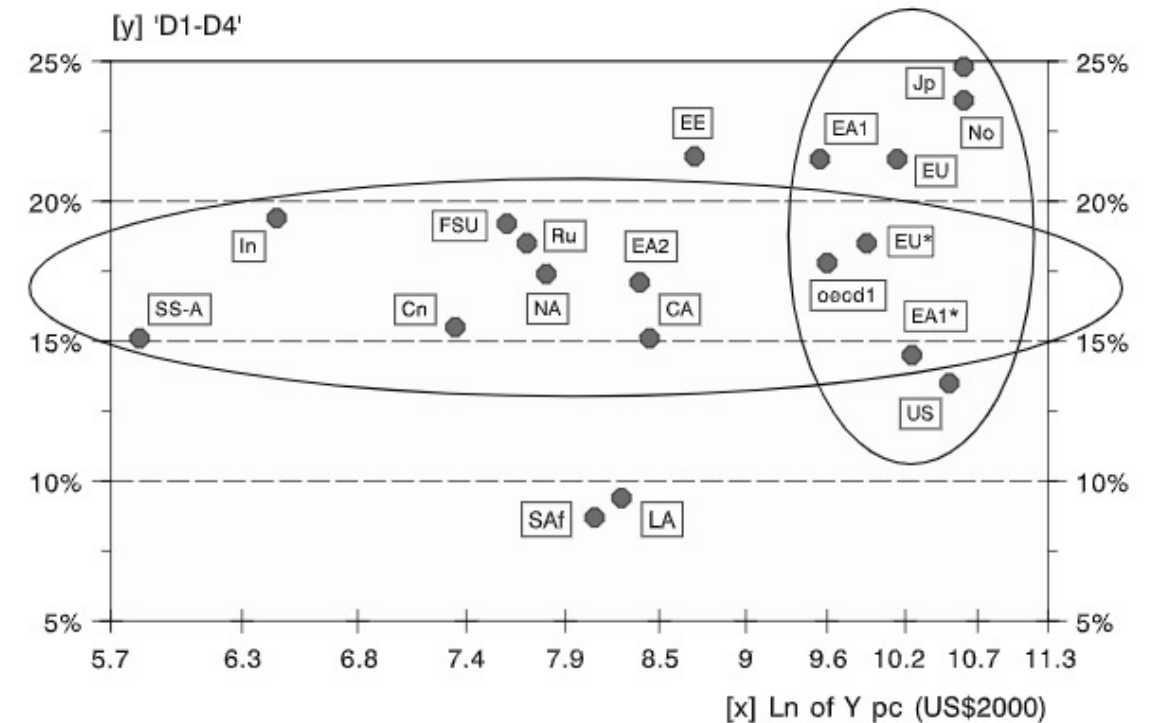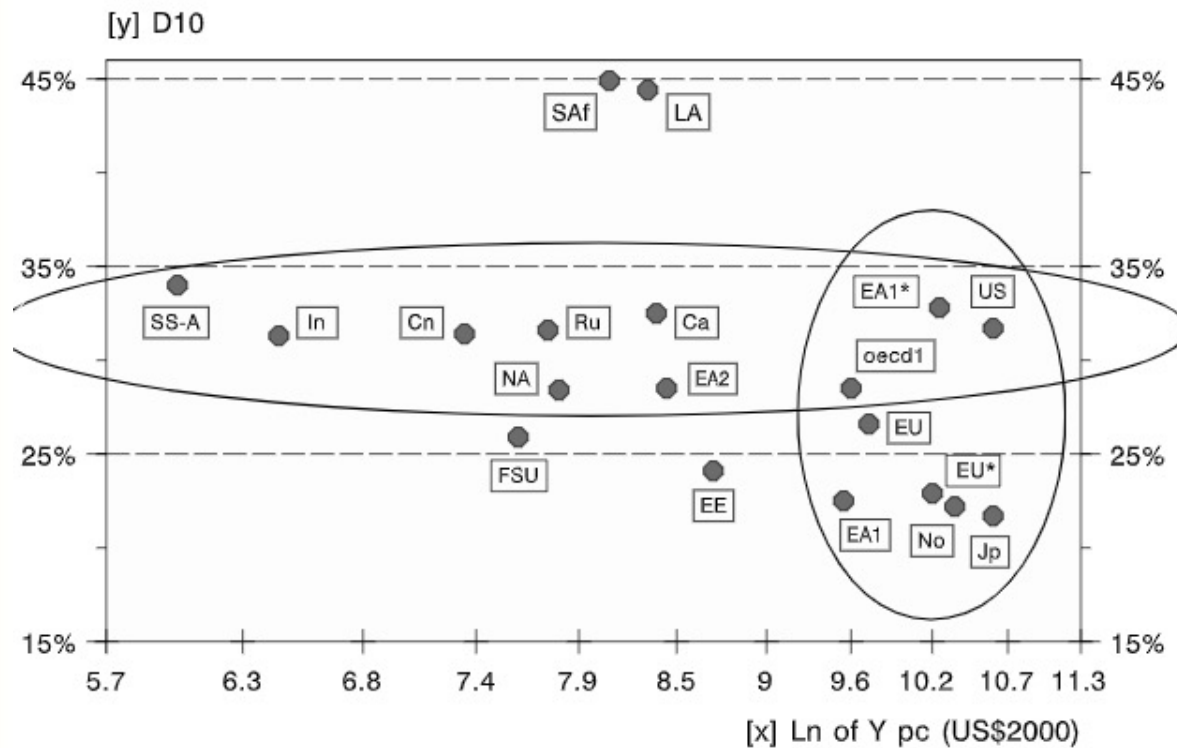
Gini vs Palma: Thailand and Indonesia
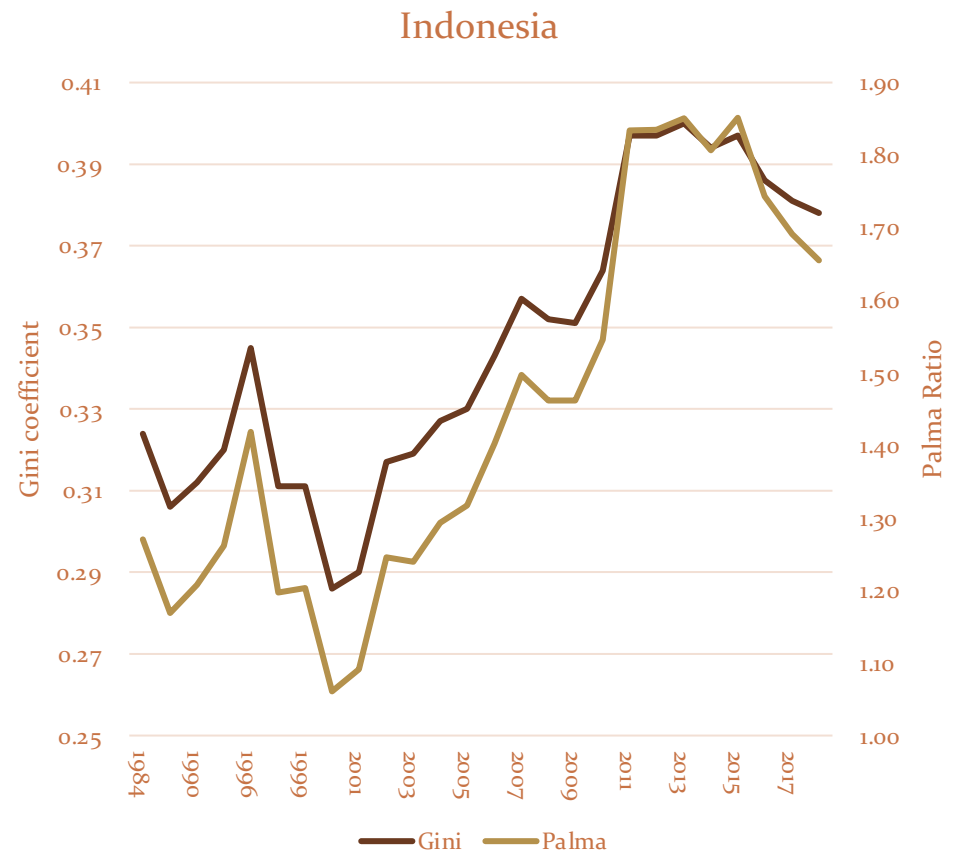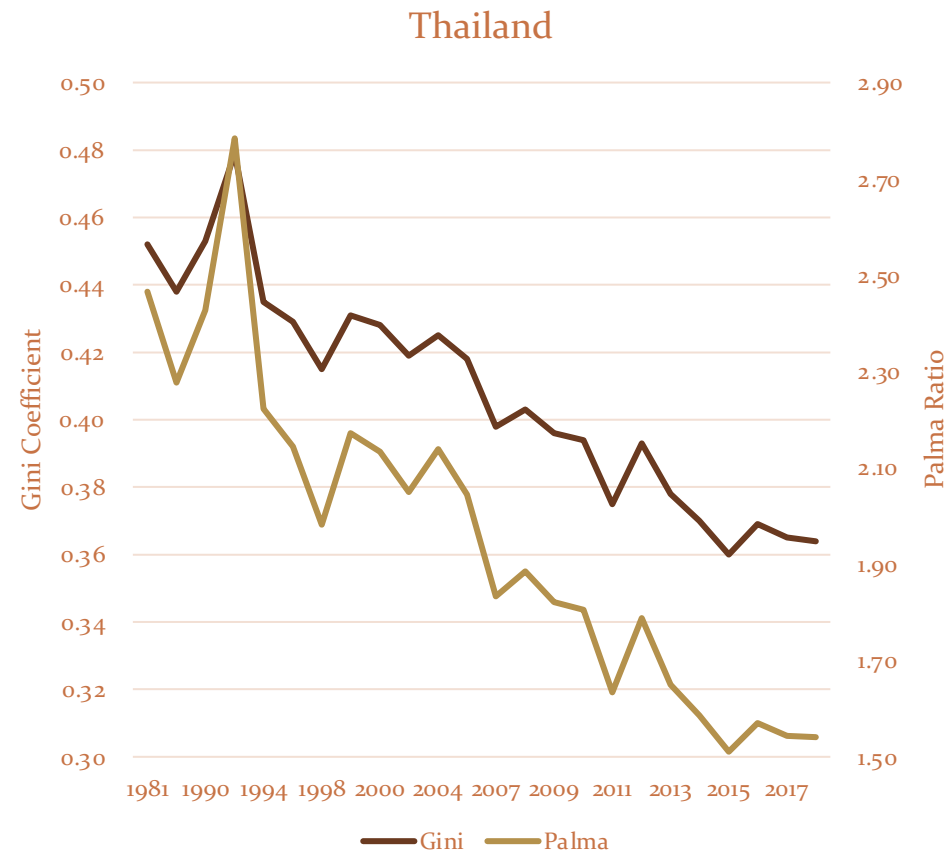
Income share of the 5ᵗʰ to 9ᵗʰ quintiles and per capita income (2005)
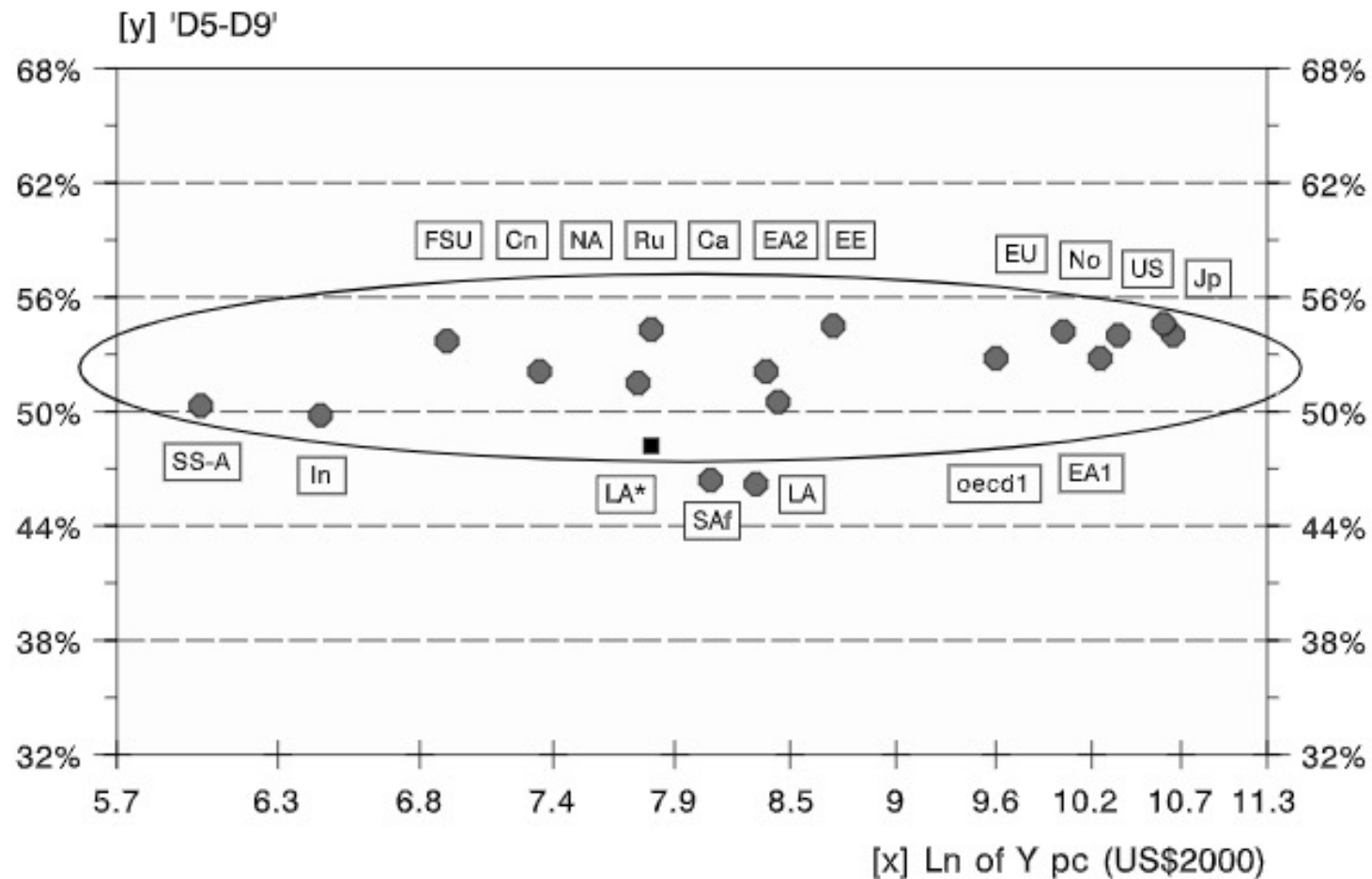
Income share of richest decile (left) and bottom 40% (right)

Palma: Stable middle and heterogeneous extremes

- Middle of the income distribution appears to be able to defend its share of income – the "administrative classes"

- Top 10% (really top 1%) has varying ability to extract income from the bottom 40%
  - Share of wages vs profits in national income
  - Rapidly growing manufacturing sector and rising labor productivity increases labor's share
  - Degree of oligopoly of economic structure (very high in natural resource-based economies)
  - Ability of elites to reduce taxes and redistributive fiscal policy

Simon Kuznets (1955): Economic Growth and Income Inequality

- Inequality is low in agrarian societies, so industrialization increases inequality

- Returns to investment increase, which accrue to the wealthy

- At higher levels of income, progressive taxation and social welfare decrease inequality

- More workers in high productivity activities like modern services
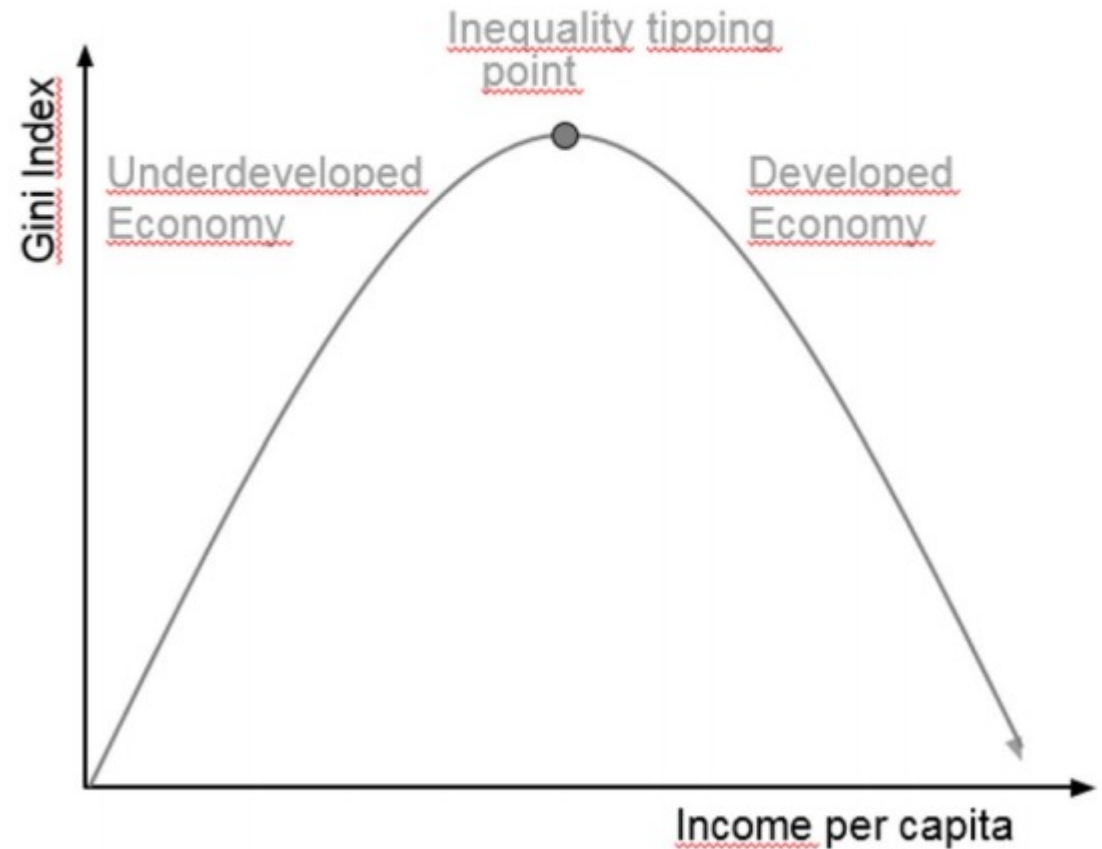
Has the world followed the Kuznets curve?

- Kuznets mainly used US data and never claimed that the curve was universally valid.

- Many agrarian economies are very unequal (Philippines): different starting points

- Tremendous diversity of inequality outcomes: Market outcomes and government redistribution

- More rapid productivity growth in industry and services reduces inequality effects of industrialization: Korea, Taiwan and Vietnam.

- But rising share of capital in national income causes inequality to rise

- Role of government varies even at high levels of national income: US vs Sweden

Does technological change cause inequality?

- Tinbergen (1975): Race between demand for skilled labor and increase in skills in the population can raise the relative wages of skilled workers and increase inequality.

- Automation reduces demand for labor and increases returns to capital: For example use of robots in automobile manufacturing

- Baumol effect: Some sectors have limited capacity for productivity increases → a string quartet will always consist of four musicians
  - Health and education are examples of public services that require human action even if automation can increase productivity to some degree
  - Suggests that as countries get wealthier they should spend more on public services to improve living standards and reduce inequality

- Atkinson: Government as the employer of last resort to reduce unemployment (which raises inequality) and increase bargaining power of workers

Milanovic: Globalization and within-country inequality

- Globalization has reduced the capacity of governments to tax mobile capital: telecommunication, finance and manufacturing

- It has weakened the power of labor (trade unions) in the advanced countries as manufacturing (and increasingly service) jobs move to Asia

- To the extent that manufacturing is geographically concentrated in Asian countries, globalization could increase inequality in developing countries (China)

- Unlikely that rising wages in China will bring these jobs back to the US and Europe: other low-wage countries will emerge (Vietnam) and automation will occur in China as well as the US

Discussion questions

1. Discuss the difference between the gini coefficient and the Palma ratio. Which do you think is a better measure of inequality?

2. Discuss the role of globalization in increasing or reducing within-country inequality.