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UNIVERSITY
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FULBRIGHT SCHOOL OF
PUBLIC POLICY AND MANAGEMENT

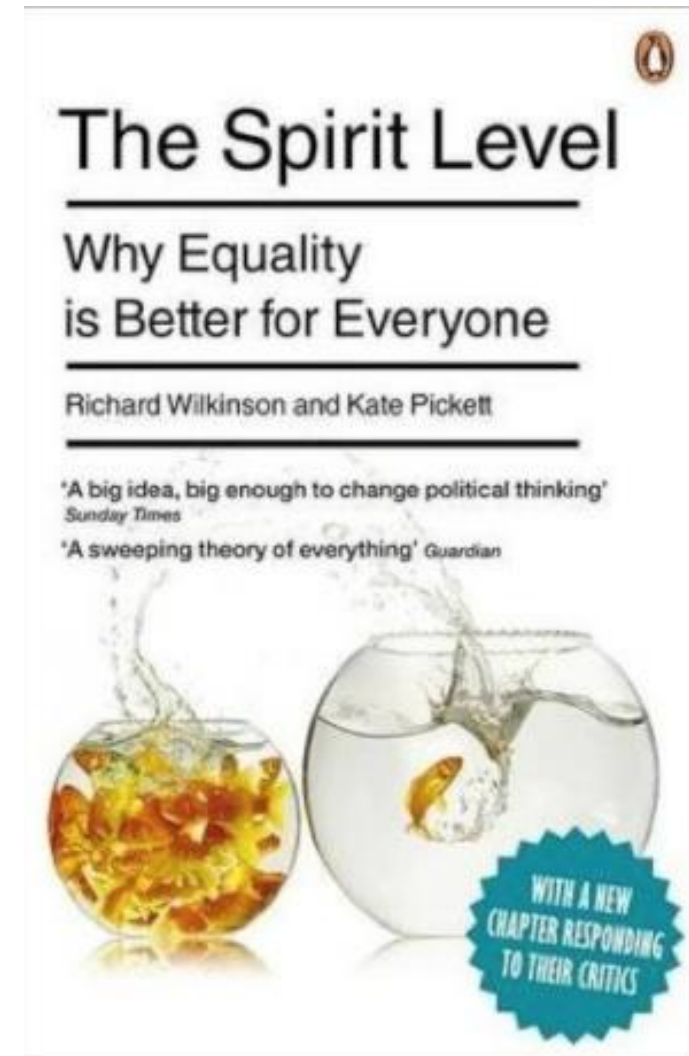
Within-Country Inequality

Development Policy
Summer 2023

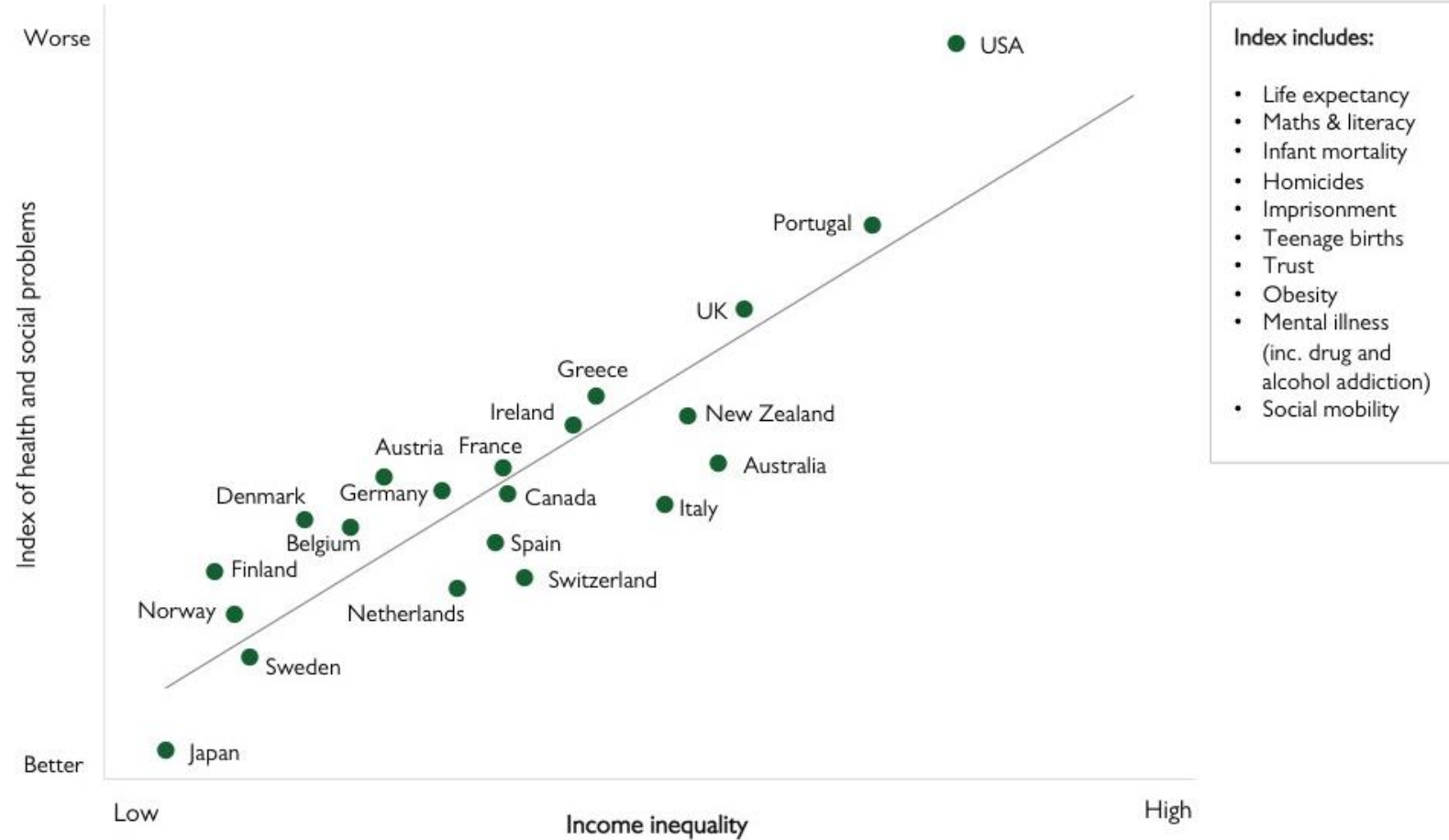


The Spirit Level (Thước Thủy)

- Why we should care about rising levels of inequality?
- Until recently, most economists believed that inequality wasn't a problem as long as poverty was falling
- But inequality is 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

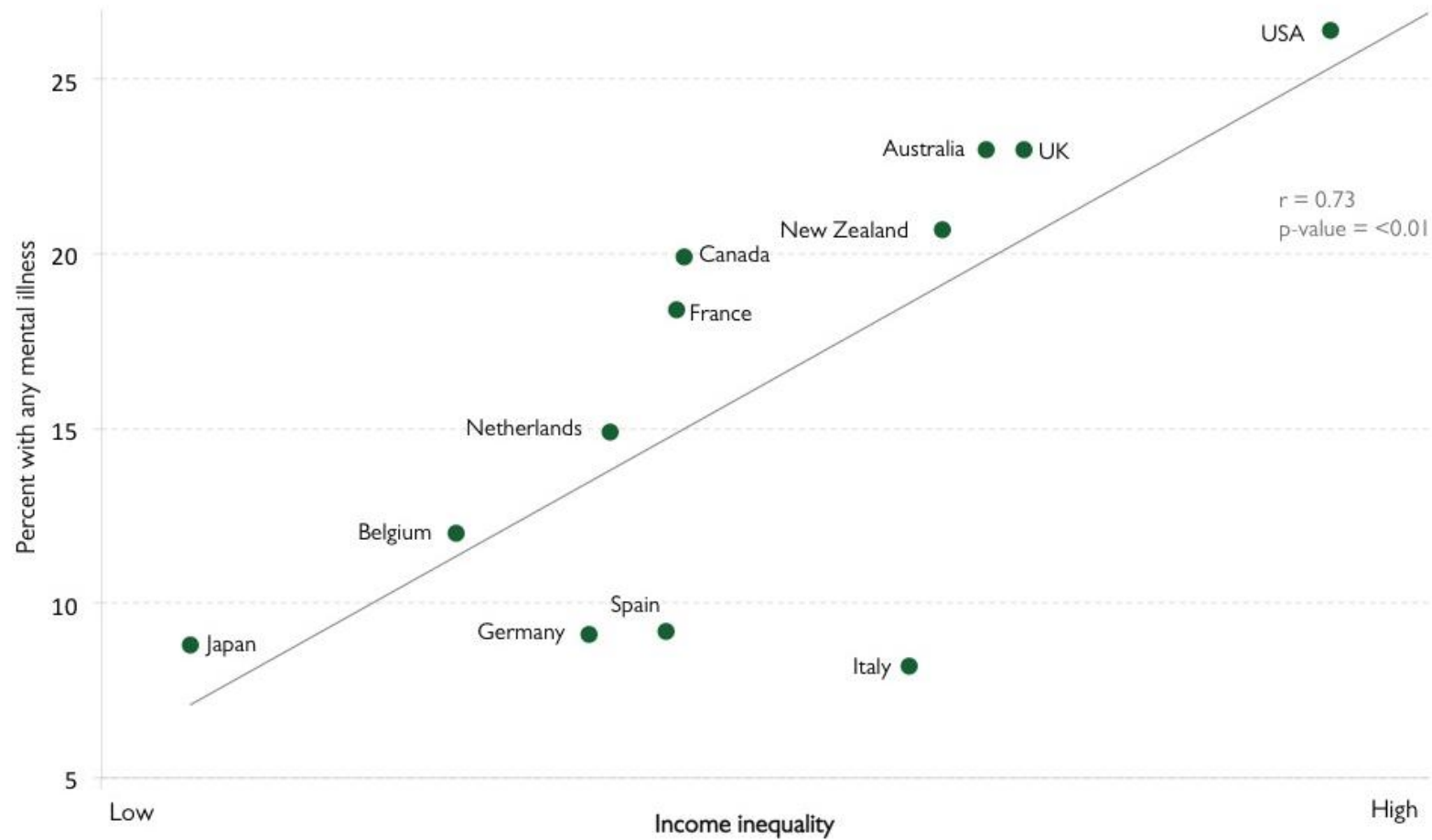


Health problems are worse

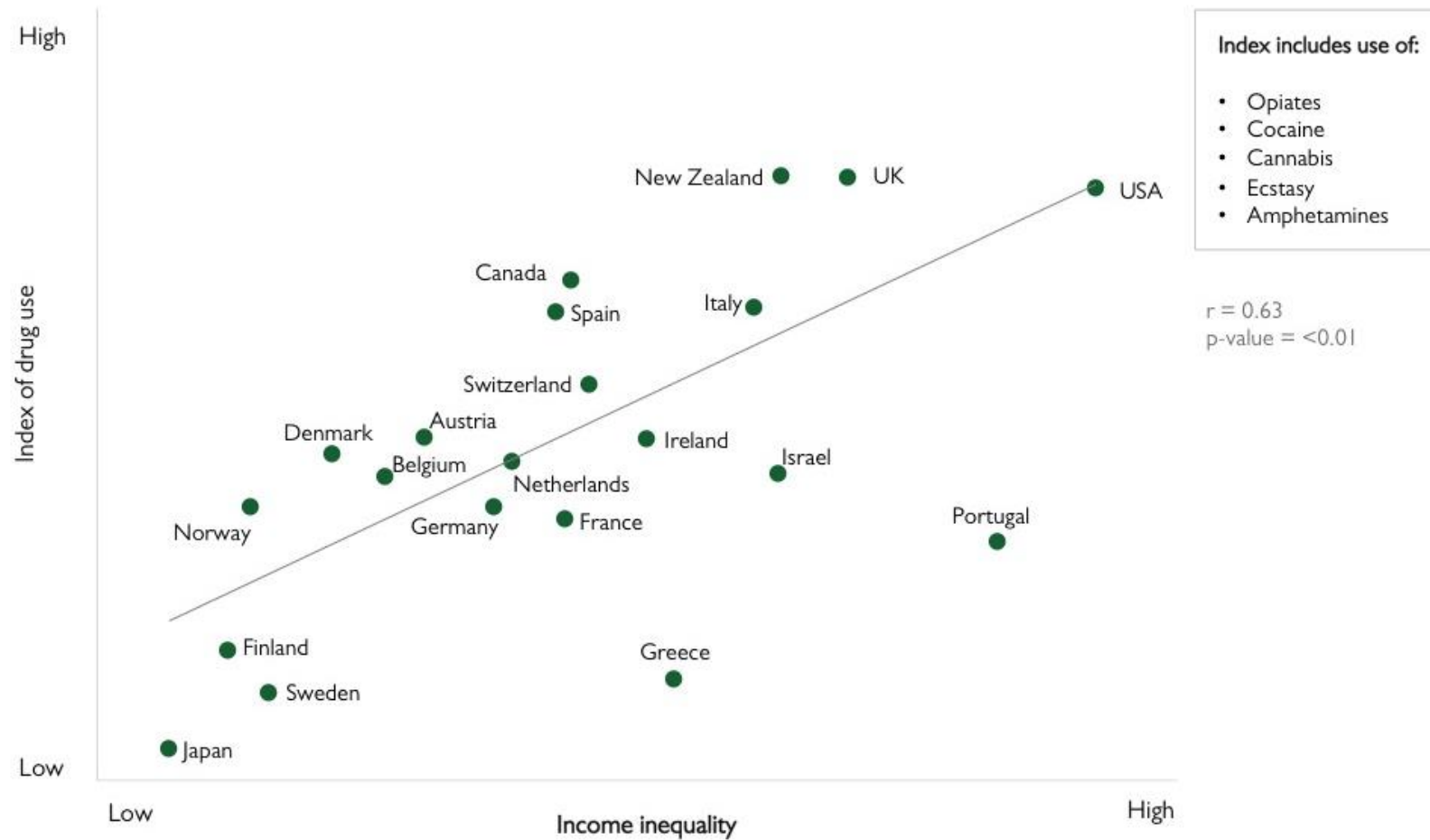




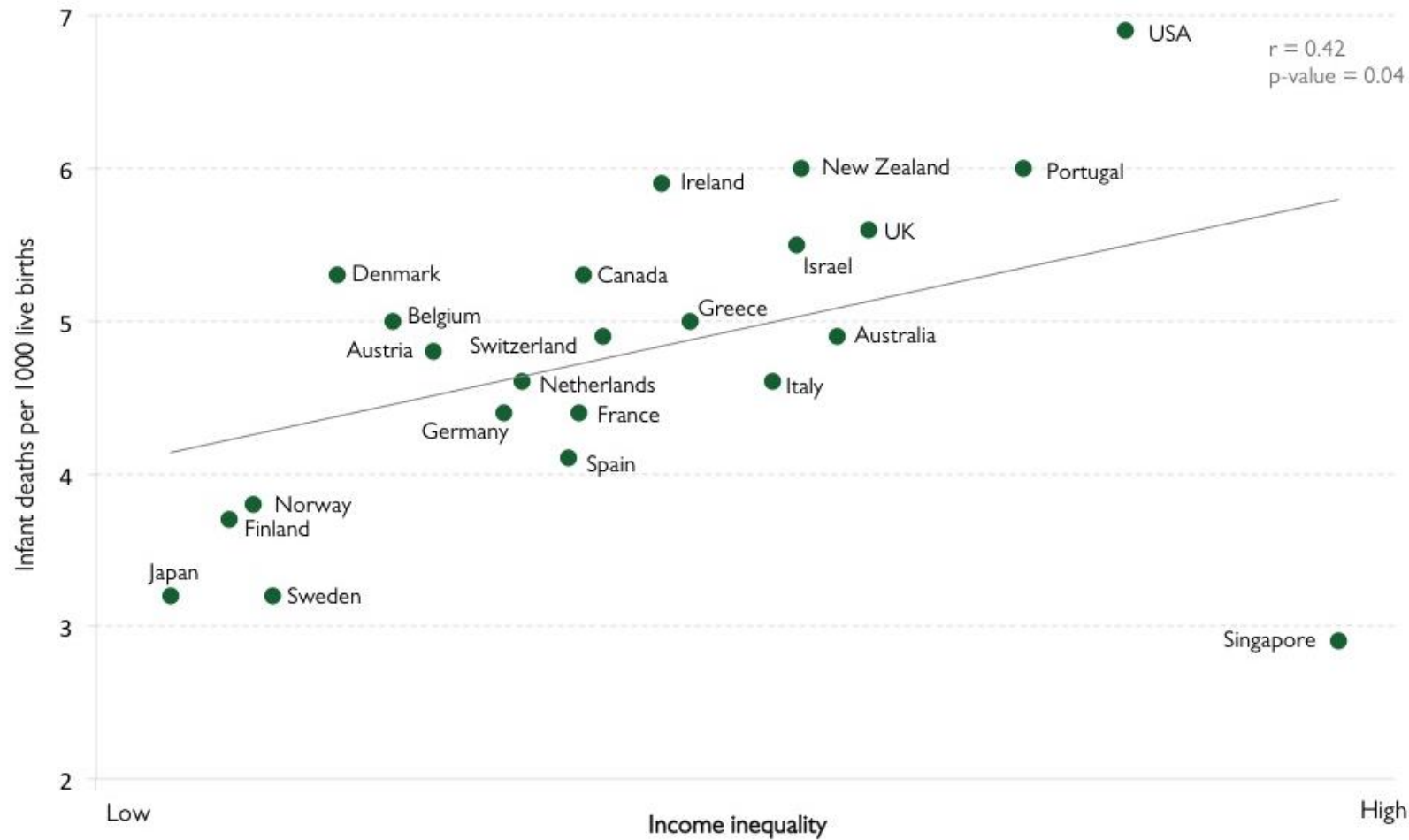
Incidence of mental illness is higher



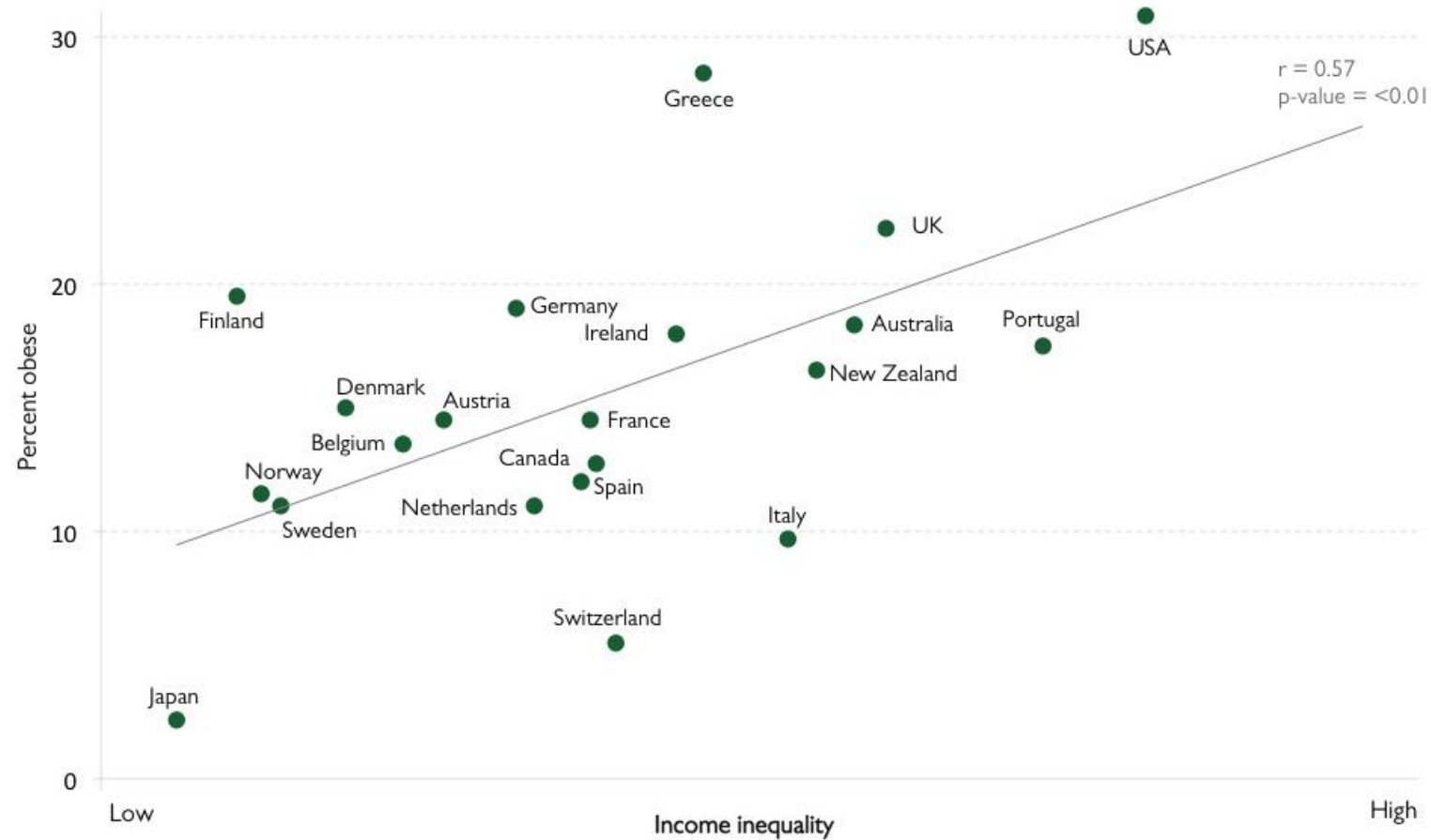
Incidence of drug abuse is higher



Infant mortality is higher

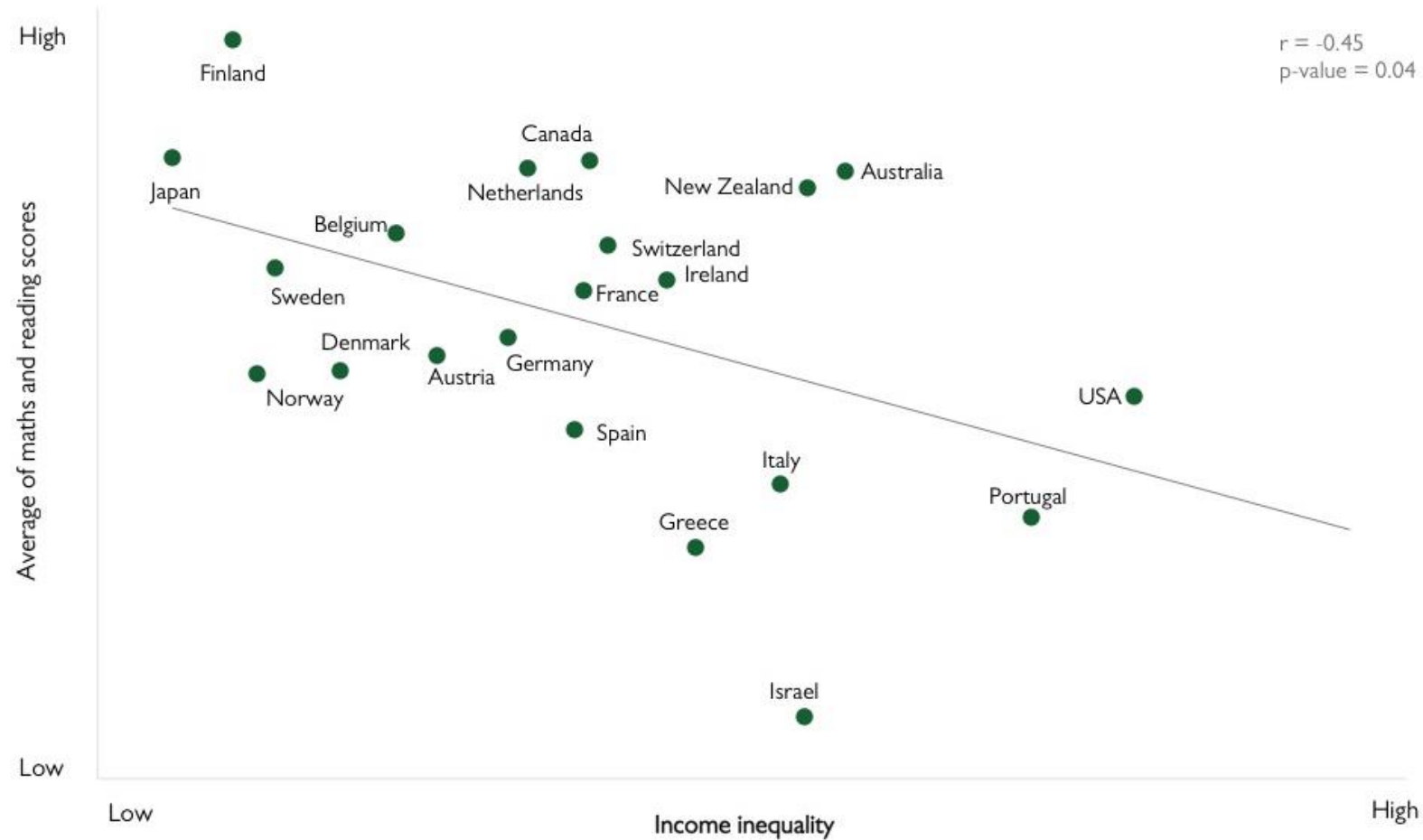


More people are overweight

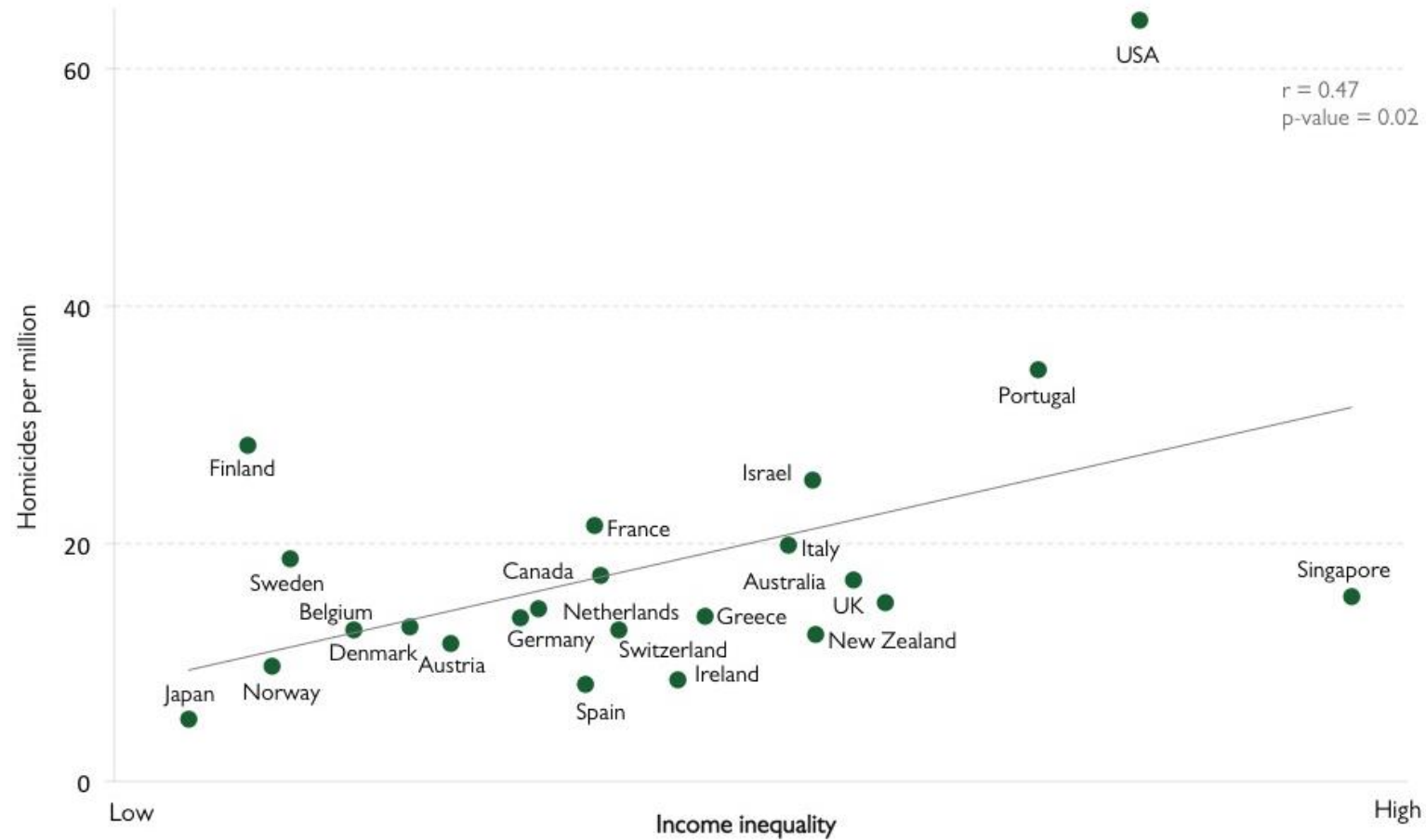




Children perform worse in school

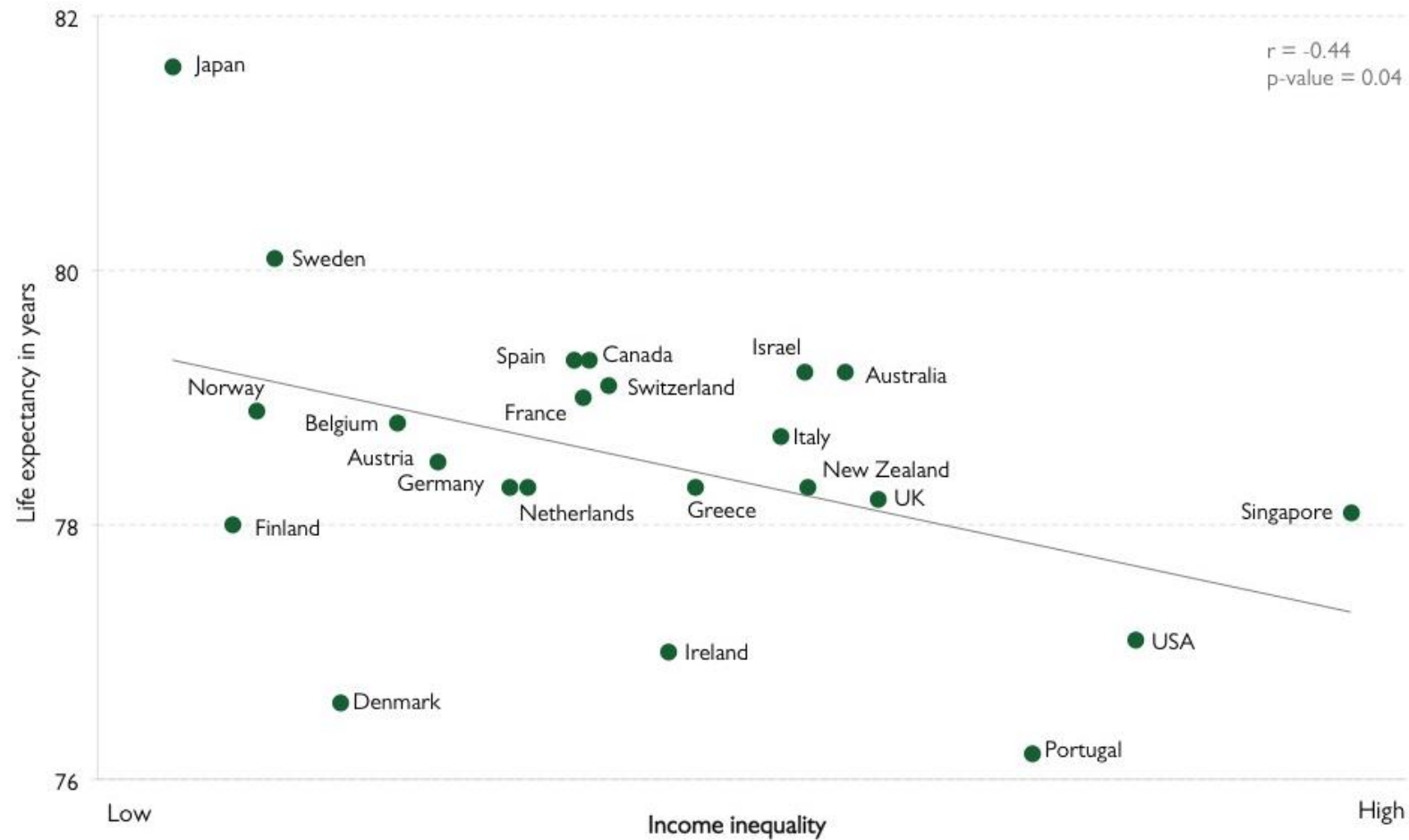


Murder rates are higher





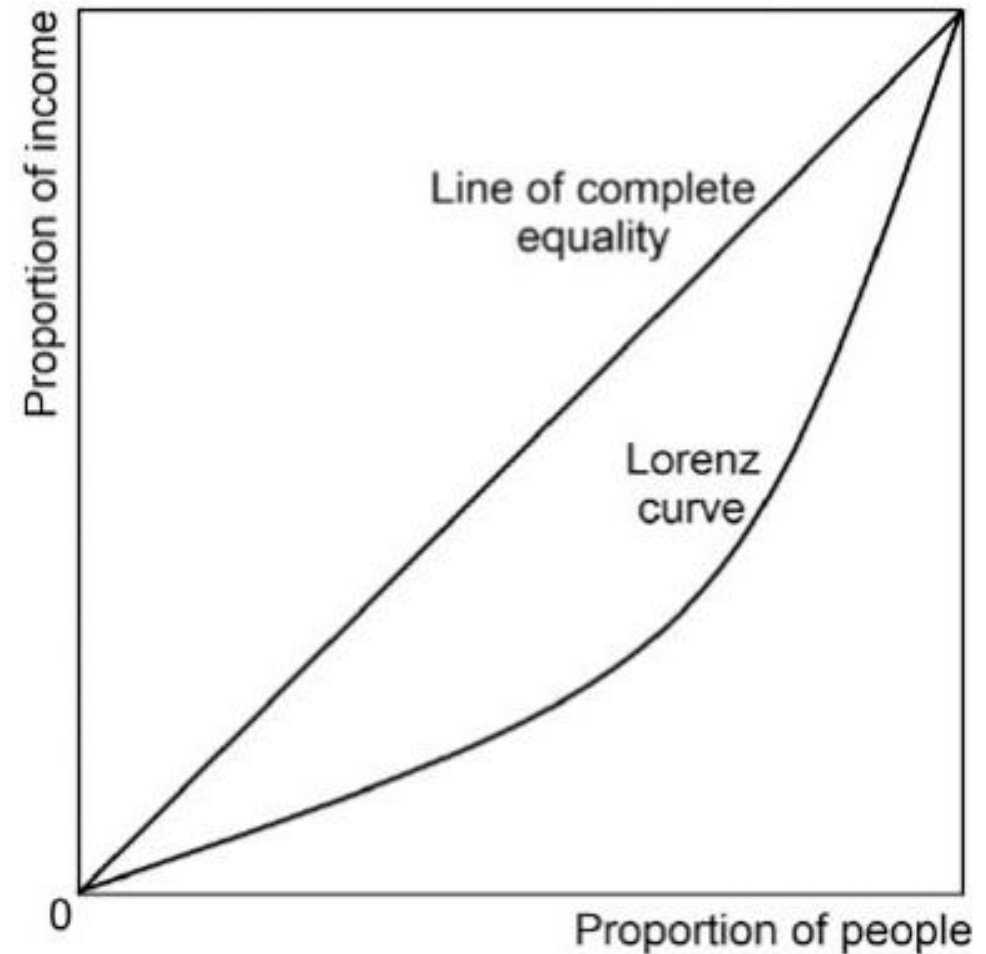
People live longer in more equal countries





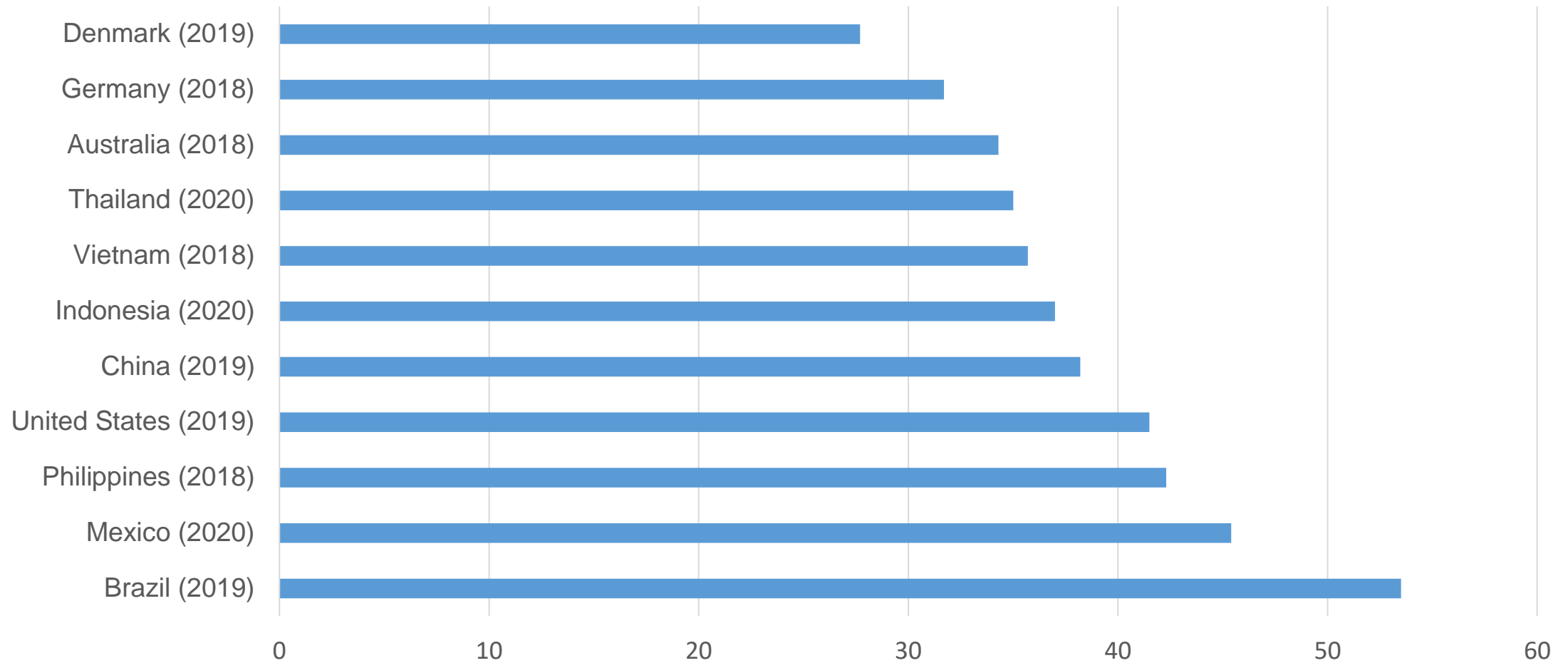
Measuring inequality

- 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 across 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?

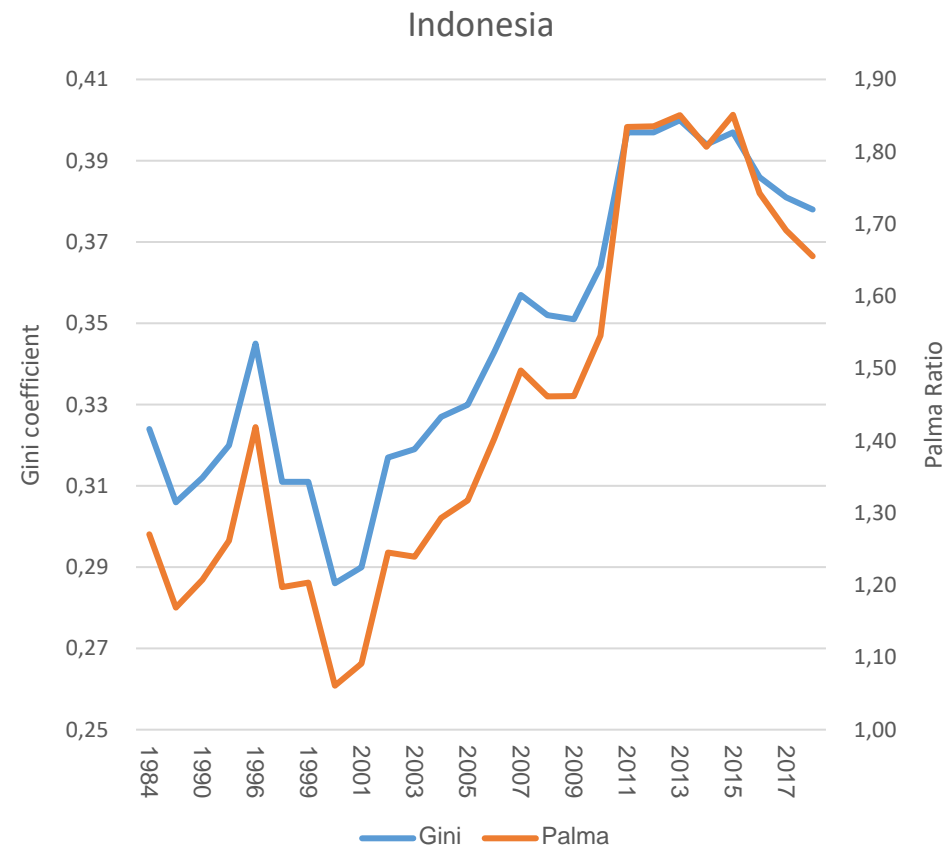
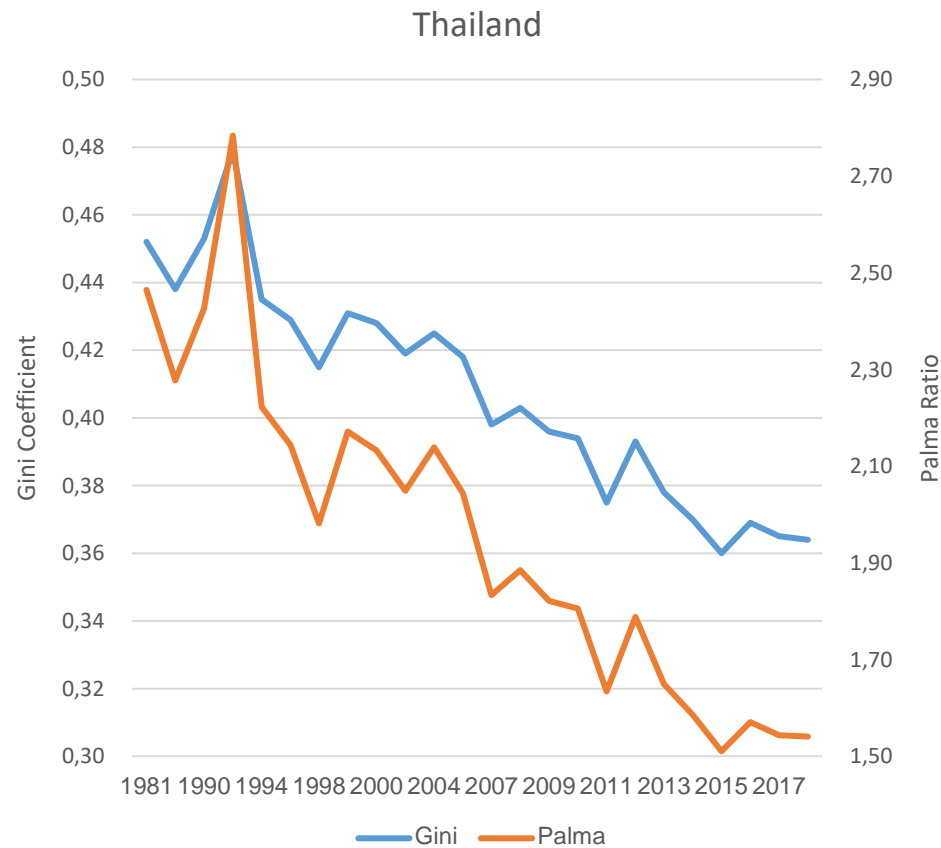


Palma ratio

- 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:

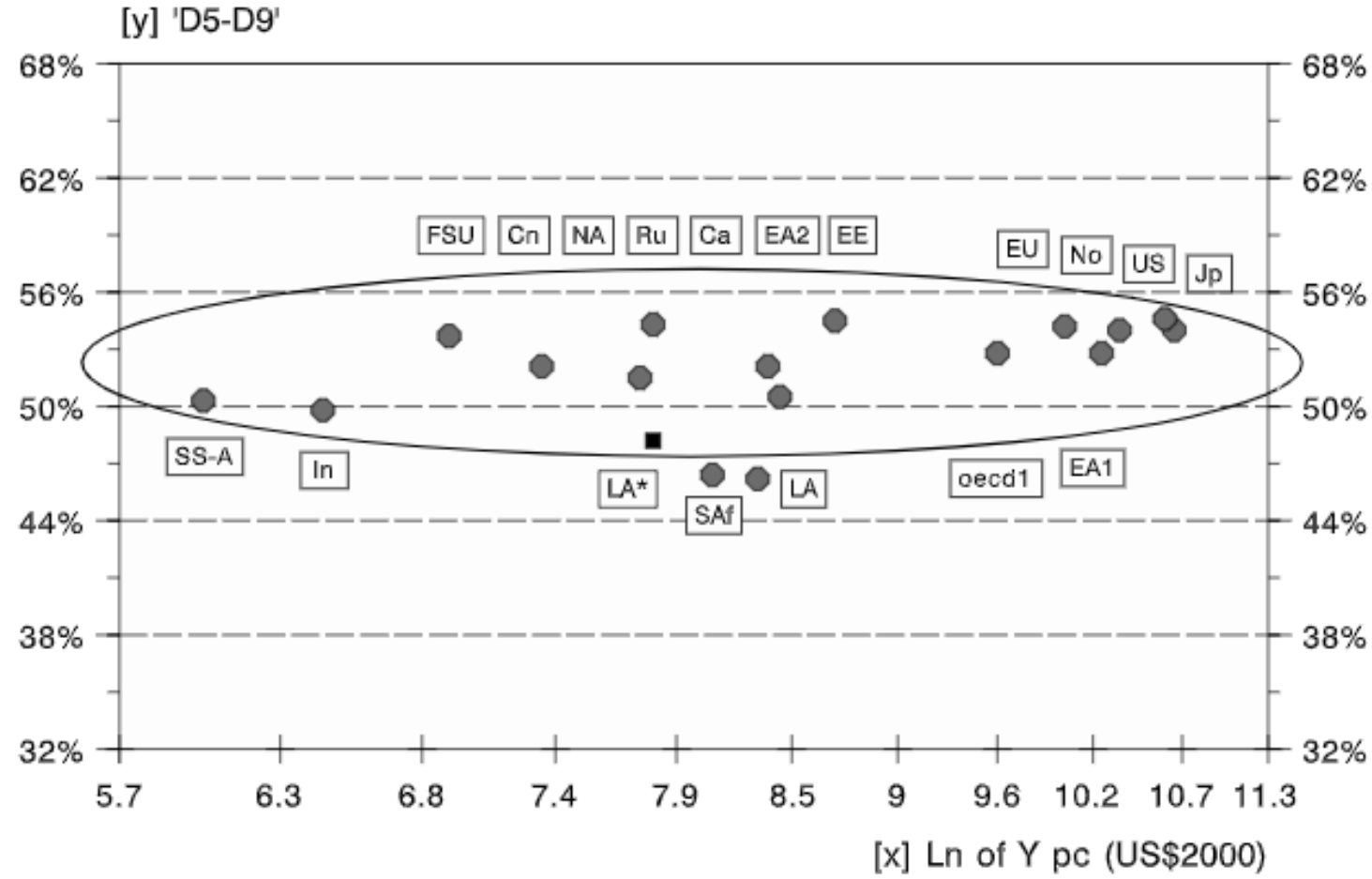
$$\frac{\text{Income share of the richest 10\%}}{\text{Income share of the poorest 40\%}}$$

Gini versus Palma



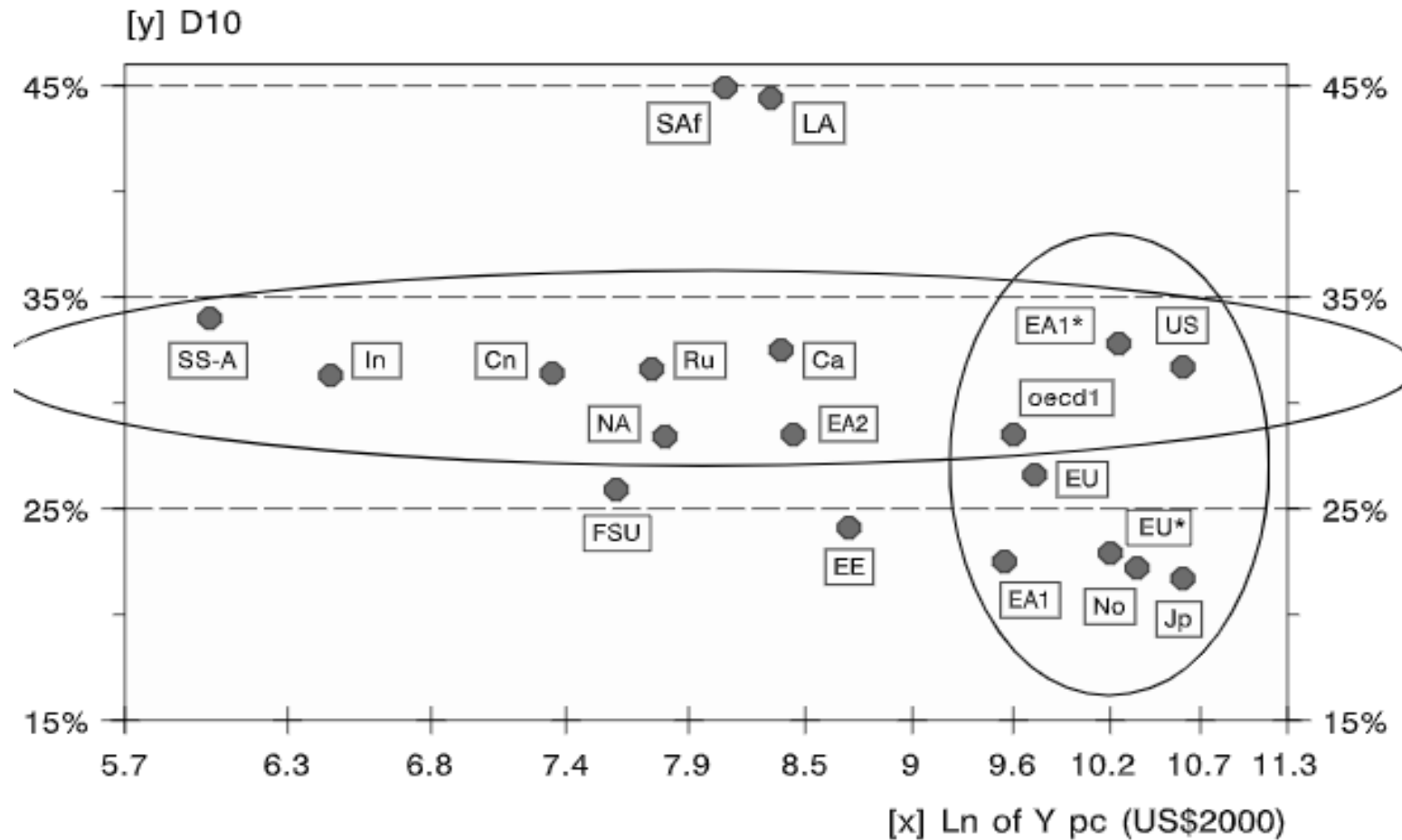


Income share of 5th to 9th deciles



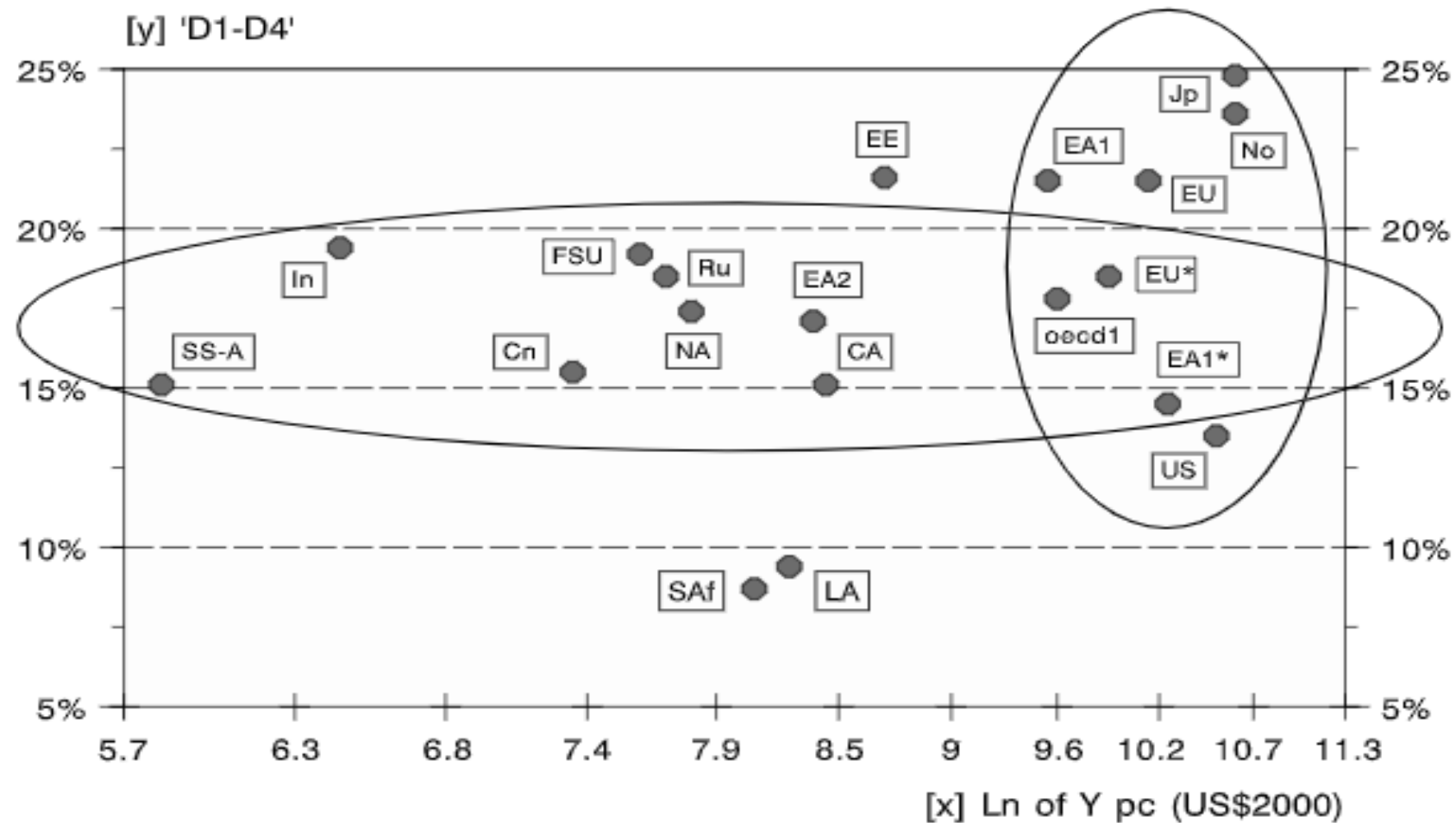


Income share of the richest decile





Income share of the poorest 40%





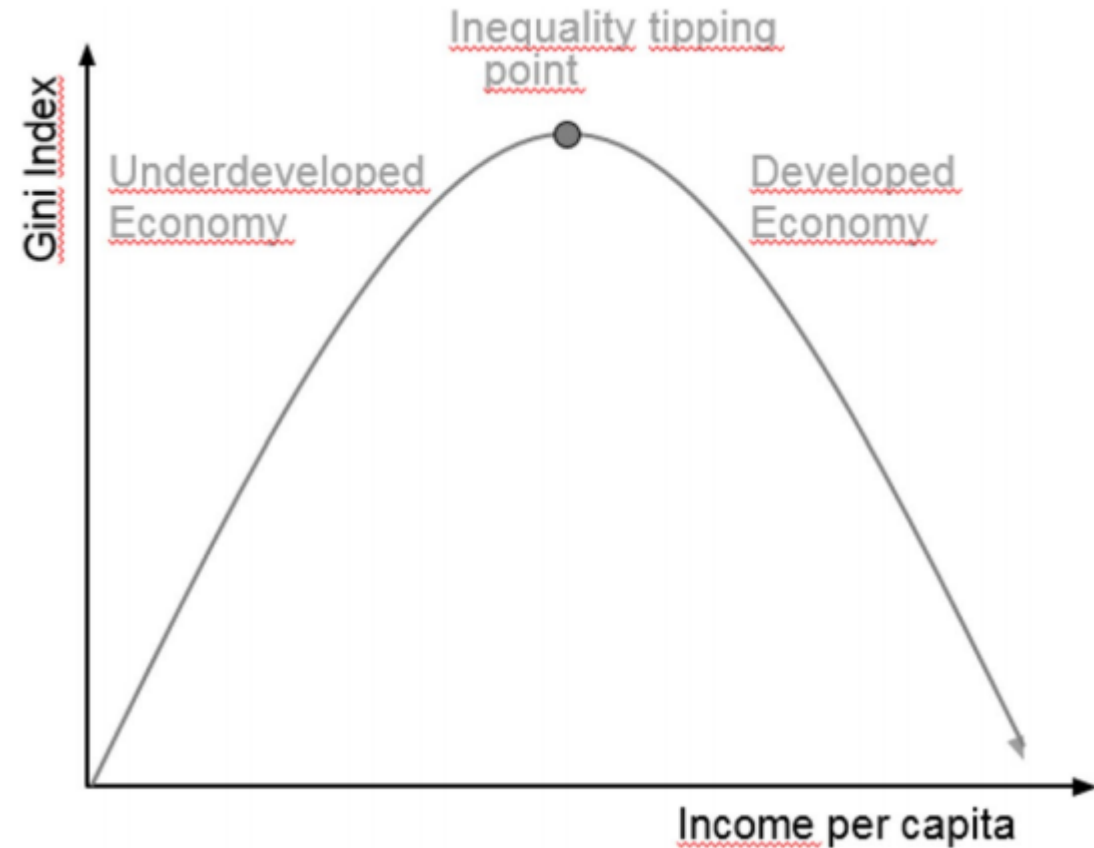
Stable middle and heterogeneous extremes

- 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



Economic growth and inequality: Simon Kuznets

- 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





Relationship between growth and development varies

- 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



Milanovic: Globalization and inequality within countries

- 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



Some policy implications

- Extreme economic inequality is associated with large social and political costs
- Measuring inequality presents serious methodological difficulties, especially comparing across countries.
- Inequality varies considerably across countries, and no stable relationship can be found between growth and inequality
- The middle of the distribution appears to be remarkably stable, with all of the action occurring at the top and bottom



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.