



Georg-August-Universität
Göttingen

Courant Research Centre
Poverty, Equity, and Growth in Developing
and Transition Countries

Inequality Reduction in Developing Countries: What can be done?

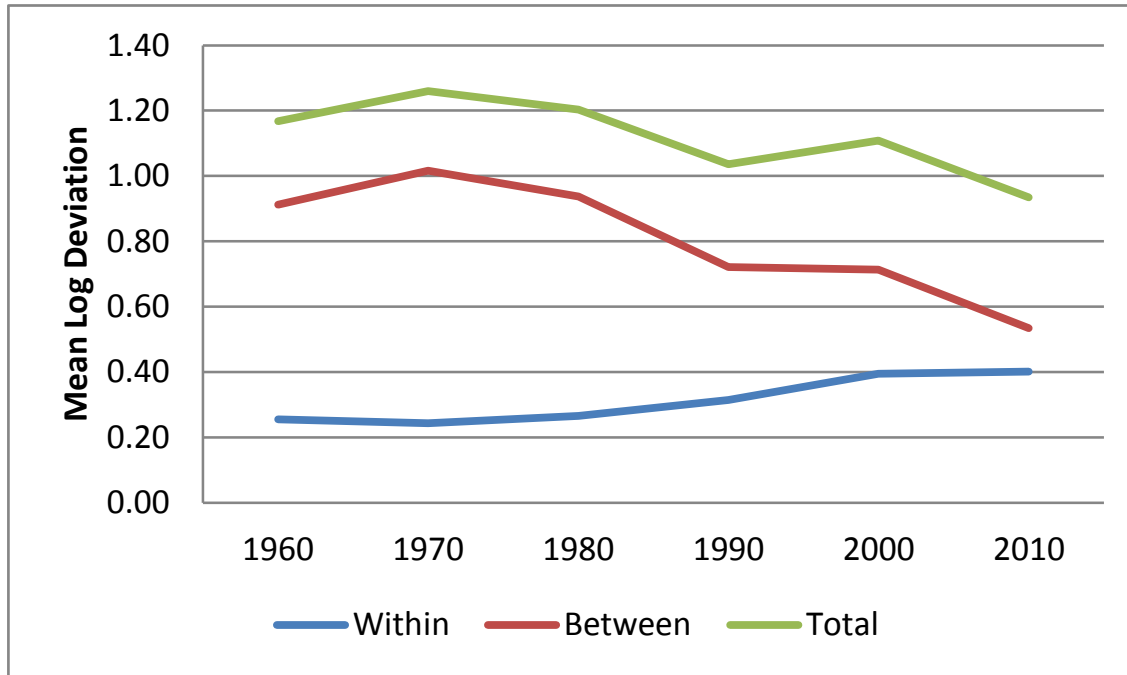
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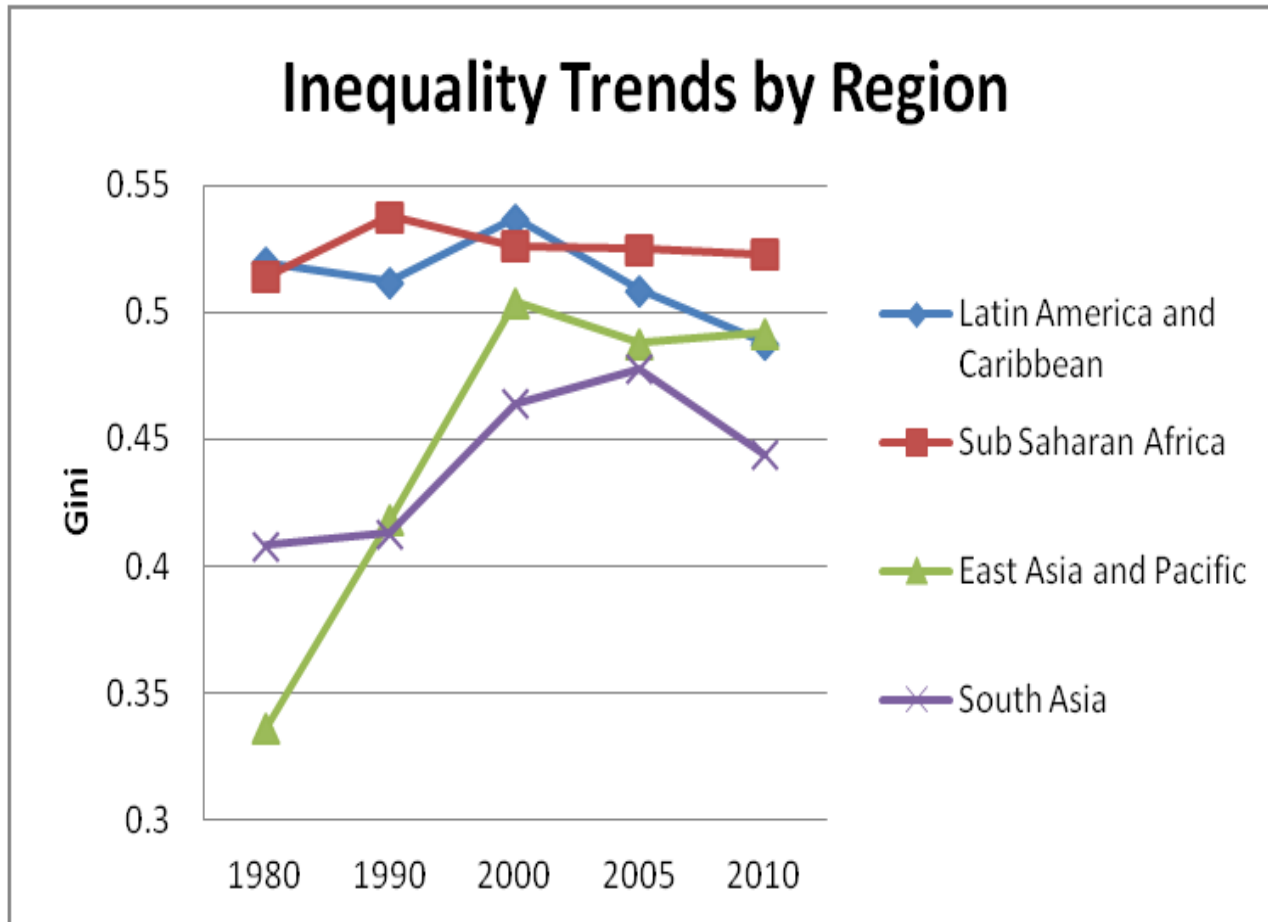
Introduction

- (Within-country) inequality reduction now firmly on the agenda
 - SDG 10 (but confusing double focus and associated targets);
 - World Bank ‚Shared Prosperity‘ Goal;
- Why?
 - Better data and analysis;
 - Equity issue;
 - Rising inequality in many developing countries since 1980s;
 - Importance for poverty reduction;
 - No inevitable trade-off with economic growth;

Figure 4: Within and Between Country Inequality Components of Global Inequality



Source: Global Income and Consumption Database.



What causes inequality?

- Inequality of assets (land, physical, human, financial capital);
- Inequality in returns (e.g. land productivity, returns to education, labor market access);
- Inequality in private transfers (remittances, mutual support);
- Redistribution by the state (tax-transfer systems);

- Strong inter-generational component;
- Group membership matters (‘horizontal’ inequality);

What are barriers that prevent reduction of inequality?

- Technical:
 - Key drivers unclear (,inequality diagnostics‘ important);
 - Inherently a multi-sectoral issue that cannot be addressed in one sectoral policy;
- Economic:
 - Economic forces might exacerbate inequality (e.g. recession, trade, inflation);
 - Economic structure favors high inequality (e.g. capital-intensive resource exporter);
- Political:
 - Inequality not seen as a key issue;
 - Political elites benefit from inequality;

Sectoral Policies to Tackle Inequality

Policy Issue	Research finding	Policy implication
Tackling asset inequality		
Land Reform	Land inequality an important driver of asset inequality in many low-income and lower middle-income countries with large agricultural sectors. Insecure tenure can reduce investments of the poor	Land reform with redistribution component an important policy-lever. Tenure reform should focus on improving tenure security for current users.
Education and health policies	Pro-poor education and health policies can reduce inequality in human capital and promote economic growth; educational inequality important driver of overall inequality	Focus public health and education expenditures on basic education and health care, enable the poor to access higher education and health (through loans, and insurance schemes, respectively)
Credit policies	Lack of access to capital a significant constraint for the poor to invest; capital markets do not work for them and many microcredit schemes bypass the poorest and/or lead to high indebtedness;	Support microcredit institutions that reach the poorest and provide sustainable credit (usually with subsidy element)
Gender policy	Gender inequality exacerbates income inequality via educational inequalities, health inequalities, inequalities in access to financial services, etc. which in turn reduces growth and pro-poor growth.	Thus, promoting female education, employment and access to health care (also to constrain fertility) will decrease gender inequality and thus promote more equality in income.



Improving returns to asset for the poor		
Infrastructure	Rural infrastructure can improve the functioning of agricultural input and output markets	Promote the construction of rural roads and associated market infrastructure
Agricultural policies	Inequality heavily affected by low agricultural productivity of poor producers, related to low access and use of modern inputs and seeds, lack of infrastructure, extension services, etc.	Prioritize access to seeds and modern inputs for poor farmers through subsidy schemes, starter-packs, targeted extension services, etc.
Labor market policy	Unequal distribution of employment and earnings key driver of inequality, particularly in middle-income countries; active labor market policies including minimum wages and training initiatives can reduce labor market inequality there	Invest in education and training of the poor; improve access to labor markets through dedicated services for them; provide incentives for formalization; consider minimum wages (in middle-income countries);

Increasing redistribution by the state		
Fiscal policy	Fiscal policies are especially important for (i) fighting inequality directly via a progressive tax regime as well as for (ii) financing social transfers and public expenditure benefiting the poor. Tax/GDP ratios generally low and increases have tended to help lower inequality, esp. in middle-income countries	Increasing the tax per GDP ratio through reducing exemptions, closing tax loopholes and tax evasion, and some increases in progressive taxation (e.g. luxury VAT, commodity taxation); re-orient public spending towards the poor by increasing access to government services, asking for co-payments among non-poor, and introducing new pro-poor programs
Social policy	Transfers to the poor (including conditional cash transfer programs and non-contributory social pensions and child grants) decrease poverty, lower inequality, can promote human capital investment, and risk-taking by the poor.	Promote social protection programs that are broad in coverage, easy to administer, and fiscally sustainable (costs less than 1-2%/GDP)
Improving public sector management	Poorly functioning public sector (government and state-owned enterprises) lowers ability to effect redistributive policies	Strengthen state capacity through improved financial management and public oversight; analyze distributional impact of public spending; harden budget constraints for state-owned enterprises.

Other policies with inequality implications		
Macroeconomic and monetary policy	Low inflation and competitive exchange rates are both important for macroeconomic stability and for fighting income inequality.	Set targets for low inflation, manage exchange rate and capital inflows, ensure low fiscal deficits;
Trade policy	Trade liberalization is important for macroeconomic stability, economic growth and diversification, but can be inequality-enhancing.	Removing export-bias and enhancing free trade (especially regional and South-South trade) is generally desirable. Temporary protection of infant industries and prevention of re-primarization (undermining industrialization by returning to a focus on agriculture and resource extraction for exports) is advisable for poor countries. Maintain competitive exchange rate
Structural policy	Since many of the poor still live in rural areas and thus depend on agriculture for income, regional and sectoral policies can benefit the fight against income inequality if focused on promoting productivity of land and labor. Regional inequalities moreover slow down economic growth and enhance inequality; industrial policy focused on urban areas can increase inequality in the short-term.	Focus on improving agricultural productivity and earnings for poorest; promote labor-intensive industrialization; accommodate rural-urban migration; promote infrastructure and agriculture in backward regions.
Governance	Poor governance usually inequality-enhancing as the poor suffer particularly under corruption, poor state capacity and inadequate services.	Promote governance reforms that increase transparency, tackle corruption, and improve state capacity, particularly in the delivery of services.

International Trends and Policies that can Affect Within-Country Inequality		
Tax transparency and compliance	Capital flight and tax evasion by wealthy individuals, and tax avoidance by multinational companies reduces tax revenues and redistribution by the state;	OECD processes to reduce tax evasion by individuals and tax avoidance by multinational companies should ensure developing countries benefit fully from new rules and systems
Trade Policy	Further trade liberalization in rich countries in agriculture and services can promote pro-poor exports; trade facilitation can promote pro-poor exports	Complete Doha Development Round (or alternative processes) focusing on facilitating exports from poorer segments of developing countries, focusing on agriculture, services, and trade facilitation;
Capital and labor flows	Capital flows can provide much-needed resources for pro-poor growth; but many capital flows, esp. short-term flows as well as most FDI will likely increase inequality; also, short-term capital inflows are destabilizing; remittances can help reduce inequality if migration of the poor is facilitated;	Regulation and management of short-term capital inflows important to prevent financial crises; transparent immigration policy can facilitate remittances and migration of poorer segments of population.

Role of Development Cooperation

- Bilateral aid only limited impact: National policies decisive;
- Analytical Support (mainly technical cooperation):
 - Inequality Diagnostics;
 - Support for development and implementation of policy;
- Financial Cooperation:
 - Budget/sector support;
 - Targeted investment in sectors with high inequality implications;
- International Dimension
 - Support initiatives to combat tax avoidance/evasion by rich individuals and multinational cooperations;
 - Transparency in resource sector;
 - Financial market reforms;

Table 10: Different Types of Indicators to Monitor Inequality Effect of Aid Programs

Complexity	Outcome	Intermediate	Input	Project-level
Headline Indicator	Levels and changes in Gini coefficient	Levels and changes in agricultural productivity of the poor	Amount of seeds and fertilizer delivered per poor household;	Improvement of agricultural productivity of targeted households
Other indicators	Levels and changes in Palma Ratio, 90/10 ratio, Atkinson measure, shared prosperity	Levels and changes in land inequality, transport costs, price margins	spending on the program/project; unit costs of inputs delivered	Comparison of treatment and control area; cost per beneficiary; cost-effectiveness
Analytical Tools	Income and non-income growth incidence curves	Income and non-income growth incidence curves, tax and expenditure incidence	Incidence analysis (who benefited from these input deliveries)	Impact evaluation methods

Conclusions

- Inequality agenda increasingly important;
- Cross-cutting issue;
- Development Cooperation can make contribution:
 - Analytical capacity (build up own competence first!);
 - Development and implementation of policies (esp. Human resource policies, fiscal redistribution, agriculture, social protection);
 - Budget support and targeted investments;
 - Engage with international processes (tax and financial sector reforms);