

# Inclusive Growth: Global Forces and National Policies

Ravi Kanbur

[www.kanbur.dyson.cornell.edu](http://www.kanbur.dyson.cornell.edu)

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# Outline

- Introduction
- Some Global Patterns
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# Some Writings

- Ravi Kanbur and Joseph Stiglitz. 2015. “Wealth and Income Distribution: New Theories Needed for a New Era.” Vox EU <http://www.voxeu.org/article/wealth-and-income-distribution-new-theories-needed-new-era>
- Michael Spence, Danny Leipziger, James Manyika and Ravi Kanbur. 2015. “Restarting the Global Economy: Three Mismatches that Need Concerted Global Action.” Vox EU <http://www.voxeu.org/article/restarting-global-economy>
- Ravi Kanbur. 2014. “Globalization and Inequality”, in A.B. Atkinson and F. Bourguignon (Editors), Handbook of Income Distribution Volume 2B, Elsevier.
- Ravi Kanbur. 2014. “Social Protection: Consensus and Challenges,” in G.A. Cornia and Frances Stewart (eds.) Towards Human Development: New Approaches to Macroeconomics and Inequality, Oxford University Press, pp. 86-98, 2014.
- Ravi Kanbur, Changyong Rhee and Juzhong Zhuang. 2014. *Inequality in Asia and the Pacific: Trends, Drivers, and Policy Implications*, (Co-Editor with C. Rhee and J. Zhuang), Routledge, 2014.
- Ravi Kanbur and Juzhong Zhuang. 2013. “Urbanization and Inequality in Asia,” (with J. Zhuang), Asian Development Review, Vol. 30, No. 1, pp. 131-147.
- Ravi Kanbur and Juzhong Zhuang. 2012. “Confronting Rising Inequality in Asia,” (with J. Zhuang), Theme Chapter of *Asian Development Outlook 2012*, Asian Development Bank.
- Ravi Kanbur. 2012. “Does Kuznets Still Matter?” in S. Kochhar (ed.), Policy-Making for Indian Planning: Essays on Contemporary Issues in Honor of Montek S. Ahluwalia, Academic Foundation Press, pp. 115-128.

# Introduction (1)

- What is inclusive growth? Huge literature on getting at a “precise” definition. But a more general, more generous, perspective, is perhaps more useful for a public lecture such as this.
- By inclusive growth I mean economic growth whose fruits are broadly shared among the population, so that the process does not leave individuals or groups behind on wellbeing in income and non-income dimensions
- Thus, clearly, the evolution of inequality as growth proceeds is important for an inclusive growth perspective. Again, a huge literature on “precise” measurement of inequality. But a more general, more generous, perspective is more useful.

## Introduction (2)

- No need to rehearse here in detail why inequality is important. There are at least three reasons:
- (i) in and of itself from an ethical standpoint;
- (ii) instrumentally, as the transmitter of growth to poverty reduction and
- (iii) instrumentally, as a determinant of growth itself.

# Introduction (3)

- In what follows I will:
- Look at global patterns of inequality change.
- Propose a framework in which we can make sense of these patterns.
- Apply the framework to understanding commonalities and diversities in patterns of inequality change.

## Some Global Patterns (1)

- We are said to be living in an age of rising inequality. Is this true?
- Consider the patterns we observe in standard money metric inequality of consumption or income.
- For OECD countries, particularly US and UK, rising inequality since the 1980s (Piketty and all that).

## Some Global Patterns (2)

- For Developing Asia, as documented in ADO 2012, and subsequent volume by Kanbur-Rhee-Zhuang, a broad pattern of rising inequality in the 1990s and 2000s.
- Inequality not rising in every country, but 85% of population living in countries with rising inequality.
- Also, if growth performance had been achieved without rising inequality, 250 million more people would have been lifted out of poverty.



## Some Global Patterns (3)

- BUT, as we all know, in Latin America inequality fell in the 1990s and 2000s. (In Brazil, to achieve the same poverty reduction without falling inequality, growth would have had to have been 3 percentage points higher)
- And in MENA countries, in particular Egypt and Tunisia, inequality was more or less stable (or even falling) in the run up to the Arab Spring.
- In Sub-Saharan Africa, recent World Bank report shows no clear pattern, with inequality rising in some (eg Ghana, Ethiopia) and falling in others (eg Tanzania, Uganda).
- (It would be useful to have an update on the patterns in Central and Western Asia to see where they fit).

## Some Global Patterns (4)

- Finally, note that even the emerging market economy most referenced for rising inequality, China, the pattern is actually quite nuanced.
- After the start of the reform process in 1978, inequality actually fell for the first 10 years as the “personal responsibility” system raised rural incomes.
- In the next 20 years, as China opened up and coastal areas grew rapidly, inequality increased.
- However, from the mid-2000s onwards, it appears as though the rise in inequality is hitting a plateau, if not actually turning down. Why?

# Assets, Returns and Transfers (1)

- Is there a framework in which we can attempt to make sense of these patterns, a framework in which commonalities can be picked up and differences can be accommodated?
- Let market income be thought of as asset A times the rate of return on the asset R. Then take home income, after net taxes and transfers T, can be written as

$$Y = AR + T$$

- From this, very loosely, inequality can be thought as being made up of three components: Inequality of assets A, inequality of rate of return R and inequality of net taxes and transfers T.
- Of course this is technically loose because we have to take into account the covariances between A, R and T. However, at an intuitive level it will suffice to make a series of points.

# Assets, Returns and Transfers (2)

- First, the evolution of inequality can now be thought of in terms of the evolution of inequality of A, of R, and of T.
- Second, policies towards inequality can be thought of in terms of policies towards inequality of A, or R, and of T.
- Third, the basic formulation of income can be disaggregated into many assets (physical, financial, and human) and their corresponding rates of return, and into many separate tax and transfer schemes. (Of course, the covariance picture will tend to become more complicated the greater the disaggregation).

## Assets, Returns and Transfers (3)

- Note that the framework does not explicitly take into account risk and vulnerability, nor does it discuss income dynamics.
- These can in principle be integrated into the framework but it is not the focus of this presentation.

# Assets, Returns and Transfers (4)

- $Y = AR + T$  is simply an accounting identity, but it can be useful as an engine of analysis, or at least the beginning of analysis.
- With this framework, a basic hypothesis is that we are living in an age where technological change is giving a strong impetus to rising inequality of R.
- A “technological progress juggernaut” is raising demand for capital relative to labor, and demand for skilled labor relative to unskilled labor.
- THIS is the sense in which we are living in an age of rising inequality.

# Assets, Returns and Transfers (5)

- The effect of this demand side force on  $R$  will depend on what is happening on the supply side. In the labor arena some have called this “the race between technology and education.”
- The idea is that if the supply of education can keep up with the rising demand for educated labor the skill premium (inequality in  $R$ ) can be held in check. Such a policy addresses the inequality of  $A$  and through this also the inequality of  $R$ , leading to a double beneficial effect on inequality.
- In addition to the forces on  $A$  and  $R$ , policy induced changes in the inequality of  $T$  will also influence the evolution of inequality.

# Assets, Returns and Transfers (6)

- This framework can provide at least a first cut explanation of some of the global patterns.
- Asia absorbed and did not sufficiently mitigate the global forces towards rising inequality.
- The US and UK absorbed the global forces and exacerbated it through increasing inequality of T. Kanbur-Stiglitz argument: We need a theory of rents to understand evolution of OECD inequality; simple “Solow growth model” approach will not do.



# Assets, Returns and Transfers (7)

- Latin America addressed the global forces through a more equitable distribution of T and policies which mitigated rising inequality in R directly (minimum wage provisions) and indirectly through the distribution of A (schooling, including CCTs which linked policy on inequality of T to policy on inequality of A).
- MENA maintained stable inequality primarily through transfers T. What then accounts for the Arab Spring?

# A Sectoral Cut (1)

- The framework is of course not enough by itself and sometimes needs to be enriched through specific disaggregations and taking into account general equilibrium effects.
- One route is to look more closely at the inequality of  $R$  across different groups in society—eg wage discrimination and unequal access to employment opportunities across gender and ethnicity. This type of approach is in effect beginning to take a sectoral approach, dividing the population up along lines that are different from assets per se.

## A Sectoral Cut (2)

- A second route is to take an explicitly sectoral approach and think of the national distribution of income as being composed of sectoral distributions. For example, if the national, urban and rural income distributions are given by  $F(Y)$ ,  $F_u(Y)$  and  $F_r(Y)$ , and the share of the urban population is  $x$ , then

$$F(Y) = xF_u(Y) + (1-x)F_r(Y),$$

and overall inequality depends on sectoral inequalities, sectoral means and the relative population share of the two sectors.

## A Sectoral Cut (3)

- For example, for the Mean Log Deviation  $L$  we can write:

$$L = x L_u + (1-x) L_r + \log [xk + (1-x)] - [x \log (k)]$$

where  $k$  is the ratio of the urban mean to the rural mean.

- Using this we can assess the impact on national inequality of an increase in urban inequality, rural inequality, the rural-urban mean differential, and the degree of urbanization.

# A Sectoral Cut (4)

- The sub-sectoral distributional analyses can be done using the A, R, T framework. But what the above shows is that for urbanizing societies the rate of urbanization also plays an important role. (This is also linked to “Kuznetsian” discussions in the literature).
- Also, of course, the sectoral cut does not have to be urban-rural. Any mutually exclusive and exhaustive cut can be handled in this framework.

# A Sectoral Cut (5)

- We can use this framework to understand, for example, the recent turn around in the evolution of Chinese inequality in the face of global forces of technology making for rising inequality.
- The within sector inequalities have been managed through various social policy initiatives—health, minimum wages, etc.
- The between sector rural-urban gap has been managed, in effect, by the “Lewis turning point” as labor markets in rural areas tighten with migration to urban areas.
- There is a “pure Kuznets effect” of urbanization beyond critical level.

# Conclusion (1)

- Are we living in an age of rising inequality which threatens inclusive growth?
- The answer is yes, in the sense that technological change is raising demand for capital over labor, and demand for skilled labor over unskilled labor, and these global forces are being transmitted to countries through trade and investment.
- But the answer is also no, in the sense that the translation of these global forces into national patterns is mediated by national economic structure and national policy, leading to quite diverse national level outcomes.

# Conclusion (2)

- Is there a framework which is rooted in an economic discourse and which can capture commonalities in global forces and yet be able to handle the differences we observe, and which can lead to a policy relevant discourse which can then be taken to a country specific context?
- The A, R, T framework presented here is one possible framework which appears to work well as a first approach, especially if supplemented by further context specific sectoral analyses.



Thank You!