



**No.02**  
NOVEMBER 2013

POST-2015 POLICY BRIEF



## GROWTH AND POVERTY ERADICATION: WHY ADDRESSING INEQUALITY MATTERS

The Millennium Development Goals have centred on social outcomes, primarily in the fields of poverty, health and education. The goal of halving extreme poverty globally has already been met, albeit in large part thanks to the remarkable performance over three decades of the Chinese economy. Greater ambition is expected for a post-2015 agenda, with the eradication of extreme poverty a possible new goal. However, this goal is very unlikely to be reached by 2030 if business as usual is the order of the day. Paradoxically, this partly reflects the lack of ambition in the conventional poverty line of \$1.25 per day, which is by any standard extremely low; but it is also because poverty eradication, even at this level of ambition, will not happen without addressing the more challenging issue of global inequality.

### The scale of global inequality

Measuring global inequality is a difficult exercise, given major data deficits. Nonetheless, thanks to considerable recent efforts to improve data collection and collation, there is a clearer picture than ever before of the global distribution of income and of its evolution over time.

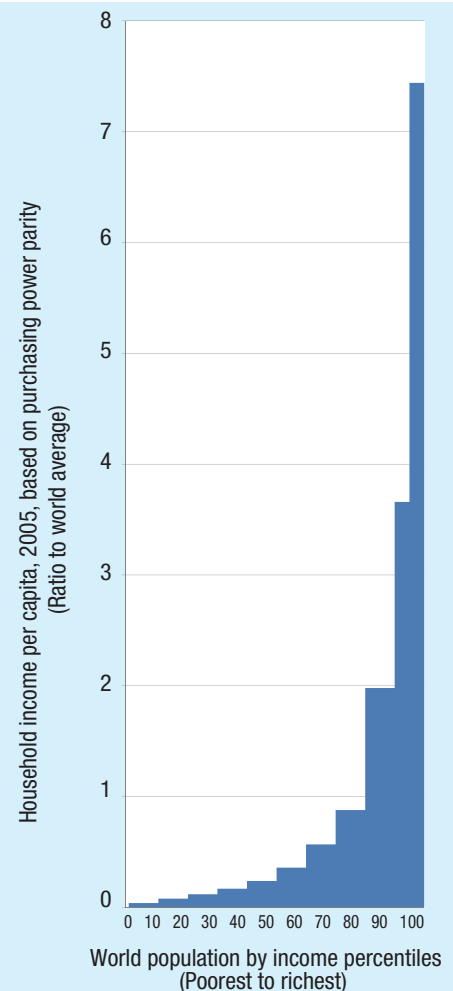
Imperfect as the data are, it is clear that the distribution of income across the world population is extremely unequal: the average income of the richest 5 per cent is estimated to be nearly 200 times that of the poorest 10 per cent (figure 1). Based on the Gini coefficient, the distribution of income globally is more unequal than in the most unequal country – and much more so than in all but a handful of countries – while inequality of income distribution increased significantly from 1988 to 2002, though it levelled off in 2002–2005 (see tables 4 and 5, Milanovic, 2012a).

To take an alternative measure of income inequality, the Palma index (the ratio between the total income of the richest 10 per cent of the population and the poorest 40 per cent) for the world as a whole in 2005 is 13.5, a figure only exceeded by Jamaica at the country level. In most countries, it is less than two (see annex I, Cobham and Sumner, 2013).

### Global growth has failed to alleviate extreme poverty

This degree of inequality means that the effect of global growth on extreme poverty, in the absence of a progressive shift in income

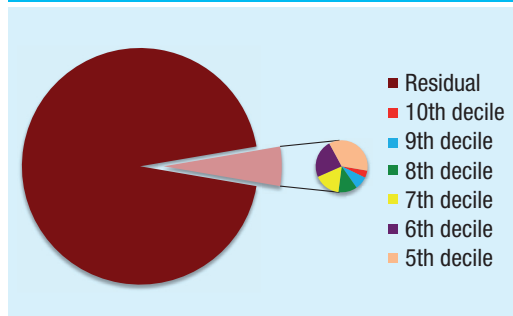
Figure 1  
Global income distribution, 2005  
(Based on purchasing power parity)



distribution, is very limited. If global economic growth were distributionally neutral, the additional output going to any income group would be the same as its share in global income; yet the total household income of the poorest 10 per cent of the world population was just 0.25 per cent of global gross domestic product in 2010, while that of the poorest half (those below about \$2.50 per day) was 3 per cent.

In fact, the recent period of global growth has been anything but distributionally neutral: despite accelerating growth across the developing world in recent years, the share of the poorest in the additional income this growth has generated has been even smaller than their average share in income. The proportion of additional global gross domestic product accruing to the poorest 20 per cent – broadly the 1.4 billion people living below the \$1.25-a-day poverty line in 2008 – has actually declined from 0.9 per cent to just 0.7 per cent. Thus, for every 100 dollars of additional income the poorest fifth are receiving only 70 cents! Precisely how small these shares are is starkly demonstrated in figure 2.

**Figure 2**  
Distribution of additional income from global gross domestic product growth, 1999–2010



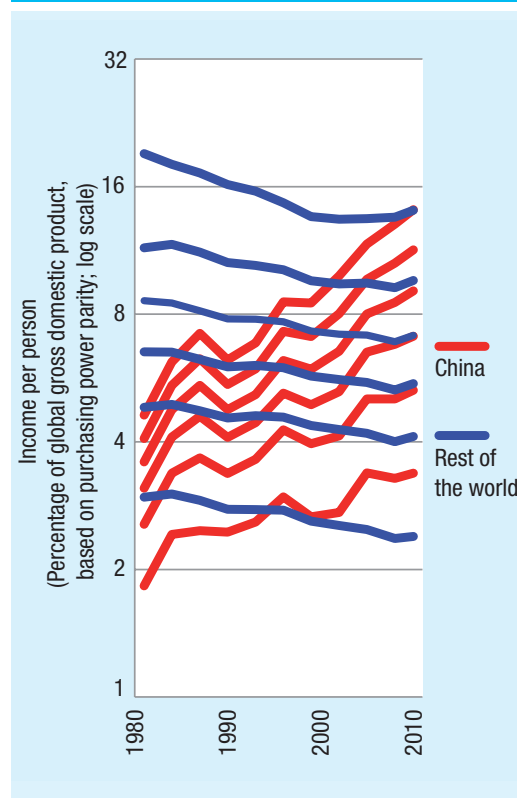
*Note:* The lighter slice of the large pie represents the share of the additional income generated by global growth going to the poorest 60 per cent of the world population (5.4 per cent). The smaller pie is shown to scale and reflects the shares of each decile within what corresponds to the poorest 60 per cent of the world population.

## The role of China

Understanding the evolution of the global income distribution in the last 30 years requires careful consideration of the role of China, which started from a very low level of income in 1981 but has since experienced much more rapid income growth and poverty reduction than the rest of the world (figure 3). Since China accounted for 59 per cent of the poorest decile of the world population in 1981, the relatively rapid income growth of poor Chinese households offset the slower income growth among the poorest elsewhere in the developing world, allowing a reasonably high rate of income growth for the poorest 10 per cent of the world population.

But as incomes in China have risen, its share in the poorest 10 per cent of the world population

**Figure 3**  
Household income relative to world gross domestic product per capita: China and the rest of the world, 5th–10th deciles



has fallen dramatically, to just 11 per cent in 2010. Consequently, this poorest 10 per cent is increasingly dominated by slower-growing incomes elsewhere (sub-Saharan Africa accounting for 45 per cent and India 27 per cent in 2010). This compositional shift has been a major reason for the dramatic slowdown in income growth among the world's poorest, from 2.4 per cent per annum in 1981–1996 to 1.5 per cent per annum in 1996–2010. However, the lowering of per capita income growth of this poorest 10 per cent to below the global average also reflects a slowdown in income growth of the poorest segment of the world's population relative to global gross domestic product per capita both in China and in the rest of the world. In the years ahead, the challenge of poverty reduction thus looks even more daunting than in the last three decades. In this respect, the contrast between China's performance and that of the rest of the world suggests a need for other developing countries to draw policy lessons from China's growth recipe – an unorthodox policy mix sensitive to growth, inflation and employment goals. That mix has combined selective capital controls, countercyclical fiscal policy and active monetary policies aimed at stable exchange rates with managed credit expansion and low interest rates, as well as a full range of active industrial policies.

## Extreme poverty in a business-as-usual scenario

A business-as-usual scenario, based on extrapolating the 1993–2010 income growth rate for each quintile point in each region to 2030 and on a poverty target of \$1.25 per day, suggests that extreme poverty could be reduced to below 1 per cent in Europe and Central Asia (0.1 per cent) and East Asia and the Pacific (0.7 per cent). This could in principle make it feasible to eliminate extreme poverty in these regions through social safety nets or other income transfer programmes (although these overall figures mask wide variations between countries). Extreme poverty would also be reduced to 1.5 per cent in the Middle East and North Africa and to 3.2 per cent in Latin America and the Caribbean, suggesting that it could also be eliminated in many countries in these regions through transfer programmes.

However, South Asia, and especially sub-Saharan Africa, would fare much less well. In South Asia, some 12 per cent of the population would remain in extreme poverty (down from 32.7 per cent in 2010). In sub-Saharan Africa, the figure would be around 37 per cent, a reduction of less than a quarter from the 2010 level (48.5 per cent) and still far above the 28.3 per cent target for 2015 set by Millennium Development Goal 1. This level would not be reached until 2049 – 34 years too late for the Millennium Development Goals and 19 years after extreme poverty should have been eradicated under a post-2015 agenda.

## Beyond the extreme poverty agenda

The \$1.25-a-day poverty line only provides an indication of the most extreme poverty: achieving this level of income falls far short of fulfilling the right to “a standard of living adequate for... health and well-being” (Universal Declaration of Human Rights, art. 25.1).

Taking \$5 as the minimum daily income which could reasonably be regarded as fulfilling this right, poverty would remain widespread even in those regions which might have largely or wholly eradicated extreme poverty by 2030. This would translate into around only 4 per cent poverty in Europe and Central Asia, but it would mean 15 per cent poverty in Latin America and the Caribbean, 30 per cent in East Asia and the Pacific and 50 per cent in the Middle East and North Africa. In both South Asia and sub-Saharan Africa, around 90 per cent of the population would still live on less than \$5 per day, leaving some 3 billion people below a \$5-a-day poverty line globally.

The above projections highlight serious failings in the existing development model and the

global economic system with regard to making growth work for poverty eradication by 2030. Even returning to the average global growth rate of 1993–2010 (3.5 per cent per annum), if the proceeds of that growth were also distributed as they were in that period, an estimated 700 million people would remain in extreme poverty in 2030 and billions more would, by any definition reflecting actual human needs, be poor.

The only way to make tangible progress – particularly if the effects of the 2007/2008 financial crisis persist – is to recognize and confront the issue of extreme global inequality as part of a renewed development narrative.

## Global inequality in a broader context

The significance of global inequality for achieving inclusive and sustainable growth goes beyond poverty numbers. The collapse of Lehman Brothers in 2008 greatly increased awareness of the close association between growing inequality, the rise of unregulated financial markets and the threat to economic and social security from shocks and crises. Inequality, instability and incohesion have become mutually reinforcing features of finance-led globalization (UNCTAD, 2011). Across most countries, the top income strata (in some cases only the top 1 per cent) have been the biggest (or even the only) winners from boom conditions, capturing higher rentier incomes through capital gains and interest payments than would have been possible under more regulated financial structures. Capital mobility has made these gains hard to tax, reducing the bargaining power of labour and increasing government reliance on regressive taxes and bond markets, further amplifying income divergence.

Two crucial variables for addressing inequalities and achieving social cohesion are jobs and wages. The tendency for wages to lag behind productivity growth is a major source of growing income inequality and an important factor in households resorting to increased borrowing and asset inflation to maintain living standards, in the process adding to financialization pressures and increasing economic volatility. Various factors have been seen as explaining this trend including skill-biased technological change and an expanding global labour force, as well as heightened capital mobility. However policy choices also matter. When low levels of inflation and labour market flexibility are given priority over job creation and decent wages, growing inequality is an almost inevitable outcome.

In many developing countries, in particular where the labour force is expanding rapidly, especially in urban areas, job creation remains the only assured way of tackling poverty on a sustained basis. But rising wages are also

necessary to expand domestic demand, which is increasingly seen as an essential component of a more sustainable growth path (UNCTAD, 2013). Consequently, more appropriate macroeconomic policies, along with active labour market policies, will need to be part of an integrated policy framework aimed at more inclusive development.

### Is a global inequality target necessary (and feasible)?

There is an emerging consensus that existing levels of inequality are not only morally unacceptable, but also economically and politically damaging. Moving beyond the Millennium Development Goals, inequality should therefore become a prominent part of the post-2015 development narrative.

Where an individual stands in the global income order still remains largely a matter of where he or she lives: an estimated 85 per cent of global inequality is explained by differences in the mean incomes of countries, and only 15 per cent is due to variations within countries (Milanovic, 2012b). However, defining realistic targets presents some difficulties, whether at the global or the national level.

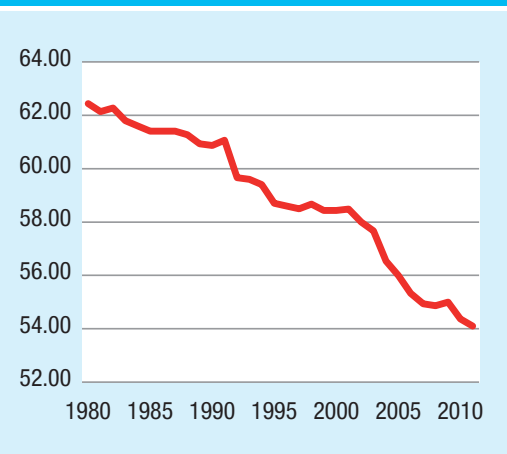
The most widely used indicator of income distribution is the Gini coefficient, which has the advantage of covering the whole income range. However, a given change in this indicator does not give a ready understanding of what this means for the redistribution of income, making a Gini-based target less intuitively appealing. It is also more sensitive to changes in the middle of the distribution than at either end, which is arguably where the issue is of greater importance. And the gap between a Gini target and policy conclusions is a wide one, particularly at the global level.

The Palma index, a possible alternative measure of inequality, is intuitively clear. However, it does not take account of changes in distribution within the top 10 per cent of the population, the bottom 40 per cent or the 50 per cent in between. This is a significant limitation, particularly as many of those in the

middle 50 per cent are clearly in poverty by a broader definition (the 40 per cent band roughly corresponding with a \$2-a-day poverty line in 2010). While the basis of the Palma index on observed regularities in country-level data makes this less problematic at the national level, these regularities do not necessarily apply to the global economy as a whole.

However, the big change in the distribution of income at the global level over the past three decades has been the slower pace of labour incomes compared with world output (figure 4). While this corresponds with a rise in profit share, the shift has not produced the expected dynamic benefits in terms of productive investment, job creation and poverty reduction. One way of including inequality in the post-2015 agenda, at least at the national level, might therefore be through a measure of functional income distribution such as the share of wages in national income. This would have the advantage of being more directly related to the orientation of policy than measures such as the Gini or Palma indices, as well as being more readily estimated. Consideration could also be given, following the lead of Jan Tinbergen, joint winner of the first Nobel Prize for economics, to setting a target rate of reduction for the ratio between the average wage and average remuneration for chief executives.

**Figure 4**  
Share of world labour income in world gross output, 1980–2010  
(Percentage)



### Contact

Richard Kozul-Wright,  
Director,

Division on Globalization and  
Development Strategies  
Tel. +41 22 917 5615  
richard.kozul-wright@unctad.org

Press Office  
+41 22 917 58 28  
unctadpress@unctad.org  
www.unctad.org



UNITED NATIONS  
UNCTAD

### References

- Cobham A and Sumner A (2013). Is it all about the tails? The Palma measure of income inequality. Working Paper 343. Centre for Global Development. Washington D.C.
- Milanovic B (2012a). Global inequality recalculated and updated: the effect of new PPP estimates on global inequality and 2005 estimates. *Journal of Economic Inequality*. 10(1):1–18.
- Milanovic B (2012b). Global inequality: from class to location, from proletarians to migrants. *Global Policy*. 3(2):125–134.
- UNCTAD (2011). Report of the Secretary-General of UNCTAD to UNCTAD XIII. Development-led globalization: Towards sustainable and inclusive development paths.
- UNCTAD (2013). *Trade and Development Report, 2013: Adjusting to the changing dynamics of the world economy*. United Nations publication. Sales No. E .13.II .D.3. New York and Geneva.