Item 3: High-level segment Tackling inequality through trade and development: A post-2015 challenge

Speaker: University of Florence

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Inequality trends, causes, impact and policies

Giovanni Andrea Cornia
University of Florence

Trade and Development Board, High Segment; UNCTAD

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1. Initial conditions: inequality in OECD/developing regions

- Initial levels of **within country inequality**

- Much higher in LA, SSA & parts of Asia (SA)

- Due to:
  - Asset concentration
  - Unequal access to schooling
  - Urban-rural gap
  - ‘Resource curse’

Source: own calculations based on WIDER and SEDLAC (CEDLAS and World Bank).
Changes during the last 30 years

• In the past economists thought within-country inequality differed across nations but was stable in each country. Growth only way to reduce poverty

• Yet, over 1980-2000 inequality rose in 73 % of countries with data

• Over 2000-10, inequality fell in LA, SEA, & parts of SSA - while it rose in other regions … so 50% rise- 50% fall. Rising concern for income inequality?

• Convergence to middle levels of inequality?

• This bifurcation of trends is a kind of natural experiment, as it allows to learn about causes of bifurcation from the countries with falling inequality

<table>
<thead>
<tr>
<th></th>
<th>OECD</th>
<th>EE-FSU</th>
<th>Asian Transition</th>
<th>L.A.</th>
<th>MENA</th>
<th>SEA</th>
<th>South Asia</th>
<th>SSA</th>
<th>World</th>
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</thead>
<tbody>
<tr>
<td><strong>1980s and 1990s</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rising inequality</td>
<td>14</td>
<td>24</td>
<td>2</td>
<td>14</td>
<td>2</td>
<td>5</td>
<td>3</td>
<td>9</td>
<td>73</td>
</tr>
<tr>
<td>No change</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>Falling inequality</td>
<td>6</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>8</td>
<td>24</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>21</td>
<td>24</td>
<td>3</td>
<td>18</td>
<td>8</td>
<td>7</td>
<td>5</td>
<td>19</td>
<td>105</td>
</tr>
</tbody>
</table>

| **2000-2010**        |      |        |                  |      |      |     |            |     |        |
| Rising inequality    | 9    | 13     | 2               | 2    | 4    | 3   | 4          | 4   | 7      | 44    |
| No change            | 4    | 5      | 1               | 1    | 0    | 0   | 1          | 1   | 1      | 13    |
| Falling inequality   | 8    | 6      | 0               | 15   | 4    | 4   | 0          | 13  | 50     |
| **Total**            | 21   | 24     | 3               | 18   | 8    | 7   | 5          | 21  | 107    |

Source: Cornia and Martorano 2012
Rising inequality in the US: Income share of top 1%, 1917–2011

Source: http://www.epi.org/publication/unequal-states/
China: fast rising Gini index, then small fall since 2009

India: Gini rose 7 points btw 1990-2004 then stagnated

Source: Cornia Martorano 2012 + Nino Zarzua 2014
Trend in av. LA regional Gini of distribution of household income/c

Source: Cornia 2014

decline 2002-2010: LA = - 5.7
SA = - 7.0, CA = - 3.9

Min: Nicaragua =+ 2.1*
Max: Argentina = - 9.1
Moderate inequality fall in SEA (Malaysia, Philippines, S.Korea, Thailand)

3.5 Gini points

Source: Cornia and Martorano 2012
Heterogeneous Gini trends in SSA

Panel (a) ‘steadily declining’ (8 countries) Burundi, Cameroun, Guinea, Mali, Niger, Senegal, S.Leone, Swaziland,

Panel (b) ‘falling, then rising from mid 2000s’ (9 countries): CAR, Ethiopia, Ghana, G.Bissau, Kenya, Malawi, Mozambique, Nigeria, Zambia

Panel (c) ‘steadily rising’ (4 countries) S.Africa, Mauritania, Botswana, Tanzania

Panel (d) ‘rising then falling from early 2000s’ (5 countries): Angola, B.Faso, C.d’Ivoire, Lesotho, Rwanda
2. Impact: Impact of high inequality on growth: beyond Gini 35-40 a rise in inequality reduces growth

- incentive traps
- free-riding
- labour shirking
- high supervision costs

Income inequality

Growth

Gini=18
Gini=60

- incentive traps
- erosion of social cohesion
- social conflicts
- uncertainty of property rights

Source: Cornia 2004
Impact of falling inequality on poverty:
Faster rise of Poverty Reduction (40% in LA)

Dark bar = distributive effect, Light bar = growth effect, Arrow = %f poverty drop

Source: Lustig, Lopez-Calva, Ortiz 2014
Impact of rising inequality from medium level.

Source: Vandermotele 2014

• (i) Skill Biased Technical Change: technological upgrading raised demand for skilled workers while supply stagnated due to low public spending on 2ary/3ary + fall in minimum wages

• (ii) increased South-North exports (with high labour content) and migration depressed low skilled wages in countries of origin/destination.

• (iii) premature adoption of domestic and external liberalization:
  – fast trade liberalization
  – liberalization of FDI + deregulated domestic financial markets
  – Liberalization of wage formation had mixed effects
  – Liberal tax reform reduced tax/GDP ratio and worsened tax incidence
  – Impact of privatization varied according to the approach followed
Explaining trend bifurcation of 2000-10

Comparing recent experience of LA+SEA (falling inequality) versus China, EE-FSU, SA (rising inequality)

- changing influence of structural causes of inequality?

- GDP growth differences? (but China, India: fast growth, Gini rise)

- good global economic conditions (trade, finance, remittances) in 2000s?

- better policies? ➔ next slide
‘Open economy growth with equity’: policies

• Evidence shows inequality can be reduced under open economy conditions + technological shocks if new policy model is adopted:

• Virtuous policy changes observed in SEA & LA:
  – Macroeconomics and trade
  – Labour market
  – Taxation
  – Public expenditure on human capital accumulation
  – Social assistance and insurance
4. A new policy approach

(a) Macroeconomics: ‘hybrid model’ (WC elements & ‘development oriented’ macropolicy)

- Prudent budget (1\textsuperscript{ary} surplus 3-4\% GDP) monetary policy
- Active and progressive tax policy $\rightarrow$ +tax/GDP ratio +3 to 9 points
- Increasing public expenditure especially on social public goods
- Countercyclical monetary-fiscal policy
- competitive real exchange rate $\rightarrow$ (+) T, (-) NT $\rightarrow$ (+) current account surplus
- Better prudential regulation of domestic banks
- Unchanged open trade regime, but changing trade pattern,
- International financing (lower foreign debt, reserves accum, debt substitution)
(b) Labor market & income policies

- rise in n. workers covered by collective contracts
- work inspections against informal employment,
- Re-centralisation of wage bargaining in Argentina, Uruguay, Brazil
- rise in minimum wage
- increase in minimum social pensions,
<table>
<thead>
<tr>
<th>Years of left regimes</th>
<th>2002</th>
<th>2004</th>
<th>2006</th>
<th>2008</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Venezuela (1999)</td>
<td>94.5</td>
<td>92.7</td>
<td>113.9</td>
<td>107.2</td>
<td>93.8</td>
</tr>
<tr>
<td>Brazil (2002)</td>
<td>114.3</td>
<td>121.4</td>
<td>145.3</td>
<td>160.8</td>
<td>182.0</td>
</tr>
<tr>
<td>Argentina (2003)</td>
<td>81.4</td>
<td>129.8</td>
<td>193.2</td>
<td>253.3</td>
<td>321.3</td>
</tr>
<tr>
<td>Uruguay (2005)</td>
<td>88.7</td>
<td>77.5</td>
<td>153.2</td>
<td>176.9</td>
<td>196.8</td>
</tr>
<tr>
<td>Costa Rica (2006)</td>
<td>99.5</td>
<td>97.6</td>
<td>99.5</td>
<td>99.5</td>
<td>105.8</td>
</tr>
<tr>
<td>Nicaragua (2007)</td>
<td>105.9</td>
<td>113.5</td>
<td>128.5</td>
<td>141.6</td>
<td>174.6</td>
</tr>
<tr>
<td>Ecuador (2007)</td>
<td>112.5</td>
<td>122.2</td>
<td>130.0</td>
<td>146.7</td>
<td>161.5</td>
</tr>
<tr>
<td>Guatemala (2008)</td>
<td>108.6</td>
<td>117.6</td>
<td>119.6</td>
<td>111.9</td>
<td>122.0</td>
</tr>
<tr>
<td>Mexico (--)</td>
<td>101.2</td>
<td>99.1</td>
<td>99.0</td>
<td>96.2</td>
<td>95.6</td>
</tr>
</tbody>
</table>
(c) Tax policy and rising tax/GDP ratios

- Low initial tax/GDP ratio in relation to intl. norm

- Tax effort accelerated in 2000s – including greater emphasis on direct taxes (figure on LA)

- tax/GDP up almost everywhere, but huge variations remain (Mexico, C. America, others) – but flat tax in EE-FSU

- Higher tax/GDP reduces macro instability, allow countercyclical fiscal policy, raise social expenditure

- □ Δ 2003–7 Δ tax/GDP moderately progressive
Trend in Average Tax/GDP Ratio, 1973-2009, L.America

Source: Cornia, Gomez Sabaini and Martorano
(d) Public social expenditure and redistribution of human capital

• Countries made big invest. in 2ary educ since 1990s chart

• Strong effect on income inequality, current and lagged

• Lower educational inequality $\rightarrow$ lower wage inequality

• Problems persist in 3ary education (still unequalizing)

<table>
<thead>
<tr>
<th>Latin America</th>
<th>1990</th>
<th>1995</th>
<th>2000</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Av. spending on education p/child 0-14 ($dollars PPP)</td>
<td>320</td>
<td>511</td>
<td>756</td>
<td>1451</td>
</tr>
<tr>
<td>Public expenditure on educ/GDP</td>
<td>2.8</td>
<td>3.3</td>
<td>4.0</td>
<td>4.4</td>
</tr>
</tbody>
</table>
+ public expenditure on educ → fall in Gini education
(e) Social assistance and income transfers

- extending coverage of **social insurance** to
  - cover people with few years of contributions (in 1990s they worked in informal sector or were unemployed)

- Large increase in well targeted **social assistance**
  - **CCT** targeted anti poverty programmes (Brazil BF, Mexixo, .. (0.5-1.0% GDP)

  - Pure transfers e.g. non-contrib pensions (Argentina, Brazil, Bolivia, Southern African countries, etc)

- Perceptible effect on income inequality, despite low-ish spending
Long term measures to deal with ‘structural inequality’

• Redistribution of assets, correction of mkt failures
  – Land redistribution in Latin America, SSA …
  – Reduce rural-urban income gap
  – Taxation of resource sector
  – Broaden access to credit/finance/insurance for smallholders & SMEs
  – Accessible secondary and university education

• Active ‘open economy industrial policy’

• Reduced dependence on foreign finance (as in E.Asia)