

On the impact of inequality on growth, human development, and governance

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'Reducing inequality – the great challenge of our time' (Bogotá, 06/10/22)

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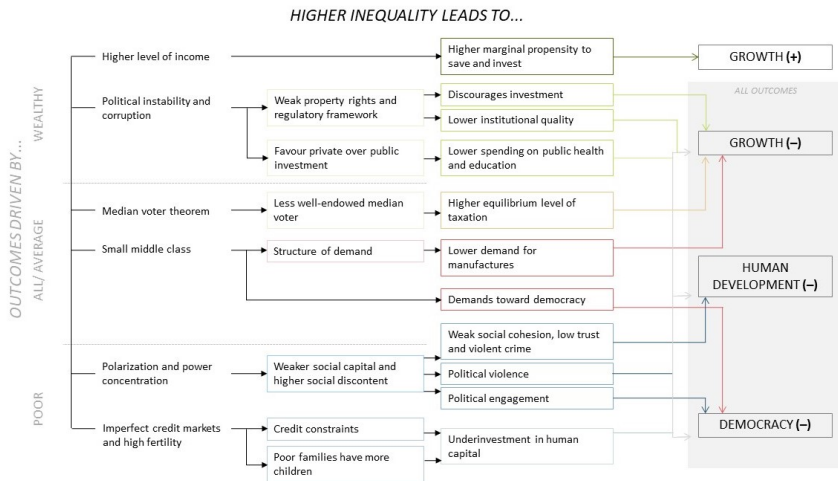
Goal

- Informed policy debate requires clear evidence
- Take stock of current knowledge on the effects on
 - Economic growth
 - Human development – health and education
 - Governance – democracy
- Core arguments and underlying mechanisms + existing evidence
 - Cross-country insights
- Literature in economics + key insights from other disciplines

Main insights

- Bring clarity through a general framework: main theoretical arguments and underlying transmission channels
- No clear consensus emerging from the empirical evidence + need for in-depth work on specific transmission channels
- Empirical challenges

Theory: impact of inequality



Evidence: growth

Table: Effects of inequality on growth: evidence from reduced form equations

Effect	Reference	Data	Measure	Data source	Data structure; Method
(-)	Alesina and Rodrik (1994)	N=46/70; 1960–1985	Gini for land and income	Jain (1975); Fields (1989)	Cross-section; OLS, 2SLS
	Persson and Tabellini (1994)	N=56; 1960–1985	Pre-tax income share 3rd quintile	Paukert (1973)	Cross-section; OLS, 2SLS
	Clarke (1995)	N=74/81; 1970–1978	Coef. var.; Theil's; Gini; P40/R20	UN; Jain (1975); Lecaillon et al. (1984)	Cross-section; OLS, WLS, 2SLS
	Perotti (1996)	N=67; 1960–1985	Comb. share 3rd and 4th quintiles	Jain (1975); Lecaillon et al. (1984)	Cross-section; OLS, 2SLS
	Cingano (2014)	N=31; 1970–2010	Gini; bottom and top inequality	OECD income distribution dataset	Panel; Sys-GMM
(+)	Berg et al. (2018)	N=153; 1960–2009	Gini	SWIID	Panel; Sys-GMM
	Gründler and Scheuermeyer (2018)	N=164; 1965–2014	Gini	SWIID	Panel; two-step Sys-GMM
	Li and Zou (1998)	N=46; 1960–1990	Gini	DS	Panel; FE, RE
	Forbes (2000)	N=45; 1966–1995	Gini	DS	Panel; FE, RE, Diff-GMM
	El-Shagi and Shao (2019)	N=123; 1960–2010	Gini	SWIID	Panel; LSDV
Depends	Deininger and Squire (1998)	N=87/66; 1960–1992	Gini; land distribution	DS	Cross-section; OLS
	Barro (2000)	N=84; 1965–1995	Gini; quintile shares	DS	Panel; 3SLS
	Castelló-Climent (2010)	N=102/23; 1960–2000	Gini; percentile ratios	WIID; LIS	Panel; Sys-GMM
	Banerjee and Duflo (2003)	N=45; 1965–1995	Gini	DS	Panel; RE, GMM, Kernel reg.
	Voitchofsky (2005)	N=21; 1975–2000	Gini; top and bottom inequality	LIS	Panel; Sys-GMM
	Halter et al. (2014)	N=106; 1965–2005	Gini	DS; WIID	Panel; Diff-GMM, Sys-GMM

Note: WIID, World Income Inequality Database; SWIID, Standardized World Income Inequality Database; DS, Deininger and Squire (1996); LIS, Luxembourg Income Study; OLS, ordinary least squares; 2SLS, two-stage least squares; 3SLS, three-stage least squares; LSDV, least squares dummy variable; FE, fixed effects; RE, random effects; GMM, generalized method of moments; Sys-GMM, system GMM; Diff-GMM, difference GMM.

Evidence: impact of inequality

Table: Effects of inequality: evidence

Outcome	Effect	Channel	Evidence
Growth	(+)/(-) Reduced form		Mixed
	(+)	Savings	Mixed
	(-)	Credit m. imp. & fertility	✓
		Gov. exp. & taxation Structure of demand Instability & rent seeking	× ? ✓
Education	(-) Expenditure		×
	(-/+) Enrollment and attainment		(-): ✓
Health	(-) All individuals		✓, ×
	(-) Population health	Absolute income	✓
		Relative income	×
		Deprivation Relative position	? ?
Governance	(-) Democratic stability & transition		Mixed
	(-) Institutional quality		✓
	(-/+) Political participation		(-): ✓

Empirical challenges

- Data quality and availability
 - Consistency in the definitions, sources and processing → empirical analyses
 - Data at the individual level
- Concept and measurement of inequality
 - Specific concept (and measure) for different mechanisms
 - Choice of indicator → implications for results
 - Criticism specific measures (e.g. Gini coefficient)
- Estimation methods
 - Measurement error
 - Misspecification of functional form
 - Approaches to tackle reverse causality

Conclusion

- Main conclusions:
 - Evidence reduced-form equations not consensual; less attention transmission channels
 - Need further research on education outcomes; no clear support for (-) effect health
 - Mixed results governance outcomes
- Further research:
 - Methods: experimental work to understand specific channels in particular contexts
 - Disaggregating the level of analysis
 - More and better data

Thank you!