

“Steady Wins the Race” (2168 words)**Entrant no: 97****1. Introduction: A personal perspective**

Economic growth occurs whenever people take resources and rearrange them in ways that are more valuable (Henderson, 2007). To achieve growth, three factors are needed: capital accumulation, technological progress and population growth. If a country has a high level of inequality, it could pose as a threat to these three factors. If, as is often observed in extreme inequality, the larger part of a country's population live in extreme poverty and only a small part of the population can afford to save, then less is saved and capital accumulation occurs at the lower than ideal rate, thereby slowing down potential economic growth. Technological progress is also hindered because only a small part of the population can afford the training and education that is needed to understand and develop tools to aid such progress, yet another case where inequality slows down growth. The inequality effects on a growing population can be looked at in different ways: a large population might mean that a bigger percentage of the population lives in poverty, thereby increasing the dependency burden. A large population might also result in a larger population, as has been the case of many developing countries. So poverty might be worsened.

This essay does not attempt to find a relationship between growth and inequality, but acknowledges that inequality is a characteristic of many economies, and argues that growth will be accelerated and sustainable in the long run if inequality is reduced.

2. Theory**What economists say**

The debate of the growth-inequality is not a recent one, classical economists and neoclassical revolutionists have also shared differing opinions on this. Classical economists are of the view that inequality is beneficial for economic growth in the post-industrialization period (Keynes, 1920 and Kaldor, 1957), while the neoclassical school of thought rejected the relevance of the distribution of income for macroeconomic analysis, and thus economic growth.

Kuznets' "inverted-U-hypothesis" postulates that at low levels of per capita income, inequality first rises with per capita income and decreases at later stages of development. This was rejected by Deininger and Squire (1997) who found no evidence of this relationship in over 90% of their data. Galbraith and Kum (2007) found evidence that supports this, agreeing that inequality tends to decline as per capita income increases *after successful industrialization* and admitting that they found a reverse relationship for the richer countries.

Easterly and Rebelo (1993) and Perotti (1996) used several measures of redistribution and found that redistribution, and thus the attempt to reduce inequality, is likely to have a positive impact on growth. Empirical studies from the likes of Deininger and Squire (1996), Chen and Ravillion (1997), Easterly (1999) and Dollar and Kraay (2002) all suggest that growth does not have an impact on inequality.

Some researchers believe that in order to assess this relationship, the way in which inequality affects growth needs to be analyzed. Deininger and Squire (1997), Galor (1988) and Zeira (1993) conclude that inequality reduces growth by causing credit market and financial market imperfections. Knowles (2001) adds onto this by citing the distortion of taxes affecting redistribution, a reduction in investments and increases in fertility being the ways in which inequality might contribute to the reduction of growth. Kaasa (2005) listed factors that influence inequality, and ultimately, growth (see figure 1 in the Appendix).

All that this theory suggests is that the evidence found is inconclusive.

3. Facts and Numbers

The World at a Glance

In the very same world, there is a lot more countries where other goals are at the centre of attention. These are countries like those in Sub-Saharan Africa and Asia, where the survival of many of their people is the matter of urgency. Furthermore, countries such as China, Korea, Japan and India, have displayed tremendous growth, surprising the world with their performance. The table below presents an estimate of the current situation in the world:

Region	Population(mil)	GNI/capita @ PPP	GDP Growth (%)
East Asia and the Pacific	1912	4969	11.4
Europe and Central Asia	446	11262	6
Latin America and the Caribbean	561	9678	5.7
Middle Asia and North Africa	313	7402	5.9
South Asia	1522	2532	8.4
Sub-Saharan Africa	800	1870	6.2

Source: world development indicator report 2009

Countries in Europe and Central Asia currently have the highest income per person, though it seems that East Asian and Pacific countries outperform the other regions with economic growth, where the Sub-Saharan African countries have the lowest GNI per capita, the highest population growth and a moderate economic growth. Given these, the role that inequality (might) play in the economic growth of countries in these different regions is interesting to examine.

A global increase in inequality has been noted, although there is no consensus reached whether this is due to rising changes in economic growth. The *IMF World Economic Outlook 2007* shows a rise in

inequality in developing Asia and Eastern Europe and the so-called “advanced economies”, while the Commonwealth of Independent State and Sub-Saharan-Africa experienced a fall in inequality. Figure 2 in the Appendix shows the experience of different nations.

It is interesting to note that East Asian countries have a high economic growth, coupled with rising inequality.

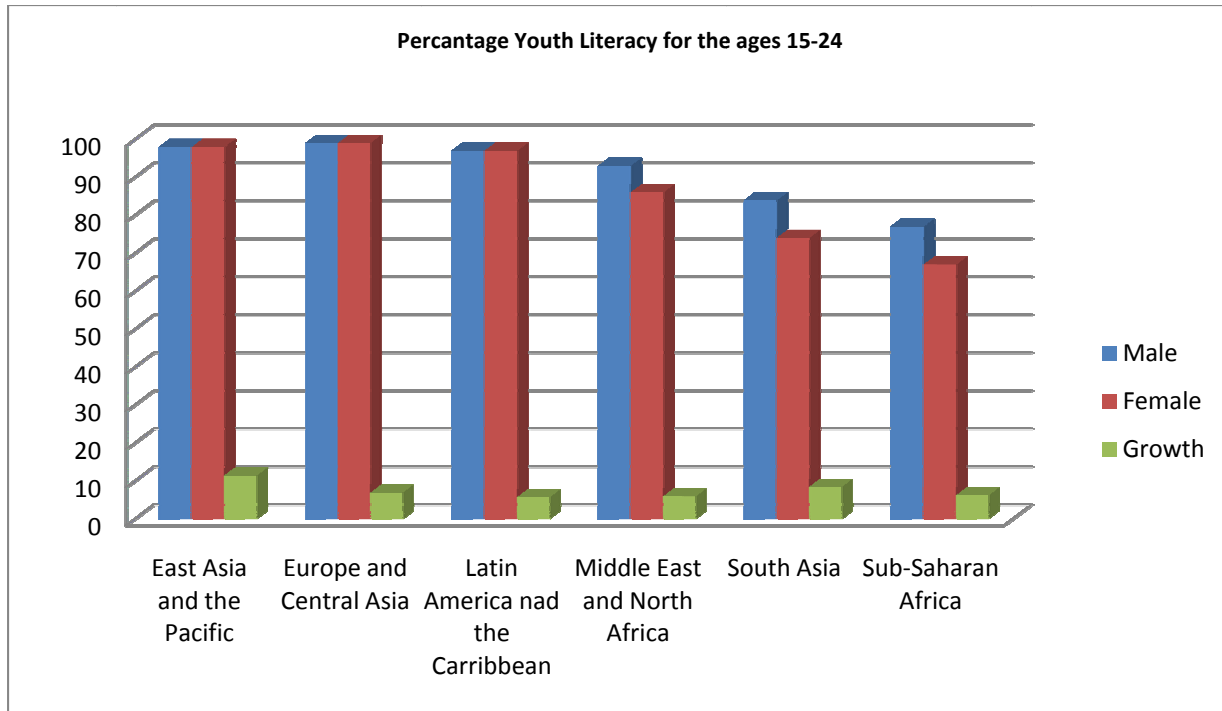
The argument posed here is that which believes promoting development in a country is key to achieving sustainable economic growth. It makes sense to conclude that countries with a high Human Development Index (HDI – the UN measure of development), are able to achieve and sustain high growth. Table 1 in the appendix shows this.

The effect of “Not-So-Humble beginnings”

Another debate being put forward is that initial conditions of inequality have a role in determining future growth possibilities of a country. Most developing countries have lingering effects from colonies, that extracted and didn't plant wealth, as well as poor climatic conditions and diseases were not prevalent in when their developed counterparts set on a journey to achieving growth. In their paper, Deininger and Squire (1997), support this notion. We cannot, however, change what happened in the past. Here is what can be changed:

The problem of the “missing women”

Gender inequality is a prevalent and serious problem in most developing countries, which has been seen by some economists to impede growth. Klasen (1999) finds that gender inequality in education reduces growth through a “distortion of incentives” and has indirect negative effect on investments. As it stands, the WDI 2009 depict the literacy rate in different regions of the world to be as follows:



Source: WDI 2009

Asia and Europe seem to have almost 99% of their youth being literate, according to 2007 statistics. Not surprisingly, East Asia and the Pacific have a correspondingly higher growth. Education also increases the chances of finding employment. Sub-Saharan-Africa has less than 50% of its women working. Klasen adds that if South Asian and Sub-Saharan African countries had focused on a gender-balanced growth (in education), “their economic growth could have been up to 0.9% per year faster than it turned out to be the case”.

Finance and Technology

Though theoretical, the model presented by Horii, Ohdio and Yamamoto (2005) emphasizes that a country’s productive technology is important for the development of its capital markets. Credit market transactions form a major part of the finance world, and income inequality plays a major role in access to credit by most families. Underdeveloped markets pose a threat to foreign investments.

East Asian countries have the largest stock market capitalization in the world, standing at \$3, 244 billions, and have the highest R&D expenditure (1.4% of GDP). Comparable statistics for Sub-Saharan Africa are \$570 billions and no data is recorded for their R&D spending. Unequal opportunities for the use and understanding of new technology hinder growth.

Inequality and Health

Child malnutrition and mortality are scary factors. SSA suffers the highest child mortality (146/1000), 27% of their children are underweight, the lowest life expectancy (51), compared to most regions. Fertility is high (only 23%) on contraception.

Deaton (2001) explored health inequality and income inequality in both poor and rich countries, and concluded that ‘income inequality will continue to affect mortality until everyone ceases to be poor, but it is not that income inequality is a major determinant of population growth’. Landman (2003) agrees that the labour force is an important part of production, especially since developing countries are known to be abundant with cheap labour. Thus highlights the importance of a healthy labour force.

Globalization

The Stolper-Samuelson theorem “implies that in a two-country two-factor framework, increased trade openness in a developing country where low-skilled labor is abundant would result in an increase in the wages of low-skilled workers and a reduction in the compensation of high-skilled workers, leading to a reduction in income inequality” (WE0, 2007).

	Exports/GDP			GNPRG 1988- 1999 (%)
	1988	1999	%change	
Non-globalizers				
Honduras	36	42	17	-1.2
Kenya	26	25	-0.04	0.5
Globalizers				
India	7	11	57	6.9
B'desh	6	14	133	3.3

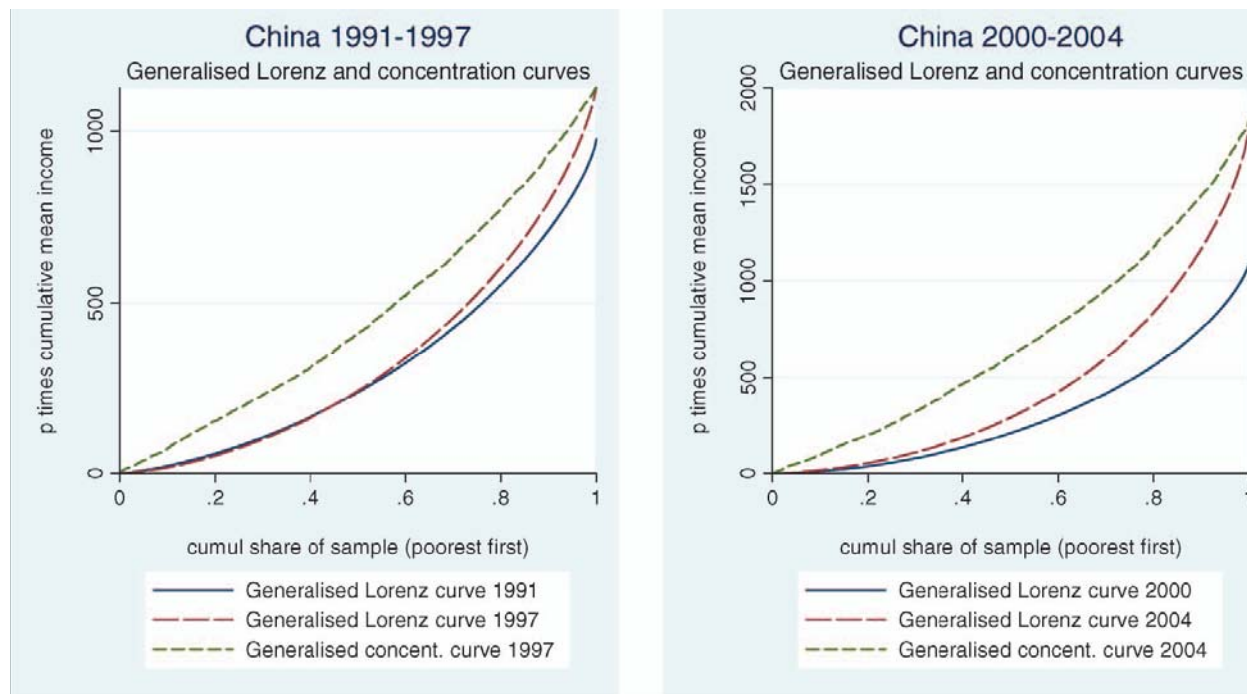
Source: *Is Globalization reducing poverty and inequality*, Robert Hunter Wade, 2003

If the effects of globalization are examined in light of the table above, then one would conclude that globalization results in a reduction in inequality, and an increased growth. Though the increase in growth for India and Bangladesh cannot be attributed solely (or even largely) to globalization, it is proof that it can play a part.

This is not “Fong-Kong”

The structure of inequality has changed in China. It is hard to say whether it is the growth that caused it, or that the growth came about as a result of this change. In 2005 (WDI 2009 The gini was 41.5. The Lorenz Curves below show that in those years, the structure of inequality changed when it comes to the

wealthier population of the nation, they received more, while the share of income received by the poor remained relatively unchanged.



Nevertheless, growth has occurred. In the year 2000, China's GNI per capita grew by 7.9% to \$3920 per capita, making the Chinese economy the 124th largest economy in the world, with a population of 1.262 billion people. World Bank statistics indicate that in 2007, China's population was 1.318 billion, and an economic growth of 13% from 2006, to \$5429 per capita.

Coming Back Home

In his delivery of the Budget Speech this year, Minister of Finance, Pravin Gordhan, quotes from a statement made by Costau:

“Unemployment remains far higher than in any comparable country in the world, and as a consequence, poverty is widespread, and we now have world-record levels of inequality”.

Post-apartheid South Africa has seen the introduction of GEAR, ASGISA, BEE and RDP policies in an effort to achieve a distribution-led growth. It is fairly safe to conclude that these policies have failed, given a current situation of widespread levels of poverty and inequality, and an unemployment rate of about 40% (Landman, 2003 and Phiri, 2005).

Landman (2003) suggest that the labour market is an important aspect of building upto sustainable growth and is supported by Cosatu General Secretary, Zwelinzima Vavi, who states that “Everything starts with a quality job...” (*Business Day*, 2 December 2003). Much of the population in rural areas still

suffer from extreme poverty, and the country faces an urbanization crisis, with people migrating to look for jobs in the cities. A lesson can be learnt from China in this regard: China has achieved a high GDP growth with a moderate urban employment growth rate. They have focused on policies that take advantage of their abundant labour and adopted policies that encourage rural enterprises, increasing their labour productivity.

The CEO of Business Leadership South Africa, raised his concerns in a *Sunday Times* article, about growth not being a national goal. He added that “the first step would be for society, led by government, but with business, labour and civil society in close support, to agree on a vision of doubling the size of the economy within a generation.” This is, to a large extent, very true. In order for the economy to grow, a redistributive element is needed, so more people can have more access to opportunities. Redistribution need not only happen by way of state grants (which, in South Africa, has been seen to contribute to the idleness of some members of the community), but by way of investments in more public goods that might add value to channeling growth (infrastructure, health, education, etc). A macroeconomic model that works closely with the private sector is also needed. South Africa is seeing more private institutions building schools and supporting tertiary education studies, which asserts the notion that “if public and private spending are linked, this can leverage existing resources and help enhance efficiencies” (Landman, 2003).

3. Concluding Remarks: Cleaning House

Studies of the growth-inequality relationship have not yet been concluded, and it is natural for a young aspiring economist to doubt that they will ever be. But what economists do agree on, is that there are a number of factors that influence growth, and these are complex and unique to each country. This essay takes the practical perspective that *sustained* economic growth will occur when inequality and its effects are reduced. Countries will have to reduce these problems in order to grow. An educated, healthy and stable nation will make educated, healthy and sound economic decisions. This will be a nation that is rich in ability, and with policies that support sound economic *and* social activities, the prosperity of such a nation will be unlimited.

“No society can surely be flourishing and happy, of which by far the greater part of the numbers are poor and miserable” – Adam Smith, 1776.

Appendix

Figure 2

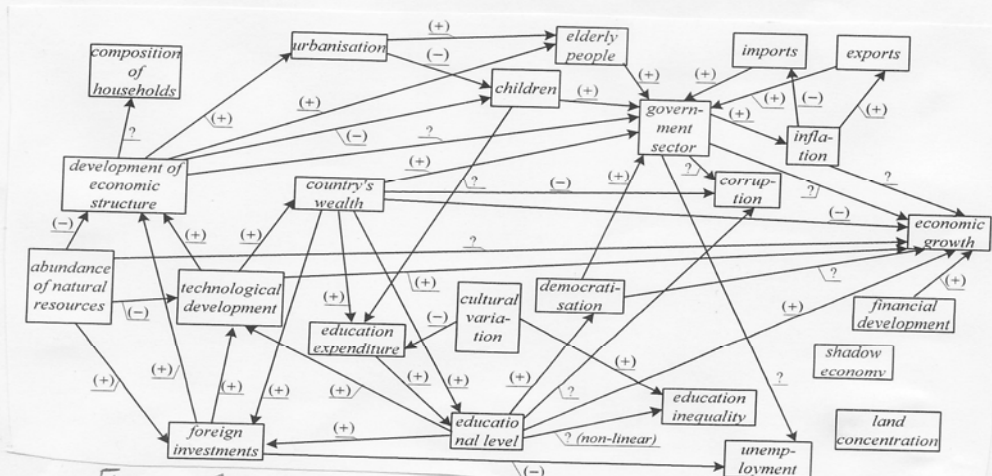
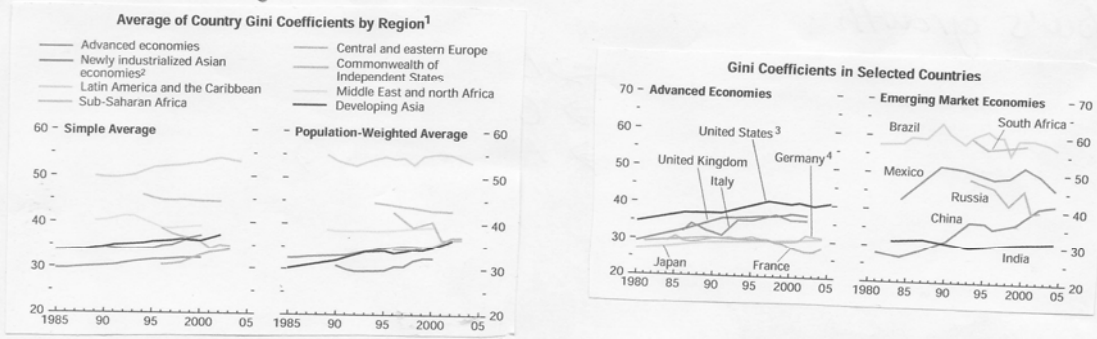


Figure 3: From *Basic problems of Developing countries*

Country	HDI ranking	HDI	GDP per head (PPP\$)	GDP (PPP\$) ranking	GDP (PPP\$) rank minus HDI rank
<i>High human development</i>					
Norway	1	0.939	28 433	3	2
Australia	2	0.936	24 574	12	10
Canada	3	0.936	26 251	6	3
Sweden	4	0.936	22 636	17	13
USA	6	0.934	31 872	3	-3
UK	14	0.923	22 093	19	5
Singapore	26	0.876	20 767	21	-5
Qatar	48	0.801	18 789	24	-24
<i>Medium human development</i>					
Russia	55	0.775	7473	55	0
Saudi Arabia	68	0.754	10 815	42	-26
Brazil	69	0.750	7037	57	-12
Armenia	72	0.745	2215	116	44
China	87	0.718	3617	94	7
South Africa	94	0.702	8908	45	-49
India	115	0.571	2248	115	0
<i>Low human development</i>					
Bangladesh	132	0.470	1483	128	-4
Nigeria	136	0.455	853	147	11
Tanzania	140	0.436	501	161	21
Angola	146	0.422	3179	102	-44
Malawi	151	0.397	586	159	8
Sierra Leone	162	0.258	448	162	0

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