

INCOME DISTRIBUTION AND ECONOMIC GROWTH

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ÖZET

Bu makale gelir dağılımı ile ekonomik büyüme arasındaki karşılıklı ilişkiler üzerine mevcut literatürü kalkınma açısından analitik olarak incelemektedir. Ayrıca yakın geçmişteki gelir dağılımı trendlerini değerlendirmektedir. Çalışmamız büyümenin gelir dağılımı üzerinde her hangi bir yönde sistemli etkisi olmadığını göstermektedir. Buna karşın gelir dağılımı birçok mekanizma aracılığı ile ekonomik büyümeyi etkileyebilmektedir. Ampirik çalışma gelişmekte olan ülkeler için bu yönde anlamlı kanıtlar sunmaktadır.

ABSTRACT

This article considers an analytical survey of the literature about the interactions between income distribution and economic growth with an emphasis to development issues. It also evaluates recent trends in income distribution. Our study does not suggests any systematic effect of growth on income distribution in any direction. On the other hand the distribution of income may affect economic growth through several mechanisms. Empirical work provides significant evidence for developing countries in that direction.

I. INTRODUCTION

In recent years Turkish economy has showed great performance with high growth rates for successive nineteen quarters as declared by the Turkish Statistics Institution. However, there are some complaints that this is not reflected in the distribution of income, based on the idea that economic growth would improve the distribution of income, reducing poverty. On the other hand, some economists have recently argued that income distribution can be mainly enhanced by economic growth.

Economists have long sought to understand the links between economic growth and income distribution: Does economic growth result in a less unequal distribution of income by market forces? Should governments consider adopting redistributive policies to improve the conditions of the poor? Do countries with unequal income distributions experience slower economic growth than more egalitarian countries? The distribution of income within a country is very important, since it affects the social and political stability, among others, by determining the poverty level for any given GDP level. In some countries such

as Brasil, with relatively high per capita income, the distribution of income is very unequal resulting in high polarization in society with high levels of poverty. In some other countries, such as Costa Rica, with relatively more equal income distribution, there is more cohesion in society with political stability (Sen,1995). However, the above questions need not to be asked from a normative perspective alone, since the effect of growth on distribution has to be examined also from an analytical perspective if there are sistematic effects in both directions.

The aim of this paper is to review analytically the interactions between income distribution and economic growth with an emphasis to development issues in order to shed light on the frame of analysis for the above questions, and to identify the areas of the future research.

The literature on the nexus of income distribution and growth is enormous, and there are many comprehensive surveys on the subject, with emphasis to different aspects of development such as poverty, age structure, fertility, human capital, trade liberalization, foreign direct investments, and so on: Among them one may refer to Adelman and Robinson (1988), Lipton and Revallion (1995) and more recently to Kanbur (2000). The scope of our survey will be limited to the two-way inter-relationship between distribution and growth considering recent trends in income distribution.

The paper is organized as follows: In section I, the ways in which growth affects income distribution are reviewed; section II considers the reverse causality, i.e. the possible mechanisms through which income distribution affects growth; section III evaluates recent trends in the distribution of income; and finally last section concludes.

I. EFFECT OF ECONOMIC GROWTH ON INCOME DISTRIBUTION

There are two main hypotheses in the literature on how economic growth affects income

distribution. The first hypothesis is the Kuznets' famous inverse U-curve, relating levels of per capita income to income distribution. In his 1955 presidential address to the American Economic Association, Kuznets proposed that the relationship between the level of per capita income and inequality in the distribution of income may take the form of an inverted U. That is, as per capita income rises, inequality may initially rise, reach a maximum at an intermediate level of income, and then decline as income levels of developed countries are reached.

Kuznets discussed the population shift from traditional to modern sectors during development process towards a theory of income-distribution evolution. He argued that income distribution was relatively more equal at low levels of income in the early stages of development in which almost all labor were employed in agricultural sector. As the development proceeded through industrialization, the distribution became more unequal with labor allocated in both the agriculture and industry sectors. Industrial wages exceeded agricultural wages (due for example to minimum wage law or to trade union power), resulting in large inequality between the incomes of two sectors. That is, in the early stages of development both economic growth and income inequality rised. Eventually, as industrialization proceeded, most of the labor were allocated in industry, the weight of agriculture in production and income generation got smaller and the distribution of income, moving in reverse direction, became more equal again (Kuznets,1955).

Several formal explanations based on dual economy models have been put forward for the Kuznets relationship. The above explanation of the *Kuznets process* was formally modeled as a dualistic model by Anand and Kanbur (1993). However another similar and earlier explanation can be found in the Lewis's labor-surplus growth model (Lewis 1954; further developed and refined by John Fei, Gustav Rannis and others).

According to the Lewis's dualistic model, there are unlimited supplies of labor in the traditional agriculture sector in the early stage of development. If an economy starts with its entire population in agriculture (stage of more or less equal income distribution), a large part of that population can be removed to the newly emerging modern industry without any reduction in agricultural output. Industry will have to pay that labor a wage a bit above the subsistence wage that is prevailing in agriculture to get it to move. Even if agriculture is completely stagnant, industry can grow without putting any demands on agricultural output. At this stage income growth takes place only in industry. As industry continues to grow, however, the supply of surplus labor will eventually be exhausted. Further removals of labor from agriculture will tend to increase agricultural output prices, forcing industry to raise the wage rate unless there is an offsetting agricultural productivity growth or population growth (Meier, 1989:120-132).

The model suggests that inequality will first increase and later diminish as development takes place. The income share of the modern sector increases as development proceeds while the income of the traditional sector remains unchanged -or even falls as population growth takes place-, thus causing to the inequality between incomes of the sectors to rise. The model's implications are consistent with Kuznets' generalization. This tendency toward increasing inequality is finally reversed when all the surplus labor is absorbed into the industrial employment, leading labor to become a scarce factor of production with further increases in labor demand increasing real wages. The rise in the general wage level brings about the downturn in inequality.

Another explanation of the Kuznets process considers the distribution of assets. An initially uneven distribution of income-generating assets contributes to rising inequality, as those with more

assets also accumulate more. But eventually in the accumulation process, as the stock of assets increases, the rate of return to assets falls, and the distribution of income, along with increases in labor income, moves in reverse direction (Stewart, 2003).

The second hypothesis on how economic growth affects income distribution is that economic growth *always* leads to increased inequality in income distribution. It has well-known origins that go back to classical economists. According to this hypothesis, growth in market economies can not take place without a worsening of the income distribution (Ray, 1998: 284-92). There are three main explanations recently discussed. First, wealth and other income-generating assets are historically unevenly distributed and only the rich can save and invest, meaning that growth goes always to the initially rich. A second argument is related to the composition of labor or broadly of human capital: Technological progress is inherently biased in favour of the skilled and educated labor, whose marginal product always rises more than the unskilled labor. Then inequality between skilled and unskilled will always pertain. The third argument is concerned with the borrowing capabilities. Only the asset owners are eligible to put up collateral and thus have access to credit for investment (Morduch, 1999).

There are mixed findings for the Kuznets hypothesis in empirical studies. Kuznets for his inverse U-curve provided evidence from a cross-country study. Paukert (1973) studied the historical data on income distribution in industrialized countries and also provided supporting evidence. Several others have also found some support for the Kuznets hypothesis (e.g. Oswang, 1994; Milanovic, 1994). However one criticism had been that the Kuznets' work related to levels of income per capita, not to the growth rate. Empirical work on growth (as against levels) of per capita income shows no relationship

between growth rates and inequality (Ahluwalia, 1976); and this is also confirmed by recent work (e.g. Bruno, Ravallion and Squire, 1995; UNCTAD, 1997). For example, Bourguignon (1995: 47) concludes that the parabolic relationship, -if there is any-, between income inequality and GDP per capita across countries is probably very weak and unstable over time.

Another criticism has been directed to using cross-country data instead of time series. As noted by Easterly, King, Levine and Rabelo (1991), results from intertemporal studies have not supported the Kuznets hypothesis. As the relationship in the hypothesis was formulated on intertemporal basis, these intertemporal studies would seem more appropriate way of testing the hypothesis than cross-country studies.

Moreover, further work by Deininger and Squire (1998) on the reduced form of the Kuznets curve with cross-section data has found the relationship weak and sensitive to alternative specifications of the estimated function. The work of Deininger and Squire provided no significance for the Kuznets hypothesis when controlled for regional-specific differences. In their test on time-series estimates with data available only for about 40 countries, only 5 countries (Brasil, Hungary, Mexico, Philippines and Thailand) had a statistically significant inverted U-curve development. Another 4 countries had a statistically confirmed development of a U-curve, signifying that initial income distribution became more even and then more uneven (Costa Rica, India, United States and UK). The remaining 30 countries had no statistically significant change in either direction.

Results from Barro (2000) on the basis of panel data provided weak support for the first part of the hypothesis that the distribution became more unequal as countries grow, and no support at all for the second part of the hypothesis that as countries get richer, income distribution will inevitably become less unequal.

A more recent investigation of income distribution in China by Ravallion and Chen (2004) shows that it has become significantly more uneven over the 1982-2001 period, the GINI increasing from 28 to 40. Recent evidence from India confirms also the increase in inequality in all dimensions. (Deaton and Dreze, 2002). Thus China and India, accounting for more than half of the population in all developing countries has hence worsening income distribution. Inequality is also increased in developed countries in the 1980s and 1990s as reported in the Human Development Report, 2005.

Despite the weak empirical results and the recent contrasting observations, the Kuznets curve has been widely accepted. It has been sometimes used also as an excuse, for taking no action on income distribution, on the assumption that the Kuznets process will unavoidably be realized in a market economy. This may, of course, be true for a liberal economy with *laissez-faire* development process leading 'naturally' to a Kuznets relationship, but policy can have a counter role which explains many exceptions to the curve. Experiences of individual countries show different combinations of growth and changes in income distribution. In some countries with high growth rates, income distribution has worsened over time: e.g. Brazil (1960s to 1990s), China (1980s), Pakistan (1970-1985), Thailand (1970s and 1980s), Botswana (1970s). However, in some others with again high growth rates, it has improved: e.g. Indonesia (1973-1993), South Korea (1950-1980), Malaysia (1970-1990), Taiwan, Province of China (1950-1980), Mauritius (1980-1995). Some countries with low growth rates showed also differing outcomes. In some, low growth rates has been observed with worsening income distributions: Post-Soviet Russia and most eastern European countries (1980s), Mexico (1980s), Kenya (1980s), Ethiopia (1980s), Guatemala (1970s and 1980s). And in some others, income distribution improved: e.g. Sri Lanka (1960-1970), Cuba and Colombia

(1980s), Morocco (1970-1984). (Demery et al. 1995, Chu et al. 1999)

Economic growth is not necessary, nor sufficient for a better distribution of income. Structural factors and policy stances are crucial in the experiences of the countries. Logically speaking, even if there is no growth, a redistributive policy may improve the distribution of income in a country, albeit the feasibility of this kind of redistribution is severely limited. This is of course not saying that economic growth is not important; it opens up the possibility of making at list some people better off without making anyone worse off. The above empirical results suggest that growth is 'distribution neutral', so that it does not necessarily lead to either a worsening or an improvement in income distribution, and may be consistent with either.

II. THE REVERSE RELATIONSHIP: EFFECT OF INCOME DISTRIBUTION ON GROWTH

The growth-versus-equality trade-off of the Lewis's surplus-labor model, influenced greatly the way of development thinking among mainstream economists from the 1950s into the 1970s. It has been suggested that inequality is an unpleasant precondition for growth; more unequal income distribution would lead to higher growth through higher savings. In case that individual savings rates rise with the level of income, then a redistribution of resources from rich to poor would tend to lower the aggregate rate of saving, reduce capital accumulation and slower growth. Higher savings propensities associated with more unequal income distribution were variously attributed to the effect of a rising profit share. Kaldor (1956) suggested that a redistribution to high-income households that have savings propensities greater than low-income households, would increase aggregate savings, stimulating investments, thereby growth. The early choice-of-

technique literature (e.g. Dobb, 1956-57) argued that more capital-intensive techniques should be chosen to maximize 'surplus' and reinvestible funds. Based on these arguments, many economists concluded that countries should grow first and redistribute later, although very little empirical evidence was available. In contrast, studies in the 1970s in mainstream development economics were aimed at identifying redistributive mechanisms for poverty reduction that would not hamper growth. In opposition to the Lewis's model characterization as "grow first, then redistribute", it has been argued that more equal initial income distribution would lead to higher growth.

This focus of the literature didn't last long and was reversed with the rise of neo-liberalism and the *Washington Consensus* in the early 1980s. According to the Washington Consensus, growth itself would reduce poverty by 'trickle down' mechanisms through which social acceptance of inequality would allow the rich to earn a greater rate of return on their assets, motivating them to accumulate wealth faster, some of which to be redistributed to make everyone wealthier. (Clarke, 1995)

In the 1990s, the arguments of both the neo-liberal analysis and the earlier Lewis's trade-off between growth and inequality were challenged by a number of studies. Recent literature has now again placed priority on poverty reduction and on possible growth enhancement from a more equal distribution of assets and income. Several mechanisms to explain the positive relationship between income distribution and economic growth have been suggested.

One mechanism is related to underinvestment in education which is attributed to **imperfect capital markets**. Economies with imperfect credit markets are typically characterized by the limited ability to borrow, asymmetric information and limitations of legal institutions. Under the condition of limited access

to credit, the ability of the individuals to borrow and invest depends on their levels of assets and incomes. Poor people in particular tend to forego investments in human capital (education) that provide high rates of return. In such a situation a distortion-free redistribution of assets and income tends to raise the average productivity of investment. Thus through this mechanism, a more equal distribution of income stimulates economic growth. An improvement in the capital markets and legal institutions in poor economies will have larger growth effects than in rich countries. Examples of models of the economic effects of inequality with imperfect credit markets are Galor and Zeira (1993) and Piketty (1997), among others.

It is suggested that inequality slows growth by causing greater conflict over distributional issues, thereby stimulating **greater government interventions** and higher **distorting taxes**. Based on a median voter type model in which the mean income exceeded the median income, majority would favor redistribution of resources from rich to poor through explicit transfer payments and public-expenditure programs such as health and education. A greater degree of inequality will motivate greater redistribution and create more distortion on economic decisions, decreasing the rate of return on assets, restricting capital accumulation that lower growth. Even if income redistribution does not occur, lobbying activities promoting corruption can have negative effect on growth. Thus less unequal income distribution will not motivate such populist policies and will not result in lower growth, e.g. Perotti (1993), Alesina and Rodrik (1994), Persson and Tabellini (1994) and Benabou (1996).

It is argued that higher inequality raises **social conflict and political instability**, motivating the poor to engage in crime, and other disruptive activities, increasing uncertainty and producing threats to property rights. These in turn reduces investment and economic growth. Thus a redistribution of income resulting in a greater

income equality would promote economic growth. This mechanism is studied in Alesina and Perotti (1994), Benhabib and Rustichini (1996), among others.

Some other mechanisms suggested in the literature pertains essentially less developed economies. **Inequality in land distribution** may also negatively affect growth. A widespread ownership of land tends to absorb more employment and raises land productivity. That is, more equal land distribution leads to a more equal rural income distribution along with an increase in rural output. This mechanism is assumed to operate under the conditions of underutilization of land (when ownership is concentrated), lack of incentives for waged agricultural workers or existence of sharecroppers without any motivation to make productivity improving investments in land. Especially in rural economies, an even distribution of land enhances the distribution of income and economic growth in the entire country (e.g. Lipton, 1993; Deininger and Squire, 1998).

One another channel is associated with scale economies. A more equal income distribution enlargens domestic markets, ensures **greater economies of scale** and hence more industrialization and growth (e.g. Murphy, Shleifer and Vishny, 1989).

A number of studies theorize a further effect of inequality on growth through the effect on **education and fertility**. Households with credit constraints, it is argued, do not use resources for the quality of children (education), but instead for the quantity of children (fertility). Poor and less educated people tend to have larger families. A variant of this argument (Lagerlöf, 2003) considers gender gap. In countries with a gender gap, parents tend to have more sons and invest more on the education of their sons than that of their daughters as their daughters are expected to marry an educated man. This results in high fertility, since the opportunity cost of having children for woman is perceived low. Greater income inequality increases the number of

poor households with high fertility rates, which in turn reduces growth (e.g. Benabou, 1996; Khoo and Dennis, 1999).

Finally, a more equal income distribution reduces poverty, leads to higher **human development** with higher education attainment and improved health and nutrition levels, allowing poor people to improve their capabilities and their productivities, which in turn results in higher growth (e.g. Ranis and Stewart, 2002).

These are main hypotheses on how income distribution affects economic growth. However one must be careful in assessing the possible mechanisms. The political economy explanations of disturbing populist policies are mainly based on an assumption about the behaviour of the 'median voter' and the existence of a democratic society. Some mechanisms seem to be more relevant for developing countries than others, as suggested by Deininger and Squire (1998).

There is a tremendous literature growing recently on the subject. Several independent studies, based on cross-country regressions and new data, concludes that countries with more equal income distribution have higher growth. The studies by Alesina and Rodrik (1994), Persson and Tabellini (1994), Bourguignon (1995), Alesina and Perotti (1994) and many others provide support for this theoretical outcome with cross-country growth regressions. Most of the recent studies involve cross-country regressions due to data constraints. There are especially severe data problems in the area of income distribution, as underdeclaration of income is common especially in developing countries. In these studies the robustness of the findings has been questioned by many (e.g. Barro, 2000).

Clarke (1995) concludes that although the magnitude is relatively small, inequality is negatively, and robustly, correlated with growth, and that this result is independent upon many different assumptions about the exact form of the

cross-country growth regression and to the various kinds of inequality measures. It is also independent upon the political regime; inequality has similar effect both in democracies and non-democracies. However, as noted by Clarke, some care should be taken when interpreting these results. Although equal income distribution is positively correlated with growth, this does not necessarily suggest that redistributive policies will improve long term growth in any way, in any economy. First, theoretical studies pointed out that this positive relationship between equality and growth is mainly due to the observed coincidence of high levels of inequalities with high levels of government intervention. Hence, the reason of this correlation may be that there is less need for these redistributive policies where there is less inequality. Second, Clark states that the direction of causality has not been determined and the effects of specific redistribution policies have not been tested. Finally, if policies to lower inequality result in greater government spending with costs outweighing the benefits of greater equality, long-term growth may be harmed. However, according to Clarke, these results do indicate conclusively that inequality is not a necessary precondition for growth.

Barro (2000) extended the analysis by using large panel data and investigated the relationship distinguishing between low-income and high-income countries. His results confirmed the findings of earlier studies, but only for developing low-income countries. For the developed high-income countries, he found a positive effect of inequality in income distribution on subsequent growth.

Investigations of time-series data in developed countries have confirmed substantially the relationship between greater equality and higher growth. Panizza (2002), using a cross-state panel data for the United States to assess the relationship finds some evidence in support of a positive relationship between inequality and

growth. The very large number of studies finding some relationship seems to point out the existence of a positive relationship between equality and economic growth.

III. RECENT TRENDS IN INCOME DISTRIBUTION

Some studies suggest that within individual countries, income distribution or levels of income inequality has little or not changed in decades (e.g. Angeles-Castro, 2006). The report of the United Nations on the World Social Situation (2005), using the data in the World Income Inequality Database (WIID), indicates that within-country income inequality decreased during the 1950s into the 1970s in most of the countries. Since the 1980s, however, inequality has risen in the majority of countries. Over the last two decades inequality has increased in 48 out of the 73 countries for which sufficient reliable data are available. In contrast, inequality remained constant in 16 of these countries, although three of them show a rise in inequality over the last years. Only 9 of the 73 sample countries which account for only a small portion of the sample's population showed a decline in income inequality. The rises in inequality are rather worldwide; they have affected high- and low-income countries equally, which is perfectly consistent with the finding that growth does not affect income distribution. Similar results can be also found in the Human Development Report 2005 and some other studies (e.g. Cornia and Court, 2001).

We need to understand the causes of this movement towards greater inequality in order to determine whether there is any scope for policy to reduce inequality. The rise in inequality has occurred in a new environment of globalization characterized with liberalization, increased marketization, rapid technological change and change in labor market institutions. Most countries in the world have been affected in one way or the other by all these changes. As there are

many different countries, each with specific characteristics, it is not appropriate to make easy generalizations, but it appears that each of these changes have played an important role in the rise of inequality, along with the 'well-known' causes such as credit market imperfections, access to education, land concentration and so on.

These well-known causes may explain most of the variations in cross-country inequality, but they are not relevant for the recent rise in inequality within countries. The specific reasons should be linked to the globalization process and the neoliberal policy reforms that have been increasingly adopted in almost all countries. The following reasons have been frequently suggested for the rapid rise in inequality over the last two decades (Cornia and Court, 2001; Stewart, 2003):

i. Trade Liberalization

In labor abundant developing economies, trade liberalization is expected to decrease income inequality as increases in exports of labor-intensive manufacturing sectors would raise employment and the share of wages, and this was what has been observed over long periods. In resource abundant countries, however, exported goods are not labor intensive, and trade liberalization can undermine the wage earners. According Cornia and Court 2001, trade liberalization has mixed effect on the income distributions of the middle-income countries. There has been a rise in inequality in the Asian countries that rapidly expanded their manufacturing exports in the 1980s. In contrast to East Asia, trade liberalization has caused to increased wage inequality. One explanation of this is through the change in the structure of labor demand in favor of skilled workers; the imports of advanced technologies or exports of high-tech products both require highly skilled labor, which increases the returns to skilled labor and reduces the demand for the locally abundant unskilled labor (Goldberg and Pavcnik 2004).

ii. Financial Liberalization

Liberalization of international capital flows in the 1990s has been encouraged in the majority of the developing countries, followed by the opening of the domestic banking and financial sectors. Lenders and rentiers benefited from increases in real interest rates at the expense of borrowers, including governments. Interest payment on public debt has increased rapidly. As a result a large part of the government budget in many developing countries is now used for interest payments rather than social expenditure. International financial deregulation in turn has caused growing instability, as is obvious by the rise in the frequency and severity of financial crises in recent years. As a result income inequality has arisen. Cornia and Court (2001) reports that financial crises raised inequality 73 percent in Latin America and 62 percent in Asia. In a recent study by Figini and Görg (2006), the effect of financial liberalization is found to differ in developed and developing countries. Wage inequality increases with inward foreign direct investments in developing countries, whereas it decreases in developed countries.

iii. Technological change

New technologies generate a demand for skilled labor which favors higher-skilled workers over lower-skilled ones and leads to increasing wage differentials between them. New technologies also tend to replace labor and changes thus the functional distribution of income. In developing countries, this effect is evident through the industrialization process in which a shift occurs from agriculture and labor-intensive manufacturing to skill-intensive manufacturing (e.g. Taiwan, Province of China, Thailand). In developed countries this takes place in high-tech industries (Cornia and Court, 2001; Acemoğlu, 2002).

iv. Changes in labor market

During the 1980s and 1990s there was a shift in policy towards greater wage flexibility, reduced regulation, erosion of minimum wages,

reduction of employment protection, dilution or breaking up of bargaining power, reduction in public sector employment. These changes in labor market institutions have significantly affected rises in wage inequality and overall inequality, especially in developing economies and OECD countries. The real minimum wage and the share of wages have declined during the reform process in many countries (Cornia and Court, 2001; Stewart, 2003).

v. Transition of socialist countries to capitalism

Income inequality has increased in all of the former centrally planned economies of Europe and the former Soviet Union. Among the transition countries of Central Europe, there were moderate changes in income inequality due probably to the preservation of the welfare state system. In the former Soviet Union countries and in south-eastern Europe, income inequality rose by an average of 10 to 20 Gini points, and the population in poverty increased from 14 million in 1989 to 147 million in 1996. This is mainly explained by taking away of the factors that previously assured a higher equality consisting of the privatization of assets, reduced restrictions on earning differentials and a rising share of self-employment including the black market (Milanovic, 1998).

These are the main explanations for increasing inequality in the last two decades in most of the countries. Despite the feasible mechanisms available to raise income equality, globalization seems to restrict the ability of the governments to practice redistributive policies because of the feared impact on competitiveness, trade and capital movements. The situation in each country depends on specific country circumstances and policy mixes. There is some scope in each country for policy towards increased equality and growth, reduced poverty with more stable social and political environment.

CONCLUSION

Poverty reduction and improved income distribution have always been a priority of development policy (albeit sometimes only at the theoretical level). Economic growth is very important for development; however growth alone seems to be a blunt instrument for poverty reduction as empirical work suggested its neutrality for income distribution. The above investigation of the literature on the interactions between income distribution and economic growth does not suggest any systematic effect of growth on income distribution in any direction, with empirics based either cross-country or time-series data.

On the other hand, the distribution of income may affect economic growth through several mechanisms. In Clarke's words, inequality is not 'a necessary evil which has to be tolerated to allow growth'. Empirical work provides significant and robust evidence for developing countries. As a result the policy literature shifted towards consideration of policies favoring redistribution of income and assets in order to reduce poverty. The suggested mechanisms to achieve redistributions seem feasible in most countries. The emerging shift in the research agenda could focus upon specific policies and instruments for redistribution.

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