Relationship Between Income Inequality And Economic Growth: A Comparative Analysis Of Developed And Developing Countries

Ekonomik Büyüme İle Gelir Adaletsizliği Arasındaki İlişki: Gelişmiş ve Gelişmekte Olan Ülkelerin Karşılaştırmalı Analizi

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ÖZ

Ekonomik büyüme, ülkelerin makroekonomik performansını değerlendirmek için en önemli göstergelerden biridir. Bu nedenle, ekonomik büyüme olarak ifade edilen gayri safi yurtiçi hasıladaki artış, ekonomik refahın bir göstergesi olarak kabul edilmektedir. Bununla birlikte, ülkelerin ekonomik büyümesine rağmen, ekonomik refahın önemli bir göstergesi olan gelir dağılımı eşitliğinin sağlanamadığı görülmektedir. Aksine, gelir dağılımı eşitsizliği tüm dünyada gün geçtikçe artmaktadır. Bu çalışmada, eşitsizlik ile ekonomik büyüme arasındaki ilişki ikincil veriler ve literatür incelenerek analiz edilmiştir. Çalışma sonucunda, ekonomik büyümenin gelir dağılımı eşitsizliğini azaltmak için yeterli olmadığı sonucuna varılmıştır. Buna ek olarak, gelir dağılımı eşitsizliği sorunu gelişmekte olan ülkelerin sorunu olduğu kadar, ***(bazı)*** *gelişmiş ülkelerin de sorunudur. Bu nedenle, bu sorunu çözmek isteyen tüm ülkeler ekonomik politikalarını gözden geçirmeli ve toplumun tüm kesimlerini kapsayacak ve toplumun tüm üyelerine eşit fırsatlar sağlayacak politikalar benimsemelidir. Örneğin, temel ihtiyaçlar, eğitim, sağlık, sosyal güvenlik ve girişimcilik sağlanmasında, toplumun tüm üyelerinin yeterli düzeyde kamu imkanlarından yararlanmaları gerekir.*

ANAHTAR KELİMELER

Ekonomik Büyüme, Eşitsizlik, Gini Endeksi, İnsani Gelişmişlik Endeksi

ABSTRACT

Economic growth is one of most important indicator in order to evaluate macroeconomic performance of countries. Thus, increase in gross domestic product, expressed as economic growth, is considered as an indicator of economic prosperity. However, despite the economic growth of countries, it is observed that income distribution equality, which is an important indicator of economic prosperity, is not provided. On the contrary, income distribution inequality is increasing day by day all over the world. In this study, the relationship between economic growth and income distribution inequality has been analyzed by examining the secondary data and literature. As a result of the study, it is concluded that economic growth is not sufficient to reduce the income distribution inequality. In addition, the problem of income distribution inequality is not only the problem of developing countries, but also the problem of developed countries. Therefore, all countries which wishing to solve this problem, should review their economic policies and adopt policies that would cover all segments of society and provide equal opportunities to all member of society. For example, in the provision of basic needs, education, health, social security and entrepreneurship, all member of the society should benefit from public facilities at an adequate level.

KEYWORDS

Economic Growth, Inequality, Gini Index, Human Development Index

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INTRODUCTION

Income distribution inequality has attracted the attention of all societies in terms of economic, political, social and moral, because the negative consequences of income inequality are multidimensional. Inequality of income distribution can lead to economic crises by leading to contraction in demand. In addition to economic results, Income inequality can cause also adversely affect public health and psychology. Therefore income inequality is a big problem for all societies; it is not only a personal problem but also is a social problem.

When literature is examined, it is seen that a significant part of the studies done are economic development and growth as the cause of the inequality. Economic growth must be ensured before the income (in)equality in a country is discussed. For this reason, an understanding of the relationship between the income distribution inequality and the economic growth rate has grown in importance through time. Rising inequality in income distribution is a widespread concern. Income inequality within most advanced and emerging markets and developing countries (EMDCs) has increased.

Some economists argue that income inequality is an inevitable part of a successful economy. For example, Kaldor maintains that lower-inequality economies have lower profit margins and relatively low levels of investment. Therefore, lower consumption, lower employment, and lower total income are occurred in these economies. High levels of investment need accumulation of capital, these lead to increasing concentration of capital. Concentration of capital results in increasing income inequality.

In this paper, the relationship between economic growth rate and income distribution inequality is examined by analyzing the related literature. Later, the relationship between economic growth rate and income distribution inequality between developed and developing countries in 1995 - 2014 was presented comparatively. At the end of the study, the possible consequences of inequality of income distribution and the economic policies that should be applied are discussed.

1.THEORY AND LITERATURE

Relation between economic growth rate and income distribution inequality have aroused interest of many researchers In this section, after summarizing the theories of principal economists, we compiled some recent empirical studies especially on developing and developed countries.

1.1.Basic Theoretical Approaches

The income distribution is determined by the national income generated in a given period in a country that is divided among individuals, households, social groups, regions or production factor owners. Income distribution is defined in four different ways based on the distribution of national income between individuals or households, sectors, regions and production factors. These four different ways are functional income distribution, Individual income distribution, Regional income distribution and Sectoral income distribution (Çalışkan,2010: 92).

Functional income distribution shows the distribution of income among production factors. Individual income distribution shows the distribution of national income among individuals or households. Regional income distribution is the definition of the income distribution used to determine the distribution of a country's national income among the regions determined according to different criteria. In regional distribution calculations, the country is usually divided into regions according to geographical regions, the nature of settlements (rural or urban) or development level. Sectoral income distribution refers to the shares of industry, agriculture and services sectors from national income (Çalışkan,2010: 93-94).

Traditional human capital approach claims that people have different abilities, skills, experiences, personal equipment, and educational levels and individual properties that influence person’s productive capacity. Therefore it is natural to be unequal in the distribution of income and it is understandable, in every respect, that the level of individual income is that better educated people earn more and returns to the less well-educated are lower(Becker 1964;Mincer 1974)

According to country-specific human capital, the reason for the income inequality between natives and immigrants in a country is that the immigrants are disadvantaged in acquiring their country-specific skills, language learning and experience (Chiswick 1978). However, it is expected that the income inequality between the natives and the immigrants will decrease. Therefore, country-specific capital is not the cause of income inequality between second-generation immigrants and natives (Vöörmann and Helemäe, 2011:121).

According to the structural approach, the inequality of income distribution among individuals with the same efficiency and characteristics is due to the fact that the working environments are significantly different These differences are the work position or job of the individual, the organization where the individual works and the national labor market (Vöörmann and Helemäe, 2011:122).

In the middle of the 20th century, private pension systems emerged in order to find an additional solution to income inequality by compensating for the decrease in income in the retirement period of individuals (İlhan:2016). Private pension systems aiming to increase the national saving level with the encouragement of individual savings started to be established in the early 20th century with various models in developed countries and have reached the portfolio size which affect global financial markets today (İlhan 2016:182).

1.2.Empirical Literature

There are many studies that have tried to explain and identify factors that cause income distribution inequality. According to these studies, the factors that affect income distribution inequality are economic growth rate, population growth rate, inflation, resource endowment level, economic development level, and economic openness. Moreover, according to a study, black market for foreign Exchange has also effect on the income inequality (Bahmani-Oskooee and others, 2006). In many scientific studies claimed that the negative relationship between economic growth rate and income distribution inequality depends on external factors such as the development level, aggregate wealth and political institutions. Even, some studies claimed that there is positive relationship between income distribution inequality and economic growth rate (Forbes, 2000). Therefore, the impact of growth on the inequality is uncertain. Because, according to some studies, increase in economic growth rate does not affect the income distribution inequality. But some studies argued that increase in economic growth rate has strong effect on the income distribution inequality. Moreover, some studies argued that income distribution inequality is good for economic growth rate, because it reduces the cost of mobilizing capital. However, some studies argued that income distribution inequality is not good for growth because it constraints on the poor in financial markets and establish a negative relationship between income distribution inequality and economic growth rate (Rehman and others, 2008).

In the 1950's and 1960's, some economists argued that *“there is a trade-off between income inequality and economic growth”*. However, in the following years, although the economies of some countries (East Asian economies) grew rapidly, income distribution was relatively low. Contrary to this situation, while in some countries economic growth has been at a very low level, income distribution inequality has taken place at a very high level. *“This reality has increased interest in the relationship between economic growth rate and income inequality level”.* In later years, it was found that income distribution inequality has negatively effects on economic growth rate as an independent variable (Forbes, 2000). Moreover, in 1955, Simon Kuznet analyzed relationship between income distribution inequality and economic growth rate. According to Kuznet, *“economic growth initially increases income distribution inequality, and then decreases it. In other words, in his opinion, there is an inverted U-shaped relationship between economic growth rate and income distribution inequality level”* (Kuznets,1955).

Saint-Paul and Verdier (1993: 399-407) argued that, in the economies with high income distribution inequality, the government can make public spending, such as education, by receiving higher taxes from the higher income group with higher tax rates. These economic policies provide an increase in human capital level and economic growth rate. Forbes (2000) argues that *“an increase in a country's income distribution inequality level has a significant positive effect on economic growth in the medium and short run”.* Scully (2001) argued that economic freedom promotes both economic growth and income equity. However, *“there is a relatively small trade-off between economic growth and inequality”.* Arjona and others (2003:119-139) argued that there is trade-offs between income distribution equity and economic growth rate because, social protection expenditure has negative effect on economic growth. Moreover, cutting social support or transfers encourages entry into the labor market, increasing economic growth rate but, at the same time, increasing income distribution inequality. Lundberg and Squire (2003: 326-344) argued that the determinants of growth and inequality are not mutually exclusive. Thus, *“research of inequality should focus on their joint determinants, and especially those that are amenable to policy*”. Heyse (2006) argued that lower-income inequality developing countries do not grow at a faster rate than higher-income inequality developing countries.

There are few theoretical studies claiming that the relationship between economic growth rate and income distribution inequality is negative. Persson and Tabellini (1994:600-621) argued that there is large negative relation between income distribution inequality and economic growth rate in democracies. The theoretical analysis result is that income distribution inequality is harmful for economic growth, because income distribution inequality leads to policies that *“do not protect property rights and it do not allow full private appropriation of returns from investment”*. Birdsall and others (1995: 477-508) argued that *“rapid economic growth rate and reduced income distribution inequality led to higher demand for education and supply of education. Moreover, low levels of income distribution inequality may have directly stimulated growth. There is a positive causal effect of low income distribution inequality on economic growth”.*

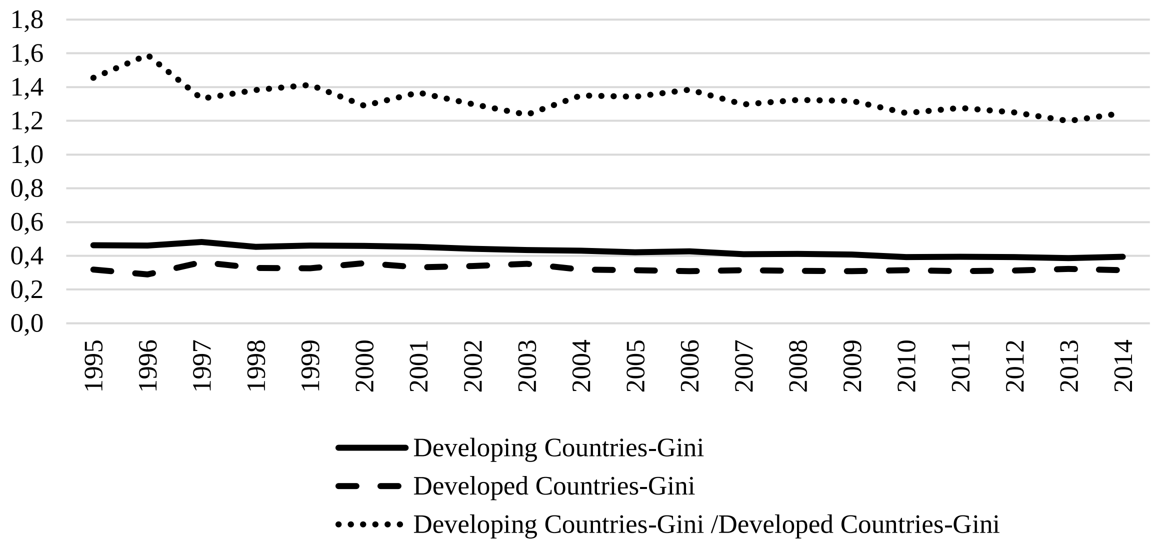
Benabou (1996) argued that, *“relationship between economic growth and income distribution inequality depends on the degree of complementarity between individuals' human capital”*. Moreover, in his analysis, the data support a negative relation between income distribution inequality and economic growth rate. Wu (1999) argued that inequality income cause to socio-political conflicts and this situation will reduce economic growth. Therefore, income distribution inequality has negative effect on the economic growth rate. Barro (2000) argued that *“the relationship between income distribution inequality and economic growth rate is weak”*. Along with this, inequality affects growth in poor regions negatively, while it encourages growth in rich regions. Banerjee and Duflo (2003: 267-299) argued that “*growth rate is an inverted U-shaped function of net changes in inequality and changes in income inequality are associated with reduced economic growth*”. Kennedy and Murray (2012:22-35) argued that economic growth and improvements in income distribution are not necessarily positively correlated. On the contrary, it is natural to have a negative relationship. Because, particularly in neoliberal economic environments where wealth accumulation takes place in an environment where the means of production are controlled by a small group of people that wields disproportionate political power.

2.RELATION BETWEEN INCOME INEQUALITY AND ECONOMIC GROWTH IN DEVELOPING AND DEVELOPED COUNTRIES

In the early stages of economic development, agriculture and the rural sector constituted most of the economic structure. The agricultural sector was relatively low in terms of income distribution inequality, as per capita income level was low. Then, when industrialization and urbanization began, the level of income distribution inequality in per capita income is increased. Consequently, in the early stages of development, the relationship between the level of product per person and the degree of income distribution inequality is directed towards urban sectors. As a result, the early stages of development, the relation between the level economic growth and the extent of income distribution inequality tends to be positive (Barro, 2000:8).

There are three approaches to measure income inequality. These are the Gini coefficient, Human Development index and The Palma ratio. The Palma ratio is a measure of inequality. “*It is the ratio of the richest 10% of the population’s share of gross national income (GNI) divided by the poorest 40%’s share”*. Inequality is measured by looking at ratios between the incomes of defined groups which specified by relative income levels.

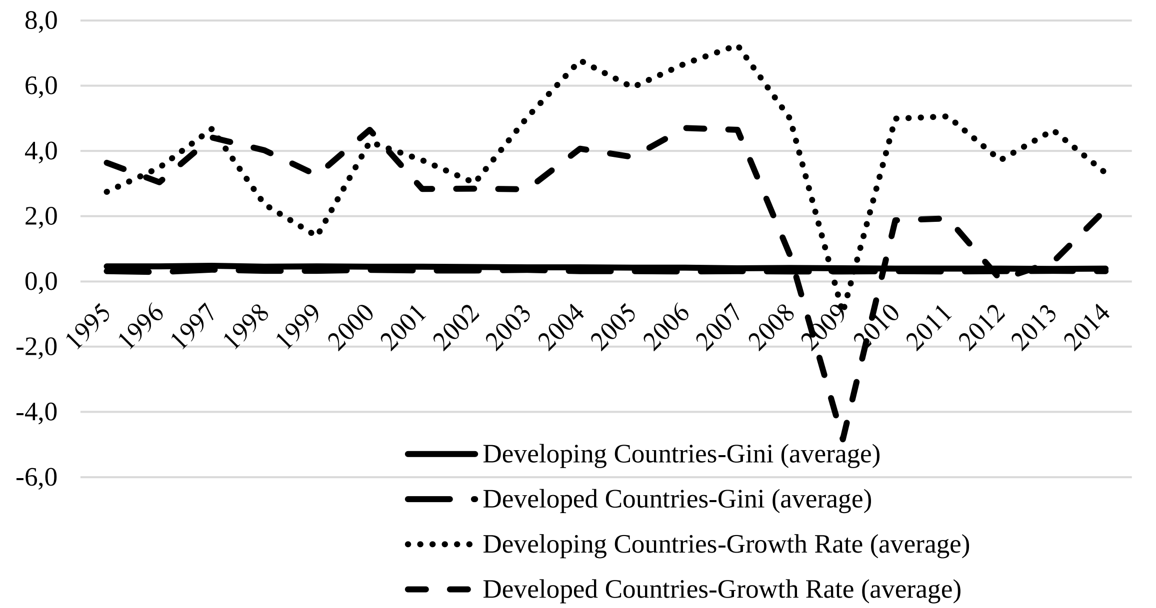
Figure-1: Income inequality in developing and developed countries



Source: http://databank.worldbank.org/data/home.aspx

The figure -1 shows that Income inequality in developing countries is higher than developed countries. However, trends in the income inequality in developing countries from 1994 to 2014 is slightly decreased, trends in the income inequality in developed countries is not changed.

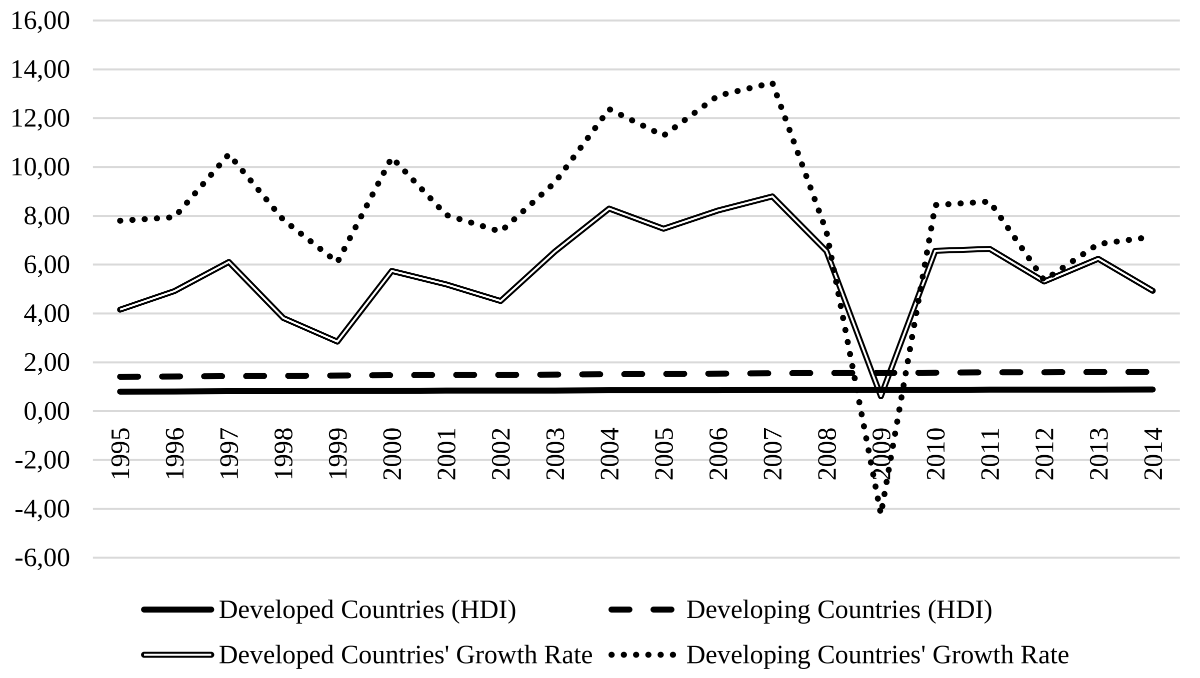
Figure-2: Income inequality and Growth rate in developing and developed countries



Source: http://databank.worldbank.org/data/home.aspx

The figure -2 shows relation between income inequality and growth rate in developing countries and developed countries. According to the figure, the growth rate and income inequality tends to be independent of each other. This means that economic growth has not effect on the income inequality.

Figure-3: Trend of Human Development Index and Economic Growth



Resource: http://hdr.undp.org/en/data#

The Figure-3 shows relation human development index and economic growth in developing and developed countries. According to the figure, the growth rate and human development index tend) to be independent of each other. This means that economic growth has noeffect on human development index.

3.THE ECONOMIC AND SOCIAL CONSEQUENCES OF INCOME INEQUALITY

The consequences of the inequality are exceedingly diverse. Thus, some economists argued that income inequality is beneficial and necessary incentive to grow, improves the standards of life for all societies (Birdsong, 2017). However, these claims are not true, because figure 1 clearly shows that developed countries are lower-inequality than developing countries. However, it is known that developed countries are more democratic and fairness countries.

Figure 2 show that there is no correlation between economic growth and income inequality. In addition, one of the most important determinants of economic growth is the labor. Thus, high income inequality has negatively effect on the ability of the human capital, therefore, it also reduces economic growth (Galor and Moav, 2004:1001–1026). Others argued that centralization of capital cause perpetually oppressed minorities, exploitation, hinder economic growth, and countless social problems. High and sustained levels of income inequality can entail large social costs.

Individuals' educational and occupational choices can be effected result from Inequality. Result from inequality, individuals can lose confidence in institutions and collapse balance for social cohesion in the future (Dabla-Norris and others, 2015:6). On the one hand, inequality increases Crime and Political Inequality on the other hand, inequality decreases education and health (Birdsong, 2017). "*There is a negative statistical association between income inequality and aggregate health outcomes across countries"* (Oishi and others, 2011: 1095-1100). Some studies argue that *"there is negative relation between income inequality and happiness"* (Birdsong, 2017).

Some inequality thesis agree that economic distance between the member of a society cause *"the anxiety and depression among the society members, regardless of their personal economic standing"*(Vilhjalmsdottir and others, 2018). One consequence of income inequality is the increase in crimes. According to merton (1938) 'the inequality of income and opportunity is the driving force of the crime. In addition, a positive relationship between income inequality and crime rates have found in a study conducted in China (Cheong and Wu, 2013).

CONCLUSION

The literature on income inequality includes a lot of studies that some of these studies have tried to identify relationship between income inequality and economic growth rate. In this study, fifteen studies are analyzed. Most of these studies argued that there is negative relationship between economic growth and income inequality. Some of these studies argue that there is positive relationship between economic growth and income inequality. However, indicators about inequality show that the economic growth does not provide income equality. In addition, experience shows that economic improvements do not reduce income inequality in the short-run, and the long-run. Therefore, increase in economic growth rate is not alone enough to overcome income inequality problem

As a result, it is concluded that economic growth is not sufficient to reduce the income distribution inequality. In addition, the problem of income distribution inequality is not only the problem of developing countries, but also the problem of developed countries. Therefore, all countries wishing to solve this problem, should review their economic policies and adopt policies that would cover all segments of society and provide equal opportunities to all members of society. For example, in the provision of basic needs, education, health, social security and entrepreneurship, all members of the society should benefit from public facilities at an adequate level.

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