

Accelerating Growth and Reducing Inequality: Trends and Policy Approaches

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Jomo Kwame Sundaram and Vladimir Popov¹

This paper is part of the Growth and Reducing Inequality Working Paper Series, which is a joint effort of the G-24 and Friedrich-Ebert-Stiftung New York to gather and disseminate a diverse range of perspectives and research on trends, drivers and policy responses relevant to developing country efforts to boost growth and reduce inequality. The series comprises selected policy-oriented research papers contributed by presenters at a Special Workshop the G-24 held in Geneva (September 2017) in collaboration with the International Labour Organization and the Friedrich-Ebert-Stiftung, as well as relevant sessions in G-24 Technical Group Meetings.

¹ Jomo K. Sundaram is former UN Assistant Secretary General for Economic Development and former G-24 Research Coordinator. Vladimir Popov is a Research Director for Economics and Politics in the Dialogue of Civilizations Research Institute in Berlin. The authors thank Allen Ng, Musaddiq Adam Muhtar and Tan Zhai Gen for their assistance.

Abstract:

Growth performances in developing countries have been uneven. The recent successes of East Asia and China have made their managed approaches to development popular. Historically, the multiplicity of developmental trajectories suggests that there are no universal recipes for rapid catch-up growth. Aggregate measures of inequality among countries have been closing. However, within most countries income and wealth inequalities have been increasing. The data suggest rising inequality due to rising profit rates, as the income shares of the richest have been growing for decades. Recent empirical analyses suggest that high inequalities hinder growth. With greater legitimization of property rights and economic rents, thanks to the prevailing neoliberal economic ideology and legal rights, as well as declining fiscal space, recent increases in wealth concentration will be difficult to reverse despite pressures for progressive redistribution.

Economic inequality has attracted growing attention by policy makers, researchers and the public in recent years, especially following the 2008-2009 global financial crisis and its aftermath. Actual progress in addressing growing inequalities has, however, been limited. Declining measures of overall global inter-country inequality since the 1980s have been paralleled by rising national or intra-country inequality (Milanovic 2016). The decline in inter-country inequality has been primarily due to China's sustained rapid growth obscuring persistent, if not growing inter-country inequalities experienced by most other developing countries. With growth by most others uneven at best, both inter- and intra-country inequalities apparently threaten future growth.

This paper reiterates the need for addressing and relating efforts to pursue growth and address inequality. Conventional approaches to strengthening property rights, human resource development, and international trade and financial liberalization have not successfully accelerated growth, while exacerbating inequalities in most countries.

The paper also highlights how national and international policies have benefited the wealthy. Internationally, developed nations have often imposed disadvantageous multilateral, plurilateral and bilateral trade and investment agreements, exercised undue influence over multilateral development banks to impose policies that benefit powerful transnational corporations (TNCs), crowded out domestic production in developing countries through selective trade liberalization, and limited national governments' capacities and capabilities to implement labor, environmental and other regulations. Nationally, greater critical scrutiny needs to be applied to strengthening property rights and legitimizing economic rents in the prevailing ostensibly neoliberal economic framework. Besides addressing rent-seeking, greater consideration of progressive social policies and labor market regulations is necessary.

This paper is organized as follows: the first section recognizes the uneven progress made by developing countries in reducing global inequality and the consequent economic heterogeneity across nations. The second section highlights the growing economic heterogeneity among developing countries, looking at both wealth and income inequalities, and how capital and labor incomes have contributed to these phenomena. The third section

explores whether economic inequality hampers country efforts to achieve growth, and considers World Bank and International Monetary Fund (IMF) perspectives on this matter. The fourth and final section discusses the effects of enacted policies and policy considerations relating to economic inequality, critically questioning whether mainstream proposals on inequality have done more harm than good.

1. Global context: Are developing countries catching up?

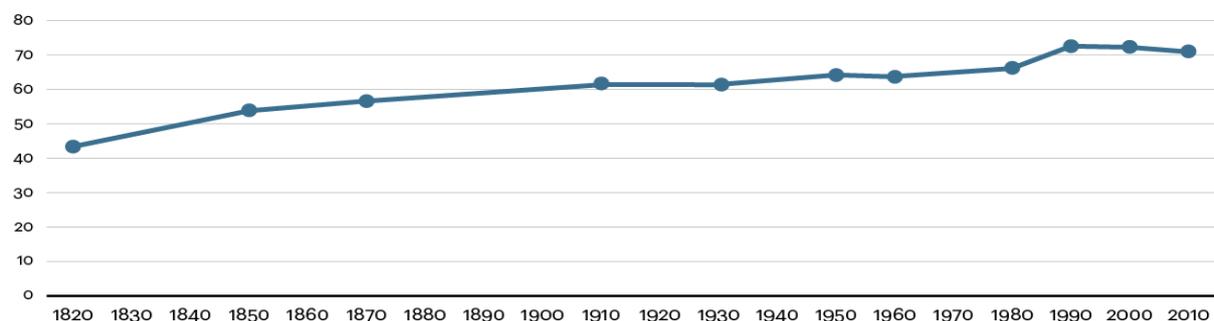
At the global level, countries ‘catching up,’ especially the fast growing large, populous economies such as China and India, has led to some income convergence between developed and developing nations, often referred to as the global ‘North’ and ‘South’ respectively, lowering overall global inequality since the late 1980s (Milanovic 2016). This U-turn to the great North-South divergence since the Industrial Revolution two centuries ago, was only temporarily slowed during the post-World War II Keynesian and post-colonial ‘Golden Age’ (see Figure 1).

These broad global trends obscure considerable variations across regions and countries, especially in the South. Over the last four decades, about half the countries in the world have recorded increases in national inequality, with Gini coefficients rising over two percentage points (IMF 2017). This has been the case for most advanced economies of the North where sizably increasing income inequality was largely driven by the accelerated growth of the incomes of their top 1 percent, related in turn to growing wealth and power concentration. Piketty (2014) noted that while national income inequalities were largely checked in the North before and after the Second World War, the decades since the 1980s have seen its resurgence. Since 1980, the income share of the top 1 percent has grown most in Australia, Canada, the UK, and the US, with wealth concentration rising even faster.

Figure 1
Global inequality has risen but is beginning to decline

Global income inequality

Gini coefficient



Note: The global Gini coefficient is measured by global interpersonal inequality rather than at the inter-country level.
 Sources: World Bank; A.T. Kearney analysis

As it stands, wealth distribution is even more unequal, with greater concentration at the top. A January 2017 Oxfam report highlights the rapid wealth concentration in recent years. Total global wealth had reached US\$255 trillion, with more than half belonging to the richest 1percent of the world’s population. The wealth of the eight richest men in the world

in 2016 was equal to that of the 3.7 billion people comprising the bottom half of the world's population. The report suggests how the super-rich and big businesses have accelerated wealth inequality: a third of the world billionaires' wealth was inherited, while another 43 percent can be attributed to cronyism. Big corporations and the super-rich accumulate more by tax evasion, minimizing costs and influencing policies and regulations (Hardoon 2017).

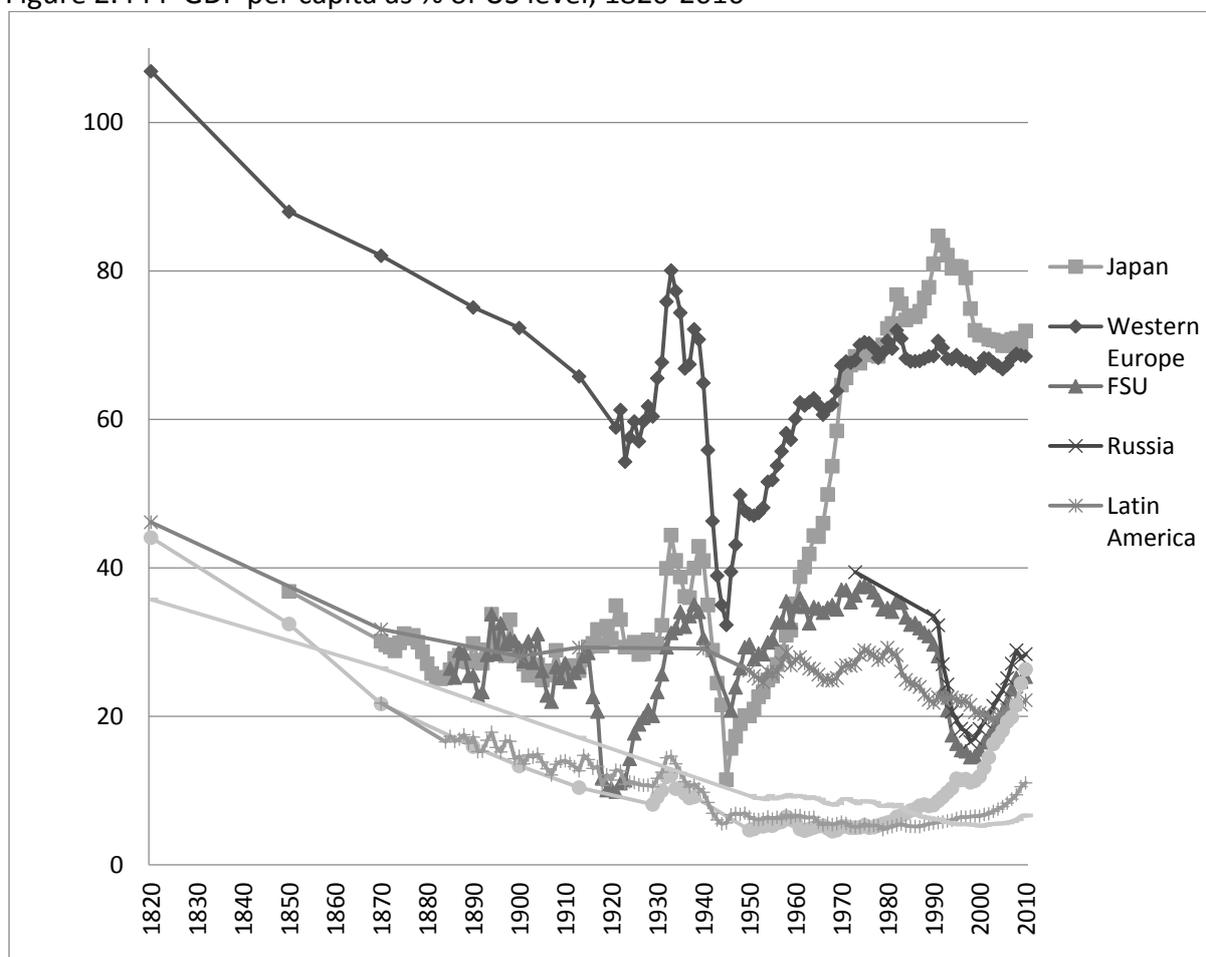
The conventional wisdom is that excessive economic 'inequality of outcome' can hurt growth and cause damaging social and political instability. Excessive inequality and exclusion undermines social cohesion, exacerbating social and political polarization and hampering economic growth (Berg and Ostry 2011; Rodrik 1999). While some inequality is said to be unavoidable due to variations in ability, talent, initiative and fortune, existing inequalities, disparities and trends enjoy little legitimacy.

Attempting to equalize societies is likely to be difficult and resisted, especially by the privileged. Undoubtedly, some societies are more tolerant of inequality than others depending on the extent to which prevailing ideologies legitimize differences. Unequal economic distribution may be more acceptable if the distribution of opportunities is seen as fair. Hence, some argue that ensuring 'equality in opportunity' is more feasible and likely to be legitimate.

Disparities among countries

The late cliometrician Angus Maddison has estimated incomes in different parts of the world for the last two millennia (Figure 1). He suggests that for the first one and a half millennia, average incomes were roughly similar in the world. Differences began about half a millennium or five centuries ago, from the time of the Iberian voyages of exploration and conquest. However, the gap between the contemporary global North and South, or between the developed (Western Europe, its mainly Anglophone settler colonies in North America and Australasia, and Japan) and developing countries, is around two centuries old, from the time of the Industrial Revolution (Figure 2). Has the income gap between the North and the developing countries, that was growing for nearly half a millennium from 1500, and accelerating from two centuries ago, started to close? If so, why?

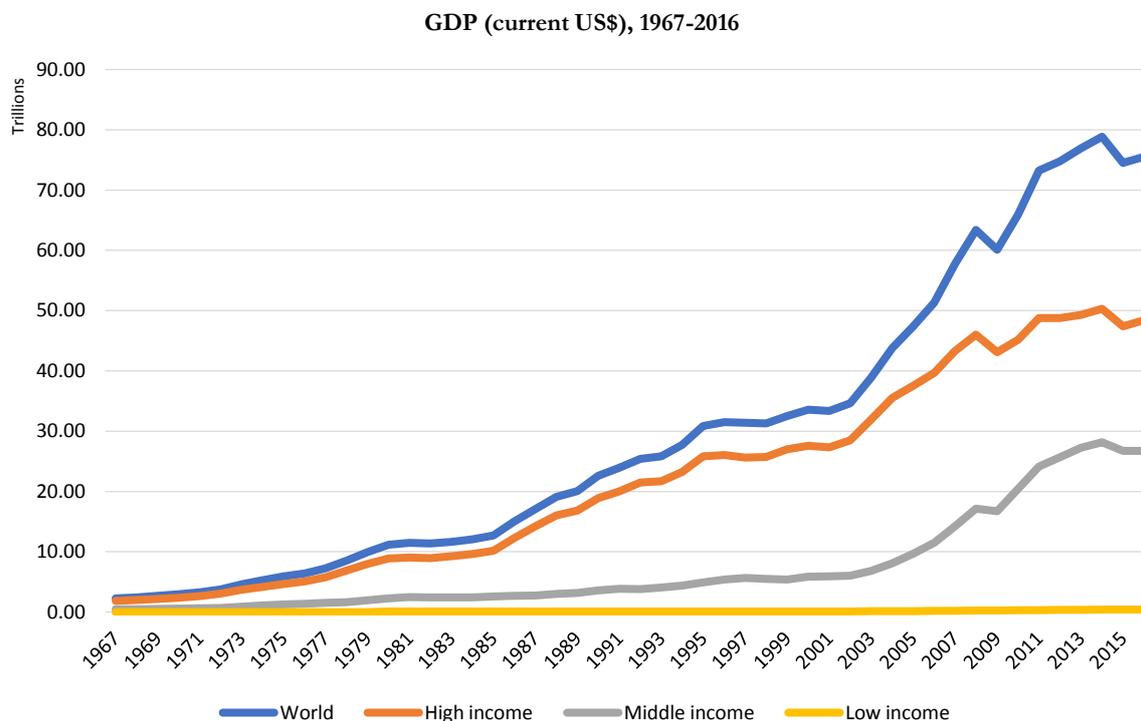
Figure 2. PPP GDP per capita as % of US level, 1820-2016



Source: Maddison project, 2018

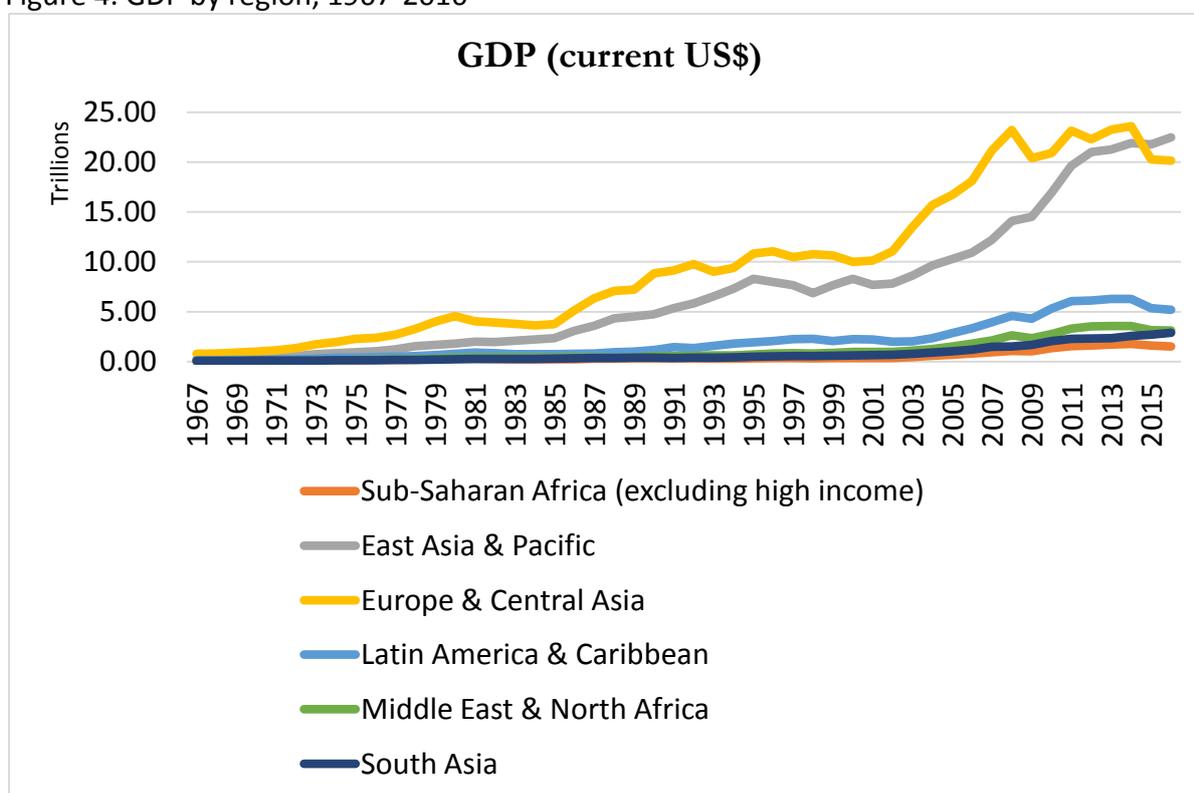
The world economy has grown very significantly over the last half century, but national income data show how uneven this growth has been. Despite growth accelerations in some developing countries from the late 20th century, world income inequality continued to increase during much of this period, as Milanovic has shown. Figures 3 and 4 show these trends among countries by income groups as well as by region. A handful of developing countries grew fast enough to join the ranks of the high-income countries, as growth in so-called (middle-income) transition economies decelerated from the end of the 20th century. For a decade and a half after the brief dot-com bubble recession after the turn of the century, middle-income countries generally grew faster than rich countries, reducing overall world income inequality, due to lower inter-country disparities. Growth in East Asia, India, Latin America and even mineral-rich countries in sub-Saharan Africa (SSA) accounted for these trends, with the trend reduced in recent years as growth rates dropped after 2014.

Figure 3. GDP by country income level group, 1967-2016



Source: WDI.

Figure 4. GDP by region, 1967-2016



Source: WDI

There have been several major attempts at catch-up development in the 20th century. Failures as well as successes can be instructive. Arguably, the former USSR from the 1930s to the 1960s was the first major non-Western country to experience successful catch-up development and to narrow the income gap with the West, although the gap ceased to narrow in the 1970s and 1980s, before widening again in the 1990s (Popov 2014). For much of the second half of the 20th century, Japan, South Korea, Taiwan, Hong Kong and Singapore grew rapidly. These have been the only economies that have successfully caught up with the West to be considered developed. However, only Japan, Korea, Mexico, Chile and Colombia have joined the Organization for Economic Cooperation and Development (OECD), known as the club of developed economies. In recent decades, from the 1970s, others in Southeast Asia, China and elsewhere have been 'catching up' as well. Growth accelerations in India and in some other developing countries from the 1980s have reversed the Great Divergence at an aggregate level.

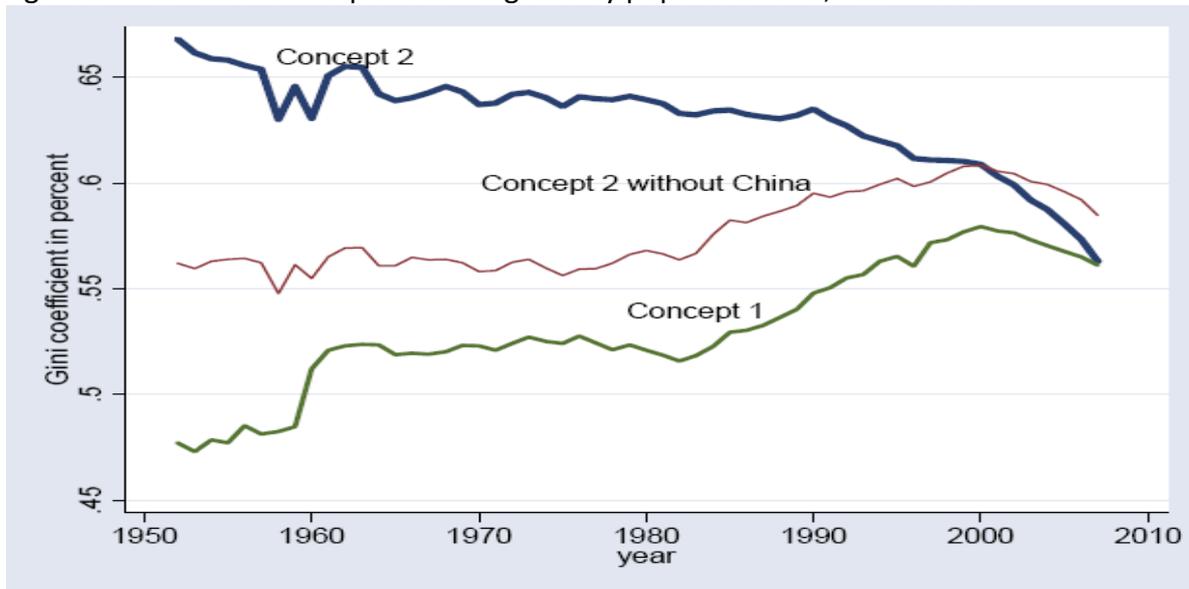
It is possible that the world may continue to experience a gradual global convergence in income levels, so that the gap between the North and the South will continue to narrow over the 21st century (Figure 3). But this outcome is not assured as there is no reason to assume that recent trends will necessarily continue indefinitely. Also, many other developing countries have not been catching up, and all too many 'growth accelerations' have not been sustained (Reddy and Minoiu 2007). Some economies with high or higher per capita incomes have become rich due to mineral wealth and relatively small populations, while many other developing countries have not been able to sustain growth, industrialization, or in some cases, have been experiencing 'premature deindustrialization,' recently associated with what the World Bank and others refer to as the 'middle-income country trap.'

Most of Latin America, the Caribbean, Sub-Saharan Africa, East Europe and the former Soviet Union have not been catching up as impressively as most of East Asia, and some countries have even fallen behind, especially in the 1980s and 1990s (Ocampo, Jomo and Vos 2007) and, most recently, since 2014. But, for the first time in two centuries, *average* per capita GDPs have been closing especially in some major economies including populous ones such as China, Indonesia and India.

From the mid-1980s, growth in most of South Asia appeared to be accelerating but unevenly sustained. Since early this century and until 2014, Eastern Europe, the Former Soviet Union countries (FSU), Latin America and the Caribbean (LAC), Middle East and North Africa (MENA) and SSA were experiencing faster per capita output growth than OECD countries for the first time in decades (Figure 4).

Inequalities among countries, if measured by weighing their mean incomes, show a clear tendency of increasing between 1820 and 1950, i.e., from the Industrial Revolution until the Second World War, and of declining thereafter. Even if China is excluded, inter-country inequalities after 1950 did not rise considerably, as they had done before. Such disparities were at least stable during 1950-1980, rose again during 1980-2000, and have fallen since (Figure 5).

Figure 5. International inequalities weighted by population size, 1952-2006

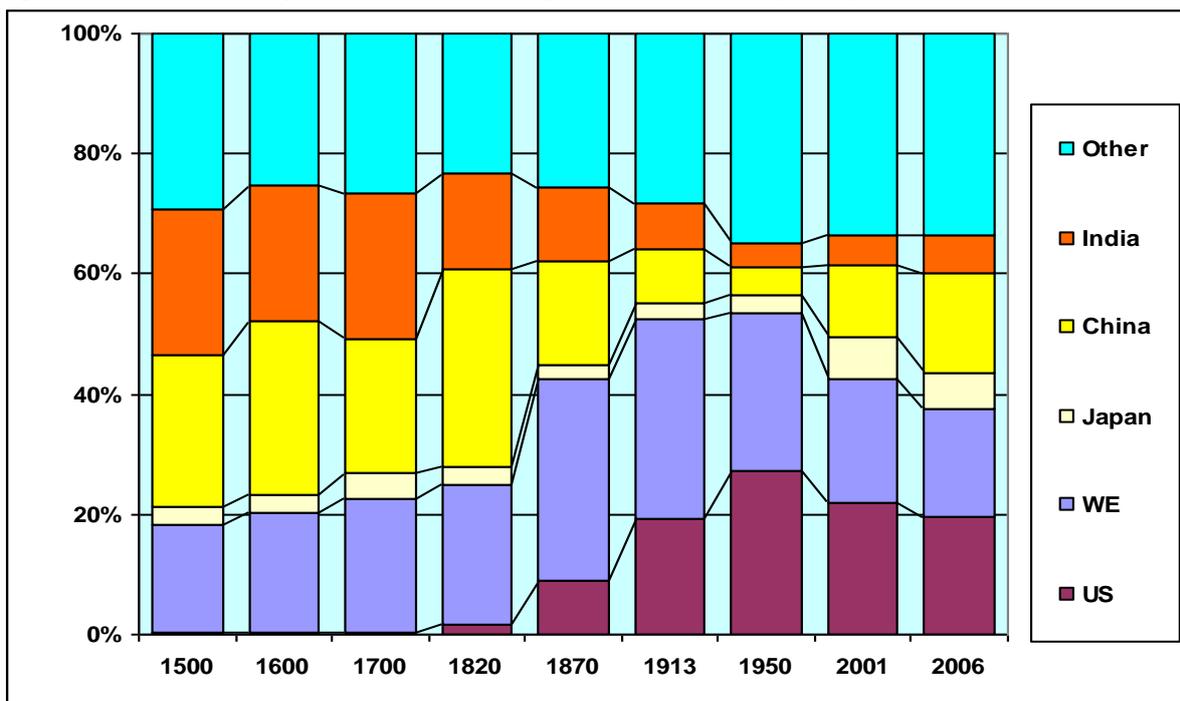


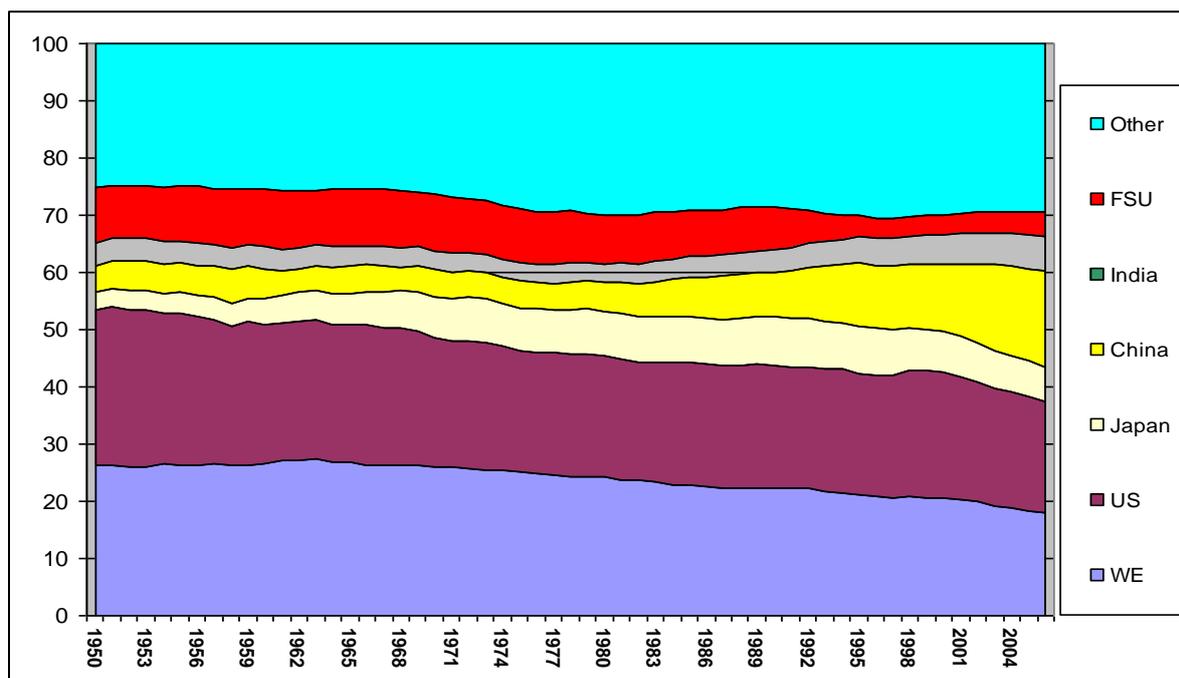
Note: Before 1960, between 80 to 90 countries were included. After 1960, the number has ranged between 130 and 150. Concept 1 inequality refers to inequalities between countries' mean incomes without weighting observations by population size, while concept 2 inequality weights countries' mean incomes by population size.

Source: Milanovic, 2009

The rise of the South has involved redistribution of world production and incomes. The shares of China, India and other developing countries, accounting for less than half of world output in 1950, have increased to exceed 60 percent a decade ago (Figure 6).

Figure 6. Shares of major countries and regions in world output by PPP, 1500-2006





Source: Maddison, 2008

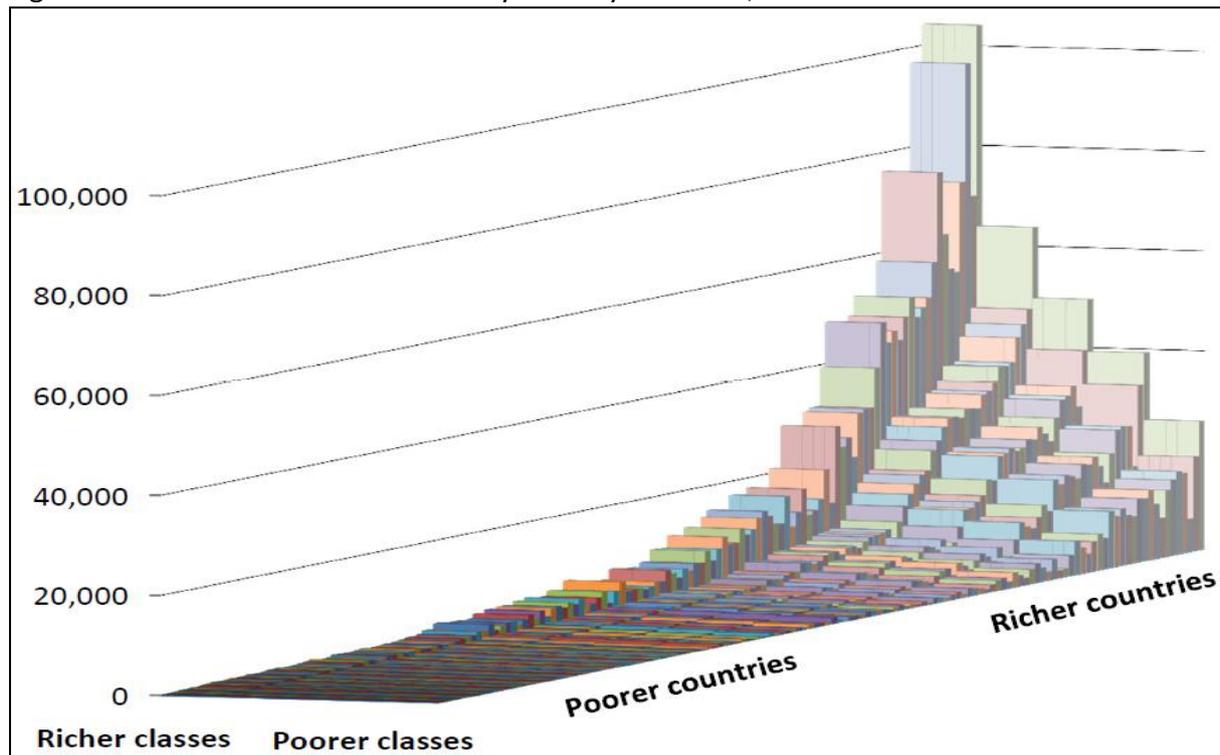
National inequalities and North-South disparities

Aggregate measures of differences in incomes of individuals or households in the world can be analyzed to differentiate between inequality *among* and *within* countries (Figures 7 and 8). Thus, global inequalities can be decomposed to distinguish between ‘within country’ and ‘among countries’ components. Growing inequalities within countries and decreasing disparities between North and South have shaped global inequalities in recent decades (Figures 9 and 10).

By and large, global inequalities grew in the 1980s and 1990s as declining disparities among countries were not enough to counter rising intra-country inequalities until around the turn of the century. Overall world inequality – among the people and households of the world – is higher than inequality even within the most unequal countries. In other words, the level of overall global income inequality is greater than national-level income inequalities, implying that location is more significant than class.

Milanovic (2005) has shown that about two thirds of overall world inequality are due to inter-country disparities, i.e., political geography, rather than intra-country inequality. With the overall growth slowdown since the 2008-2009 global financial crisis, the North-South gap continued to close as many developing countries, e.g., in Sub-Saharan Africa, continued to grow faster thanks to high mineral and other primary commodity prices that increased due to continuing demand growth from other industrializing countries in the South. Figure 11 shows that over the last four decades of the 20th century, the already huge differences in output between the twenty richest and poorest countries actually increased.

Figure 7. Global income distribution by country and class, c. 2010



Source: UNICEF Working Paper: Global Inequality: Beyond the Bottom Billion – Review of Income Distribution in 141 Countries (<http://equityforchildren.org/2011/06/unicef-working-paper-global-inequality-beyond-the-bottom-billion-review-of-income-distribution-in-141-countries/>)

Figure 8. Changing Gini coefficient by country, 1966-2008

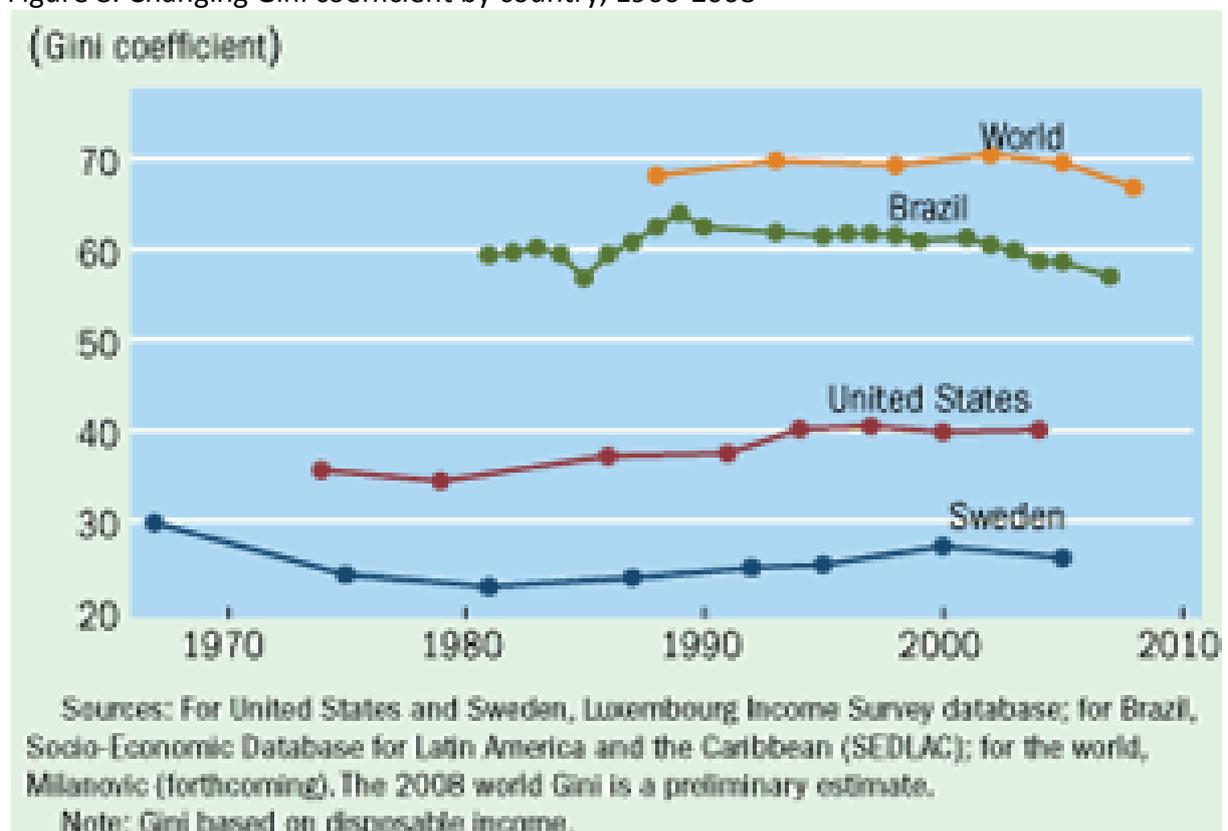
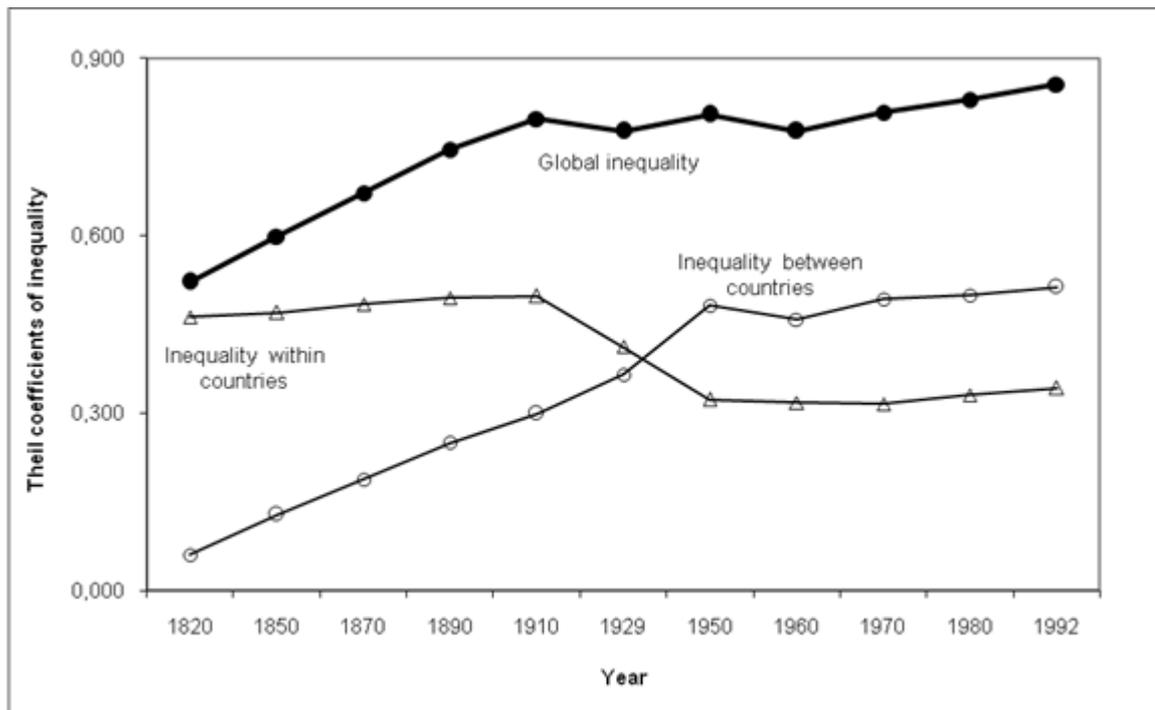
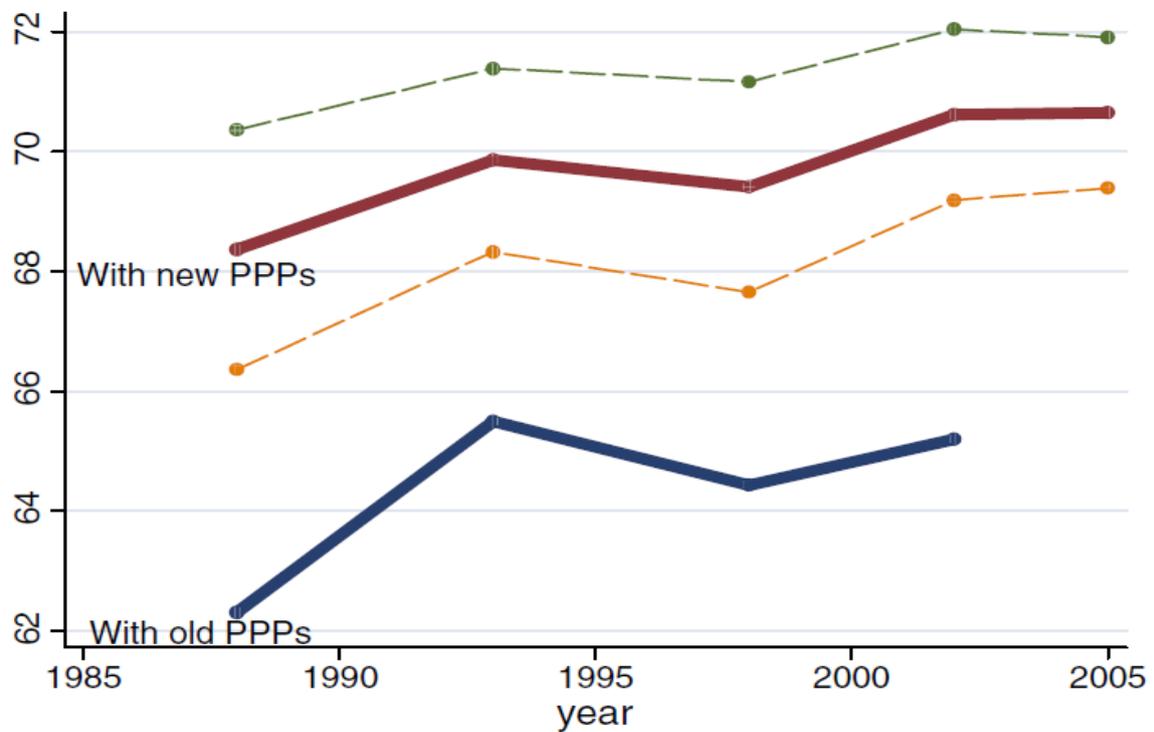


Figure 9. The global coefficients of income inequality, 1820-1992



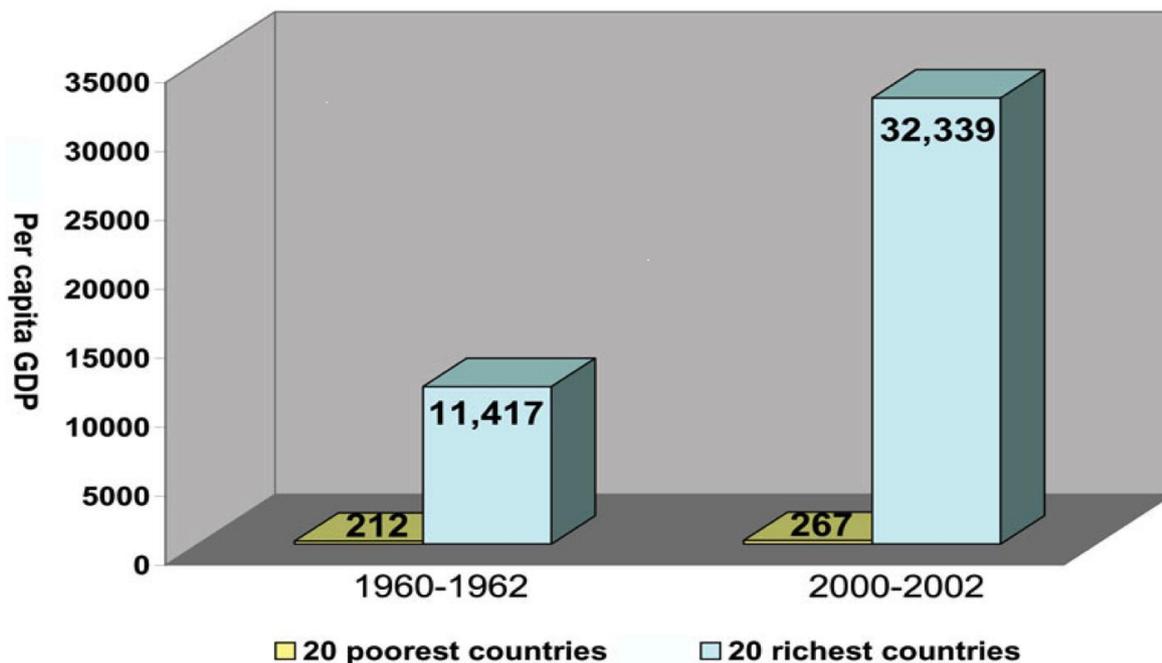
Source: Bourguignon and Morrisson, 2002

Figure 10. Global income Gini coefficients, 1988-2005, calculated with new and old PPPs



Source: Milanovic, 2009

Figure 11. Per capita GDP of 20 poorest and richest countries, 1960-2002



Source: Inequality inconsistent with UN charter vision (<http://fayllar.org/inequality-inconsistent-with-un-charter-vision.html>).

Maddison (2013) estimated the ratio of average per capita income in Western Europe to other countries at approximately 1:1 around 1500. By 1900, the ratio of average per capita incomes in the West (Western Europe and the British dominions, former settler colonies in North America and Australasia) to the global South (developing countries) stood at 6:1, and remained thereabouts at the end of the 20th century. If China is excluded, the ratio of average per capita incomes in rich countries to poor countries has actually increased, but not as quickly as before the mid-20th century (Wade 2004; Popov and Jomo 2017: Figure 2).

Closing inter-country disparities

Successful catch-up development cases grew in number in the second half of the 20th century as Japan and the four other East Asian newly industrialized economies successfully caught up with the West. While much of the rest of the developing world lost the 1980s, if not more, growth accelerated in Southeast Asia (Jomo *et al.* 1997) and China (Lin 2012) before slowing down with the 1997-1998 East Asian crisis in the former, and with renminbi appreciation a decade ago in the latter. With growth accelerations in India, Bangladesh, Ethiopia and some other developing countries, the Great Divergence appears to have come to a partial, uneven end for the time being (United Nations 2010). The North-South gap in average per capita incomes stopped widening, and has started to close.

The decades since 1950 have seen increased developing countries' shares of world income and population. Developing countries now also account for larger shares of international trade, international investment, industrial production and manufactured exports than ever before. Nayar (2013) argues that developing countries can only sustain this if economic

growth, human development and social progress rise together. But progress so far has been uneven among countries and over time - with relatively few, albeit large, developing countries sustaining high growth over several decades to bring about overall North-South convergence.

With much of the rest of the world left behind, or unable to sustain growth beyond brief spurts, it is unlikely that disparities within the South will not continue to grow (Popov and Jomo 2017: Figure 2). Various regions in the global South – especially Sub-Saharan Africa, but also much of Latin America – as well as Eastern Europe and the former Soviet Union, have not been catching up since the 1970s except early in the 21st century. Some have even fallen further behind, even after the 1980s and 1990s (Ocampo, Jomo & Vos 2007).

Nevertheless, declining overall North-South income disparities point to slow and uneven economic convergence, despite several reversals, following Asian and African decolonization after the Second World War. National per capita incomes diverged considerably during 1820-1950, before converging a little during the post-Second World War Golden Age until the 1960s. Even if China is excluded, the disparity between North and South rose modestly from 1950 to the 1970s, before rising again during the next two decades, and then falling thereafter (Milanovic 2009). North-South disparities have started to decline, reversing the previous divergence in per capita income levels (United Nations 2014).

While some fast growing developing countries are catching up with the rich countries, most are not, with some even falling further behind. Amsden (2004) differentiates among the 'Rest' (countries outside the West and Japan), and distinguishes between what she calls 'independent' (East and South Asia) and 'integrationist' (Latin America) late industrialization. China, India, South Korea and Taiwan had relatively low income inequalities in the 1960s and 1970s, invested heavily in research and development (R&D), and supported nationally, including state-owned, manufacturing enterprises. Latin American countries had much more unequal income distribution in the late 20th century and have allowed transnational firms to increasingly dominate their economies.

20th century catch-up attempts

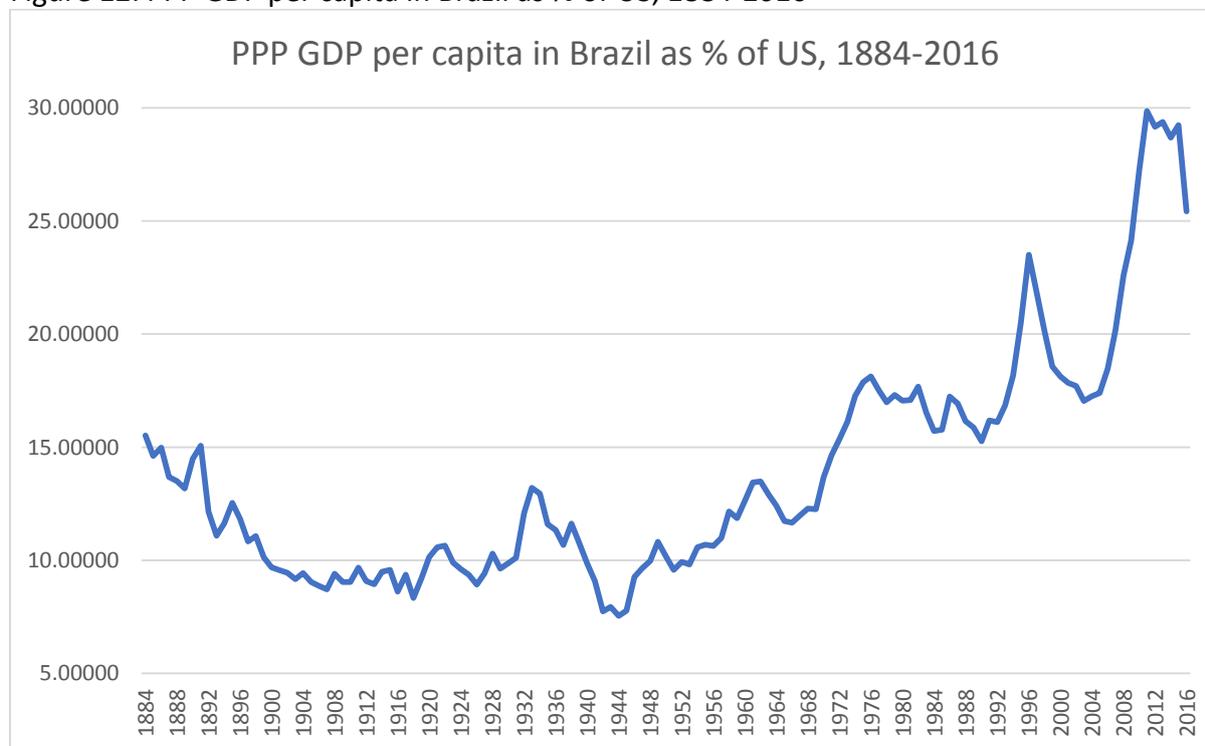
Most countries in the 'North' have become and stayed rich, whereas the 'South' has stayed relatively poor, with average per capita incomes below half the level of the West until the mid-20th century. The USSR and Japan were the first major countries to successfully catch up from the 1930s to the 1960s, narrowing the average income gap with Western Europe and the US despite World War Two (Popov and Jomo 2017: Figure 2).

Japanese growth after the 1868 Meiji Restoration barely kept pace with the post-Civil War boom in the US until the 1929 Great Crash. Average Japanese income was about 30 percent the US level during 1870-1930, rising to 40 percent following US income contraction during the Great Depression. Due to the Second World War, Japan only closed average output and income gaps around the 1970s, despite earlier progress (Bradberry, Fukao & Zammit 2015).

Brazil experienced a half century of rapid growth from the 1930s until the 1970s, closing its gap with the US despite the latter's own impressive growth from the New Deal to the early

1960s. Brazil's achievement was diminished by rapid population growth, involving considerable immigration. After two decades of virtual stagnation from the 1980s, growth during the Lula presidency was all the more impressive, due to employment gains, social protection gains and lower inequality from the beginning of the 21st century (Figure 12).

Figure 12. PPP GDP per capita in Brazil as % of US, 1884-2016



Source: Maddison project, 2018

Soviet growth in the 1950s was comparable to Japanese growth from the 1950s to the 1970s as well as Korean and Taiwanese growth during 1960-1990 (Table 1); rapid increases in labor and overall productivity greatly offset declining capital productivity (Easterly & Fisher 1995). Rapid Soviet growth was not sustained for even two decades in peacetime, whether before or after World War II (Popov and Jomo 2017: Figure 2), whereas it continued for four decades in East Asia. By contrast, Chinese central planning avoided many problems that Soviet central planning exhibited during 1929-1991.

Table 1. Growth in Japan, South Korea, Taiwan, 1950-1990

Country (period)	Capital-output ratio	TFP growth (unit elasticity of substitution)
Japan (1950/57/65-85/88/90)	2.3–3.2	1.7–2.5
South Korea (1950/60/65-85/88/90)	2.8–3.7	1.7–2.8
Taiwan (1950/53/65-85/88/90)	2.6–3.1	1.9–2.4

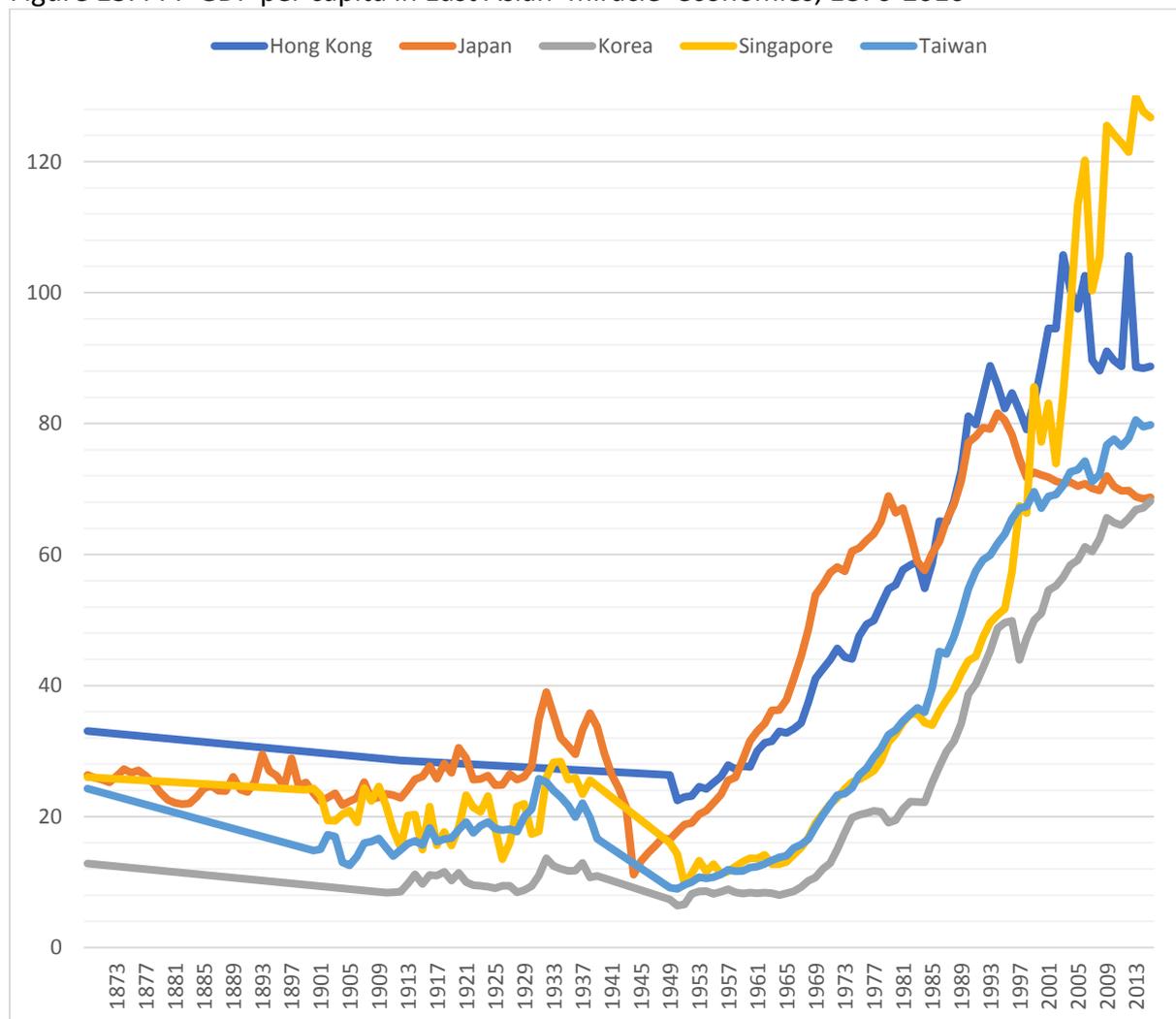
Source: Easterly & Fisher, 1995

In the course of the second half of the 20th century, some countries in Latin America, Africa and the Middle East experienced growth spurts, and seemed to be catching up for a while but most such growth spurts did not last (Reddy and Miniou 2009). From the 1950s to the 1970s, many Latin American and African developing countries experienced relatively rapid

growth, but most lost momentum after the early 1980s' debt crises, resulting in a 'lost decade' in Latin America (1980s) and longer stagnation in Africa for a quarter century from the late 1970s.

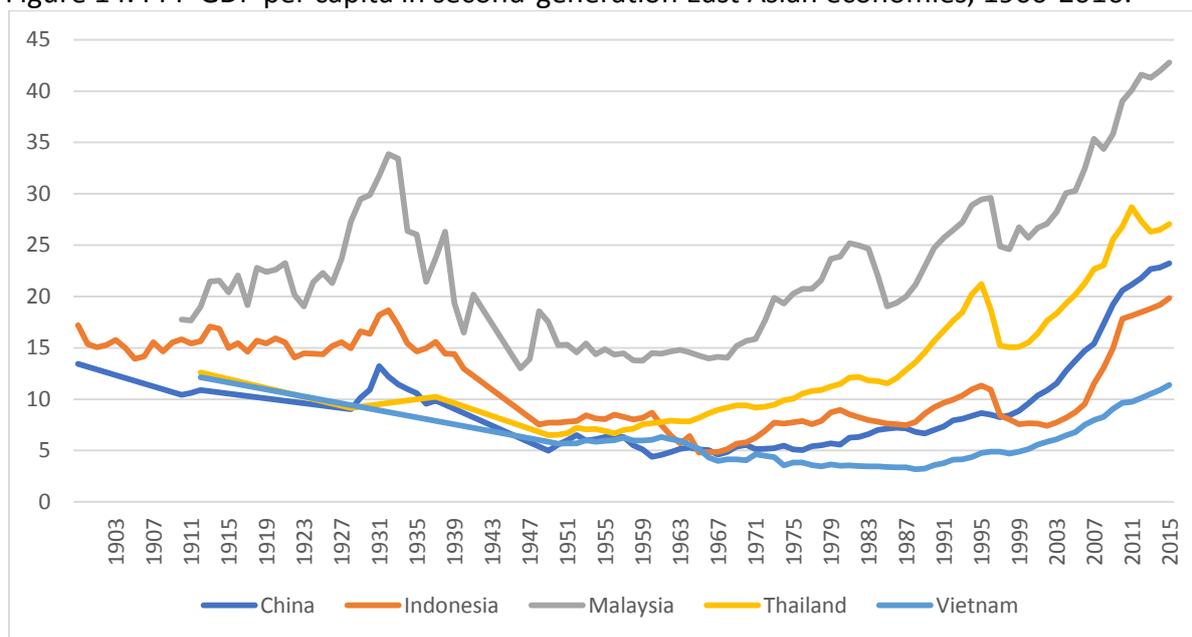
As with the US Marshall Plan in Western Europe from the late 1940s, rapid post-war growth in Northeast Asia was helped by US anti-communist priorities in Asia. Generous aid as well as policy and fiscal space were crucial for accelerating economic growth and structural transformation in these economies. By contrast, five economies in East Asia with per capita incomes between 10 to 40 percent of the US level before the Second World War, joined the rich countries' ranks in the second half of the 20th century. Japan, Hong Kong, Singapore, Taiwan and South Korea were the only economies to successfully catch up to become developed economies during the second half of the 20th century (Figure 13). China resumed growth and structural transformation in the 1950s, accelerating from the 1980s, while Malaysia, Thailand and Indonesia accelerated, albeit less consistently, in the 1970s, and Vietnam followed with pragmatic 'Chinese-style' market-oriented reforms from the mid-1980s (Figure 14).

Figure 13. PPP GDP per capita in East Asian 'miracle' economies, 1870-2016



Source: Maddison project, 201

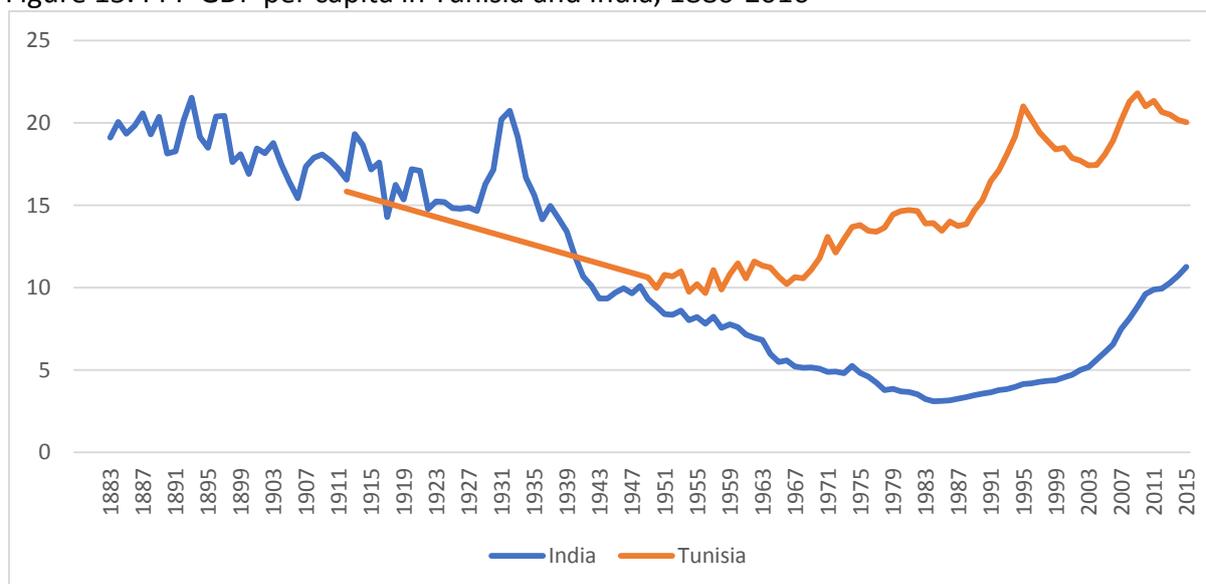
Figure 14. PPP GDP per capita in second-generation East Asian economies, 1900-2016.



Source: Maddison project, 2018

Growth accelerations were not unique to East Asia, involving countries as varied as Botswana and Lesotho in SSA, India and Sri Lanka in South Asia (SA), Israel, Oman and Tunisia in the MENA region (Figure 15). In Europe, rapid growth was observed in Greece, Ireland, Montenegro, Portugal and Spain (Table 2). While no other countries achieved developed country status, the gap in economic development levels between North and South was reversed with the widespread developed country slowdown following the 2008 global financial crisis and the commodity price boom until 2014. Some have interpreted Mexico and Chile joining the OECD as evidence of Latin American countries making comparable progress.

Figure 15. PPP GDP per capita in Tunisia and India, 1880-2016



Source: Maddison project, 2018

Table 2. Average annual per capita GDP growth rates of fastest growing countries 1950-2016

<i>Country / Period</i>	<i>%</i>
South Korea	5.4
Taiwan	5.3
Oman	5.2
Singapore	5.2
China	4.3
Japan	4.1
Thailand	4.1
Ireland	3.8
Hong Kong	3.8
Botswana	3.7
Myanmar	3.7
Portugal	3.6
Austria	3.5
Greece	3.5
Indonesia	3.4
Malaysia	3.3
Israel	3.2
Sri Lanka	3.1
Lesotho	3.1
Spain	3.1
Tunisia	2.9
Montenegro (after 1952)	2.8
India	2.2

Source: Maddison project, 2018

Uneven development

Determining why some countries grow faster than others is arguably the main analytical challenge for development economics. It is a variation of Smith's question about the nature and sources of the wealth of nations (Smith 1776). Related questions include why the West got rich before the Rest? and why some developing countries are catching up with the West, while others are not? But there is no consensus among economists on the policies needed to achieve sustained rapid growth (Popov 2010).

Various economists claim that economic success stories prove what they have been claiming. Privatization of state-owned enterprises, freer trade, financial liberalization, and democratic political institutions are said to be pre-requisites for successful development by

the Washington Consensus.² Economic liberalization is said by neoliberals to be the basis for rapid growth. In contrast, others have credited progress to policy interventions, including industrial policy. For others, foreign direct investment (FDI) is considered essential for developing country growth, although FDI was not significant for late industrialization in Japan, South Korea, Taiwan and perhaps even pre-1990s' China.

It is also moot whether foreign aid boosts growth or crowds out domestic savings and investment (United Nations 2002; Channing, Jones & Tarp 2010). Besides, many policy options used by the now rich countries in the 19th and 20th centuries are no longer available to most poor countries today (Reinert 2007).

The breathtaking success of Japan in becoming a developed country in just two post-war decades was explained by some in terms of Japanese-style corporatism, involving special relations between: the government and companies; between banks and non-financial companies in its bank-based financial system; between companies and workers, e.g., guaranteed lifetime employment and the 'seniority' wage system. After the protracted stagnation from the 1990s following Japan's 'Big Bang,' and especially after the 1997-1998 East Asian financial crisis, these factors were criticized as typical of Asian 'crony capitalism' blamed for the crisis and subsequent stagnation (Jomo 2001).

In the former Eastern Europe, economic liberalization undermined excessively bureaucratic and centralized planning, and involved pragmatic privatization, e.g., to stakeholders already directly engaged in enterprise operations. However, in Sub-Saharan Africa and Latin America, often modest state capacities and interventions were done away with, even when they could have been reformed to better support investments and growth. FDI was expected to fill the lacuna, but rarely did so, with the shortfall typically blamed on the inadequacy of governance reforms. Governments were then pressured to further diminish their already limited capacities and capabilities, ostensibly to further economic liberalization measures in order to 'liberate' forces expected to accelerate investment and growth (Jomo 2012).

Partial economic liberalization seemed to help in China and central Europe, but undermined inherited state capacities and capabilities from the past in Russia and most other Commonwealth of Independent States (CIS) governments. In China, and parts of Central Europe, such state capacities and capabilities were reformed and deployed for new ends, rather than destroyed, to help accelerate investments and growth (Popov 2014).

² The Washington Consensus was principally reflected in the main 'neo-liberal' policy conditionalities and advice of the World Bank and International Monetary Fund (IMF) especially during the 1980s. Some research publications of the Bank during the mid-1990s suggest a broader range of perspectives. For example, while the World Bank's (1993) *The East Asian Miracle* volume acknowledged the role of the state and 'functional' policy interventions in the region's rapid growth, its 1996 *World Development Report* (World Bank 1996: 142) argued that consistent policies, combining liberalization of markets, trade, and new business entry with reasonable price stability, can achieve a great deal even in countries lacking clear property rights and strong market institutions. The following *World Development Report* (World Bank 1997), entitled *The State in the Changing World*, emphasized the importance of state institutions for growth.

There are no universal recipes for rapid catch-up growth as one-size-fits-all solutions do not exist. After all, reforms needed for success are not the same in different contexts (Polterovich & Popov 2005a; 2006). Rapid growth will only happen if several conditions are met, but these may be difficult to anticipate, although they may be easier to recognize with the benefit of hindsight.

Sustaining rapid growth is a complicated process typically requiring various crucial inputs—infrastructure, human resources, strong institutions, economic stimuli, among other things. If any ingredient is missing, growth may not take off or be sustained. Rodrik, Hausmann & Velasco (2005) propose ‘growth diagnostics’ to overcome such ‘binding constraints’ holding back economic growth. Such constraints may be due to ‘incomplete’ markets or lack of state capacity or appropriate human resources or infrastructure or other relevant factors.

Due to poor governance, corruption and inadequate or inappropriate reforms, growth in emerging economies may be slowing down compared to the 2000-2014 period when growth was atypically high (Åslund 2013). But most predictions assume that particular policies will or will not be enacted. Some favour more liberalized or privatized economies while others prefer more centralized and (government) interventionist ones a la East Asia. The Washington Consensus strongly promoted greater individual freedom, trade and financial liberalization, extending private property rights and ‘entrepreneurship.’ Since the 1990s, more emphasis has been put on ‘good governance,’ democracy and cross-border economic liberalization, often referred to as globalization.

The rise of East Asia, and especially of China, in the last few decades has made (state) interventionist or *dirigiste* catch-up development models and strategies more attractive. But not all developing countries have or can develop the same institutional capacities and capabilities as China, some of which may be necessary for successful sustained growth. However, many do have them, and those which do not may be able to develop them, perhaps if multilaterally enabled and supported to strengthen needed capacities and capabilities.

Despite considerably increased income inequalities in China after 1985, it has been argued (Popov 2014) that the level of inequality may still be acceptable given the ‘continental’ size of the country’s population. In the 20th century, income inequality in many countries was checked by socialist and populist movements and demands, including fiscal redistribution, social protection and welfare programs. Growth accelerations in much of the South, albeit temporary have reduced previously growing international disparities.

2. National Income Inequalities in Developing Countries

Long term trends suggest income and wealth inequality increased from ancient times, and more sharply so in the early 19th century, before reaching an all-time peak in the early 20th century (Table 3, Figure 16). They then started to decline after the First World War and the 1917 Russian revolution.

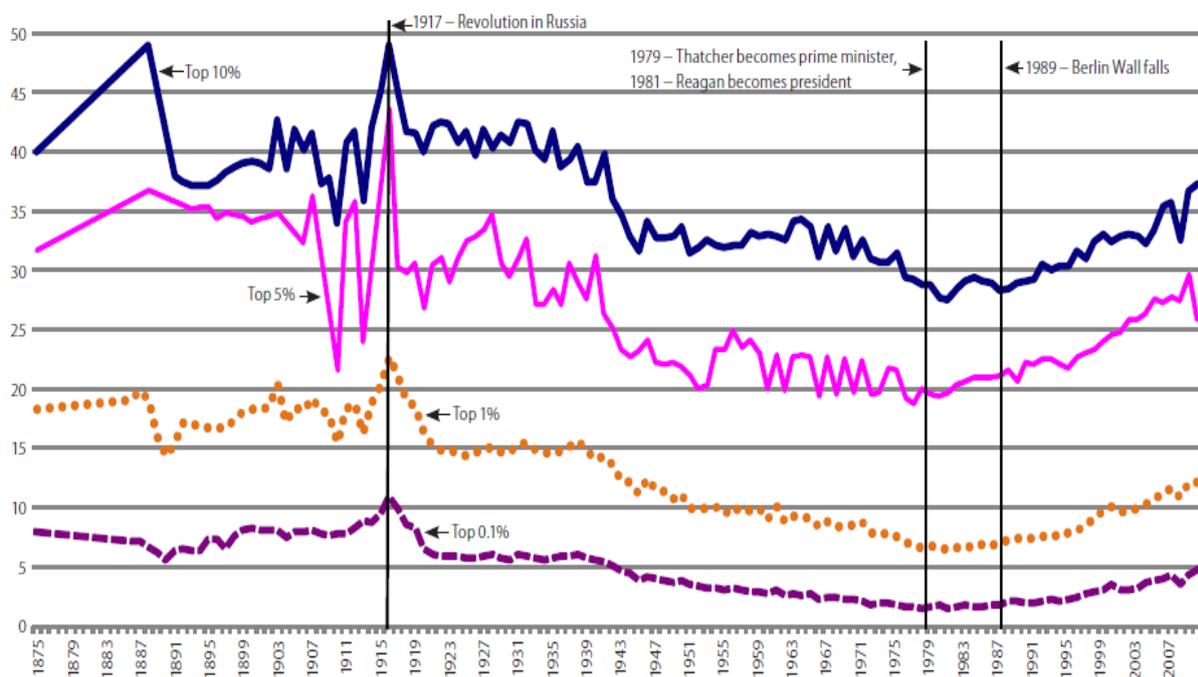
Table 3. Gini coefficients around particular years in some Western locations, %

Years	14	1000	1290	1550	1700	1750	1800	2000
Rome	39							
Byzantine		41						
Holland				56		63	57	30.9
England			36.7		55.6	52.2	59.3	37.4
Old Castille/Spain						52.5		34.7
Naples/Italy							28.1	35.9
France							55	33

Source: Milanovic, Lindert, Williamson. 2010; some data for 2000 from World Development Indicators database.

Figure 16. Income shares of top 10, 5, 1, 0.5 and 0.1 per cent, 1875-2011 (unweighted average for 22 countries)

Chart: Income Shares, Average for 22 Countries



European countries: Denmark, France, Germany, the Netherlands, Switzerland, UK, Ireland, Norway, Sweden, Finland, Portugal, Spain, Italy; North America: United States and Canada; Australia and New Zealand; Latin American country - Argentina; Asian countries - Japan, India, China, Singapore, Indonesia; Sub-Saharan Africa - South Africa, Mauritius, Tanzania. Overall - about 1/2 of the population of the world.

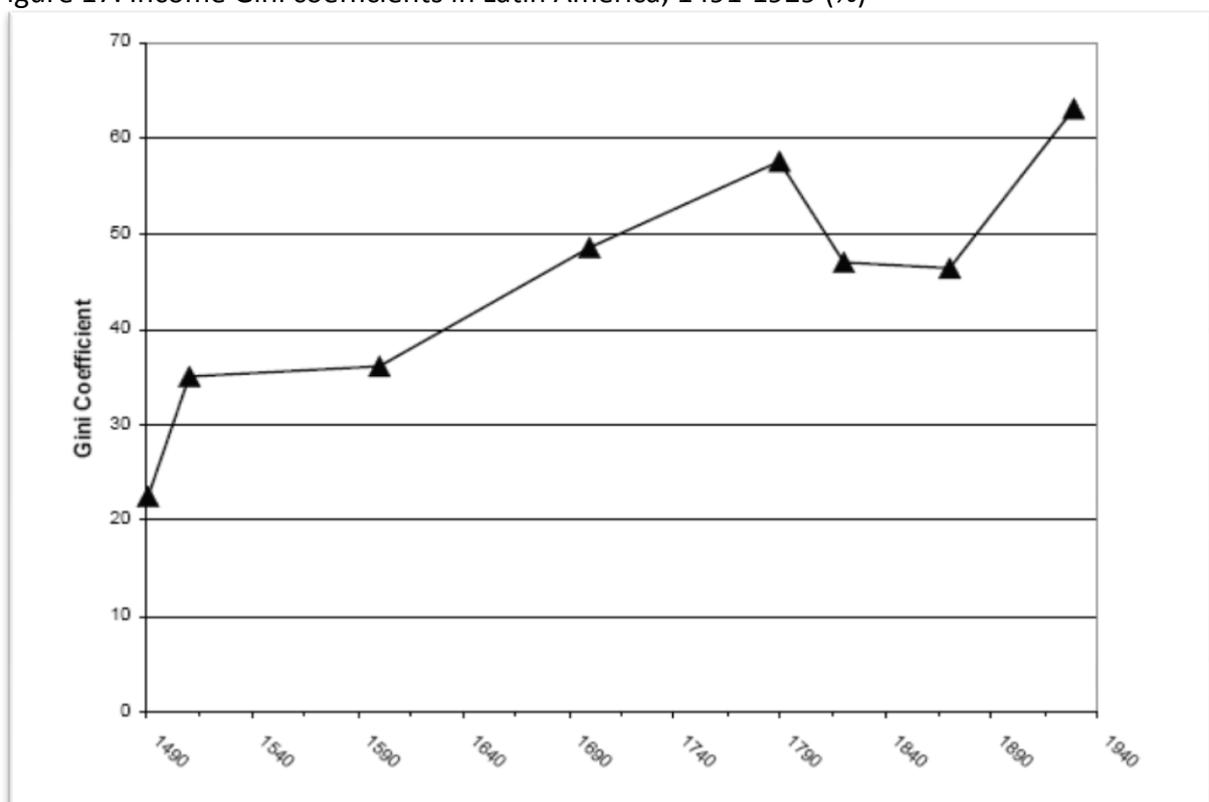
Source: Alvarado, Facundo, Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, "The World Top Incomes Database", <http://g-mond.parisschoolofeconomics.eu/topincomes>, 25 April 2012.

Growing inequalities within countries

The destruction of communal and collectivist institutions has been accompanied by increasing wealth and income inequality in most societies. During Hobsbawm's 'short 20th century' from the 1920s to the 1980s, increasing income and wealth inequalities were temporarily interrupted, due to the greater egalitarianism of socialist countries with lower levels of inequality (with Ginis between 25 percent and 30 percent on average) and checks to rising inequalities by socialist and other egalitarian movements (Figure 17). The European colonization of Sub-Saharan Africa, Latin America, and, to a lesser extent, of South and Southeast Asia led to the transformation and exploitation of their economies through their subordination to Western domination. Many countries retained vestiges of often 'invented traditional' community institutions under colonialism, albeit with changing implications in their new historical contexts.

Inequality increased and remains high in SSA, Latin America and the FSU, where institutional continuity was interrupted and institutional capacity weakened. Regressions, relating Gini coefficients of income distribution to per capita GDP, population density, urbanization, and colonial status, suggest that colonialism greatly increased inequality: colonies had Gini coefficients nearly 13 percentage points higher than non-colonies (Williamson, 2009). In Latin America, inequality increased from an estimated 22.5 percent in 1491 to over 60 percent in 1929 (Figure 17).

Figure 17. Income Gini coefficients in Latin America, 1491-1929 (%)³



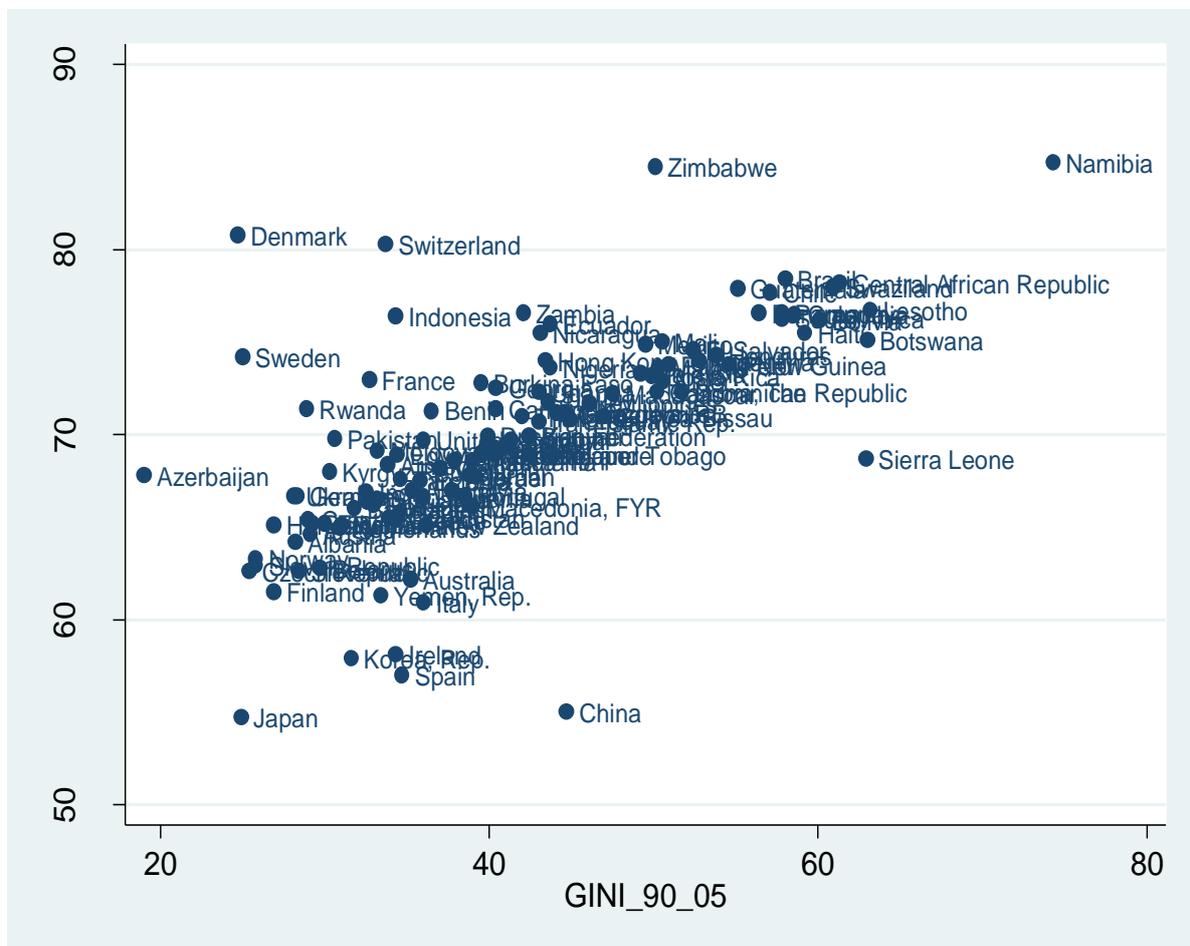
Source: Williamson, 2009

³ These are not actual Ginis, but estimated Ginis constructed using the regression equation mentioned.

Wealth and income inequalities

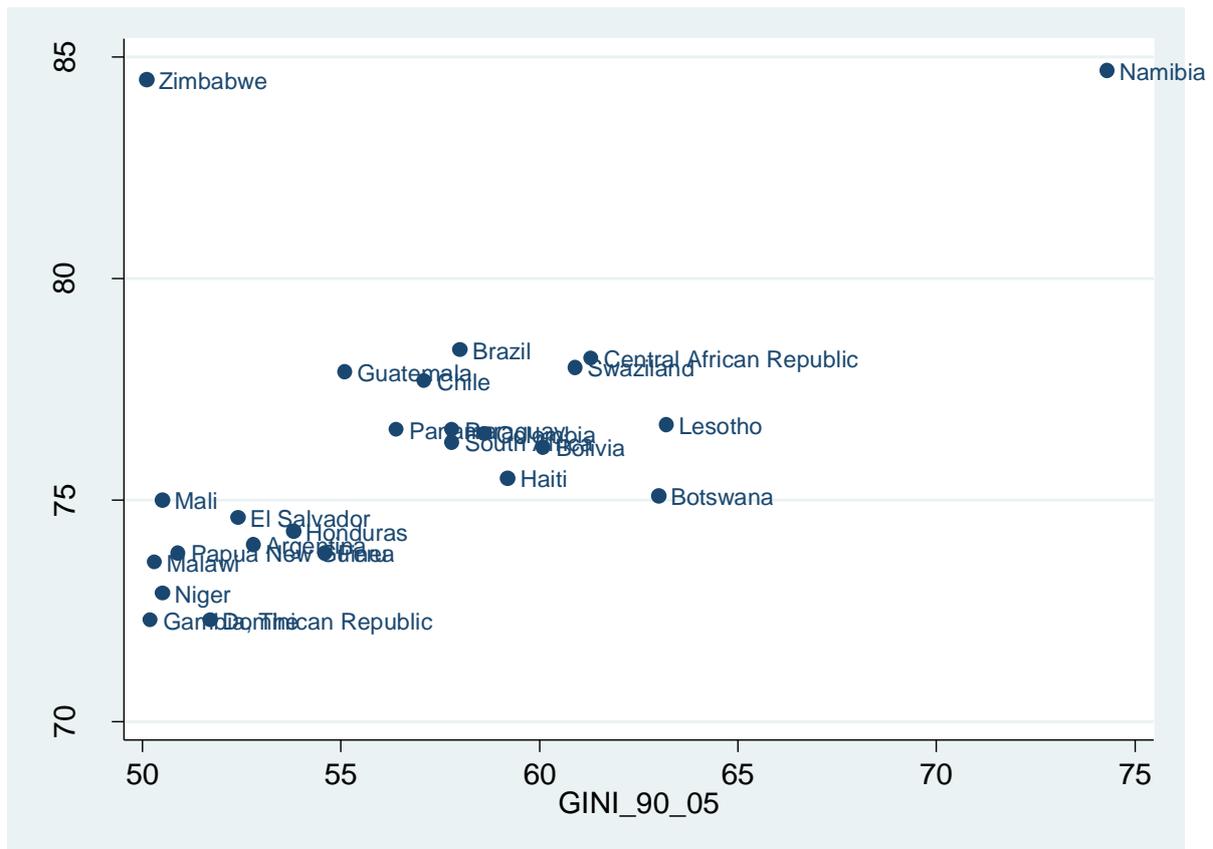
Wealth inequalities are strongly correlated with income inequalities, although there are some important exceptions (Figure 18). Almost all countries with income distribution Ginis higher than 50 percent and wealth distribution Ginis higher than 70 percent are in SSA (Botswana, Central African Republic, Lesotho, Malawi, Mali, Namibia, Niger, South Africa, Swaziland) and Latin America (Bolivia, Brazil, Chile, Dominican Republic, Ecuador, Guatemala, Haiti, Paraguay, El Salvador), with the sole exception of Papua New Guinea (Figure 19).

Figure 18. Gini coefficients for income and wealth distribution in many countries, 1990-2005 (%)



Source: WDI database; Davies, Sandstrom, Shorrocks, Wolff (2007)

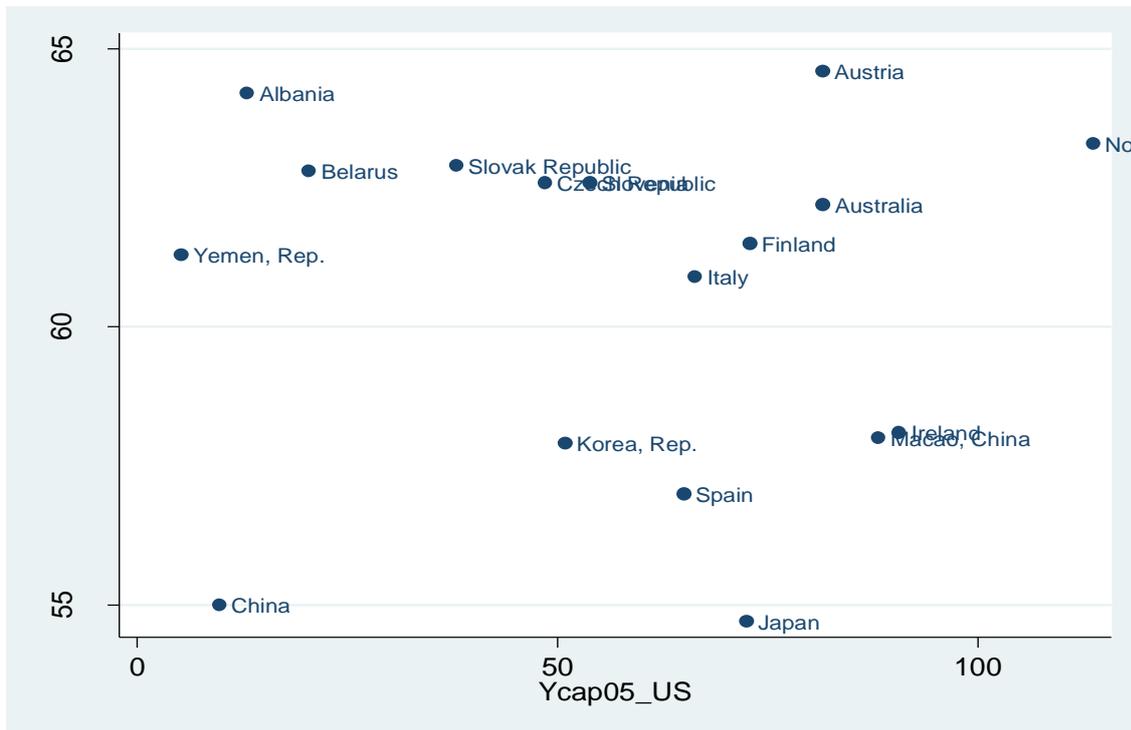
Figure 19. Countries with highest income and wealth inequalities, 1990-2005 (%)
 (income Ginis higher than 50 percent and wealth Ginis higher than 70 percent)



Sources: WDI database; Davies, Sandstrom, Shorrocks, Wolff, 2007.

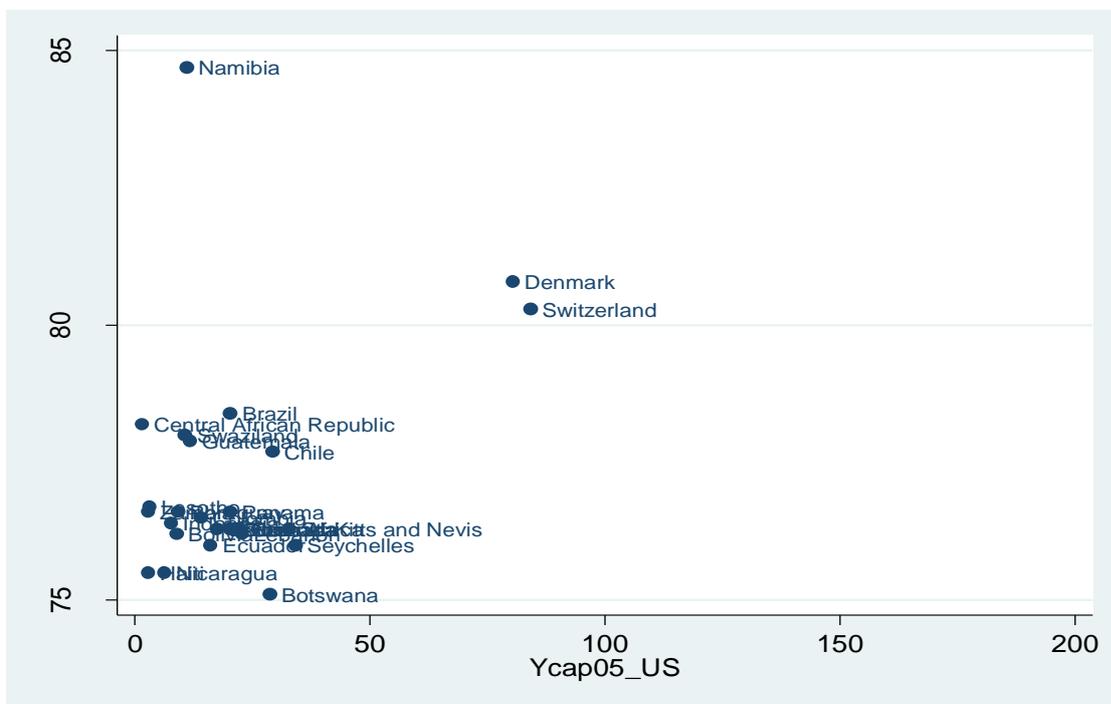
The countries with the lowest wealth inequalities are in Western Europe (Austria, Finland, Italy, Ireland, Norway), Eastern Europe (Albania, Belarus, Czech Republic, Slovakia, Slovenia), East Asia (China, Japan, Korea), Middle East (Yemen); Australia also belongs to the group (Figure 20). Countries with the highest wealth inequalities are mostly in SSA (Botswana, CAR, South Africa, Swaziland, Mali, Namibia, Zambia, Zimbabwe), LA (Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Nicaragua, Panama, El Salvador, St. Vincent and the Grenadines, St. Kitts and Nevis); the important exceptions are India, Indonesia, Denmark and Switzerland (Figure 21).

Figure 20. 2005 per capita PPP GDP of countries with Gini coefficients of wealth distribution below 65%, as % of US level, 1990-2005.



Sources: WDI database; Sandstrom, Shorrocks, Wolff, 2007.

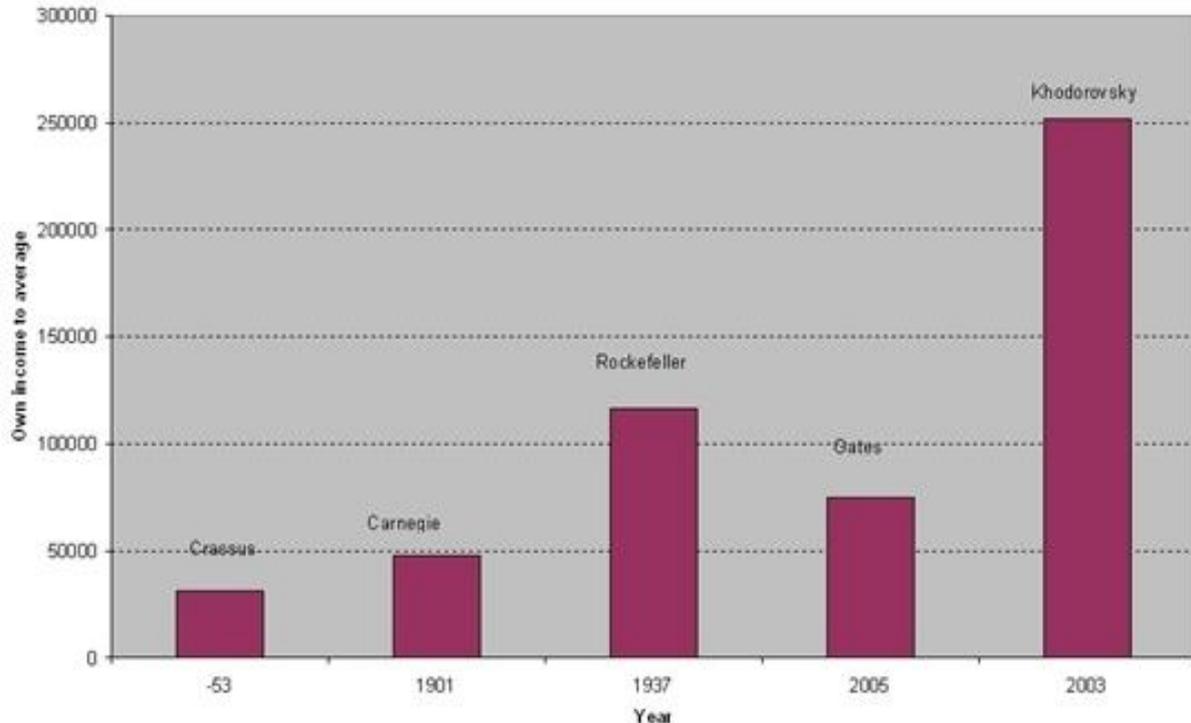
Figure 21. 2005 PPP GDP per capita of countries with Gini coefficients of wealth distribution above 75%, as % of US level, 1990-2005



Source: WDI database; Sandstrom, Shorrocks, Wolff, 2007.

Comparing the wealth of the richest men in different places at different times in time (Popov and Jomo 2017: Figure 22) still points to a similar conclusion. Bill Gates was relatively richer than Carnegie and Crassus (but not Rockefeller), whereas Russian tycoon Mikhail Khodorkovsky was relatively richer in 2003 (compared to the median Russian income) than all the others. Thus, despite different income distribution trends, the world may still be moving to the greatest wealth inequality ever observed in human history.

Figure 22. Incomes of the richest as multiple of average national income



Source: Milanovic, 2011.

Forbes magazine's data set of billionaires reflects the very top of the wealth pyramid (Figure 23) suggesting that the number of billionaires depends on the size of a country's GDP; per capita GDP is also important, but much less so.⁴ The deviations from predicted values shown in Figure 23 and Table 4 are quite telling. Countries with more than twice the predicted number of billionaires, include some developed countries (Canada, Hong Kong, Israel, Germany, Spain, UK), and even more developing countries such as India, Turkey, Saudi Arabia, Egypt, Malaysia, Philippines, Brazil, Russia, Ukraine and Kazakhstan. The number of billionaires was considerably lower than predicted in Japan, China, most countries of Western Europe, Oman, Argentina, Romania and the Czech Republic.

⁴ The relationship is non-linear:

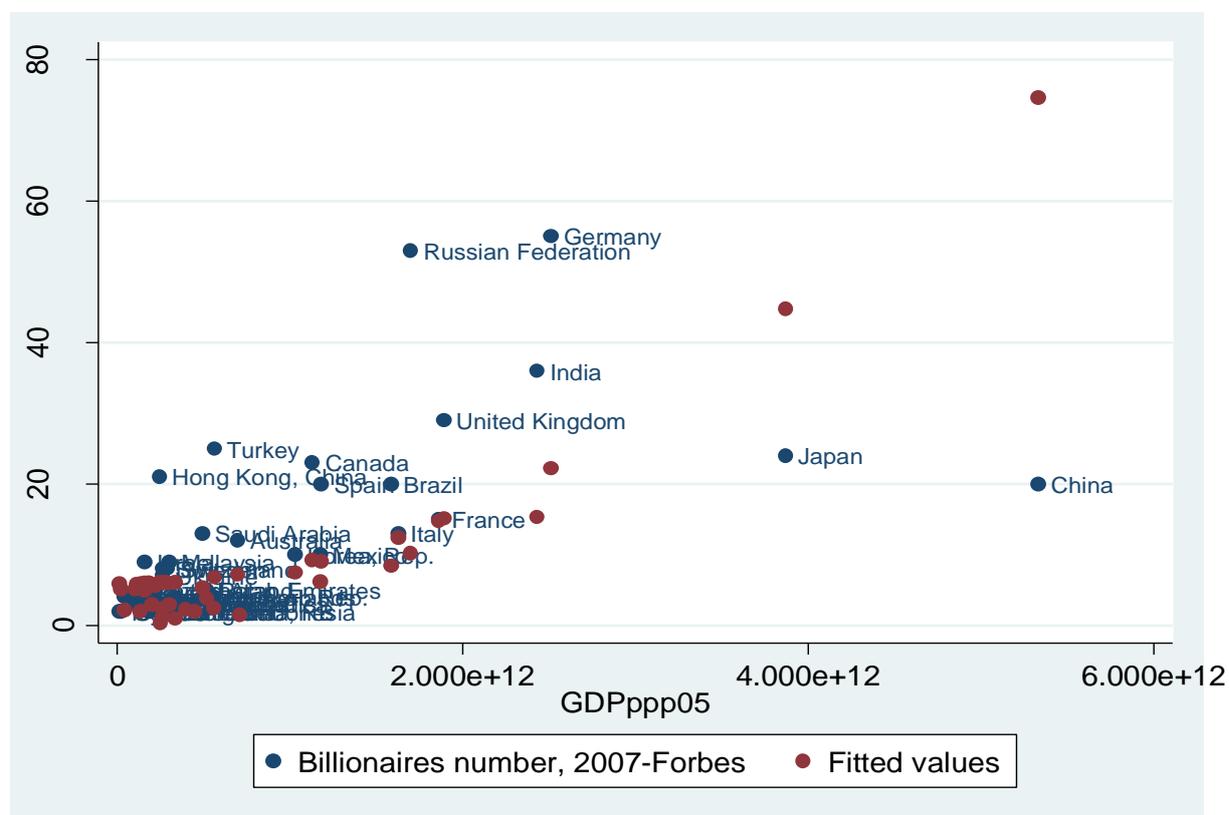
Number of billionaires in 2007 = $-0.9 + 0.367y - 0.0049y^2 + 2.6Y^2$, where

y – PPP GDP per capita in thousand \$ in 2005,

Y – PPP GDP in 2005 in trillions.

$N = 181$, $R^2 = 0.95$, all coefficients significant at 1% level.

Figure 23. Actual and predicted (using PPP GDP and per capita PPP GDP, 2005) number of billionaires in 2007



Sources: WDI database; Forbes’ billionaires website (<http://www.forbes.com/billionaires/>).

This picture is not completely consistent with previously described income and wealth distribution patterns. The major difference is the ‘excessive’ number of billionaires in MENA countries especially in the Gulf characterized by relatively equal distribution of income and wealth.⁵ East Asian and MENA countries have different models of wealth distribution – in East Asia, overall income inequalities were relatively low, even at the very top, whereas in MENA, they were also low overall, but very high at the very top. East Asia in general, and China in particular, have less unequal income and wealth distribution, even at the very top.

Table 4. Number of billionaires in various countries; actual and as predicted by the regression (see footnote 3)

<u>Country</u>	Number of billionaires, 2007 (1)	Predicted number of billionaires (2)	‘Excess’ number of billionaires (3) = (1) – (2)
United States	415	406.6816	8.31842
Canada	23	9.251191	13.74881
Australia	12	7.159441	4.840559
New Zealand	3	5.160714	-2.16071
Japan	24	44.74035	-20.7404

⁵ After controlling for total GDP and GDP per capita, variables such as resource abundance, the fuel share of total exports, an ‘Islam dummy,’ the democracy ‘level’ in 1972-2002 and in 2002-2003, are not significant in explaining the number of billionaires.

Korea, Rep.	10	7.412775	2.587225
Israel	9	4.933641	4.066359
Western Europe	174	143.5547	29.44531
Austria	3	6.101611	-3.10161
Belgium	2	6.076476	-4.07648
Cyprus	2	5.130645	-3.13065
Denmark	2	5.96753	-3.96753
France	15	14.75755	0.242449
Germany	55	22.14579	32.85421
Greece	1	5.896141	-4.89614
Iceland	2	5.933949	-3.93395
Ireland	4	6.018197	-2.0182
Italy	13	12.37973	0.620265
Monaco	1		
Netherlands	4	6.735513	-2.73551
Norway	4	5.587771	-1.58777
Portugal	1	4.560953	-3.56095
Spain	20	9.061349	10.93865
Sweden	8	6.023916	1.976084
Switzerland	8	6.10613	1.89387
United Kingdom	29	15.07143	13.92857
South Asia	36	15.27553	20.72447
India	36	15.27553	20.72447
Sub-Saharan Africa	3	2.239379	0.760621
South Africa	3	2.239379	0.760621
Mid. East & N Africa	56	27.0434	28.9566
Turkey	25	2.449126	22.55087
Saudi Arabia	13	5.282312	7.717688
UAE	5	5.923986	-0.92399
Kuwait	4	5.80726	-1.80726
Lebanon	4	2.129064	1.870936
Egypt, Arab Rep.	4	0.932453	3.067547
Oman	1	4.519195	-3.5192
East Asia	70	93.30109	-31.3011
China	20	74.62421	-54.6242
Hong Kong, China	21	6.0921	14.9079
Malaysia	9	2.921038	6.078962
Taiwan	8		
Singapore	4	5.961581	-1.96158
Thailand	3	1.930812	1.069188
Philippines	3	0.271333	2.728667
Indonesia	2	1.500013	0.499987
Latin America	38	24.04917	13.95083
Brazil	20	8.358649	11.64135
Mexico	10	6.20589	3.79411
Chile	3	2.933496	0.066504

Colombia	2	1.233129	0.766871
Venezuela, RB	2	2.39524	-0.39524
Argentina	1	2.922763	-1.92276
Ex-Soviet Union	65	13.32743	51.67257
Russian Federation	53	10.24829	42.75171
Ukraine	7	1.143777	5.856223
Kazakhstan	5	1.935362	3.064639
Eastern Europe	8	12.51761	-4.51761
Poland	5	3.835576	1.164424
Romania	1	2.183728	-1.18373
Yugoslavia, FR (Serbia/Montenegro)	1	1.885332	-0.88533
Czech Republic	1	4.61297	-3.61297
ALL	946	816.648	120.352

Source: *Forbes* billionaires' website (<http://www.forbes.com/billionaires/>).

The income shares of the richest have been growing for decades. In the US, for example, the share of total income of the top ten percent of the population was 40–45 percent in the 1920s and 1930s, fell to 30–35 percent from the 1940s to the 1970s, and rose again from the early 1980s, to 45 percent in 2005.

Recently, rising inequality has paralleled increasing profit rates. During the post-war Golden Age, higher profits were shared with other social groups, partly through taxation and public expenditure. In the 1950s and 1960s, for instance, wages, salaries and social security benefits grew with rising profit margins. But since the 1980s, profit margins have involved rising inequalities.

Where will income inequalities lead? Kuznets (1955) hypothesized that there is an inverted U-shaped relationship between economic growth and inequality, with inequality increasing with industrialization, as urban-rural income disparities rise, but declining later with the rise of the welfare state. But empirical research does not unequivocally support the Kuznets hypothesis.

Piketty (2014) has argued that recently rising national-level income inequality is permanent because the profit rate is higher than the economic growth rate. Rising inequality is the long-term trend due to an increasing wealth (capital) to output ratio (K/Y), raising capital's share of national income. This otherwise permanent trend, was temporarily interrupted in the 20th century *inter alia* due to the destruction of capital during the two world wars. But, it is not clear why the sustained increase of capital (*viz-a-viz* labor) has not lowered the profit rate by the same logic (Milanovic 2014).

An alternative explanation is that the reversal of growing inequality followed the 1917 Bolshevik revolution in Russia, the strengthening of socialist and populist movements, the growth of the welfare state and other changes noted in Karl Polanyi's *Great Transformation* (Polanyi 2001). Education and health care access not determined by personal and family means as well as other egalitarian alternatives constrained economic inequalities, especially

while socialism was dynamic. As socialism lost its dynamism from the 1970s and became less attractive as an alternative, national level income inequalities started to grow again.

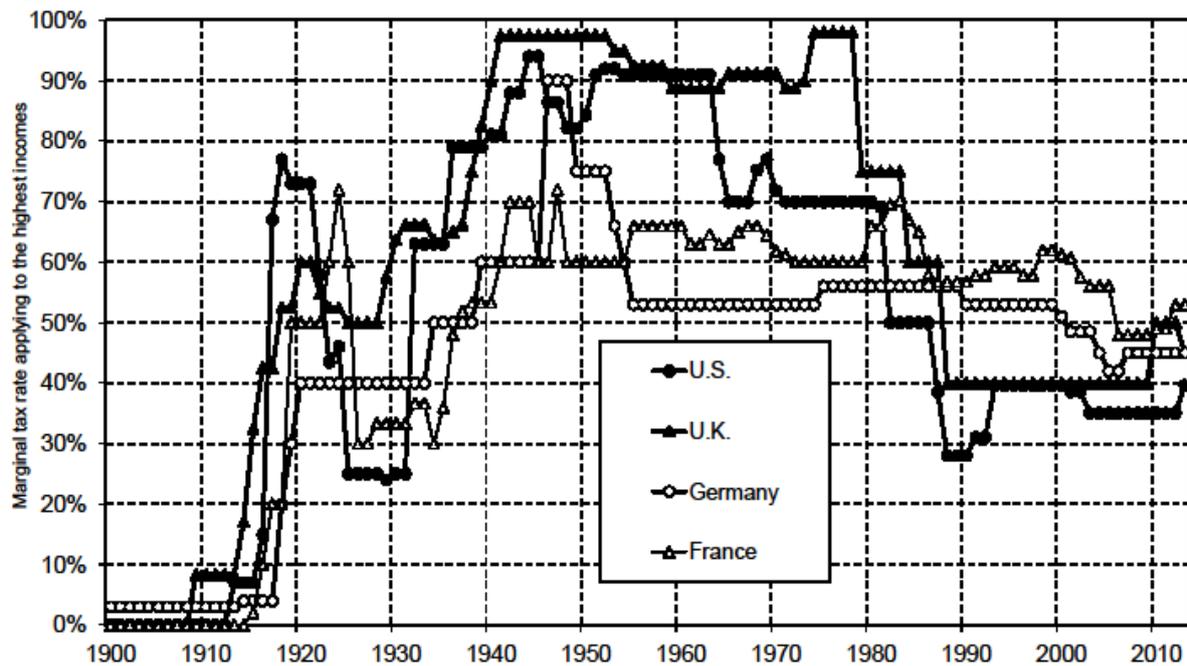
Capital, rents and labor incomes

If producers are mainly wage earners, income distribution will be influenced by the nature of wage determination. Where unemployment is high and incomes low, for example, workers are generally more willing to accept lower wages. But where labor is better organized and wage determinations more regulated, wages are more likely to rise with productivity increases. For several decades, living standards in China did not rise as much as productivity, but in recent years, wages and living standards have risen faster as employers face labor shortages and need greater employee skills and productivity. Moreover, with greater social protection and provisioning (public health, education, housing), the 'social wage' increases more than the money wages or even the 'real wages' workers receive. In most countries, the 'social wage' has not risen more than profits since the 1980s as public social expenditure have declined relatively if not absolutely with growing fiscal constraints.

In historical perspective, the 2008-2009 global financial crisis does not yet seem to be a turning point comparable to the Great Depression of the 1930s (Eichengreen and O'Rourke 2009) and certainly not unique in terms of recent stock market collapses (Popov and Jomo 2013). However, the collapse of world output by 3.4 percent in 2009 was the largest decline in the last seven decades – much greater than the 1.4 percent fall in 1982, the 0.4 percent decline in 1974, and the 0.8 percent reduction in 1975 (Popov and Jomo 2013). US profit margins and rates reached their lowest post-war levels in 1974, 1980 and 2002 (Popov and Jomo 2013) and US unemployment reached its post-war peaks of 9.7 percent in 1982 and 9.6 percent in 2009 (Popov and Jomo 2013). Meanwhile, US real wages are well below their early 1970s' level, while profits remain high.

In the 1970s, Western capitalism seemed under threat from within and without. High inflation and economic slowdowns in major Western countries followed the two oil price shocks. This unexpected 'stagflation' seemed unresponsive to traditional Keynesian fiscal and monetary policy measures. The neoliberal reaction in the Anglophone West, led by the UK and US governments of Thatcher and Reagan in the 1980s, soon followed weakening left and labor movements. Government spending, including social spending, stopped growing, as many social security programs were cut, and unemployment rose sharply, as trade unions were defeated in their industrial actions, and union membership fell. The top income tax rates dropped sharply (Popov and Jomo 2017: Figure 24) while income and wealth inequalities have risen in many Western countries since.

Figure 24. Top income tax rates in the US, UK, Germany, France, 1900-2010 (%)

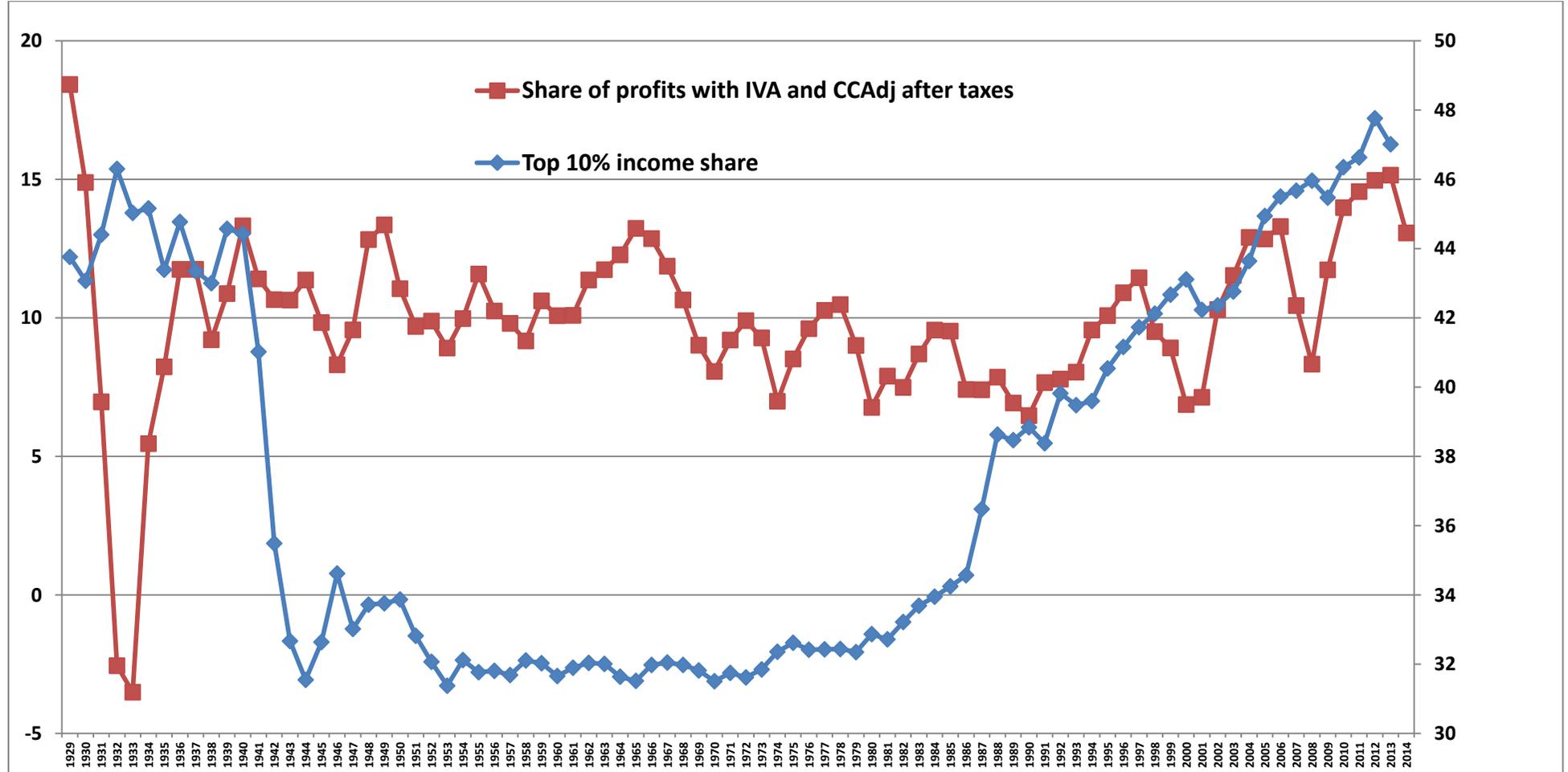


Source: Piketty, March 2014. Technical appendix to *Capital in the 21st century*
<http://piketty.pse.ens.fr/capital21c>

National income shares accruing to capital increased at the expense of labor, with rentier shares – e.g. accruing to finance or intellectual property rights – growing much more than the real economy. Labor movements have declined since the 1980s. Whereas in the 1950s and 1960s generally high profit margins allowed social welfare programs to expand, mitigating income inequalities, increased profit margins since 1990 have been reflected in rising income inequalities (Figure 25).

Thus, the counter-revolution of the Thatcher and Reagan governments in the 1980s was global in impact giving rise to the neo-liberal Washington Consensus. Since then, the debate has largely been among varieties of capitalism, e.g., between a neo-liberal ideal and some regulated variation, rather than between capitalism and some systemic alternative.

Figure 25. Shares of profits in net corporate income (left scale) and of top 10% individuals in total income (right scale), 1929-2014 (%)



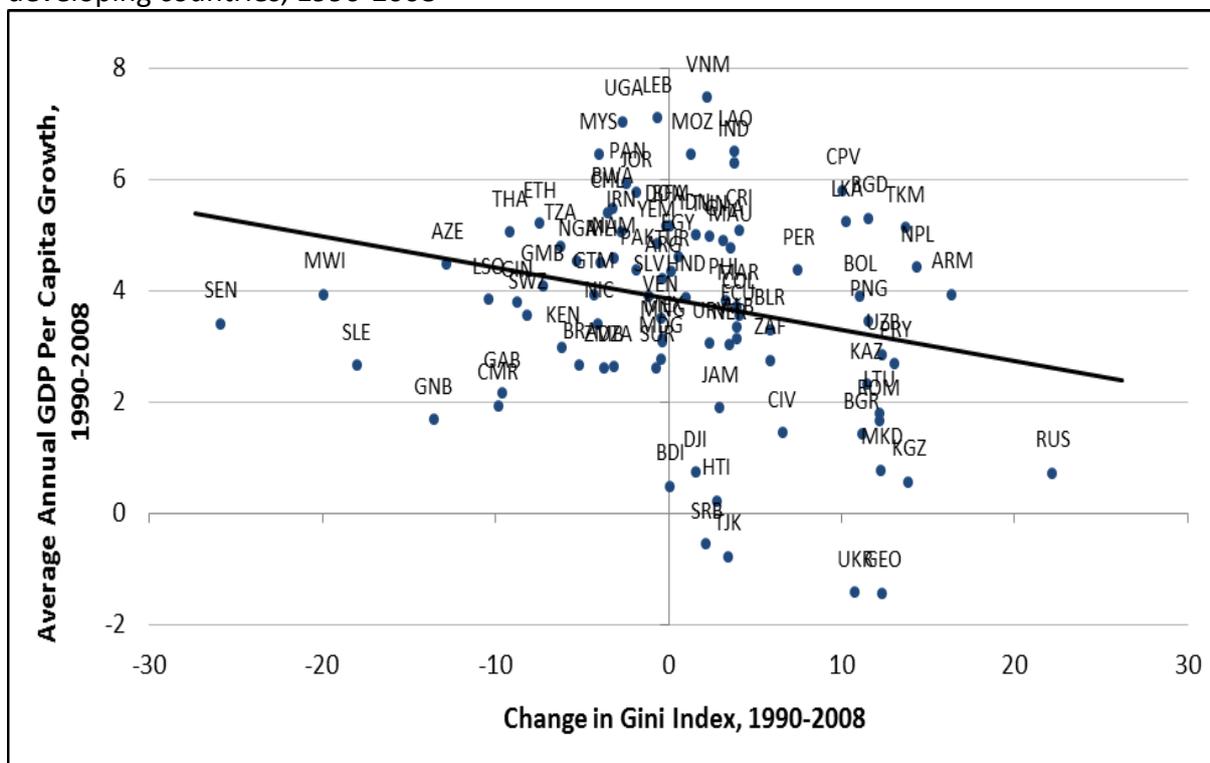
Source: Alvaredo, Atkinson, Piketty and Saez, The World Top Incomes Database. Bureau of economic Analysis NIPA tables (https://www.bea.gov/iTable/index_nipa.cfm).

3. Do Economic Inequalities Retard Growth?

The recent period has seen greater wealth and income inequality in most, though not all societies. In recent decades, social provisioning has not only declined in many ‘welfare states,’ but also in postcolonial societies offering some tax-financed social provisioning. Such social provisioning has also declined in China, Russia and many other ‘economies in transition.’

Meanwhile, the relationship between growth and income inequality in recent decades appears to be negative: countries experiencing greater increases in inequality during 1990-2008 had lower per capita GDP growth rates (Fig. 26).

Figure 26. Per capita GDP growth and change in Gini coefficient of inequality in 94 developing countries, 1990-2008



Source: Ortiz, Cummins (2011).

Developing countries with high income inequalities are more likely than others to end up in a vicious circle of poor quality institutions, low growth, low social mobility and high social tensions. Often, major transformations, while disruptive, are necessary to break out from such vicious circles. “The frequent claim that inequality promotes accumulation and growth does not get much support from history. On the contrary, great economic inequality has always been correlated with extreme concentration of political power, and that power has always been used to widen the income gaps through rent-seeking and rent-keeping, forces that demonstrably retard economic growth” (Milanovic, Lindert & Williamson, 2010).

As Stiglitz (2012: 83, 117) noted, “widely unequal societies do not function efficiently, and their economies are neither stable, nor sustainable in the long run... When the wealthiest use their political power to benefit excessively the corporations they control, much needed

revenues are diverted into the pockets of a few instead of benefiting society at large... That higher inequality is associated with lower growth – controlling for all other relevant factors – have been verified by looking at the range of countries and looking over longer periods of time.” Latin American countries, writes Stiglitz, show the future to other states on the road to growing inequalities: “The experience of Latin American countries, the region of the world with the highest level of inequality, foreshadows what lies ahead. Many of the countries were mired in civil conflict for decades, suffered high levels of criminality and social instability. Social cohesion simply did not exist.” (Stiglitz, 2012: 84)

Redistribution has long been perceived as harmful for growth. The “median voter” theorem claims that the tax rate selected by a government is that preferred by the median voter; this view has become influential in discussion of elections, inequalities, redistribution and growth. As high income inequality encourages consideration of redistribution options, these become attractive, sometimes as an alternative to promoting growth to ‘lift all boats.’ For the poor majority, losses due to growth slowdowns or stagnation can be more than offset by redistribution (Alesina and Rodrik 1994; Person and Tabellini 1994).

Alesina and Rodrik (1994) argued that redistribution measures are more likely in democracies than under authoritarian regimes where governments can ignore the poor. Democracies with higher income inequalities, they argued, will face greater pressures for income redistribution in favor of the poor, and are more likely to redistribute progressively, at the expense of economic growth. However, there is little evidence that there is indeed more redistribution going on in democracies with high inequalities (e.g., see Perotti 1996).

Instead, Polterovich and Popov (2005b) offered evidence that democratization leads to slower, not faster growth of government revenue as a share of GDP. Also, there is no strong evidence that less redistribution, other things being equal, leads to higher growth; the ratio of government revenue/spending to GDP, or even the amount of transfers, are not necessarily good indicators of redistribution, as tax systems and government spending may be more or less progressive, and may benefit certain influential lobbies more than others (Milanovic 2000).⁶

Another complication in considering relations among inequality, democracy and growth is that while democracy may mitigate income inequalities, sharp inequalities may undermine democracy. Many authors have pointed out that greater income inequalities can ruin democracies because concentrated control over economic resources may leave the door open for the politically powerful wealthy to block political reforms that extend rights and entitlements to others. Also, inequality makes democracy more costly, especially for the rich, due to the pressure for redistribution that it inevitably creates (see Gradstein and Milanovic 2004 for a survey). So, democratic regimes in countries with greater income inequalities are likely to be less stable and may end up becoming more despotic.

It is widely presumed that democratic regimes may mitigate income inequalities via redistribution which, if successful, may ensure greater stability and be more conducive to

⁶ Milanovic (2000) identified data problems and showed why many tests of the redistributive impact of income inequalities in democracies have not produced meaningful results.

high growth. However, the record of democracies in this respect is not clear. Empirical studies of inequality and democracy show that East Asian countries, such as Taiwan and South Korea, achieved less unequal income distribution under despotic regimes, while inequality actually increased following democratization in the post-communist countries of Eastern Europe. Gradstein and Milanovic (2004) wrote “while the earlier research failed to detect any significant correlation between democracy and inequality, more recent studies based on improved data sets and bigger data samples typically cautiously suggest existence of a negative relationship between the two. The hypothesis that seems to be especially promising in the light of this recent research defines democracy in terms of the length of democratic experience, ‘accumulative democracy,’ as opposed to just current indicators of democracy noting that democratic stability could be a defining factor for inequality reducing policies.”

Specific conditions may be needed for democracies to reduce income inequalities. Analyzing panel data from 1960 to 1998 for 126 countries, Gradstein, Milanovic and Ying (2001) argued that ideological preferences can be important determinants of income inequality: while the expansion of democracy is likely to result in significant inequality reduction, mainly in certain Western countries, this effect is negligible or altogether absent in most other countries. Instead, it was found that “for Muslim, Buddhist/Hindu and Confucian societies, democracy has either hardly discernible, or even a positive, effect on inequality. Yet these societies seem to possess some features which make them intrinsically more equal than the Judeo-Christian societies. It could be – although our empirical test does not account for that – that, the same ‘desired’ level of inequality which in the Judeo-Christian societies is achieved through expanded franchise and government-sponsored redistribution is implemented in the Muslim, Buddhist/Hindu, and Confucian societies informally, through family and ethnic ties.” (Gradstein, Milanovic & Ying, 2001) While such cultural generalizations are undoubtedly gross caricatures, they do reflect important historical and cultural nuances.

But, perhaps the argument is not so much about ideological or cultural preferences, but rather about informal institutions and processes with similar redistributive effects as government-led redistribution efforts in a democratic context. In countries where democratic transition undermines traditional redistributive mechanisms, without creating alternative, democratic mechanisms, the net impact of democratization may even increase income inequalities that eventually undermine growth (see Polterovich & Popov 2005b).

Inequalities may also influence growth via political instability. Alesina and Perotti (1996) argue that high income inequality leads to greater political instability, which worsens investment conditions with adverse consequences for growth. Statistical evidence supports both their hypotheses: of links between inequality and political instability, and between investment and growth. Overall, there is no evidence that higher inequalities cause greater (state) redistribution or that greater redistribution negatively impacts growth, but there is strong evidence that inequality hinders growth.

Correct diagnosis of the relationship between inequality and growth is crucial for developing appropriate policy remedies. Inequality may damage growth by causing social or political instability. Conversely, reducing income inequalities should also reduce instability and

increase incentives, investments and growth. But if inequality undermines growth due to disruptive interventions intended to achieve progressive redistribution, or if some inequality incentivizes investment and growth, the implications are quite different. Also, particular voting arrangements may be more conducive than others to limiting inequality and promoting growth.

Interest in social mobility has grown due to the presumption that it is associated with ensuring greater equality of opportunity and less likely to be opposed as public policy, at least in principle. Hirschman's 'tunnel effect' argument (Hirschman and Rothschild 1973) suggested that progress achieved by others may initially be tolerated if people expect it to be followed by their own mobility. But if they continue to stagnate as others overtake them, people are likely to consider alternatives, possibly leading to social unrest and political agitation.⁷

Hence, the OECD, *inter alia*, cautioned that high inequality and limited social mobility could retard economic growth (Cingano 2014). Some argue that high inequality restricts progress up the socio-economic ladder for those below, and perhaps some more than others, thus worsening inequalities and disparities. Hence, enabling social mobility and ensuring equality of opportunity are considered to be better and more legitimate, and hence, defensible socio-economic policy goals.

As social mobility is usually related to inequality, including disparities and stratification, an inverse relationship between inequality and mobility is widely presumed, and supported by some evidence of linkages between the two. The so-called Great Gatsby curve, for instance, suggests cross-country links between inequalities of outcomes and opportunities. Greater inequality is presumed to be associated with less mobility across generations, with evidence for several countries, including the US, UK, Denmark, Italy and France.

Conversely, social mobility seems higher in countries with lower inequality such as Finland, Norway, Denmark and Sweden (Corak 2013). Nevertheless, evidence that greater social mobility actually lowers inequality, or conversely, that low inequality is necessary for rising mobility, is not conclusive. And if greater social mobility reduces inequality, then it becomes an important intermediate goal in the larger effort to reduce economic inequalities.

Despite increasing income inequality since the 1980s in most countries, as well as growing wealth concentration at both national and international levels, improved growth performance in developing countries in the first decade of the new century until the commodity price collapse in 2016 has accelerated the decline in overall global income inequality. To be sure, the trend had begun as growth picked up in East Asia and India from the 1980s. Increasing demand from these newly industrializing economies thus contributed to the primary commodity boom for over a decade. Improved employment in the southern

⁷ Nevertheless, there have also been others who suggest that inequality is not necessarily harmful and may not lead to social ills. This assertion is underpinned by the claim that differences in income and wealth distribution are necessary to provide incentives for people to make their best efforts and utilize their talents in productive economic activities. In turn, this is supposed to promote greater social mobility and economic growth (Davis and Moore 1945).

cone of South America as well as better social provisioning also reduced national level inequalities although these trends have since been reversed.

Inequality: World Bank and IMF perspectives

Without caricaturing the views of the Bretton Woods institutions, the following discussion of their changing perspectives suggests more informed ways to engage with these two powerful and influential bodies.

According to the World Bank, Gini coefficients fell in five of seven world regions during 2008-2013 despite or perhaps because of much slower growth. Poverty and Shared Prosperity 2016: Taking on Inequality (World Bank 2016) was the World Bank's first annual report tracking progress towards the two key Sustainable Development Goals (SDGs) on poverty and inequality. The report – which was possibly its last one as none was published in 2017, perhaps reflecting the Bank's own priorities – focuses on inequality, generally neglected until recently by most international organizations other than the UN itself.

It provides some useful analyses of inequality, including discussion of its causes. The report evaluates progress towards reducing extreme poverty to 3 percent of the global population and sustaining per capita income growth of the bottom 40 percent of the population faster than the national average. With global economic growth slowing, the Bank acknowledges that reduction of income inequality will be necessary to ending poverty and enhancing shared prosperity. However, its analysis does not explain its claim of a modest partial reversal of growing inequality during 2008-2013.

The report's policy recommendations were rather limited. It neither analyzed nor proposed measures to address wealth inequality, which is much greater than and greatly influences income inequality. Although it recognized that increasing minimum wages and formalizing employment can contribute to reducing income inequalities, it did not consider the determinants of wages, working conditions and employment. It also had nothing to say about land reform – which had contributed to shared prosperity in East Asia, especially in China, Vietnam, Japan, Korea and Taiwan.

The report cited the case of Greece, where after impressive growth for a decade, the Greek economy went into recession in 2008-2009, together with other European countries. With severe austerity measures imposed by the EU and the IMF as bailout conditions, Greece fell into a full-blown depression with various adverse income and distributional impacts. The greatest increase of inequality during 2008-2013 occurred in Greece, where the mean household income of the bottom 40 percent shrunk by an average of 10 percent annually. Some modest measures – such as lump sum transfers, introduced in 2014 for low-income families and the vulnerable, along with 'emergency' property taxes – prevented additional surges in inequality. The Greek experience is interesting because it highlighted the effects of IMF style policy conditionalities on an OECD economy although the requirements were not those of the IMF alone, but also involved the Eurozone finance ministers, among others.

Brazil is the most significant of the Bank's five 'best performers' in narrowing income inequality, with its Gini coefficient falling from 0.63 in 1989 to 0.51 in 2014. The report

attributed four-fifths of the decline in inequality in 2003-2013 to labor market dynamics and social program expansion. Labor market dynamics – deemed far more important by other analysts – include regular minimum wage increases, formalization of unprotected workers and strengthened collective bargaining rights. Social pensions and other social program benefits account for much more of the decline in inequality than the much touted Bolsa Familia. However, most of the measures responsible for the earlier progress achieved in Brazil have since been reversed.

Disappointingly, the World Bank's discussion of fiscal consolidation's impact on inequality is misleading, even claiming that European Union (EU) countries have embarked on comprehensive fiscal consolidations based on clear equity considerations in response to the 2008–2009 financial crisis. This implied that fiscal consolidation had yielded long-run equity gains at the cost of short-run pain which can be cushioned by safety net measures – a finding contrary to International Monetary Fund (IMF)'s research findings (Furceri and Loungani 2013).

Meanwhile, the Bank's Doing Business Report 2017 implies that labor market regulations have adversely impacted inequality, even though it admits that they reduce the risk of job loss and support equity and social cohesion. Yet, the Bank urges labor market deregulation in the form of fixed-term contracts with minimal benefits and severance pay requirements. The report also suggested that lower business regulation results in lower inequality, citing inverse associations between Gini coefficients and scores for starting a business and resolving insolvency. Yet, curiously, and conveniently, it did not discuss the relations between other Doing Business scores, e.g., paying tax or getting credit, etc., and the Gini index.

Shared prosperity?

Instead of the more conventional inequality measures, such as the Gini coefficient or the more innovative Atkinson index, the World Bank has been promoting boosting the incomes of the bottom 40 percent. Much of the report abandoned this indicator in favor of the Gini index. Nevertheless, the report dwells on its 'shared prosperity premium,' defined as the difference between the increased income of the bottom 40 percent and the growth in mean income.

About two-thirds of the 83 countries analyzed had a 'shared prosperity premium' during 2008-2013, a period characterized by asset price collapses and sharply increased youth unemployment in many OECD economies. The Bank's unrepresentative sample is uneven across regions, and even some large OECD countries – such as Japan, South Korea and Canada – are missing. Recognizing that the 'shared prosperity premium' is generally low, the report conceded that the goal of ending poverty by 2030 cannot be reached at current levels of economic growth, and that reduction of inequality will be key to reaching the poverty goal.

IMF analyses of inequality have found that in OECD economies, the gap between rich and poor is at its highest level in decades. Inequality trends have been more mixed in emerging market and other developing countries, with declining inequality in some countries.

Meanwhile inequities in access to education, health care, and finance have increased as fiscal consolidation or restraint has become an important policy priority in many advanced and developing economies. Rising inequality in many advanced and developing economies has thus seen growing public support for income redistribution. Considerable work suggests that income inequality adversely affects growth and its sustainability (IMF 2017).

Dabla-Norris et al. (2015) of the IMF have shown that if the income share of the top quintile increases, then GDP growth declines over the medium term. By contrast, an increased income share of the bottom quintile is associated with higher growth. Reviewing a diverse group of developed and developing countries, they also argue that technological progress and the resulting rising skill premium and weakening labor market institutions have exacerbated inequality, with globalization making a smaller, reinforcing contribution. Rising skill premia are associated with widening income disparities in advanced countries, while financial deepening is associated with rising inequality in developing countries.

Policies focusing on the poor and middle class can mitigate inequality for all levels of economic development. Improved access to education, health care and social protection, as well as labor market institutions that do not 'excessively penalize' the poor, can help raise their income shares. The paper concludes that there is no universal policy panacea for tackling inequality. Appropriate policies depend on specific causes as well as contexts. Growth and equity complementarities imply that policies to raise living standards can also influence income distribution and better inclusion.

Ostry, Berg, and Tsangarides (2014) of the IMF have noted that rising inequality has contributed to the fragility of growth, the relationship between inequality, and financier leverage, and the role of 'political economy' factors (especially the policy influence of the rich) in allowing financial excess to grow ahead of the crisis. Inequality undermines progress in health and education, causes investment-reducing political and economic instability, and undermines the social consensus required to adjust to shocks, and thus that reduces the pace and sustainability of growth.

Greater equality seems to ensure higher and more sustainable growth. At the same time, inequality may impede growth partly because it prompts redistribution efforts that undermine growth. Thus, for the IMF, even if inequality is bad for growth, taxes and transfers would be the wrong remedy. But it doubts the simplistic conclusion that addressing inequality is worse for growth. Egalitarian interventions could help growth, e.g., taxes on activities with negative externalities (e.g., excessive financial risk-taking) or transfers, to enable better school attendance. The macroeconomic consequences of redistributive policies will reflect the totality of fiscal policies which may be pro- or anti-growth. Macroeconomic policies have distributional implications which need to be considered in this connection.

The IMF's cross-country dataset, distinguishing inequality before and after taxes and transfers, indicates that: more unequal societies tend to redistribute more; lower net inequality is robustly correlated with faster and more durable growth; and redistribution has generally benign impacts on growth except in some extreme cases. The combined effects of

progressive redistribution are pro-growth on average, thus rejecting the common presumption of a trade-off between growth and redistribution.

Nevertheless, an IMF (2014) Fiscal Affairs Department policy paper recommended that tax and expenditure policies be carefully designed to balance distributional and efficiency objectives, including during fiscal restraint. While acknowledging that appropriate instruments will depend on government capacities, its commitment to redistribution and other relevant considerations, it recommends efficient redistributive policies besides incentives to work and save.

Government expenditure patterns suggest two phases since the global financial crisis. During 2008-2009, many governments initially introduced counter-cyclical fiscal programs, raising public spending. From 2010, however, fiscal cuts became widespread, despite continued need for counter-cyclical public spending. The first contractionary shocks around 2010-2011 were followed by another round after the commodity price collapses from late 2014.

This second adjustment shock is expected to impact 132 of 187 countries from 2016, with the developing world most severely affected; 81 developing countries and 45 high-income countries are expected to cut public spending. 30 per cent of countries cut expenditure beyond pre-crisis 2005-2007 levels. Austerity is thus expected to impact more than two-thirds of all countries during 2016-2020, affecting four-fifths of the world's population by 2020.

An ILO-South Centre-IPD (2015) review of more than 600 IMF country reports showed that then recent IMF (2010a; 2010b) advice had sought to: (i) eliminate subsidies (in 132 countries), including progressively designed subventions for public transport, smallholder farmers and food; (ii) impose wage bill cuts and caps, including for education, health and other public sector workers' salaries (in 130 countries); (iii) require targeting for social 'safety nets' and other social protection measures (in 107 countries); (iv) achieve pension reforms (in 105 countries); (v) promote labor market reforms, typically increasing 'flexibility,' casualization, vulnerability and precariousness (in 89 countries); (vi) accelerate healthcare reforms (in 56 countries), undermining progress towards universal health care provision; (vii) introduce or broaden more regressive consumption taxes especially value-added taxation (VAT) (in 138 countries); and privatizing state assets and services (in 55 countries).

In line with IMF advice, many governments also implemented revenue-enhancing measures by introducing or broadening consumption taxes, especially value-added taxation (VAT). Not surprisingly, policy measures under consideration include privatization of state assets and services as well as public-private partnerships (PPPs). Such austerity measures have been implemented or are being seriously considered in Europe as well as most developing countries.

United Nations Global Policy Model projections suggest that the spending cuts advised by the IMF would negatively affect GDP and employment in all regions. Compared to a baseline scenario without reducing public expenditure, global GDP would be 5.5 per cent lower by

2020, resulting in a net loss of 12 million jobs. Upper-middle and low-income countries would be hit hardest, with fiscal adjustment reducing GDP over the 2016-2020 period by about 7.5 and 6.0 per cent respectively. East Asia and Sub-Saharan Africa would be the most adversely affected regions.

4. Policy Considerations

Addressing income inequality is especially challenging for several reasons. First, the challenges involved in addressing international or inter-country disparities are quite different from those required to mitigate national level or intra-country inequalities. Second, stronger property rights and greater legitimization of economic rents associated with the prevailing neoliberal economic framework make growing wealth concentration not only likely, but almost inevitable. In turn, this is likely to result in growing inequality in primary or market income distribution.

With fiscal space also thus constrained, there is even less scope for progressive redistribution, both through taxation as well as expenditure, e.g., via social protection measures. Tax and transfer instruments have long been opposed as market-distorting and efficiency-reducing, besides all the conventional arguments against activist or interventionist fiscal policies.

Declining inequality in the southern cone of Latin America during the first decade of the 21st century was largely due to rapid employment growth and its wage effects, rather than social protection measures. It is unlikely that the extension of social protection can offset the typical Bretton Woods-recommended or required structural reforms involving labor market liberalization. Although Peter Lindert argues that the progressive fiscal impact of the welfare state has not been eroded, such institutions are largely limited to the North, and not elsewhere. In the former Soviet Union, Eastern Europe, China and elsewhere, 'post-socialist' economic reforms have all exacerbated income and often wealth inequalities as well.

Policy responses to the underlying forces exacerbating or sustaining economic inequalities are more constrained than ever before. Furthermore, conventional recommendations largely focus on seeking to enhance labor productivity through 'human resource development' or skill acquisition measures believed to be more appropriate to contemporary labor market conditions. However, considerable evidence suggests that the functional or factorial distribution of national income has been far more important than skill differentials in determining the primary or market distribution of income (Devroye and Freeman, 2002; Giovannoni, 2008). Most such measures also ignore property rights, and often strengthen them as necessary to overcome poor governance and strengthen the rule of law, thus empowering those better able to shape law and public policy in their own interests and otherwise create or extend the bases for rent capture.

All too often, competition policy is inappropriate for developing country conditions, by mechanically insisting on competition when economies of scale are crucial to developing international competitiveness (Roberts 2016). Until recently, even minimum wages and other apparent labor market distortions have been strongly opposed by the conventional wisdom deemed appropriate for such economies, ignoring their role in mitigating inequality,

not only in Europe or Japan, but also in Latin America.

There has also been growing recognition of looming global constraints to progressive redistributive policies, often compromising policy efficacy. Growing mobility of capital eases corporate tax evasion, while the resurgence of ‘supply side economics,’ including the empirically discredited Laffer curve, has augmented resistance to taxation. ‘Excessive’ tax rates are also likely to adversely affect investment rates, contributing to a ‘race to the bottom.’ Similarly, greater ease of international mobility for professionals and skilled labor is expected to contribute to another ‘race to the bottom’ with recent arguments even being made about the greater mobility of unskilled labor.

Meanwhile, international trade and investment agreements increasingly constrain governments’ ability to enact, enforce and implement labor regulations and standards. Meanwhile, growing recognition of cross-border spillover effects has recast many such cross-border concerns in terms of addressing global public goods problems. Yet, at the same time, an institutional vacuum is growing with the assault and erosion of multilateralism and its institutions, raising troubling questions about the efficacy of international governance in addressing such challenges.

In the face of such constraints, it has become all the more urgent to address these challenges by reconsidering options to overcome such global constraints. International tax cooperation to enhance developing country governments’ fiscal capacities is clearly urgent. In this regard, it is important for multilateral institutions to provide the needed leadership. The UN clearly has the confidence of developing countries and a broad membership, and the IMF and OECD, with their expertise, can play a crucial complementary role.

With little evidence that financial globalization has helped increase investments in the real economy, the IMF must reconsider its previous advocacy of international financial, including capital account liberalization, especially in light of its record of causing and broadening massive and debilitating disruptions.⁸ There has been all too little progress on enabling capital account management despite the devastation of the global financial crisis and earlier regional crises. In any case, there is no evidence that cross-border changes in portfolio investment ownership has contributed to investments in the real economy and economic growth more generally. Facilitating cross-border investments in the real economy is clearly a different matter and should ultimately be determined by national governments, not international bodies.

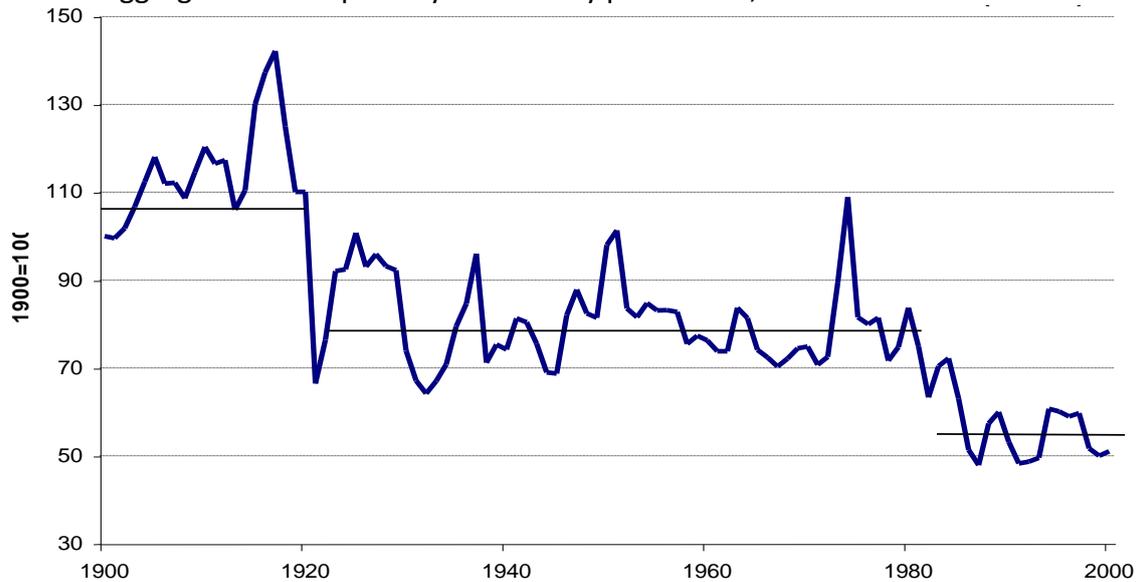
Exchange rate undervaluation despite foreign exchange reserves accumulation, export-oriented industrial policy, prudential management of international capital flows and other such measures can, thus become legitimate instruments of catch-up development. Reforms to intellectual property rights to facilitate affordable technology transfers, new regulations for the international trade in energy and resources, new monetary arrangements, new

⁸ In recent years, there has been growing discussion in the IMF regarding the merits of capital account liberalization. A 2012 IMF Policy Paper titled “The Liberalization and Management of Capital Flows – An Institutional View” noted that volatility stemming from “inflow surges and disruptive outflows can create policy challenges.”

agreements for cutting undesirable emissions and other such measures may be implemented if enabled by multilateral reforms (Montes & Popov 2011).

Growing inequality in the world economy has been increasingly attributed to many factors, including trade liberalization. Over the course of the 20th century and since, the terms of trade have generally declined against primary commodities compared to manufactures (Figure 27) as shown for the first half of the 20th century by Hans Singer and Raul Prebisch, and against tropical agricultural products against temperate counterparts as postulated by W. Arthur Lewis. More recently, the terms of trade of manufactures produced by developing countries have suffered a similar fate compared to those produced in the North.

Figure 27. Aggregate non-oil primary commodity price index, 1900-2000



Source: Grilli and Yang (1988); Ocampo and Parra (2003).

While the evidence and arguments for attributing inequality to trade are mixed, the transition from the General Agreement on Tariffs and Trade (GATT) to the World Trade Organization (WTO) in the mid-1990s arguably frustrated development as well as welfare aspirations in the South. Nevertheless, it is also generally agreed that plurilateral and bilateral free trade agreements (FTAs) as well as bilateral investment treaties (BITs) are generally even more biased to the North and disadvantageous to developing countries. The more recent undermining of economic multilateralism by the West, especially by the US, is especially problematic in the area of trade. With a biased multilateral trade agreement already in place since the end of the Uruguay Round and the establishment of the WTO, and the North unwilling to make concessions, as promised in 2001 to start the ongoing Doha Round of WTO negotiations, developing countries have to live with conditions systemically disadvantageous to them.

Instead of supporting industrial policy measures which have enabled 'latecomer' countries to 'catch up' with the developed economies, OECD economies have generally used their influence in multilateral development banks and other international financial institutions to impose or recommend other policies which have sometimes exacerbated, rather than mitigated such problems. Thus, for example, rather than enable developing countries to

develop their own international competitive productive capacities and capabilities, they have been urged to participate productively in 'global value chains' under the aegis of powerful transnational corporations (TNCs).⁹ To sustain late industrialization, developing countries need to gain access to markets, technology and other expertise beyond what TNCs are willing to share in their own interest. Thus, many host governments have revised their national laws and policies to provide infrastructure and other facilities desired by such investors while minimizing taxation of these TNCs, effectively subsidizing them.

There has been little attention given to how trade liberalization has accelerated deindustrialization, harmed food security and limited other industrial or development policies. The greatest contemporary advocate of the virtues of trade liberalization has probably been Jagdish Bhagwati, who has always opposed approaches which undermine multilateralism as well as allowing trade agreements to embrace a variety of ostensibly trade-related issues, such as IPRs. In advocating 'aid for trade' in 2005, Bhagwati urged attention to the need to compensate developing countries for the loss of tariff revenue as well as existing productive and trading capacities and capabilities due to trade liberalization. He also acknowledged the need for support in light of the difficulties and costs of building internationally competitive new capacities and capabilities. Thus, while all economies stand to gain from cheaper imports, few developing countries, especially poor ones, will be able to achieve market access as they are disadvantaged in this respect.

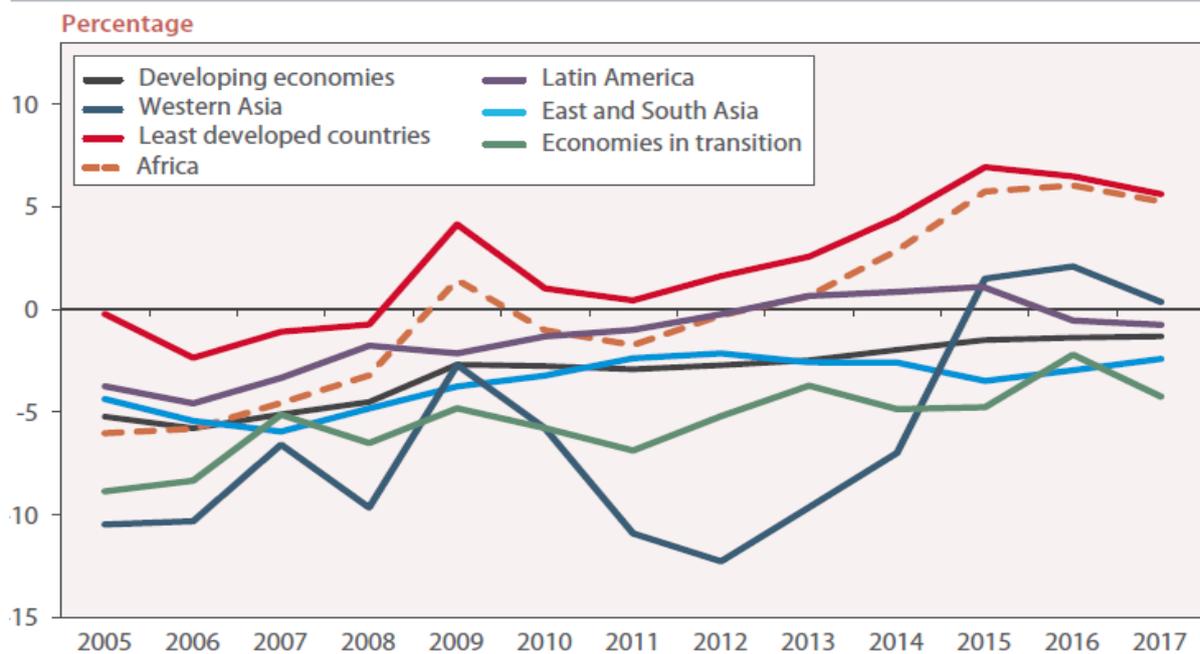
Other policy options and recommendations have had modest consequences even when positive. While regulatory reforms have helped to shift the functional or factorial income distribution from labor to capital, much of the income accruing to capital is in fact rents reinforced and legitimized by the consolidation and extension of property rights, e.g., in the form of intellectual property rights. While better education and training is welcome, greater productivity does not necessarily accrue much to labor if labor market conditions are unfavorable. Another common recommendation is greater female labor utilization with little attention to increased burdens on women in terms of unpaid care work in the absence of supportive social institutions. Very rarely, do these institutions recommend strong employment or minimum wage policies as these are seen as market distorting. Nor is there much attention to appropriate anti-trust policies in circumstances where small economies are not able to achieve economies of scale.

The case for financial globalization has declined over recent decades as there is little evidence that greater access to international finance has contributed to the development of the real economy while the frequency of currency and other financial crises have not only been disruptive but have also set back economic development (Ostry, Loungani & Furceri 2016). It has also become clear that financial opening has led to a net outflow of scarce financial resources over the long term, although there have been short-term floods of finance (Figure 28). The accelerated accumulation and concentration of financial rents, facilitated by implicit government guarantees, has heightened such skepticism, although there is little evidence of the tide turning, even after the 2008-2009 global financial crisis

⁹ For example, the World Bank's *Global Value Chain Development Report 2017* claimed that "in developing countries deeply involved in GVCs, virtually the entire population benefits from the expanded trade and faster growth." However, the report also acknowledged the uneven distribution of growth due to trade.

and the protracted economic slowdown since.

Figure 28. Net transfer of financial resources from South to North by region, 2005-2017, % of GDP



Source: United Nations 2018: p. 44.

As the economic strength of the South has grown, as shown in Figure 29, changes in international economic relations could be more conducive to catch-up development (Arrighi 2007) in the South, reducing disparities between the world's 'rich' and 'poor'. However, such outcomes are far from guaranteed, and could be reversible. Furthermore, without significant resource use efficiencies, there may be significant resource constraints to improving living conditions for those 'catching up.' New international divisions of labor have allowed developing countries to industrialize and become more productive although productivity gains may improve consumer welfare rather than working conditions and wages.

Figure 29. Other countries/regions' PPP GDP per capita as % of US level, 1820-2060 projections
(2060 scenario assumes continuation of 1960-2010 growth rates during 2010-2060)



FSU – former Soviet Union.

Source: Maddison project, 2013.

Mechanization and automation as well as relocation of new employment abroad have had profound economic social, cultural and political consequences. Recent Western 'chauvinist-populist' rejection of 'globalization' and of multilateral arrangements and institutions is likely to pose new challenges, limiting, if not undermining multilateral institutions and solutions. A new international economic order, the popular demand of the South in the 1970s, requires new developing country institutions such as the BRICS' New Development Bank and the Asian Infrastructure Investment Bank. 'Democratization' of international economic relations including adoption of rules-of-the-game giving greater voice and weight to the South together with accelerating developing country growth, can bring about cross-border economic liberalization or globalization on different terms and conditions to enable 'catch-up' growth.

Meanwhile, the scope for serious consideration of progressive social policies, e.g., in health, education, housing and social protection, has also been quite limited. This has come hand in hand with the influence of supply-side views of taxation, and the skeptical attitude to progressive tax and transfer reforms. Fiscal reforms in most of the world have tended to be regressive, both on the revenue and expenditure side. This has been especially evident with the fate of direct taxation of both income and property, as well as the shift to indirect taxation, especially of consumption, even of the poor. With austerity the hallmark of fiscal consolidation in the world, there is generally less available for spending on redistribution and sustaining employment growth. Nevertheless, this has not diminished the BWIs' promotion of modest redistributive initiatives such as conditional cash transfers.

5. Conclusion

Broadly speaking, inter-country inequality has declined while intra-country inequality has increased. However, closer analysis reveals that declining inter-country inequality has been primarily due to China's rapid growth of the last four decades. For the remaining developing countries, catch-up growth has been uneven at best. The heterogeneity of developmental pathways shows how there is no universal solution for growth.

Arguments about economic inequality tend to pit growth against equality. However, empirical evidence indicates that economic inequality traps countries within vicious cycles of weak institutions, low growth, limited social mobility, and rising social tensions. Rising inequality has likely played a role in the strongmen populist movements sweeping across the world today.

Milanovic, Lindbert and Williamson (2010) argued that "great economic inequality has always been correlated with extreme concentration of political power, and that power has always been used to widen the income gaps." Economic and political inequality reinforce each other, thus resisting the appropriation of national and international policies for the benefit of the – increasingly transnational – wealthy. Such reforms are essential for moving forward.

Thus, equality and accelerated growth are not necessarily contradictory. Beyond the moral imperative to ensure equity, addressing within-country inequality could, in fact, promote both stable political institutions and economic growth.

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