

# **GROWTH, INEQUALITY AND POVERTY**

## **IN OUR TIMES**

### **A Personal Reflection**

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*Life is not what one has lived, but what one remembers and  
how one remembers it in order to recount it.*

*Gabriel Garcia Marquez*

#### *I. How Have Growth, Inequality and Poverty Evolved in Our Times?*

##### *A Personal Perception*

In 1944 I entered elementary school in Mymensingh, then a town of sixty thousand people in the British Indian province of Bengal. My continuous memories about life and environment probably date approximately from that year. We were then living in a small house of three rooms, without electricity and internal plumbing. My parents had purchased it three years before. At the time our family consisted of my parents and their seven children. There was an open well which supplied water for general use; drinking water had to be fetched from a public tube well a few minutes' walk from the house. In 1945 we installed a tube well with hand pump in our home. Looking back on my childhood I have often wondered why I and members of our household felt no sense of deprivation in those days. The reason must be that there was only one household in the neighborhood which was significantly better off than we were and most of the others were so much worse off that we considered them to be deprived. Poverty is relative especially in its perception and is thus closely linked with inequality.

In the sixty five years since that date my living standard has been dramatically transformed. One could distinguish three components of this transformation. The first is the improvement of the average living standard of a Bangladeshi over this period. Precise

comparison of change in living standard over this period is beset with too many difficulties, poor and incomplete data compounding the inherent problem of comparison over long periods when the composition of consumption undergoes major changes. Overcoming these difficulties as best I can, I estimate the increase in per capita income over this entire period at 2.6 times, an average of about 1.5 per cent per year. The growth rate was much slower, two-thirds of a per cent per year, during the first three decades. It became much faster during the most recent two decades, about three and a half per cent per year. Basic nutrition has changed little as probably has *average* shelter per person. Clothing and access to other consumption goods has expanded a good deal with things like radios becoming widely available and more modern consumer electronics within the reach of many. Even more important have been improvements in other indicators of living standard. It is hard to establish the average life expectancy in the mid 1940s. I remember that as a child I read in a children's book of general knowledge that an average Indian lived for thirty seven years. I have no idea how reliable an estimate for India it was and for what time period; nor do I know if it applied to my childhood community. Today the life expectancy at birth for a Bangladeshi is estimated to be about 65 years. I have vivid recollection of how five members of the family of a school friend, who lived in the same neighborhood, were wiped out in a single night by cholera when I was in grade IV. Such events are unknown today: most epidemics have been eradicated and the effects of many other causes of mortality, especially of infants, blunted. I am not aware of any estimate of adult literacy rates for Bengal during my childhood; if I were to make a guess I would put the figure at well below a fifth. Today about a half of the adults are literate.

The second component of the increase in my living standard is the vertical mobility within Bangladesh that I would have experienced if I had continued to live there. I have only fragmentary information about the contemporary living condition of those in my cohort in that neighborhood in Mymensingh. It is, however, without doubt that the distribution of income among them, even without counting the international migrants like me, has become much more unequal. The sources of inequality have been many: unequal access to trading and business opportunities accentuated by economic policies that arbitrarily distributed the benefits of state patronage, such distribution being skewed in favor of those who were initially better off. But perhaps the most important

source of increased inequality among those who remained in the country, not necessarily in the same neighborhood, has been the unequal attainment of human capital. Increased inequality means that the decline in poverty has been less than what might have been possible with the growth that occurred. During my recent fleeting visits to my childhood hometown I have seen many of my cohorts continuing to live in the same old conditions, their meager housing greatly marginalized by the encroachment by the better off. At the same time modern luxuries have adorned many new housing of a quality unknown during my childhood. One aspect of change that has adversely affected everyone is extreme overcrowding, something that I like to consider as a manifestation of overall environmental degradation that Bangladesh has suffered, an indicator that is absent in all calculations of change in standard of living and an aspect of change that I shall not be able to take into account in this paper.

In comparing my own living standard in recent years with my living standard at the time I entered elementary school, I would have to include the effects of a third factor, the difference between what my living standard would have been if I had continued to live and work in Bangladesh and the actual living standard that I have enjoyed as a migrant in one of the richest countries of the world. Pushing heroically ahead with the assumptions that my living standard in 1944 was four times the average for the part of Bengal at the time that constitutes Bangladesh today; taking the purchasing power parity dollar (PPP\$) income in the USA to be 36 times that in Bangladesh in recent years (which is the new World Bank estimate for 2006); and further putting my average living standard in recent years at about 2.3 times the average for the US population (which seems to have been the ratio of the average income of the top 20 per cent to the overall average income in recent years), I arrive at the estimate that my living standard today is about 55 times that of what it was in 1944. As I have said above, this can be split into three components: (a) *the growth effect*, a rise of 2.6 times that would have occurred if my relative position in the income distribution scale had remained unchanged in Bangladesh; (b) *the inequality effect*, the additional increase in my living standard, even if I had remained in Bangladesh, due mainly to the vastly more human capital that I acquired as compared to the members of my cohort (based on the information about the earnings of people with similar human capital in Bangladesh today, I conservatively

estimate that this factor would have raised my living standard by an additional 5.4 times, or by a total of 14 times, together with the growth effect); and (c) *the international migration effect*, which served as the additional multiplier residually estimated to be 3.9.<sup>1</sup> *I would like to underline that, if I am roughly right, proportionately the biggest source of improvement in my living standard has been the domestic inequality factor and the smallest the domestic growth factor.*

Note that if I had been one of those in my childhood neighborhood who made the least improvement between 1944 and 2009, my living standard would have increased by less, perhaps by much less, than 2.6 times and if I were one of the very poor in 1944, I might have remained poor today. Far fewer people crossed the poverty threshold, however defined, than would be the case if the growth in income for all was the same. Had everybody's income grown at the average rate, all those who had an income of at least 38 per cent of the poverty line in 1944 would have been lifted above it; there would be very few poor today for the simple reason that not many people would have been more than 62 per cent below the poverty line in 1944. I am not questioning that there was a reduction in poverty in my childhood community, perhaps by quite a reasonable proportion, over this period. I am merely saying that there was less of it than would be possible even with the modest growth that took place and the reason for that is the increase in inequality. Numerical estimates of the extent of income inequality in Bangladesh during my childhood are not available; but it appears that inequality was limited; the Gini ratio is unlikely to have been above 0.3. Today the distribution of income is greatly more unequal, with the Gini ratio of 0.45.

Admittedly these are very crude estimates and another person, using somewhat different figures and assumptions, would produce substantially different estimates. And yet I doubt that there would be much quarrel about the broad orders of magnitude of these changes over the long time period under review. Many would find this long-term outcome for my childhood community quite positive: an average long-term growth rate that puts the growth rate during the first century of the British Industrial Revolution to shame; and a significant reduction in absolute poverty however measured. I have, however, failed to consider the outcome in a similar light and instead felt that there has

been too little growth, too much of an increase in inequality and too little reduction in poverty.

Consider growth. As I have ventured to guess, my own living standard improved by a factor of 55 over the 65 years between the dates I entered elementary school in Mymensingh and now in Long Island, USA. This is a sea change, one that is of dizzying proportions. It appears incomprehensible that this could happen to an entire country of significant size. Or is it? For this to happen to an average person in a society, per capita income in that society would have to grow at 6.3 per cent per year. A number of East Asian countries actually sustained that rate of per capita growth over something like four decades and made a transition from the World Bank category of “low-income countries” to the World Bank category of “high-income countries” in a much shorter time period than has elapsed since my childhood. An average person in those countries has experienced something close to the kind of change that I have experienced by combining with my country’s growth an extreme vertical mobility within my country of origin and the maximum possible “horizontal mobility” from one of the poorest to one of the richest countries of the world. In this context I judge that growth in my world, South Asia, has been pitifully slow. It has been even slower in most other developing regions over the period under review as a whole.

Another important point is that in my country of origin, the pitifully low rate of growth was not equally shared by all. The result, as already noted, is that a substantial proportion of population experienced a much lower improvement in living standard than the average increase of 2.6 times and many have failed to rise above poverty as compared to the counterfactual of unchanged inequality. Again, compare this outcome with the one in some East Asian countries where growth in per capita income of 6.5 per cent or more was sustained over decades with no increase in initial inequality which itself was modest. Not just an *average* person but most of the people in those societies experienced during their lifetime something close to the change that I have experienced.

Please note that I am not lamenting the fact that the developing world, including my country, did not experience an outcome comparable to what a handful of the finest performers in economic development in the post-World War II period achieved. The point is that the actual growth achieved by countries in most of the developing regions

was far lower than what should have been within their grasp and the growth that they achieved was accompanied by too great an increase in inequality. Together they led to far too slow a rate of reduction in poverty. *Indeed in few countries the poverty rate experienced a sustained and steady decline during the period under review.*

## *II. The Pursuit of Inequality-Averse Growth in Our Times – A Personal View*

I enrolled as an undergraduate in the economics department of the University of Dhaka in 1955. As in most universities around the world at the time, the program at Dhaka did not treat development economics as a distinct component of the undergraduate economics curriculum. It was not until the fourth and final year of studying economics that we came across a newly-introduced subject called development economics.

The justification for the introduction of the subject of development economics was that the standard assumptions of economic theory, especially the ones relating to the efficient working of a competitive market, do not even approximately apply to the developing countries. W. Arthur Lewis' *The Theory of Economic Growth* was assigned as our main text book. The works of Nurkse; Rosenstein-Rodan; and Prebisch and Singer were the other major theories on which the course was built.<sup>2</sup> These were the foundation stones on which rested the structuralist development theory, the overwhelmingly dominant paradigm in development economics in the post-World War II decades until the 1980s. What was the relative emphasis that these theories placed on growth, inequality and poverty reduction and how successful were the policies that followed from them in promoting inequality-averse growth?

The explicit focus of these theories was primarily on growth in societies that had been bypassed by the industrial revolution and capitalist development which the developed world had experienced. They set out to create a source of adequate capital formation; overcome the constraints on the demand side by dealing with indivisibilities and discontinuities; and adjust calculations of comparative advantage by taking into account the inelasticity of external demand for primary exports. There was very little that these theories explicitly said about income distribution and poverty reduction. Indeed the

distributive consequences of the process of capital formation in the Lewis theory appeared very similar to that in the classical model of Smith and Ricardo: real wages of the workers could not rise during the transition to self-sustaining growth, a period over which an ever increasing share of income would accrue to the capitalists. And yet I find it hard to argue that the authors of these theories were conceiving economic growth as a disequalizing process. In the Lewis theory, as in the classical theory, economic growth is characterized by a rising share of profit and a falling share of wages in aggregate *social product*, but not a similarly rising share of the capitalists in aggregate *consumption*. This is because the capitalists in these theoretical systems are motivated by an overwhelming passion for accumulation. Indeed they are conceived as the custodians of social surplus, agents who ensured that such surplus was directed to productive investment. Furthermore, according to my understanding, the “capitalists” in the theory of Lewis need not at all be private capitalists: the process is quite consistent with social ownership of means of production.<sup>3</sup> Both the Lewis and the classical models can be viewed as providing a mechanism for poverty reduction by employing more and more persons per capita at the constant real wage in the most productive sector. The structuralist development *theories* cannot therefore be attributed the authorship of inequality-inducing growth.

It is widely accepted that the above theoretical system served as the basis for development policy in much of the developing world in the period since World War II, especially in Latin America and South Asia. As is well known by now, the actual development in these country groups cannot be characterized as inequality-averse growth. Growth itself was modest to moderately high by historical standard. In Latin America it was highly disequalizing while in South Asia it was by no means inequality-averse. How might one explain the difference between what the theories led one to expect and what turned out to be the outcome of the policies claiming justification from the same theories?

I believe the basic explanation of the difference is that development policies in these country groups did not actually adhere to the theories listed above. The theories argued for systematic interventions in the market to make it better reflect social costs and benefits. The policies that purported to be inspired by them were on the other hand so

arbitrary that the resulting market signals were completely useless guides to resource allocation. Particularly since the late 1960s the neoclassical critique of structuralist development policies forcefully made this point. What they did not explain well was the failure of these policies to promote greater equality, a glaring omission in view of the neoclassical allegation that these policies were often ‘socialist’ and the readiness of the structuralist policymakers to go beyond the original theorists in supporting redistributive interventions in commodity and factor markets, ostensibly to benefit the workers and the poor. In reality the support for redistributive policies proved merely rhetorical: serious land reforms were never pursued; product market interventions helped workers much less than their employers who found urban rationing of food as a way to keep real wages low; labor market interventions did little to benefit the working population as a whole; and capitalists in these countries were not high savers.

During our times structuralism was not the only strategy we placed our hopes on. Even before I embarked on the study of economics, I had been exposed to Marxian socialism which came to be viewed by many of my generation as the great hope for the developing countries in their quest for rapid and equalizing growth. I had much difficulty seeing any connection between my admiration for socialism and my training in early years in academic economics. By the time we started reading the newly-introduced subject of development economics the chasm did not appear as great. I got a copy of Paul Baran’s *Political Economy of Growth*<sup>4</sup> in the same year in which I and my fellow students received copies of the treatises by the post-WWII development theorists who inspired structuralist development. In retrospect I am struck more by the points of agreement between the Marxist treatise and the structuralist development theory than by their differences.

For a period I thought that Baran’s book was the Marxian alternative for the non-socialist Third World; that the path followed by the countries that had experienced socialist revolution was different. Much later, after I became better acquainted with the socialist system, I came to realize that the actually existing socialist development policy was basically an extreme form of structuralism plus state ownership of means of production, a position supported by many parallels between structuralism and actually

existing socialist development policies: the near identity of the models of Feldman and Mahalanobis; the similarity of justification for capital-intensive techniques of production in labor-abundant economies; the argument for protection (“export pessimism” in the Indian case and the more extreme “closed economy” assumption in Soviet planning).

How does one judge the performance of these countries in promoting equitable growth during our times? Take first the Soviet model. In my early youth this was viewed as the great hope by much of the developing world and the great threat by even the knowledgeable among the economists in the West. The stark contrast between rapid growth in the Soviet Union and stagnation in the capitalist world in the 1930s was still fresh in memory. Furthermore, the 1950s and the 1960s seemed to be periods of high growth in the Soviet Union, combined for the first time with a convergence between the rates of growth in output and consumption. This, however, quickly gave way to a sharp fall in the rate of growth starting in the 1970s and a gradual march to the extinction of the system two decades later. There is a widely held view that growth in these countries faltered largely because of the disincentives that emanated from their pursuit of equality. I have had difficulty with this explanation if only because the achievement of these countries in attaining equality was by no means spectacular. These countries never achieved as much equality in personal income distribution as the North-West European countries, the descendants of the renegades from the time of the Second International, did in our times. China might appear to have been an exception. However, if one takes into account the great inequality that existed between urban and rural China, I doubt if personal income distribution there at the height of the Cultural Revolution would compare favorably with that in Scandinavia. While policies affecting distribution undoubtedly contributed to inefficiency and lower growth, there is no reason to believe that the achievements of these countries in the realm of equality can be considered a redeeming feature of their inability to sustain growth.

I seriously started seeking an understanding of the poor performance of the socialist countries from the time I got my first opportunity to carry out field research in what was then the Soviet Union. It was only gradually that I came to realize that there never was a Marxist theory of socialist development. Marx believed that economic development was the historical responsibility of capitalism which would inevitably

experience socialist transformation only at a very high level of material production. What fragmentary writing he left behind on the future socialist society was entirely concerned with distribution and, on the evidence of the meager pages of the posthumously published *Critique of the Gotha Program*, must be considered highly utopian.<sup>5</sup> When, contrary to what Marx had expected, socialist revolution occurred in pre-industrial societies, the builders of the new system had to create a theory of socialist development. After the utopian start under War Communism and course-correction under the New Economic Policy, it metamorphosed into central planning under Stalin. While it fundamentally differed from structuralism by opting for state ownership of means of production, it was very similar to, indeed a far more extreme form of, structuralism in completely rejecting the market. The problem was that it could not replace the capitalist market by an alternative system of rational economic calculations to guide economic decision making. As the work of Oscar Lange, and others, suggests, like capitalist technology and science, the capitalist market needed to be freed from the evils of capitalist wealth distribution and adjusted for other inadequacies and imperfections to be transformed into a powerful tool for socialist planning.<sup>6</sup> This theoretical piece of socialist planning, especially the Lange version, was worked out nearly two decades after the Soviet Revolution and there is no evidence that this would have been endorsed by the leaders of the revolution if it had been available earlier. Furthermore, it is impossible to know how this model would have worked if it had been tried and what further adjustments and additions in the model would have been necessary. There is, however, no doubt that in the absence of a system of rational economic calculations socialist planning could not avoid massive inefficiencies that dragged down the productivity of investment.

Neoclassical economics made its entry in the third quarter of the 19<sup>th</sup> century as a critique of the classical value theory with primary focus on microeconomics and allocation of resources. Early development theorists in the post-World War II period did not turn to it for ideas about how to deal with macroeconomic issues of growth. By expanding its scope and contents neoclassical economics gradually found a role for itself in development economics. By the turn of the 1970s it emerged as the major critique of the structural development policy and by the 1980s structuralism had been replaced by

the neoclassical alternative as the dominant paradigm in development economics.<sup>7</sup> In the realm of actual development policies, developing countries rapidly moved away from much of the trade and market interventions under structuralism, opted for denationalization, privatization and integration with the global economy. There was little that neoclassical development theory and policy said about the distribution of income. Original neoclassical theory stopped short of extending the theory of diminishing marginal utility of income to an argument for income redistribution by denying the possibility of interpersonal comparison of utility. How does one interpret the position of neoclassical development theory on the issue of income distribution? One possible interpretation is that it implied that distribution of income would automatically turn out to be acceptable once the whole gamut of neoclassical policies were in operation, an interpretation for which it is hard to find support from neoclassical economic theory. It is also possible to interpret their position as an acceptance of the Kuznets process. An alternative interpretation, however, is that neoclassical development theory did not consider the problem of income distribution as one of primary concern; instead it focused attention on poverty reduction by supporting certain minimal interventions beyond the employment-intensive development that it envisaged for the developing countries. The last interpretation appears to be closer to the position taken by the World Bank and other major practitioners of neoclassical development policy.

At various points since the beginning of the 1980s much of the formerly structuralist and the formerly socialist world fell under the sway of this strategy. For about two decades, i.e., until the late 1990s, the strategy failed to generate growth in Latin America, Africa and former Soviet republics and, in more recent years, growth in these regions has paled in comparison with the peak rate of growth during their prior development experience. There is considerable evidence that the countries which opted for this new paradigm have failed to avoid increased inequality in the distribution of income. Admittedly in the rare cases of rapid growth inspired by this paradigm, e.g. in Chile, increased inequality was accompanied by reduced incidence of poverty.

During our times the developing continent of Asia is the only region which experienced steady acceleration of growth. It is also the only region in which growth accelerated in the period following the decline of the structuralist/socialist paradigms of

development. Within Asia growth has been most rapid in East Asia and parts of South-East Asia. Only in more recent years has growth been rapid in South Asia, mostly and particularly in India.

Even though Asian growth accelerated roughly in tandem with the world-wide spread of reforms inspired by the Washington Consensus, it is hard to attribute their success to neoclassical policies. Growth in China and Vietnam resembles the growth of the “East Asian pioneers” (Japan, the Republic of Korea, Taiwan, Hong Kong and Singapore) infinitely more closely than any neoclassical model that one can visualize. In their 1993 study *The East Asian Miracle*, the World Bank treated Thailand, Malaysia and Indonesia in the same category as the pioneers.<sup>8</sup> If India’s growth in recent years is not nearly as closely inspired by the East Asian experience, nor is it close to the neoclassical vision. I have therefore reached the conclusion that the neoclassical development paradigm, as enshrined in policies peddled by the Washington consensus, can not be credited with Asian growth. More generally it has not been friendly to growth, not to speak of equity. To understand why, I like to juxtapose its contents against the contents of the growth strategy of the East Asian pioneers, the most successful of the development strategies during our times.

Views about the nature of the East Asian strategy have evolved over time, but I believe that the current consensus is that, while the pioneers were less disrespectful of the market than the structuralists have been, they rejected the obeisance to market fundamentalism that the neoclassical strategy advocates.<sup>9</sup> In trade, they strongly opted for integration with the global economy by setting up an incentive structure that systematically promotes exports over import substitution, but they rejected free trade. Worthwhile infants were promoted but the promotion of infant exports received priority over the promotion of infant import substitutes, the justification being that for a new entrant in the world market all new exports are infants facing competition from the established players. Promotion of infants did not degenerate into support for ‘perpetual infants’ because the policy was time bound. Within these broad principles there was plenty of protection, including quantitative trade restrictions, control of capital flows and even hostility to foreign direct investment.

Macroeconomic stability was emphasized to the extent that these countries avoided uncontrolled inflation for long periods. But they did not make a fetish of macroeconomic stability that often immobilizes countries, as under deflationary IMF conditionality. Financial repression was often practiced, for example to finance export subsidies, although the extremes of prolonged negative real interest rates were avoided.

Interventions in the product and factor markets were generally regarded as inefficient tools for improving welfare of the consumers and workers. In the labor market, interventions that reduce the mobility of labor and create protected markets of 'labor aristocracy' were avoided. The emphasis was on the rapid expansion of employment and its productivity that led to a rise in real wage at approximately the same rate as the increase in average income. With the demand for labor growing at a very fast rate, the Republic of Korea, for example, had no difficulty in frequently going through massive restructuring of employment even though there were absolutely rigid statutory obstacles to the firing of workers.

All these countries instituted major redistribution of assets – land in Japan, the Republic of Korea and Taiwan; and publicly-provided housing in the city states of Hong Kong and Singapore – during the early phase of development. Redistributive effects of these initial egalitarian policies were strengthened by the wide access to human capital. Unlike the withering role of the state advocated by the neoclassical theory, the strategy of these countries was led by a strong state making large investments in physical and social infrastructure, generally building a consensus among the principal entrepreneurial groups about the goals of development while avoiding state ownership of activities in which properly-regulated private enterprise has comparative advantage.

It is not hard to see why the neoclassical paradigm, overly concerned with the efficient rules of resource allocation in a perfectly-functioning but unreal market, while rejecting the above policies to promote equitable growth, achieved neither rapid growth nor equality. The experience in much of the developing world serves as evidence. Those parts of the developing world that were finally able to resume growth, after prolonged stagnation during the 1980s and the 1990s, often did so by moving away from significant parts of the strategy.

I have argued that the high growth in the East Asian countries like China and Vietnam has been inspired more by the East Asian pioneers than any of the other strategies that we have discussed. Indeed China's growth in the last three decades has significantly exceeded the growth rate that any of the East Asian pioneers achieved during their fastest growth decades. And yet there is one great difference between the experience of the East Asian pioneers and the experience of China, or for that matter of any of the other countries that achieved rapid growth in recent years and decades. The growth of the East Asian pioneers started with relative equality of income distribution and that feature was maintained over the period of their transition to high-income countries. All the contemporary cases of rapid growth have been characterized by increased inequality. It is particularly noteworthy that in the case of China and Vietnam growth has been strongly disequalizing despite the continued equality of access to land in those countries. Indeed I have not found a significant case of sustained growth with sustained equality of distribution of income in recent history. It seems that if some countries have learned how to grow like the East Asian pioneers, or even beat them in that game, they have done so only at the cost of allowing inequality to increase. I have taken the position that the difference in the distributional outcome between these countries and the East Asian pioneers is partly due to the difference in initial circumstances but largely due to avoidable policies.<sup>10</sup>

I want to underline here that the outcome clearly brings out that what the development community needs to learn is not just how to attain rapid growth, but how to attain rapid growth with equity, a test that the three major development paradigms during our times have failed. It hardly needs to be argued that benefits of a given rate of growth are greater if it is accompanied by lower inequality. If we define growth in terms of change in "equally distributed income equivalent", with a positive inequality-aversion parameter, then a given increase in per capita GDP/GNP would translate into a smaller rate of growth the higher the inequality. China's spectacular rate of growth during the last three decades would look more down-to-earth once measurements are based on such an index of growth and even more so once further adjustment is made for environmental degradation.

The policies of the East Asian pioneers, the most successful development strategy that combined very rapid growth with equity during our times, do not belong to any of the three strategies widely implemented in the developing world during the post-WWII period. I have found it helpful to view this strategy as an eclectic combination of useful components of all the major theories of development: the classical emphasis on the centrality of capital accumulation; the neoclassical advocacy of the market as the principal mechanism for resource allocation; the structuralist recognition of the limitations and failures of the market; and the socialist rejection of inequality as the goal of development. Sadly its recent imitators have failed to emulate its egalitarian characteristic.

### *III. Historical Evolution of Concern for Equality and Poverty*

I have argued that growth in most developing countries became significantly more disequalizing since the beginning of the 1980s. I do not have sufficient data to document the extent of the universality of this phenomenon. I think it is easy to show that this is the case for all the regions in Asia and in the former Socialist countries. For Africa data are scant but evidence for rapid inequality-averse growth is hard to come by. In much of Latin America inequality remains high and possibly continues to increase although Brazil in very recent years appears to be an exception.

Indeed it appears to me that there was a worldwide shift in the trend in inequality sometime in the late 1970s/early 1980s. The world came out of World War II with high marginal rates of taxes. There was a very sharp increase in the proportion of world population that came to live in countries that adopted the socialist system. Starting with Britain social democracy spread and deepened its roots in much of Western Europe. The United States experienced inequality-averse (mildly equalizing) growth for about three decades after the end of World War II. At least rhetorically, many structuralist regimes were strongly pro equity.

All this seemed to change sometime around 1980. In the advanced industrial world the Thatcher/Reagan doctrines led to the erosion of trade union power and steady increase in inequality. Even before the socialist system finally broke down, China's

reforms, starting at about the same time as the beginning of the Thatcher/Reagan revolution, sounded the clarion call to “fight egalitarianism”. The official adoption of this apparently ridiculous slogan was justified by Deng Xiaoping’s disciples by arguing that in China arbitrary egalitarianism was the cause of stagnation; its abolition would lead to rapid growth which, even with some increase in inequality, will allow a faster reduction in absolute poverty than otherwise. In the specific Chinese context in the late 1970s and the early 1980s it might have made sense *up to a point*, but only up to a point.

The neoclassically-inspired development paradigm, as practiced by the World Bank and the international development community which it led, embraced poverty reduction as the principal development goal. This enthusiasm for poverty reduction appears to me rather curious when I juxtapose it against the complete lack of concern for inequality. Indeed in far too many World Bank assessments of poverty an observed increase in inequality is dismissed as of no consequence when it is possible to show that poverty, by one of the many possible measures, has declined. I read this as a very different argument from what Deng’s disciples were saying in justification of reforms. In general it is hard to make the case that in the developing Third World - Latin America, Africa and South Asia – there was too much equality which was an obstacle to growth. Unless one can make that case, one can not dismiss the rise in inequality as inconsequential just because poverty is not increasing simultaneously.

Given the rate of growth in income, a rise in inequality can have three possible kinds of effect on poverty:

(a) It is logically possible, though empirically rare, for the income share of the poor to increase when overall inequality increases. This can be the case, for example, if the poor are entirely concentrated among the bottom two deciles of the income distribution scale and inequality, measured by a summary index like the Gini ratio, increases because of a redistribution of income from the middle-income groups to the higher income groups along with a trickle down to the bottom deciles. In such an unlikely case, poverty reduction is possible with rising inequality even if there is no increase in overall income.<sup>11</sup> This, however, is an unlikely outcome when the threshold that is used to measure poverty is a high proportion of average income, as should be the case in very poor countries.

(b) In the more likely event of a fall in the income share of the poor due to an increase in overall inequality, poverty will increase unless the rate of growth in income is fast enough to prevent an absolute fall in the average income of the poor.

(c) With the income share of the poor falling due to an increase in inequality, the rate of income growth can be rapid enough to permit an absolute increase in the average income of the poor thereby reducing the incidence of poverty. But the reduction in poverty would be less than what I call the potential reduction in poverty. The “poverty reduction gap” – the gap between the *potential* poverty reduction that would result from an unchanged income distribution and the *actual* reduction in poverty – must be attributed to the increase in inequality. *In this sense any increase in inequality must be considered a cause of increase in poverty – the prevalence of a poverty rate in excess of what it would have been had inequality not increased - unless it can be shown that in the absence of the increase in inequality growth itself would have fallen.* Since the 1990s a substantial body of literature has actually argued the opposite: certain redistributive policies for greater equity actually help promote faster growth.<sup>12</sup>

I think the dichotomy between the objectives of inequality aversion and poverty reduction is a serious cause for concern. To lose sight of the connection between the two goals is both artificial and an obstacle to coherent policymaking. I have increasingly felt that this artificial disconnect encourages all kinds of statistical acrobatics to create poverty estimates that present too optimistic a picture. After all, there are far too many alternative ways to measure poverty. One can vary the poverty line. One can choose between different indicators of standard of living: income or consumption or simply “expenditure”, their definitions being allowed to be flexible. One can use different sources of data for estimating changes in the selected indicator: e.g., consumption from household surveys or from GDP accounts. One has significant leeway to play with alternative estimates of the consumer price index. By a combination of suitable choices from all these alternatives one can work wonders. In a recent paper I have tried to show how this kind of game blurs the picture to the detriment of a proper understanding of the circumstances in Bangladesh.<sup>13</sup> Estimates of inequality are usually simpler though by no means free of problems. It is not without reason that controversies about changes in poverty are much more intense and wild than controversies about changes in inequality

even though the two measurements should use substantially the same data. The point I am making is that vowing to reduce poverty while allowing inequality-inducing policies and programs to flourish is an unhealthy approach to policymaking. Attention must firmly be shifted back to inequality as well and ways to curb it.

I have lamented the increase in inequality within nations. The increase in inequality between nations has perhaps been even more serious. Bourguignon and Morrisson have shown that inequality among citizens of the world has steadily increased over the period 1820 to 1992.<sup>14</sup> The Gini index leveled off in the decade leading to 1992 though the Theil index continued to rise through 1992. These measurements are necessarily subject to substantial errors, more so than are the inequality measures for individual countries. Still I think the evidence tells us something interesting. First, inequality for the world as a whole – with a Gini index of over 0.65 for 1992 – is greater than the inequality within all but a handful of nations. Secondly, this inequality has increased steadily over time. Thirdly, as shown by the decomposition of the Theil index, within-country inequality has steadily become smaller as a proportion of total inequality while the proportion of inequality contributed by between-country inequality has steadily increased. Before WWII within-country inequality contributed a higher proportion of total inequality than between-country inequality. After WWII their relative shares were reversed: by 1992 the share of within-country inequality had fallen to 40 per cent of total inequality.

One might think that for very recent years such measurements would show a decline in the share of between-country inequality and even a decline in overall inequality due to China's hyper growth and India's very rapid growth. There are, however, at least two offsetting factors that need to be taken into account. The first is the effect of the recent revision of the PPP\$ incomes – on which the world inequality estimates are based – by the World Bank.<sup>15</sup> These revisions have sharply increased the PPP conversion factors for the developing countries (i.e., increased the number of units of their domestic currencies that is equivalent to a dollar in purchasing power than was the case before) thereby vastly widening the estimated gap between their real per capita income and that of the advanced countries than was previously believed. This should sharply raise the share of between-country inequality and almost certainly the overall

*level* of inequality among the citizens of the world. The effect on the trend in world inequality and its sources would depend on the time trend of the overestimation of the PPP conversion factors about which I have very little information. Another aspect of international inequality that one should worry about is that while inequality between China and India on the one hand and the richer world on the other has fallen in recent years, the inequality between much of the rest of the developing world on the one hand and the remaining world on the other has increased. I have no idea what the result would look like once all these, including the sharp increase in inequality within nations, are put together to extend the Bourguignon- Morrisson estimates beyond 1992.

#### *IV. Concluding Comments*

I started by venting my perception that in our times most of the developing world, including the world of my childhood, experienced too little growth, too great an increase in inequality and too slow a reduction in poverty. I have noted that the lament about slow growth and poverty reduction might sound incongruous in the context of their historical evolution; my disappointment emanates from the sense that opportunities that were well within reach were allowed to slip.

I have also underlined that while the development community routinely emphasizes the need for more rapid growth and faster reduction of poverty, there is no comparable concern about inequality. I am particularly dismayed that the developing countries that have grown rapidly in recent decades have allowed inequality to increase, often very sharply. This association of increased inequality with accelerated growth was largely unnecessary.

These days I wonder if the world will come out of the ongoing “great recession” with a different approach to inequality, both between and within countries. The year 2009 was probably the first in modern history to witness a growth in aggregate output in the developing world that exceeds the growth in aggregate world output: output in the developing world as a whole probably grew at about 1.5 per cent while the industrialized countries as a whole experienced a 3.8 per cent decline in output.<sup>16</sup> What this will do to

inequality between countries is, however, quite uncertain. Growth in the developing world in 2009 was more than fully accounted for by the growth in China and India; aggregate output in the rest of the developing world fell. China and India are likely to continue to increase their share of world output in 2010 and beyond. The prospect for the rest of the developing world, particularly its poorest parts, looks uncertain for years ahead. The crisis could lead to a reduction in the index of inequality between countries by bringing down growth for most countries, by more for the countries at the richer end of the spectrum than for the countries at the poorer end. That would hardly be something to feel cheerful about. What is of importance is that the inequality is brought down by a broad surge of growth among poor countries that leads the world out of the crisis. Fantasy rarely takes hold of me so completely as to make the prospect for such an outcome appear particularly bright.

Could the crisis be an opportunity to contain the forces of inequality within countries? After three decades of unrestrained supremacy, the forces of inequality may be on the retreat the world over. Contrary to the prediction made by many, the wave of globalization could not sweep away the social protection and equality of European social democracies even when many of these countries came to be ruled by conservative governments. In the United States the overwhelming appropriation of the gains of growth by the richest groups during the last three decades is being questioned far more widely than before. I have argued elsewhere that the Asian Crisis of the late 1990s led the Chinese leadership to make a course correction that significantly weakened the march towards inequality.<sup>17</sup> Their recent stimulus, the largest of all countries' per unit of GDP, seems to be strengthening that trend. The current crisis is making them look for a solution by boosting domestic demand in ways that has the possibility of bringing about a better distribution of income between regions, sectors and individuals. Similar solutions will hopefully be sought by other developing countries. There are moments when I feel that all these forces will help the developing countries come out of the crisis with a stronger commitment to inequality-averse growth. Then there are moments when the memories of dashed hopes of the past return to haunt me.

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## NOTES

<sup>1</sup> **(2.6)(5.4)(3.9) = 55** (neglecting the rounding error). It is possible, indeed likely, that I have underestimated the inequality factor and perhaps even the international migration factor. I am, however, confident that the ranks of the three parameters are correct. This may be a good place to briefly indicate the sources of the main data used in this section. Growth rates for the Bangladesh economy for the period 1980 to 2006 are from Khan (2009) and for the period 1949/50 to 1980 from Khan and Hossain (1989). For years before 1949/50 the early 1950s growth rate was extrapolated backwards and for years since 2006 the growth rates are based on the Bangladesh Bureau of Statistics estimates reported in Government of Bangladesh (2009). Inequality estimate for Bangladesh for recent years is from Khan (2005). Purchasing power parity incomes and income distribution for the USA are from World Bank (2008).

<sup>2</sup> The main texts are Lewis (1955), Nurkse (1953), Rosenstein-Rodan (1943), Prebisch (1962) and Singer (1950).

<sup>3</sup> Nurkse's accumulation process is more problematic: it envisages greater effort on the part of the workers at constant real wage which can be interpreted as declining real wage per unit of work effort. I have long argued that Maoist communes are the only examples that come close to the accumulation process visualized by Nurkse. As we well know, that institution, though criticized for inefficiency, rejected inequality.

<sup>4</sup> See Baran (1957).

<sup>5</sup> See Marx (1891). Note that the pamphlet consists of marginal notes on the draft program of the German Workers' Party meant for circulation among some colleagues, not intended for publication. Sixteen years after they were scribbled and 8 years after Marx's death, Engels edited them for publication.

<sup>6</sup> See Lange (1936-37).

<sup>7</sup> For an early comprehensive critique of structuralism from a broad neoclassical standpoint see Little, Scitovsky and Scott (1970).

<sup>8</sup> World Bank (1993).

<sup>9</sup> For an account of the features of the East Asian development see World Bank (1993) and the pioneering works of Alice Amsden and Robert Wade cited therein.

<sup>10</sup> An analysis of the nature and causes of disequalizing growth in China can be found in Khan and Riskin (2001).

<sup>11</sup> In this and the two following cases the conclusion about the effect on poverty is based on the change in the headcount rate of poverty and the assumption that the distribution of income *among the poor remains unchanged*. More generally, the indicated change will apply to one or more of the three "Foster-Greer-Thorbecke" (FGT) indices of poverty: the headcount rate, per-capita poverty gap and the squared poverty gap. For the definitions of the three FGT indices see Fields (2001), chapter 4.

<sup>12</sup> See for example Alesina and Rodrick (1994), Deininger and Squire (1998) and Persson and Tabellini (1992). A useful summary of the arguments can be found in Helpman (2004), chapter 6.

<sup>13</sup> See Khan (2005).

<sup>14</sup> Bourguignon and Morrisson (2002).

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<sup>15</sup> The revised PPP conversion factors and PPP\$ income estimates are reported in World Bank (2008).

<sup>16</sup> These are based on the IMF estimates/projections made in July 2009 (IMF, World Economic Outlook Update, July 8, 2009). According to them developing Asia's growth should be 5.5 per cent (7.5 per cent for China and 5.4 per cent for India), -5 per cent for Central and Eastern Europe, and -2.6 per cent for developing Western Hemisphere. Sub-Saharan Africa and Middle East should grow at positive rates (respectively 1.8 per cent and 2 per cent), but their growth rates would be lower than their population growth rates.

<sup>17</sup> See Khan and Riskin (2001).

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