

Rough Guide to Economics:

Poverty and Inequality

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Measuring Inequality

Personal or size distribution:

1. Deciles or quintiles: percentage of people within particular groups. Allows statements such as bottom 20% of individuals receives only 5% of total income. Useful way to summarise
2. Lorenz curves: %income graphed against %recipients: The further away from the diagonal the more unequal. But if cross?
3. Gini coefficient: from Lorenz curve (area between curve and diagonal divided by area under diagonal) lies 0-1. In practise highly unequal 0.5-0.7
4. Coefficient of variation: mean divided by standard deviations.

Principles for index:

- Anonymity
- Scale independence
- Population independence
- Transfer principle

Functional Distribution:

1. Distribution factor shares: labour capital land
2. Contribution to production
3. Workers/capitalists peasants/landlords/bourgeoisie
4. Doesn't allow for non-economic power structures

Measuring Poverty

General issues in literature: attempts to define poverty and to identify the poor.

Basic measures:

1. Absolute: basic needs measures (Rowntree in UK)
2. Relative: relate to general standard of living of the society
3. Subjective: ask people
 - a. Questionnaire:
 - b. Consensus: get generally agreed minimum

Other issues:

- Income vs consumption measures
 - Wealthy can have high education low income
- Relative vs absolute
 - -absolute is focus on individual –blame?
 - -political preference:
 - right: inefficiency of welfare
 - middle: politics of envy?
 - left: inefficiency of capitalism: need for poverty
- Objective vs subjective
 - Importance of subjective well-being in society
- Physiological vs Sociological

- Latter considers deprivation even when resources available
 - Economic constraints
 - Social constraints
 - Human capability approach to deprivation

- Ends vs means
 - Ultimate goal social inclusion
 - Focus: measures of inputs: life expectancy; literacy; malnutrition

- Social Exclusion: the underclass
 - Economic underclass
 - Moral underclass
 - Educational underclass

Clearly its absolute poverty that is of most relevance in the developing world

Measuring Absolute Poverty

1. Head count index:

- Proportion of the population below the poverty line: minimum health standard
- Specify number of people unable to command sufficient resources to satisfy basic needs
- Anybody living on 1\$ per day in ppp dollars: can then compare people in NYC and in Bogata for eg.
- But cant accept in unquestioning way:
 - Define adequate basket of food :
 - Household survey identify typical food basket that meets nutritional requirements:
 - Add in other basic needs expenditures
 - Likely to be more than \$1 a day

But setting an agreed line and counting number is deficient (though easy to measure). Can miss problems below the line.

2. Measure the poverty gap

- Total amount of income necessary to raise everyone below the poverty line up to it.

3. Other Poverty Indices

- Measures that take into account degree of inequality among the poor

- Human Poverty Index: UNDP alternative to HDI and WB
 - Measure in terms of 3 key deprivations:
 - Of life: life expectancy
 - Of basic education: literacy
 - Of economic resources: (% without health service; % without safe water; % underweight children)
 - Give very different rankings to usual measures

Bottom line

There is no one measure that can deal with all concerns.

- Need to use a variety or choose carefully
- Recognise limitations
- Look at the figures/distribution

Inequality, Poverty and Economics

- What's bad about it?
- Absolute poverty clearly bad but relative poverty?

1. Extreme income inequality leads to economic efficiency

- Smaller fraction can get credit
- Smaller fraction educated or start business
- Low savings rate
- Lower domestic demand (rich import)
- Capital flight possible

Growth policies based on increasing inequality don't make sense.

2. Inequality can lead to inefficient allocation of resources

- Overemphasise higher education rather than basic education
- Landowners and subsistence may be inefficient
- Lower income and lower growth path

3. Extreme income inequality undermines social stability

- No solidarity
- Strengthens political power of rich
- Facilitates rent seeking rather than production
- May lead to damaging conflict

- Opposition based on redistribution not more growth?

4. Extreme inequality is unfair:

- Rawlsian judgements
- Other social contract theorists
- Other issues/views

Inequality and Economic Growth

- Distinguish different forms of growth
 1. Modern sector enlargement: dual economy with increasing modern sector, but wages maintained.
 - Likely to lead to Lorenz curves crossing
 2. Modern sector enrichment: growth limited to the modern sector
 - Likely to lead to Lorenz curve shifting down – increasing inequality
 3. Traditional sector enrichment: all benefits of growth benefit the traditional sector
 - Likely to lead to Lorenz curve shifting in – increase in equality. Reduce absolute poverty even at low income, but economic risks.

- Inequality as an inevitable stage of development:
 1. Idea that inequality may increase temporarily but will eventually make everyone better off.
Kuznets
 - But no evidence that inevitable
 - Evidence doesn't really support
 2. Idea that CMP is most productive phase of human development and will provide resources for future fairer society: Marx
Yet to see –Meghnad Desai's book
Marx's Revenge

- Growth and Inequality: evidence
 1. Cross country evidence doesn't show any obvious relation
 2. Character of economic growth determines the degree to which reflected in living standards
 3. No reason why reducing poverty should harm economic growth

Specificities of Growth and inequality

1. The lack of simple relations shows importance of specificities
 - Historical
 - Regional
 - Strategic
 - Social structure

2. Economic Characteristics of Poverty Groups
 - Rural
 - Women
 - Ethnic Minorities

Policy Options

1. Alter functional distribution

- Change relative factor prices
- Remove “distortions”
- Traditional economic approach
- Change power relations

2. Alter Size Distribution

- Redistribution of assets
 - i. Unequal ownership important physical and financial
 - ii. Land reform
 - iii. Redistribution for growth
 - iv. Human capital
- Progressive taxation
 - i. Progressive taxation sensible
 - ii. But progressive on paper can be regressive in practise
 - iii. Indirect taxation can be regressive if not careful
- Direct transfer payments
 - i. Expenditure to very poor and subsidies can be effective
 - ii. Problems possible:
 - a. targeting benefits debate/dilemma

- b. dependency
- c. diversion from productive activity
- d. create resentments of the just
above
- e. incentives created

- Alter specifics

- i. Agricultural policy for rural poor
 - ii. Environmental policy
 - iii. Microcredit and enterprises

Issues:

1. International Trade

2. World Bank and IMF Policies

- The background
- The record
- Differences in attitudes
- Changes over time
- Poverty Reduction Strategies

3. Aid Agencies:

- Government
- Non –Government

4. Other NGOs

5. Conflict and Post Conflict Reconstruction

- The background
- The experience
- The debate
- New developments