Inequality and growth: a unique path?

A recent article by The Economist "Inequality v growth", March 1st, 2014 offers an interesting starting point to discussions that have taken place in Chile for a long time now: in brief, there is no clear answer as to whether inequality affects growth, though it is fairly accepted - and evidence points into that direction - that a more inclusive system tends to give better and more stable long term economic results. But it remains open to prove how much "inclusive" the system should ideally be as measured in terms of income distribution –.

Based on the Standardized World Income Inequality Database (SWIID) put together by Professor Frederick Solt that would allow historical and cross country comparisons, two Gini indices are estimated: a market or gross income index and a net income index, where the last one includes the net effect of taxes and transfers by Central Governments or equivalently captures the impact of income redistribution on the equality index. Under Gini scale, perfect equality corresponds to a 0 figure, whereas perfect inequality is associated with a 1 figure.

Among other findings pointed by Professor Solt, in the developing world differences in gross income inequality explain 93.5% of the variance in net income inequality, whereas in advanced countries they explain 56.1%. In other words, among advanced countries differences in redistributive policies are much more important to explaining differences in net inequality.

As to comparing Chilean and US cases, the following table is useful:

GINI time path, CHILE and US **Source: SWIID**	*1980*	*1990*	*2000*	*2010*	*2011*
Market income Gini Chile	50.44	51.7	51.61	48.64	48.54
Net income Gini Chile	48.78	50.15	50.43	47.2	47.08
Market income Gini US	38.64	43.31	46.06	46.86	46.5
Net income Gini US	30.36	34.19	36.7	37.3	37.2

Five considerations might be derived from this table:

1. Income distribution in Chile, in gross terms, has been pretty stable, with a tendency to improve after year 2000 towards a 48 Gini index; net income distribution has also shown the same tendency, with redistributive policies having improved gross income Gini coefficients by 1.5 points approximately each year, ending in year 2011 at 47 on a net income basis.

2. Income distribution in the US, in gross terms, has consistently worsened during this 31 year period, flattening around a 46 Gini index as last decade went by; net income distribution shows

the same path, with a larger than Chile´s redistributive impact from Central Government policies by 9 points in Gini indices, ending in year 2011 at 37 on a net income basis.

3. Net redistributive impacts from taxes and expenditure have been considerably stronger in the US than in Chile. It is also noticeable that during this 31 year period, redistributive policies have had stable "corrective" effects on income distribution in each country – 1.5 or 9 points in each case -, even taking into account that taxes and expenditures have changed along three decades.

4. The bulk of income distribution is derived from gross or market incomes, not net incomes that take into account Central Government redistribution policies.

5. It might be noteworthy that some European countries such as Germany or France have net income Gini indices around 30, a 20 point difference with respect to their own gross or market income Gini indices. Market income Gini indices around 50 are quite similar to those of the US or Chile.

It is difficult to ascertain which the most important forces behind these gross and net income distribution figures are, but educational level is clearly one of them, along with access to markets under different competitive conditions, whether they are financial or non financial ones.

On the other hand, it might be interesting to remind that, in absolute terms, per capita income levels in Chile and the US, in PPP current US$, were US$ 2.240 and US$ 12.550 in 1980 and US$ 19.820 and US$ 50.860 in 2011, respectively, according to the World Bank. US inflation averaged 3.41% per year in the 31 year period. **Chile´s per capita income went from 18% to 39% of that of the US, annually growing in real terms by 3.75% whereas US´s did so by 1.16% per year.** Chile started from a more unbalanced income distribution, slightly improving along the way; the US from a more balanced income distribution position which worsened significantly. Chile enjoyed stronger per capita income growth converging to US income levels, though there is **still a big 61% gap to close**.

Would it be desirable to have a more balanced net income distribution in Chile? Sure. For some reasons, most probably related to better and wider access to education – not necessarily free - from younger generations than older ones, it is getting corrected by itself on gross and net terms. Would a more active income redistribution policy further correct Gini indices? Sure. Would there be a cost in terms of lost product? Probably in the short term but in the long term it would be dependent on the efficiency of taxes and expenditures – their not to be forgotten effective rate of return -.

Economic growth is complex; income distribution is more so. If we do not want to be doomed to fail on a long term growth path with wider benefits to all, policies should be centered on the first one with an intelligent, focused but subsidiary eye on the second one. Reversing roles has been shown, time and again, it does not work, both on an economic and political basis.

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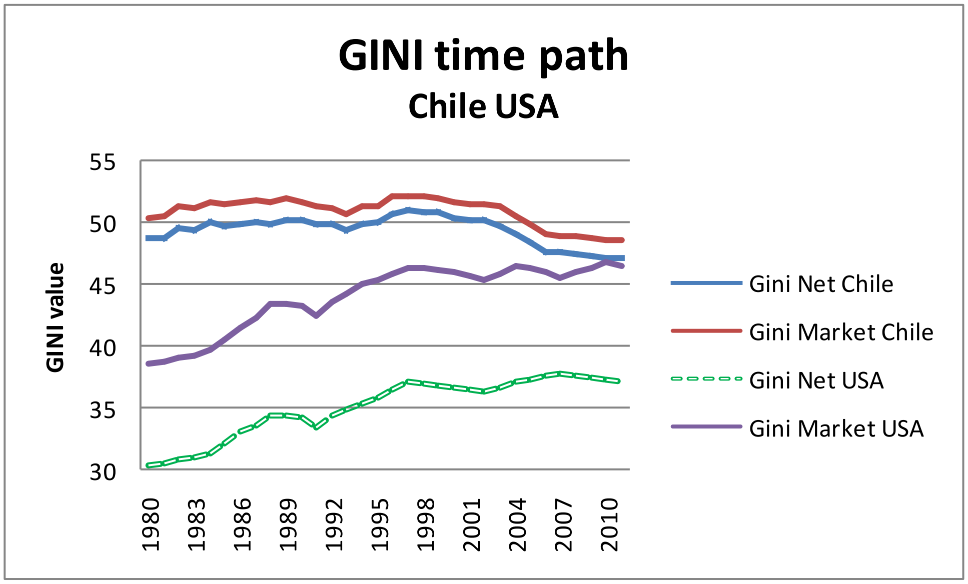
GINI time path
Chile USA
GINI value
55
50
45
40
35
30
1980
1983
1986
1989
1992
1995
1998
2001
2004
2007
2010
Gini Net Chile
Gini Market Chile
Gini Net USA
Gini Market USA