**Inequality and Sustained Growth**

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Bon jour. Permettez-moi commencer de remercier le Cercle des économistes de m'avoir invite à cette intéressante réunion dans la belle ville d'Aix-en-provence.

Ma langue maternelle est l'espagnol but I will now switch to English as my French is not strong enough and probably your Spanish is not either.

My remarks will focus on the relationship between income inequality and sustained growth.

In particular, I want to address two main questions:

1. Is lower income inequality associated with sustained economic growth?
2. If it is, how can you change inequality levels without, in turn, jeopardizing growth?

There is a third question of relevance that I will not discuss: How do you prevent growth from generating higher inequality that, in turn, could threaten the sustainability of growth? If there is time, we may turn to is during the discussion period.

Let me start with the first question: does lower inequality predict longer periods of sustained growth?

While not every existing econometric study shows this, the bulk of the evidence finds that high inequality is associated with lower growth.

Of particular interest is a 2012 by Berg, Ostry and Zettelmeyer in the Journal of Development Economics that shows that among the characteristics that predict sustained growth in developing countries is a more equal income distribution.

This article focuses not on the performance of average growth rates, but on which variables explain the duration of growth spells: i.e., the number of years a reasonable growth rate of per capita income can be sustained.

Berg et al.’s results show that openness to trade and foreign direct investment, the share of skill/technology intensive exports, low inflation, fewer instances of sharp currency depreciation, and slower accumulation of debt, are good for sustained growth. They also show that democratic institutions, improvements in education and health, and a more equal income distribution predict growth spells of longer duration.

In particular, they show that a one percentage point higher in the Gini coefficient—a typical measure of inequality—is associated with an expected duration of the growth spell that is between 11 and 15 percent lower. Not small.

Interesting, this relationship holds for ‘initial inequality’: i.e., the inequality that prevailed at the beginning of a growth spell. Changes in inequality within a growth spell, did not have predictive power. Most likely, because some of these changes might have been brought about by actions that jeopardize growth: for instance, populist redistribution, a theme to what I shall return later on.

Why might less equal societies experience more volatile growth? Two main explanations have been put forth: because less equal societies breed populist growth and redistribution policies (Sachs; Dornbush and Edwards); because they have weaker institutions and reduced capacity for managing shocks (Rodrik; Easterly and others).

Let me now turn to the second question. If initial inequality levels are important determinants of sustained growth, how do you change these initial conditions (i.e, reduce inequality) without unleashing the dynamics that might kill growth?

There are three main instruments to/processes that change income inequality: direct redistribution of assets or wealth; redistribution through public spending and taxation; and, redistribution through labor policies.

History provides successful and unsuccessful examples of all three. Success meaning that redistribution led to more equitable and sustained growth.

The pulverization of wealth that took place in the US and Western Europe during the Great Depression or in the latter during WWII are—as shown by the work of Atkinson, Piketty and Saez-- examples of successful assets/redistribution of wealth. These wealth-destroying events opened an era of, largely, several decades of equitable sustained growth in both Europe and the US. The same is true with large-scale land reforms in Japan, Korea and Taiwan.

However, there are many cases in which attempts at redistributing wealth through, for example, land reform, triggered backlashes and conflict, and put and end to both growth and the attempt at redistribution.

Progressive taxation and public spending have been tremendously successful instruments of redistribution in Western Europe. In several countries of the new millennium Latin America, redistribution through fiscally prudent progressive fiscal policy has been successful too. However, in other parts of the world attempts to emulate the European welfare state ended up in economic disaster. This was particularly so in the region where I come from—Latin America-- and even more particularly so in my country of birth—Argentina--.

The good news is that history tells us that initial conditions can be changed: i.e., it is possible to generate a more equitable distribution of income without killing the goose of the golden eggs of growth. The question is at what price. If it is at the price of bloodshed, then we may think that the ‘means’ do not justify the end.

It would seem that redistribution of human capital assets in the form of wider access to education and health could be one of the few “win-wins.”

That is, as long as the rich accept to contribute to the fiscal coffer in the amounts that will reduce inequality at the required pace. And we know that in many countries this is still not the case.

And this is the crux of the matter: if the elites do not agree to a process of ‘benign’ redistribution, shorter growth spells and destructive political and social instability, will be with us for the time to come.