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The world's leading development economists can't agree on how to tackle inequality

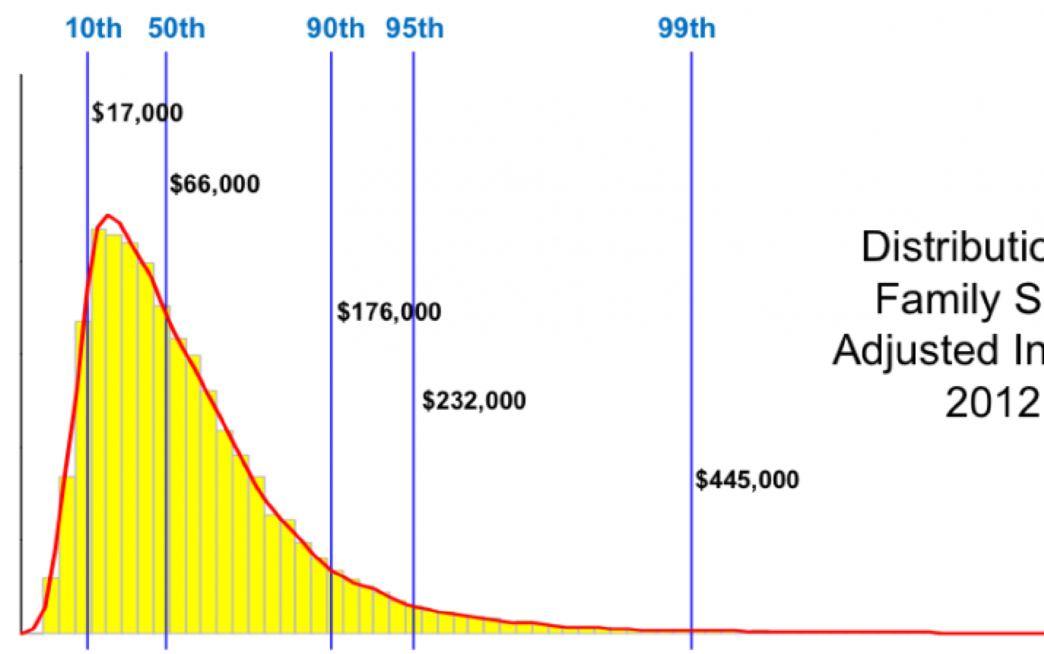
By Howard Schneider, Updated: September 19, 2013

A quick quiz on income inequality:

Wages are flat here at the Washington Post because a) we do a bad job, b) Jeff Bezos is worth $23 billion, c) we work in a business where technology has severed the link between the product and money.

In a perfectly equal world where everyone can choose their job and everyone gets paid the same, there would be a) too many rock stars, b) not enough garbage collectors, c) all of the above.

It is easy to get mad about income inequality, and the release of the latest census data showing that big, immobile lump at the low side of the graph is as good a time as any to fret about the Great Stagnation.



Note: To adjust your income by family size relative to a 4-person family, use the following factors:
Single person, multiply income by 2.2
Married-couple, multiply income by 1.5
Married-couple with one child, multiply income by 1.4

That is one depressing lump on the left.

But it’s much harder, it turns out, to determine how much inequality is too much; whether the forces driving it are good and necessary or profligate and evil; and whether policymakers should focus on reducing inequality in and of itself, or instead focus on related issues that contribute to inequality, like public education, health standards among the poor, or evidence of discrimination in the labor market.

In fatc there is a pretty pitched debate underway about all this even among the folks who are of a like mind on the topic – the development economists and analysts who focus on improving the lot of the poor around the world.

There’s a general sense of fairness involved in arguments that inequality matters – that to function well an economy needs a way for people to get a foothold and progress, or else the whole enterprise folds in on itself as the social contract breaks (think Egypt and Tunisia) or for lack of demand and investment (think the Soviet Union). But between the extremes – between the gouge-the-rich-for-being-rich crowd and the every-nickel-I-earn-is-a-God-given-right set – the hunt for a consensus has proved so thorny that, in crafting a new set of development objectives to replace the Millenium Development Goals, a high-level panel decided to pretty much avoid the issue.

“There was no agreement on including a standalone goal on income inequality,” Rebecca Grynspan, associate administrator of the United Nations Development Program, said this week at a Center for Global Development seminar on the issue. “There’s a political economy problem.”

In other words, no consensus on how to measure inequality, or what to say about it once measured.

One might expect such a group to have a reasonable grip on how to deal with the issue. But it isn’t so easy.

The economist who pressed the World Bank two decades ago to set a global line for extreme poverty – the $1.25 a day figure that now serves as the benchmark deprivation – isn’t sure measurements of inequality should even be included in the discussion.

Too much concentration of wealth and earnings may be a bad thing, said Georgetown University professor Martin Ravallion.

But “low inequality can also slow development” said Ravallion. One can imagine a country that is uniformly poor – it’s “equal” but not in good shape – or one where policies tax and redistribute in such a heavy-handed way it messes up the incentives to work, save and invest.

“Unless you get a clear mind about it, people race off. I think inequality is too high in many place. That is an opinion. People don’t know. I would not want such an argument to hijack focusing on poverty and human development. That is the primary objective.”

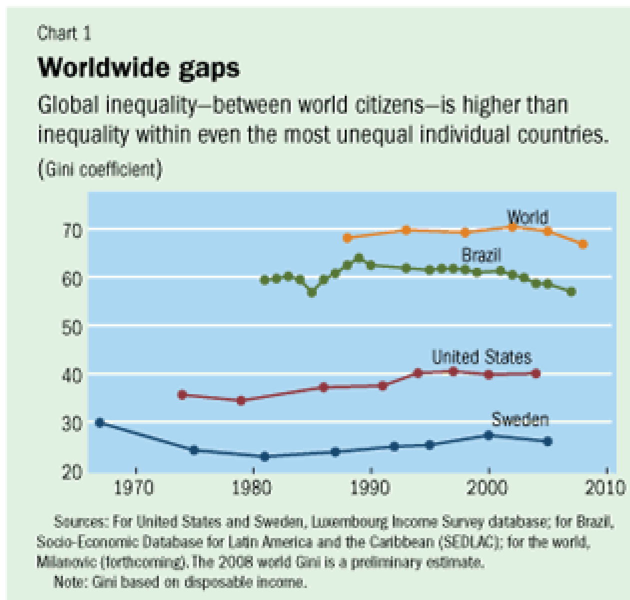
Rising inequality in China, for example, is cited as an emerging stress in that society. But does it matter if the forces behind it are also lifting tens of millions out of poverty?

The World Bank wants its work to increase the incomes for the bottom 40 percent of wage earners in all countries – a goal that seems to speak to questions of inequality and inclusion.

But incomes for the bottom 40 percent could increase while those at the top end grow faster. Does it matter? Is the bottom 40 percent even an adequate cut off, since those in the fiftieth or sixtieth percentile may be pretty badly off as well in some countries?

Then there's the issue of measurement and, ultimately, policy. Some skewed income distributions look less so once the effect of taxes and social programs are taken into account. Others, it turns out, look worse. Tulane University Latin America expert Nora Lustig calculates that while Brazil's highly-touted transfer payments have helped grow the middle class, they are for some income groups almost completely wiped out by the country's high and highly regressive value added tax.

Globally, it is not even clear what direction inequality is heading. Within countries, it is generally getting worse, and there is a body of research suggesting that more equal distribution of income is associated with faster growth.



But take the world as a whole and one World Bank analysis suggested that the shift of manufacturing to the developing nations, the rise of China, and other factors were leavening incomes overall.

It is is an easy problem to get upset about, a harder one to resolve.