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# Why Equality? How Equality?: The Desirability of a Focus on Income Distribution

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Why Equality? How Equality?  
The Desirability of a Focus on Income Distribution

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Paper for a Conference in Honor of Azizur Rahman Khan  
*Reflections on Employment, Inequality and Poverty Reduction*  
26 September 2005, ILO, Geneva

**Abstract**

Much of the discussion of economic development in low and middle income countries and of poverty reduction has either ignored the issue of income distribution or has tended to view income distribution only in terms of its impact on economic growth. In this paper I argue that such an approach is misguided. I will explain, first, why I believe that it is desirable to give a great deal of attention to income distribution in the analysis of economic development and poverty reduction. My argument includes conceptual, political and practical elements. Second, I will suggest some of the ways in which economic programs might be structured when income distribution is a central consideration. My purpose in this latter section of the paper will simply be to illustrate what could be done, not to lay out any sort of general program for economic development and poverty reduction.

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During 1967, Aziz Khan and I shared an office at the Pakistan Institute of Development Economics at the Old Sind Assembly Building on Bunder Road in Karachi. Together we constructed input-output matrices and capital account matrices for the then two major regions of Pakistan, East and West. The construction of these sorts of data sets, however useful, leads one to focus on things rather than people. We spent a lot of time worrying about such matters as how to aggregate pucca and kutcha construction, how to treat gur and ghee production, and how inputs to grain production might change along with the introduction of the new seed varieties of the ‘green revolution.’ Although tedious, it was interesting work, and it taught me a great deal about the technical aspects of production. But it did not teach me much about people, about the conditions and needs of peasants and workers in East and West Pakistan, about the social relations that surrounded their work, or about the kinds of changes that might have improved their conditions.

In the middle of our input-output efforts, Aziz took a break for several days and focused his attention elsewhere. The result was his “What Has Been Happening to Real Wages in Pakistan?” (Khan, 1967) It was a very instructive paper, partly because, based on his usual meticulous examination of the data, Aziz had demonstrated (among other things) that during the decade from the early 1950s to the early 1960s real wages were stagnant or falling in both major regions of the country, in spite of the fact that, in those days, Pakistan was held out as a relative economic development success story. More important for me, however, the paper was a reminder of what economics is (or should be) all about – the well-being of most people, especially those at the bottom, in any society. It was something that one could easily forget, enmeshed as we were in our input-output efforts.

That 1967 paper was an early entry into the long list of research projects and publications that Aziz would undertake to examine – and, through examination, to try to improve – the “well-being of most people.” In the analyses of employment, inequality, and poverty in Bangladesh, China, and several other countries, Aziz and the people he

worked with were ahead of many economists in international institutions who have only recently begun to give attention to these issues instead of focusing simply on economic growth as the defining feature of economic development in low and middle income countries.

Today, however, “poverty reduction” in particular has become the watchword in development agencies, in international lending institutions, and among development economists generally. The focus on poverty reduction perhaps reached a high point with the publication in early 2005 of the Sachs Report, *Investing in Development: A Practical Plan to Achieve the Millennium Development Goals*. (UN Millennium Project, 2005)

Yet, much of the discussion of economic development in low and middle income countries and of poverty reduction has either ignored the issue of income distribution or has tended to view income distribution only in terms of its impact on economic growth. In the entire text of the Sachs Report, neither the term “income distribution” nor the term “distribution of income” appears, and nowhere in the Report’s “Ten Key Recommendations” is there any reference to inequality or equality, except for the inclusion of “gender equality” along with many other issues on which poverty reduction strategies should focus (e.g., rural productivity, health, education, etc.)<sup>1</sup>

In this paper I would like to do two things. First, I will explain why I believe that it is desirable to give a great deal of attention to income distribution in the analysis of economic development and poverty reduction. My argument includes conceptual, political and practical elements. Second, I will suggest some of the ways in which economic programs might be structured when income distribution is a central consideration. My purpose will simply be to illustrate what could be done, not to lay out any sort of general program for economic development and poverty reduction. At various points, I will note connections to Aziz’s writings.

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<sup>1</sup> There is in one place a use of the term “distribution of wealth,” but only in a box discussing the factors affecting “The Poverty-Conflict Nexus.” Neither the word “redistribution” nor the term “land reform” appears in the Report. As best I can tell, the closest that the Report comes to addressing the distributional issues comes in Chapter 6, “Key elements for rapid scale-up,” in a section on “Infrastructure,” where the following appears: “To prepare draft investment plans, many countries use population-to-facility ratios as guidelines for determining how many of a given facility they need to build for their population. This is a good start. But in the final strategy, countries will obviously need to conduct a more detailed analysis of where their facilities are located, and where and how many they need to build or rehabilitate. When building more facilities, countries also need to pay attention to equity of access. For example, many developing countries have first-rate hospitals and modern schools in their capital cities, but dilapidated facilities in their rural districts. *A much more equitable distribution of resources is vital to achieving the [Millennium] Goals.* Countries thus need to create investment plans that explicitly aim to increase the percentage of the population that has access to high quality facilities, such as the percentage of the rural population that with access to a functioning clinic within 10 kilometers.” [emphasis added] (pp. 105-106). This is a very limited substitute, to say the least, for addressing issues of income or wealth distribution.

## Why Equality?

There is no question about the desirability of programs that raise the absolute material well-being of the poor. Absolute poverty, however defined, is wide-spread in the world, and creating conditions that move people – or, better yet, conditions that allow them to move themselves – from less than one dollar a day or less than two dollars a day to some higher material level is extremely important. Yet the exclusive focus on absolute poverty, which omits direct and explicit consideration of the distribution of income, has problems.

*The first problem is conceptual. It is often misleading to conceive of poverty simply in absolute terms – in terms, for example, of living on less than one dollar a day or less than two dollars a day. We generally think of people in poverty as those who are deprived of their needs, and “needs” are largely a social construct.<sup>2</sup> They vary among societies and over time. As a society’s average income rises, needs rise as well – not simply in a psychological sense, though that is important, but also in a practical sense. For example, as income rises in society, jobs tend to move out of and away from the home, generating a need for transport facilities. As another and related example, economic growth is generally accompanied by rising participation of women in the paid labor force, generating needs for services (or home capital equipment) to replace the work traditionally done in the home by women in most societies.*

A society’s standard of needs, then, tends to rise as income rises, and it seems reasonable to understand the standard as somehow related to the mean. In this sense, how far one is (in terms of command over commodities) from the standard – that is, how much one’s needs are not being met – is determined by how far one is from the mean. The further people are below the mean, the greater their degree of poverty. This is what is meant by “relative poverty.” In general, the greater the degree of inequality in the distribution of income, the greater will be the degree of poverty in this relative sense. Also, it is of course quite possible that with economic growth everyone’s income may rise, but there may be no reduction in poverty defined in this way.<sup>3</sup> (One might alternatively think of the standard as being set by those at or near the top of the income distribution, rather than by those at the mean. Then the gap between the top and bottom becomes the measure of poverty.)<sup>4</sup>

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<sup>2</sup> To say that needs are largely a “social construct” is not to say that they have no relation to biological reality. Biological factors are certainly relevant. An analogy exists to gender and sex. Gender is a social construct but it certainly has a relationship to sex, a biological factor.

<sup>3</sup> At least one standard dictionary defines poverty in these social terms. The *Merriam-Webster Online Dictionary* provides the following: “Poverty: 1 a : the state of one who lacks a usual or socially acceptable amount of money or material possessions.” <http://www.m-w.com>.

<sup>4</sup> There are many problems with the concept of relative poverty or, more generally, relative well-being, associated with the frame of reference for determining “relative.” There is, in particular, the problem of what constitutes the society; people establish their standards differently in different regions of the same nation, and they establish their standards partly on the basis of the situation in other countries. Also, there is a time dimension. When economic growth takes place with an unchanging distribution of income, the relative poverty conception may lead us to see even those at the bottom as being better off because the

Lest I be accused, in spite of my comments above, of failing to recognize that for many people in the world absolute needs – in terms of basic biological needs – are not being met and that those needs are not a social construct, *my point is not that poverty is simply a relative phenomenon. My point is that it is not simply and always an absolute phenomenon.* The two concepts have different relevance in different circumstances. Where the distribution of income is dramatically unequal – in Brazil, South Africa, increasingly in China, and even in some very low-income countries – relative poverty is of considerable importance. In much of sub-Saharan Africa, where the level of income is extremely low, and falling in several countries, absolute poverty may be the defining issue – Niger leaps to mind in the middle of 2005. (However, the situation is never simple: Niger is among the countries with extremely unequal income distributions. The “share of the poorest quintile in national income or consumption” is only 2.6 percent in Niger, compared to 2.2 percent in Brazil, 3.8 percent in Guatemala, and 3.0 percent in Colombia. Several other very low-income countries in sub-Saharan Africa are similarly unequal.) (World Bank, 2004, pp. 254-55)

There is a large literature concerning the definition of poverty, not only dealing with the issue of whether it is best understood and measured as an absolute or relative phenomenon, but also whether it is a concept concerning commodities or capabilities and many other facets of the issue.<sup>5</sup> One of the things that is immediately clear in this literature is the apparent but unstated belief among most participants that a one-dimensional definition of poverty, or of economic well-being in general, is necessary. While one-dimensional definitions and one-dimensional measurements often have political appeal, they are probably seldom accurate ways to describe complex socio-economic phenomenon.

The definition of a social problem affects how we understand it and how we try to deal with it. Development programs based on a conception of poverty that is absolute and that tend to ignore the distribution of income will be constructed differently and their success will be measured differently than programs based on a more complex, multi-dimensional conception of poverty and development, one that takes account of relative as well as absolute poverty. Most important, the absolute conception can readily – though not automatically – become the rationale for programs that focus simply on growth.

*A second problem with ignoring income distribution in the formulation of development programs and in efforts to alleviate poverty is a problem of power.* The distribution of income (and wealth) is a central factor affecting social and political power,

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standard is in part determined by past experience – they are relatively better off than they were. These are real complications, but they do not undermine the concept itself. And they do not undermine the importance of taking current income distribution into account in telling the story of people’s well-being; they simply underscore the fact that current income distribution within a country is not the whole story.

<sup>5</sup> I find Sen (1984) a particularly clear statement of the issues. Sen’s essay is reprinted in Subramanian (1997), which contains several other useful relevant essays.

and power, in turn, is of overwhelming importance in affecting the nature of economic change.

Political philosophers have long emphasized the importance of a relatively equal distribution of income as a foundation for democracy.<sup>6</sup> It seems virtually uncontroversial to argue that, if income (and wealth) is very unequally distributed, it is unlikely that meaningful democracy – i.e., popular control of government and not just the forms of democracy – can be effective. Whether by using their money to influence directly political life, shape the institutions (e.g., the media and the school system) that generate popular ideology, or constrain popular decisions through the threat of disinvestment or capital flight, the wealthy in any society, even a formally democratic society, have a disproportionate amount of political power. (Wright, 2000)

Aside from the question of whether or not democracy is something to be valued in itself in the economic development process, a lack of meaningful democracy is likely to have detrimental impacts in terms of both absolute and relative poverty (and perhaps on economic growth).<sup>7</sup> People use political power to enhance their own economic positions, and the connection between economic inequality and political power becomes a circular, self-reinforcing relationship. A high degree of inequality means a relative lack of political power for the poor which means less likelihood of economic changes that will improve the conditions of the poor. The situation certainly falls under the heading of a ‘vicious cycle of poverty’ (and I shall return below to the possibilities for ways in which the circle might be broken).<sup>8</sup>

As a practical matter, if income distribution and the issues of political power associated with income distribution are ignored, proposals for improving the economic conditions of the poor are likely to be unrealistic. For example, the Sachs Report makes numerous proposals for expenditures to reduce poverty without much attention to how, aside from foreign development assistance, these expenditures would be financed. How will the wealthy, who have the resources and wield political power, be coerced or persuaded to pay for the changes? The lack of any mention of land reform in the Sachs Report is also worth noting, as it is hard to conceive of how, in many countries, progress in rural areas can take place within the confines of existing land tenure relationships. The problem is not simply economic – a problem of low productivity on large estates; it is

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<sup>6</sup> Reference needed here

<sup>7</sup> Certainly by some widely accepted definitions of economic development, democracy is a central part of the process. Also, democracy would seem an essential part of Sen’s development-as-freedom concept. (Sen, 1999). And, furthermore, in light of Sen’s argument that famines tend not to occur in democracies (Sen, 1981), democracy appears to be an important factor effecting an avoidance of the most absolute form of poverty.

<sup>8</sup> Conversely, it is generally recognized that programs of poverty reduction tend to be more effective when the poor are involved in their formulation and implementation; see, for example, Joshi and Moore (2002). The less the degree of inequality, the more likely that such “empowerment” will be meaningful.

also a question of power, as large landowners have no interest in paying for economic change and, at times, actively resist the social change that comes with economic change.<sup>9</sup>

*A third problem associated with focusing on absolute poverty and ignoring the distribution of income is that the distribution of income in itself has direct impacts on the material quality of people's lives. As Wright (2000, p. 145) has stated the point: "income inequality ... fractures community, generates envy and resentment, and makes social solidarity more precarious."*

The pernicious impacts of income inequality depend at least in part on the origins and degree of the inequality. If, for example, the inequality is largely based on race or ethnicity or gender, as is so often the case, then it will be generally perceived as unfair (at least by those on the bottom) and generate considerable resentment. Similarly, when inequalities are seen as arising from family privilege, they will tend to be viewed by many people as illegitimate and unfair. Income inequalities that are seen as arising from differences in skills or efforts are less likely to be viewed as illegitimate. Nonetheless, if inequality is large, it is likely to be viewed as unfair because few people would view legitimate bases of inequality (e.g., differences in effort) as generating large inequalities.

Illustrations of the social discontent that is generated by inequality are provided by recent experience in China, where along with the extremely rapid rate of economic growth has come a sharp rise of inequality. (Khan and Riskin, 2001) In November 2004, the international press reported a string of "incidents of violence." According to the *Christian Science Monitor* of November 22, for example: "At least eight major incidents of violence and rioting have erupted in recent weeks, against a backdrop of thousands of minor incidents in recent years....The Chinese magazine Outlook put the 2003 figure of local disturbances [at] about 58,000 involving an estimated 3 million persons." (Marquand, 2004) Such "incidents" have their particular catalysts, and basic causal factors surely include the political situation in China. Yet both the Chinese leaders and foreign commentators view the sharp inequalities, especially the rural-urban inequalities, as significant factors. As a March 2005 *New York Times* article described the situation: "Chinese leaders open their annual legislative session this weekend trying to resolve a vexing pair of problems: the economy is growing too fast, and most people feel left out of the boom. China's bubbly economy ... has produced a yawning wealth gap and fueled a surge of social unrest that top leaders worry could undermine Communist rule. Although the leadership has focused on social inequality and wealth distribution for over a year ... there have been several mass riots and thousands of small protests over land seizures, corruption and unpaid wages." (Kahn, 2005)<sup>10</sup>

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<sup>9</sup> As Dreze and Sen (1995, p. 107) note in their discussion of India: "In some cases, the rural elite has been known not only to be indifferent to the general promotion of local public services but even to *obstruct* their expansion to prevent the empowerment of disadvantaged groups." Also, Bowles (1978) has demonstrated a connection between the concentration of land holdings and low levels of education, explaining the association by the resistance of large land holders to the social change that would come with improvements in education; also, see Alesina and Rodrik (1994).

<sup>10</sup> Even more recently, on August 24, 2005, the *New York Times* reports: "[According to China's] public security minister ... [there] were 74,000 mass incidents, or demonstrations and riots, that occurred in 2004,



There is nothing especially unusual in China's experience with social conflict arising in a period of rapid growth when that growth is accompanied by high or increasing (or high and increasing) inequalities. Similar sorts of conflicts – all coming under the general rubric of 'riots' – have marked periods of rapid growth in situations as disparate as England in the late 18<sup>th</sup> century, Germany in the mid-19<sup>th</sup> century, and Brazil in the mid-20<sup>th</sup> century. (Ackerman, 1974).

In addition to the overt social protest involved in riots and other forms of mass action, expression of the fractured community, envy and resentment, and lack of social solidarity that is generated by inequality appears in the form of crime. It is especially relevant that the correlation, and apparent causal link, between inequality and violent crime seems to be particularly clear. (Demombynes and Ozler, 2002; Kelly, 2000; and Lederman et al, 2002) Likewise, there is substantial evidence – though also controversy over the issue – that inequality contributes to poor health, and one of hypothesis attributes this relationship in part to the social tensions (fractured community) that are generated by inequality. (references).<sup>11</sup>

The point here is not simply that riots, crime and ill-health are negative social outcomes, but that these outcomes are manifestations of the negative social consequences of inequality. In addition, there is reason to believe that these outcomes also undermine economic growth – an issue I will return to shortly.

*The final reason offered here for giving emphasis to income distribution in dealing with poverty and development concerns very practical matters.*<sup>12</sup> There are two related practical matters that deserve attention: the difficulty of dealing with absolute poverty without effecting a more equal distribution of income, and the possible positive contribution of relative equality in the distribution of income to economic growth.

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an increase from 58,000 the year before, and only 10,000 a decade ago.” The *Times* comments: “For reasons that range from rampant industrial pollution to widespread evictions and land seizures by corrupt local governments in cahoots with increasingly powerful property developers, ordinary Chinese seem to be saying they are fed up and won't take it any more.” And: “There re a great many socioeconomic factors to stimulate protest, such as the increasing gap between the rich and poor and many land and environmental factors,” said Wu Guoguang, a former government advisor and *People's Daily* editorialist who now teaches political science at the University of Victoria in Canada.”

<sup>11</sup> Of course absolute poverty is a very important cause of poor health. And this is a good point to reiterate that the argument here is not that relative poverty is more important than absolute poverty, but simply that both are important.

<sup>12</sup> There are other reasons that we might value relative equality in the distribution of income and wealth that lie beyond my scope in this essay. One of these is the absolute ethical argument that it is simply unfair or unjust for a society to tolerate large disparities of material well-being. Another is that there is a strong link between the existing distribution of income and wealth and equality of opportunity. While there is very wide acceptance of the desirability of equality of opportunity, it is often ignored that equality of opportunity depends in large part on the existence of relative equality in the distribution of income and wealth.

In his early study of the Bangladesh economy, Aziz Khan pointed out:

“In the context of the above [examination of absolute poverty in Bangladesh/East Pakistan over the preceding decades], it is no longer in doubt what the priorities of sensible planning must be. It no longer makes sense to talk merely in terms of rates of growth when so much depends on how the increment is distributed... Mere emphasis on the overall growth rate will not necessarily solve these problems [of starvation, inadequate housing and clothing, poor health and mass illiteracy]. In fact, the last two decades of development planning in the then Pakistan is an outstanding example of emphasizing the objective of overall growth.... In the name of promoting growth, income was redistributed in favour of the (West Pakistan) capitalists and traders through exchange rate policy and fiscal policy, through the distribution at nominal prices of the entitlement to scarce resources, through the suppression of working-class organization, and a host of other direct and indirect measures. As a result, there has been ‘impressive industrialization’ in West Pakistan. But income distribution became worse, aggravating many of the above problems... If the balance of political power at the central government had been different, Bangladesh could have had a share of such industrialization and growth while the problem of [absolute] poverty would have remained unsolved and just as pressing!” (Khan, 1972, pp. 27-28; also see Griffin and Khan, 1972)

More recently, in summarizing his analysis of a set of several UNDP and ILO/SIDA country studies, Aziz Khan has given emphasis to this same practical point:

“Rapid economic growth *and* the containment of the forces of inequality are essential for healthy and sustained [absolute] poverty reduction. Increased inequality can offset the benefits of even a rapid rate of growth as far as poverty reduction is concerned. Continued, or even improved, equality of income distribution is an uncertain guarantee against increased poverty when growth is weak and narrowly-based. Equality in this context means maintaining at least an unchanged share of incremental income for the poor, rather than holding down some overall indicator of income distribution. This kind of equality is best ensured by a rapid expansion in remunerative and productive employment.” [emphasis added] (Khan, 2005, p. 30)

And earlier in the same paper he illustrates the argument with the case of China:

“In the case of China, the sharp increase in inequality resulted in a fragile poverty outcome despite its historically unprecedented rate of growth: urban poverty during 1988-95 probably increased overall and in many regions poverty failed to register a decline. The powerful effect of distribution on poverty in China is also demonstrated by a subsequent

study which showed that the poverty reduction effect of a per cent increase in personal income sharply increased during 1995-2002 over what it was during 1988-95 because inequality stopped increasing during the second period as compared to the sharp increase in inequality in the first period.” (Khan, 2005, p. 9; also see Khan, 2004)

The argument that downward redistribution of income brings about the reduction of absolute poverty and therefore should be a guiding principle of economic development policy is generally countered with the claim that such downward redistribution will tend to reduce the rate of economic growth and thus, in fact, increase (or fail to reduce as rapidly as possible) absolute poverty. This claim held sway among economists across the political spectrum for most of the last two hundred years and thus became the ‘conventional wisdom,’ to use Galbraith’s sarcastic term. It was based largely on the belief that a more equal distribution of income would reduce savings (as the rich tend to save at a higher rate than the poor) and thereby reduce investment and growth. In recent years, the claim has also been buttressed by the allegation that inequality is needed to generate the incentives that lead to greater investments and greater work effort.

Like much other ‘conventional wisdom’ the growth-necessitates-inequality contention has been greatly weakened, if not entirely demolished, by the facts.<sup>13</sup> Various studies, first undertaken in the early 1990s, have demonstrated rather clearly the lack of a positive correlation between greater inequality and a higher rate of economic growth. Although these studies do not establish a clear link in the other direction – that is, they do not clearly establish a positive, causal connection between relative equality and more rapid economic growth – they do suggest that such a link may exist. (Alesina and Rodrik, 1994; Persson and Tabellini, 1994; other references)<sup>14</sup> At the very least, they establish that such a link can exist – that is, under appropriate conditions, which could include appropriate policies, a more equal distribution of income can raise the rate of economic growth.

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<sup>13</sup> In the context of the quotation above from his 1972 study of the Bangladesh economy, Aziz Khan provides a response to the growth-necessitates-inequality contention: “It was argued that the preoccupation with the problem of income distribution would slow down the rate of growth as it would call for distributing income away from the ‘saving class’, i.e., the capitalists, and in favour of the non-saving poorer classes. ... [But] the ‘saving classes’ do not seem to have saved at anything near the expected rate... Moreover, what appears to be ‘impressive industrialization’, giving the industrialists enormous control over resources, is on closer scrutiny of much lower value to the society when its contribution to real income is accounted for by evaluating all inputs and outputs in relation to true social scarcities rather than at distorted prices resulting from high and non-uniform effective protection. (Khan, 1972, pp. 27-28).

<sup>14</sup> The results of these studies have been challenged, for example, by ( ). However, what has not been challenged and what seems to me most important, as I note, is that the results of these studies allow one to reject the argument that an emphasis on a more equal distribution of income is *necessarily* in conflict with more rapid economic growth. This, in turn, opens the door to the questions: which policies are most consistent with both greater equality and more rapid growth? This is the question I will take up shortly. For my own and more thorough discussion of these issues, see MacEwan (1999, esp. ch. 3).

There are several reasons that greater equality in the distribution of income could contribute to a higher rate of economic growth. Both Alesina and Rodrik and Persson and Tabellini suggest that inequality has a negative impact on growth because it undermines social and political stability, and instability depresses savings and investment rates. Clearly riots, crime, poor health – the various factors referred to above that reflect fractured community – would not be auspicious bases for rapid economic expansion. Also, greater equality may have positive impacts on technological change (a la Habakkuk, 1962) and the structure of aggregate demand (Murphy et al, 1989). I have argued elsewhere (MacEwan, 1999, ch. 3) that in fact a more equal distribution of income can have positive incentive impacts, through an ‘efficiency wage’ type of effect, and can also raise labor productivity through reducing the conflict and resentment associated with great inequalities (the fairness issue).<sup>15</sup>

Experiences in East Asia suggest that relative equality in the distribution of income may also have positive impacts on the rate of economic growth through bringing about greater investment in social programs in general and schooling in particular. Birdsall et al (1995) emphasize ‘virtuous circles’ in the East Asian experiences, by which schooling contributed to both economic growth and greater income equality, and then growth and equality contributed to greater investment in schooling. To the extent that schooling is privately financed, inequality tends to reduce the overall level of educational attainment because the poor are unable to afford the expense – either the direct expense or the expense of income foregone or both. To the extent that schooling is publicly financed, inequality tends to reduce educational attainment because of reluctance on the part of those with money (and power) to pay for the schooling of ‘other people’s children.’<sup>16</sup> The causal nexus involving schooling (and other social programs), equality and economic growth is potentially of special importance because of the policy options it suggests.

## **How Equality?**

In the remainder of this paper, I will put forward some aspects of policy that would focus on the distribution of income as well as economic growth, and I will point

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<sup>15</sup> Furthermore, the argument on the other side, that greater inequality generates a higher rate of savings and investment, is much weaker than it might first appear. It depends, first of all, on a classical, supply-side notion of how investment is determined. If technological change – perhaps induced, as suggested above, by factors related to greater equality – generates investment opportunities, the rate of savings and investment may rise regardless of the distribution of income. In other words, savings and investment may be driven by the demand-side rather than the supply-side. Also, when a large amount of savings comes from government, corporations, and foreign sources, the distribution of personal income may play a small role in affecting the saving rate. Finally, there is some evidence that, when appropriate institutions are established, low income people may save at a relatively high rate. Although the achievements and potentials of micro-finance programs such as the Grameen Bank have often, in my opinion, been exaggerated, these programs nonetheless have established that, with appropriate policies, people with very low incomes will save at a reasonably high rate. Experience in Indonesia also offers some interesting examples; see Patten and Rosengard (1991).

<sup>16</sup> These arguments are set out more fully in MacEwan (1999, ch. 3).

out ways in which the policy framework presented here differs from that which is often presented for development and poverty reduction, as in the Sachs Report. I will make no effort to offer a complete program, but only to illustrate the implications of placing a greater emphasis on the distribution of income. The defining idea here is that because relative equality in the distribution of income is important along with economic growth, it is necessary to find policies that simultaneously support both goals. The premise of the discussion is that, contrary to the ‘conventional wisdom,’ growth with relative equality is clearly a possibility.

Two caveats are in order. First, as I have suggested above, economic policy is in large part a question of political power. Those who have high levels of income (and wealth) tend to have a disproportionate share of political power, and they are unlikely to willingly support programs that would lead to greater income equality. Therefore, any economic policy proposals directed towards greater equality should be seen as an effort to demonstrate what is technically possible even their adoption is politically unlikely. Nonetheless, I will suggest why some aspects of the policy framework I will offer may have political possibilities. Second, while I am critical of policy frameworks that do not emphasize income distribution issues, as in the Sachs Report, many of the particular proposals contained in such frameworks are very positive. My intention is to suggest the limits of the framework, not to denigrate the proposals.<sup>17</sup>

The policy areas I will discuss in order to illustrate the implications of a general program designed to attain economic development and reduce income inequality come under four headings: social programs, land reform, macroeconomic policy, and empowerment. There is little, if anything, that is original in these illustrations, but they may help define a framework that departs from much of the discussion of development and poverty reduction, a discussion that tends to ignore the distribution of income.

*1. The primary element of a general program to attain economic development and reduce income inequality would be heavy investment in social programs, schooling in particular.* An emphasis on schooling, health care, and other social programs (e.g., environmental preservation and repair) does not in itself distinguish the sort of policy advocated here; a wide range of development policies, at least in their articulation if not in their practice, advocate investment in social programs. Moreover, the provisos that within schooling principal attention should be given to primary education and that a similar structure should define health care investments are widely accepted. World Bank proposals have often espoused these goals, and the Sachs Report views “ensuring universal access to essential health services” and “ensuring universal primary education and expanded postprimary and higher education” as central parts of its overall proposal. (UN Millennium Project, 2005, ch. 5)

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<sup>17</sup> Moreover, even while I am critical of the framework of the Sachs Report, I view it as a substantial improvement over much analysis and policy on development and poverty reduction issues. It involves a departure from the “Washington Consensus” and, if its proposals were implemented, it would lead to some significant changes in the approaches of governments and international agencies to economic problems.

The problem is, however, that education, or schooling,<sup>18</sup> is not a single thing, not a one dimensional item of which a society has more or less. Different kinds of schools prepare people for work and life in different ways. In almost all societies, the schooling received by the wealthy is different from the schooling received by the poor, not simply in terms of good-versus-bad, but in terms of the type of behaviors and skills that the schools inculcate in their students. Because of such differences, schools can become mechanisms to preserve, if not increase, inequalities.<sup>19</sup> The clue that rising levels of schooling do not necessarily lead to improvements in the distribution of income lies in the facts that over the last several decades more schooling and more literacy has been virtually the world-wide norm, yet there has not been a corresponding reduction of income inequality.

To state the differences in an extreme manner: some schools prepare people to defer to authority, follow directions, come on time, and work hard for extrinsic rewards; other schools teach people to create, develop their ideas, solve problems, work in groups, and understand the nature of their tasks. Both types of schools can produce more productive workers, but they will produce very different types of workers. Most important, they contribute to economic growth in different ways, and the ways in which schooling is structured contribute to different degrees of equality in society. Simply put: if schools are to make their maximum contribution to equality then the schools themselves must be equal. Economic policies that simply provide “more schooling,” may contribute to economic growth, but they will not make the maximum contribution to both growth and equality.

Furthermore, “empowerment” of the poor (which I will take up shortly) is currently an element in many, if not most, poverty reduction programs, and schooling is usually seen as a mechanism to increase empowerment. Yet, while there is no doubt that literacy and numeracy are important foundations for empowerment, schooling can also be a mechanism of social control instead of empowerment (and it can also be contradictory, containing elements that empower and elements that control). If schooling is to empower the poor and through empowerment to contribute to equality, then both the content – the sorts of skills and behaviors transmitted to students – and the organization of schooling are important. In particular, it is desirable when greater equality is a goal of development policy that the people who are served by schooling and other social programs be involved in determining the direction and organization of those services. Schooling, primary

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<sup>18</sup> When economists say “education,” what they usually mean is “schooling.” After all, one way or another, with or without schools, people get educated. They obtain knowledge of the society and culture in which they live, and they obtain various skills. An illiterate peasant and a nuclear physicist are both educated, and each knows and understands things that are beyond the ken of the other. But the nuclear physicist is schooled, and the peasant is not. There is, it seems, something about the particular kind of education that takes place in schools that is especially important for economic progress. This schooling-education distinction strikes me as important, but it is not an issue I will pursue here.

<sup>19</sup> I am familiar only with U.S. studies that elaborate this sort difference and the inequalities developed in the school system. See, for example, Carnoy and Levin (1985, ch. 5) and Bowles (1972). While the experience of the United States may be of limited relevance to the situation in low and middle income countries, the general findings regarding the ways the structure of schooling can exacerbate inequalities does seem relevant.

health care, and many environmental programs offer substantial opportunities for the poor to be involved in establishing the nature of the programs that affect them, and, what's more, the poor are often the best informed about their particular needs in these areas. Simply "more schooling" is not a sufficiently defined policy.

*2. In many parts of the world, land reform deserves equal status with an emphasis on social programs as a foundation for policies that would further both growth and equality.* Land reform is important because it not only has the potential to raise the incomes of the poor and contribute to greater output per unit of land; also, by changing the distribution of productive wealth, it can contribute to an alteration of the distribution of social and political power.<sup>20</sup>

Land reform, however, is today seldom on the agenda in discussions of development policy. Instead, under the rubric of "rural development," programs such as that advocated in the Sachs Report put forward numerous new technologies as a means to improve conditions in rural areas. Perhaps the most heralded such technology has been the set of changes involved in the 'green revolution,' the introduction of new, more productive seed varieties and the application of other inputs (chemical fertilizers, etc.) that complement the new seeds. Most recently, genetic engineering has been introduced as a further step in the same process. The Sachs Report gives emphasis to these sorts of changes (though genetic engineering is not mentioned, perhaps to avoid the controversy), and goes further in calling for agricultural extension work (e.g., teaching small farmers new agricultural techniques) and offering some programs for landless laborers.

Any steps that raise agricultural productivity can have positive impacts, and both the introduction of new agricultural technologies and agricultural extension can be useful. However, although new agricultural technologies are theoretically neutral with regard to scale, they often tend to have significantly greater pay-offs for larger farmers because the larger farms have better access to credit, marketing facilities and water and a better basis on which to take the risk (or perceived risk) of new inputs. Thus the results of this type of rural development when it takes place within existing land tenure relationships can be the consolidation of larger land holdings, more landlessness, greater inequality in the countryside, and increased rural-to-urban migration.<sup>21</sup>

At the same time, changing land tenure relations through land reform is also likely to be insufficient in bringing about rural progress in terms of both output and income distribution. The sorts of agricultural extension services, especially access to credit and improved marketing facilities, advocated in the Sachs Report and other rural development proposals are a necessary component of an effective development policy. Also, effective change in the countryside would need other important components, including: the

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<sup>20</sup> Khan (1972), in discussing then possibilities for Bangladesh, explains how, even in a situation where land holdings are extremely small and large land owners are those with perhaps 30 acres of land, land reform can contribute to greater productivity as well as greater equality and poverty reduction.

<sup>21</sup> An excellent description of this whole process is provided by Edelman (1980). Also, see de Janvry (1981).

elimination of government interventions that create terms of trade unfavorable to agriculture, as advocated, for example, by Khan and Riskin (2001, ch. 7) in the case of China;<sup>22</sup> support for non-agricultural rural production; and support for various forms of rural cooperatives in which small producers can exercise more control over their activities (measures which can bring about greater empowerment – see below). Land reform provides the social context for a broad set of changes in rural areas, a context that is likely to make those changes have a greater impact on production and is virtually certain to lead towards greater equality.

*3. An effective set of development policies emphasizing income equality requires a progressive system of finance within the context of a macroeconomic policy that maintains stability.* Any economic development program must be financed. Whether the authorities give primary attention to industrialization, physical infrastructure, or social programs, the investment funds have to be provided. With regard to poverty reduction in particular, the Sachs Report (p. 62) acknowledges: “To achieve the Millennium Development Goals, *huge new investments* and, in many cases, better policies and institutions are needed to implement the practical measures we know to work.” [emphasis added] While the Report calls for an expanded role for international aid, it also recognizes that beyond aid a substantial increase of internally generated funds will be required to finance the “huge new investments.” Yet it offers only brief and vague generalizations on how these funds would be generated: “[The expansion of government spending needed to achieve the Millennium Goals] is achievable through using broad-based revenue sources, such as a value added tax, strengthening tax collection, and redirecting current spending.” And: “Households are expected to contribute financially within their means to sectors where the incentive effects of well designed user fees are compatible with the overall policy objectives of ensuring effective and equitable access to basic infrastructure and social services.” (pp. 245-46)<sup>23</sup>

In this arena of financing development programs, however, issues of redistribution necessarily come directly to the fore. Ignoring those issues will not eliminate them. There are only four sources of government finance – moving funds from other uses, higher user fees, deficit spending, and higher taxes. The opportunities for the first of these are quite limited, except in a few countries where military spending is especially large. Higher user fees may be appropriate in some circumstances, but there is no reason to think they would make a large contribution.

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<sup>22</sup> In part, the unfavorable terms of trade imposed on agriculture in many countries are part of a policy to limit industrial imports in order to promote national industry. As I have argued elsewhere (MacEwan, 1999, ch. 8), a country’s control of foreign trade is likely to be an important part of any comprehensive development policy, and it may be quite reasonable to favor national economic activity over imports. However, there are times when import limits may be applied to agricultural goods as well as industrial goods. Moreover, even when it is reasonable for a country to bear a high cost for the development of certain industries, there is no reason that this must cost must be disproportionately borne by agriculture.

<sup>23</sup> The Report adds the important proviso that all direct and indirect fees for primary education and basic health care should be discontinued.



Deficit spending cannot provide a significant and lasting basis for financing new programs without undermining stability. Although the extreme demands typical of International Monetary Fund policies have little legitimacy, when a high level of deficit spending is used on a continuing basis to finance development programs or deal with external shocks (as opposed to situations where deficit spending is employed as a traditional Keynesian counter-cyclical policy), it is likely to generate macroeconomic imbalances that both disrupt growth and harm the poor.<sup>24</sup> Moreover, as Khan and Muqtada (1997, p. 1) point out: “Unsustainable macroeconomic imbalances forced nations to a kind of stabilization which proved disastrous for the growth of output and employment.”<sup>25</sup> Also, it is useful to recognize that when authorities fail to confront issue of income distribution, deficit finance can appear as an attractive option, in spite of its long run consequences (or perhaps because those consequences are long run).

We are left with taxes. Higher tax rates have two problems. First, it is widely believed that raising taxes is in conflict with economic growth, especially in an era of international financial liberalization. Higher taxes, it is alleged will reduce the incentive to invest (because the return on investment will be lowered) and encourage capital flight. Second, higher taxes introduced as part of a development program emphasizing the reduction of income inequality would have to be progressive taxes; indeed, where the distribution of income is highly unequal, it is unlikely that significant revenue increases could be attained without raising taxes on the rich disproportionately. Yet a progressive tax system aggravates the investment incentive problem and raises problems of political practicality.

Although these problems are often exaggerated, they are real and need to be addressed. One part of dealing with these problems would be the introduction of capital controls to limit capital flight as taxes are raised. Also, the details of tax proposals have to be spelled out in some detail. For example, a value added tax as suggested in the Sachs Report might be desirable if it were structured with exemptions for food and, perhaps, other necessities, or if it were directly tied to compensatory measures for the poor.<sup>26</sup> Discussion of capital controls and the details of a tax system would require that conflicts over income distribution be immediately and explicitly addressed – and of

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<sup>24</sup> Various sets of evidence tend to support the position that, while limited deficit and moderate inflation – in the one to two digit range – are consistent with strong economic expansion, larger and persistent budgetary deficits contribute to an instability that harms growth. See, for example, Bruno and Easterly (1996) and Akerlof et al (1996).

<sup>25</sup> Elsewhere, Khan (1993) provides an analysis of the “stabilization which proved disastrous.” Focusing on the programs prescribed by the World Bank and IMF, he provides the following understated conclusions: “The claim that, on average, official adjustment programmes under the auspices of the World Bank and the IMF have performed well, not only by the conventional standards of promoting adjustment and preserving growth but also in terms of protecting the poor, is very hard to substantiate convincingly... It is hard to see how these programmes were systematically based on any meaningful application of the criterion of protecting the poor.” (p. 67)

<sup>26</sup> To work politically, the ties would have to be clear and direct. Simply to argue that the whole package of government programs would be progressive would not alleviate popular objection to a regressive tax.

course the issue of capital controls would raise conflicts with international agencies and, at least, the U.S. government. Yet it is difficult to imagine how an effective development program can be implemented unless these issues are addressed.<sup>27</sup>

4. *Empowerment of the poor is both a goal and a means in program of poverty reduction or in development policy directed toward greater income equality.* It is a goal because, if we accept that idea of “development as freedom” as at least a part of the reason why we seek economic change, it is necessary for people to have practical control over their political and economic lives (empowerment) as a foundation for freedom. It is a means for two reasons. First, there is the issue of power and what it gets used for. As noted above, people use their power to enhance their economic positions, and if the poor have very little power it is unlikely that they will be able to attain any sustained improvement of their position. Second, the knowledge about what the poor need generally resides with the poor. A failure, therefore, to involve the poor in solutions to the problem of poverty – i.e., a failure to empower the poor – is unlikely to be most effective, regardless of the efforts and motivation of the authorities.

Although empowerment can have real meaning, the concept has become somewhat of a cliché in discussions of economic development. Often empowerment of the poor means little more than providing more income and jobs or assuming an automatic connection between schooling and health care, on the one hand, and empowerment, on the other hand. The Sachs Report, for example, devotes a good deal of attention to empowerment. (Chapter 5 is entitled, “Public Investments to Empower Poor People,” and thus implicitly justifies many of its proposals on the basis that they would move societies towards the goal of empowering the poor). Yet, the Report’s keys to empowerment are investments that would improve the economic, educational, and health conditions of the poor, with virtually no attention to the process of change and how the process of change itself would affect empowerment. That is, there is no attention – beyond statements of the desirability of “good governance” – to the mechanisms and institutions that could involve the poor in decisions regarding these changes and that might provide a basis for continuing maintenance and improvement of their conditions.<sup>28</sup>

The Sachs Report’s keys to empowerment – income, jobs, health care, schooling – are desirable in themselves and can contribute to empowerment. But there is much more than needs to be done; mechanisms and institutions of empowerment need to be

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<sup>27</sup> Interestingly, at least on one point, the Sachs Report does come into conflict with the policies of international agencies and the U.S. government. In listing the six criteria that should be met by the public investment plans for a poverty reduction strategy, the Report includes laying “the ground for private sector-led economic growth, with particular support to the *indigenous* private sector.” [emphasis added]. (p. 65)

<sup>28</sup> The Report does devote a great deal of attention to gender equality and the empowerment of women. This strikes me as very positive and important, though here too the issue is viewed almost entirely in narrow economic terms with virtually no attention to institutions or mechanisms of involvement. Also, as important as it is to empower women, it is not the same as empowering the poor. In much of the current literature on development economics, it seems, gender issues are more readily addressed than are class issues.

established as part of a poverty reduction and development program. The process of change itself, the degree to which the poor are involved, also needs attention.

Schooling and other social programs such as health care and environmental preservation and protection offer special opportunities for involvement of the poor in reducing poverty, as I have suggested above. I have made the general argument elsewhere (MacEwan, 1999; p. 176) in the following terms:

“...social programmes, financed and organized in the public sphere, offer the opportunity for *direct* popular participation – direct democracy – in their implementation. One of the central problems of democracy in any large, complex society is that the great majority of the population has no (or very limited) direct political role in the operation of economic activity. The majority can (within constitutional limits) set government policy regulating private economic activity, but efforts to expand that role always run the risk of alienating business interests and undermining investment and economic growth. Yet public programmes can involve direct participation, direct democracy, without any such threat (or only minimal and indirect threat) to business. So the larger the sphere of public programmes, the larger the opportunity for democratic participation in economic activity [i.e., the larger the opportunity for empowerment].”

This opportunity presented by social programs, however, would be realized only if it were supported as a central part of a development program. Schools, health care centers, and environmental projects can be designed and organized in various ways. If empowerment is the goal, then they are best organized along participatory lines.

Another opportunity for empowerment of the poor lies in the way agriculture is organized – in particular, in the extent to which farmer cooperatives of various sorts receive support. When small farmers are provided with technical assistance – the components of the rural development advanced by the Sachs Report – and even when they are the beneficiaries of a land reform, they still face numerous problems that are difficult, if not impossible, to solve individually. These problems include everything from access to markets and credit to management of water and the absorption of new technical knowledge. Cooperatives can create a potential for dealing with these sorts of problems, and, because they require group activity, they provide a basis for empowerment. They can become the sorts of civil society organization that are counterweights to both the market and the state. Their success, however, requires support in various forms – for example, in the ways credit is made available and in the ways marketing, water distribution, and the dissemination of knowledge are organized.

More generally, the issue of empowerment is one of group activity, the processes by which people in general and the poor in particular can enter into joint action to bring about changes in their conditions. Empowerment is not simply a matter of what is done but of how things are done. Because it is a question of social interaction, it cannot be accomplished on an individual basis.

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Perhaps the primary criticism that can be leveled against the Sachs Report is that it is unrealistic.<sup>29</sup> Viewing the problems of poverty in technical terms and seeking technical fixes, the Report offers proposals that, however desirable and reasonable in themselves, are unlikely to bring about “an end to poverty.” Failing to address the issue of income distribution and thus failing to focus on the social nature of poverty, the authors of the Sachs Report, like many others who offer programs for economic development and the reduction of poverty, are unable to offer a sufficient program.

It would be disingenuous, however, to suggest that the Sachs Report is unrealistic without addressing the realism – or lack of realism – of the proposals offered here. As I have acknowledged above, there is a vicious circle connecting economic inequality to a lack of political power for the poor to a continuation of economic inequality. I have no easy answers to the question of how to break this vicious circle – no new seed, of maize or knowledge that will solve the problem. I do, however, in conclusion have three comments to offer:

First, the problem of economic development and poverty reduction is in large part a political problem. One of the important functions of formulating economic proposals that would bring about progress is to demonstrate that the problems could be solved but for political barriers. Those political barriers are in significant part built upon a ‘conventional wisdom’ that claims that there are no practical economic solutions to these problems – for example, the ‘wisdom’ that income equality would harm savings or that land reform would undermine agricultural efficiency. Proposals that show how things could be done differently and that show the problem is not a lack of practical economic solutions are useful in reducing the political barriers to change.

Second, social programs do offer some promise of practical implementation; they offer a point at which it may be possible to break into the vicious circle. There is broad recognition that schooling, health care, environmental protection and preservation, and other sorts of social programs are necessary for social stability and economic growth. Thus, at least in a very general form, the implementation of such programs can gain support across social classes. Furthermore, when these programs are formulated as universal programs, programs that are not simply focused on the poor (even though the poor may reap the largest proportional benefit), they can also garner widespread support. Finally, there is a long history that establishes the legitimacy of the public provision of these sorts of programs, and this history provides a basis to withstand efforts (e.g., privatization) that push in the other direction. As I have emphasized above, the nature of social programs – their content and their form – makes a great deal of difference. But, if they can be expanded in some form, then there arises the possibility of shaping them in

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<sup>29</sup> Indeed, William Easterly (2005), reviewing Jeffrey Sachs’ (2005) book, which appeared at roughly the same time as the Report and contains much of the same analysis and many of the same proposals, describes it as “utopian dreams.”

ways that can bring about the most positive form of economic change. So social programs provide an opening.

Third, the problem of economic development and poverty reduction cannot be solved by ignoring the problem of income distribution. I have tried to argue in various ways – conceptual, political, and practical – that income distribution lies at the center of the development problem. If the proposals I have offered as illustrations – the “how” of bringing about greater equality – are impractical or insufficient, that does not mean that income distribution can be ignored. It simply means that other means must be found to address the issue.

It is here, in this last point, that I think that Aziz Khan has made some of his most important contributions. The theme that arises over and over in his work is that income distribution must be a central concern. Whether addressing poverty reduction, employment, or economic growth, he has always tied the issues together and linked them to the distribution of income. Others do well when they emulate his approach.

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