

How Much Should We Care About Changing Income Inequality in the Course of Economic Growth?

**Gary S. Fields
Cornell University
March, 2007**

Extended Abstract

In December, 2006, the new President of Chile, Michelle Bachelet, convened a workshop on economic inequality. Chile has achieved a 4.2% annual rate of economic growth over the last thirty years, an enviable record indeed for a Latin American country. In the course of this economic growth, indigence and poverty have been falling continuously. Yet, Chile has one of the most unequal distributions of income in Latin America, which is the highest inequality region in the world, and income inequality in Chile remains, in the President's words, "stubbornly stagnant." This fact motivated her to convene a workshop on the question of how much should we care about income inequality. This paper, based on the keynote speech I delivered at that workshop, attempts to answer this question, not just for Chile but for the developing countries more generally.

Inequality often rises with economic growth, but equally often it falls. When inequality is rising, it could be because the rich (or more precisely, the non-poor) are getting richer while the poor are getting poorer. But then again, it could be that the poor and the non-poor are both getting richer but the non-poor are getting richer at a faster rate than the poor are.

The fact that inequality and poverty could move in opposite directions – for example, inequality rising while poverty is falling – matters not only for analytical purposes but also for policy purposes. In the paper, I talk about two contexts in which it has been shown to make a difference. One of them was at a conference I attended in Mexico City, at which then-President Vicente Fox said in his opening address that the emphasis of his administration would be to "combat poverty." After the President left to attend to other matters, his Minister for Social Security addressed us, stating that the government's principal aim was to "combat poverty and inequality and redistribute." It is easy to think of policies that would combat poverty and yet raise inequality. It is also easy to think of redistributive policies that would combat inequality but

increase poverty. The same policies would not necessarily be chosen by the President and the Minister.

Many of us were left confused about what the government of Mexico was really trying to do.

Given that inequality and poverty can move in different directions and as an empirical matter often do, how much attention should be given to inequality change in the course of economic growth? My own views can be summed up as follows:

First, do not worry much about what Lorenz curves, Lorenz-consistent inequality measures, and most other standard inequality measures are telling us.

Second, worry some about what the ratio of high incomes to low incomes is telling us.

Third, worry more about the inequality between salient groups.

Fourth, worry even more about inequality of opportunity, especially by socioeconomic origin.

And fifth, worry the most about poverty.

Specifically, from a policy point of view, I would urge governments to declare poverty, not inequality, to be the principal concern, precisely as President Fox did. I would want priority to be given to policies to reduce poverty by focusing economic growth and other efforts on the lower tail of the income distribution. I would also stress policies aimed at improving equality of opportunity. Such a program might involve: a) Improving the ability of the poor to earn their way out of poverty, be it in wage employment or in self-employment; b) Upgrading workers' productive skills and abilities; c) Strengthening social protection for the very poor; and d) Offering improved opportunities to the lower classes.

Such choices are consequential. The fate of hundreds of millions of economically miserable people in the world lies in the balance.