EVIDENCE-INSIGHTS-POLICY

INEQUALITY IS BAD FOR GROWTH OF THE POOR

(BUT NOT FOR THAT OF THE RICH)

CONTEXT

The link between inequality and growth is one of the oldest issues in economics. Inequality measures summarize how incomes are distributed across the population at any given point in time. Existing literature examines only the effect of inequality on growth of the average income, not the effect on growth rates at various parts of the distribution. This seems paradoxical. Van der Weide and Molanovic (2014), therefore, unpack growth impact and verify whether the income growth of the poor and the rich are affected differently by inequality.

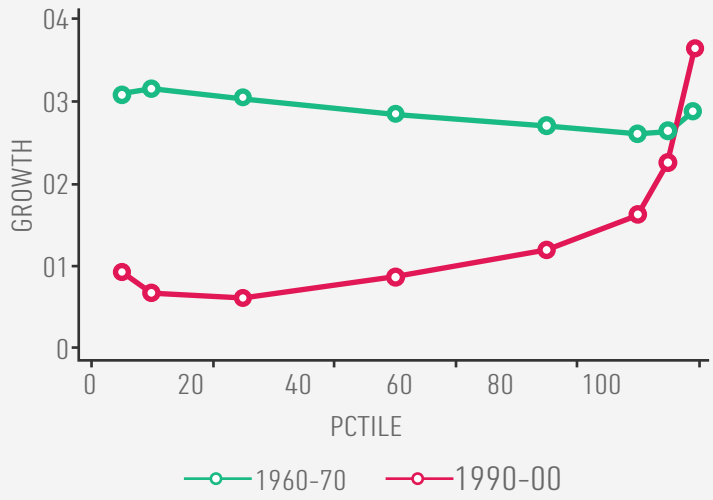
DATA

The analysis uses US micro-censuses that sample 1% (and more recently, 5%) of households in each state, conducted every ten years from 1960 to 2010.

FINDINGS

- US per capita growth rate decelerated significantly, and growth shifted from being pro-poor (with growth rates higher among the poor than among the rich) to being pro-rich (the reverse). Growth rates from 1960-1970 were higher than those in the period 1990-2000 for all percentiles of income distribution except the very rich, the top 1% (Figure 1).

Figure 1. US: The average population-weighted state-level growth rates of real income at different points of the income distribution (decennial averages)



- High levels of inequality reduce the income growth of the poor but help the growth of the rich. If a state's level of inequality were reduced by a one-standard-deviation, keeping everything else equal, the annual growth rate of the very poor (bottom 10 %) would increase by 0.9 percentage point. Since their average growth over the 50-year period was about 0.8%, such a reduction in inequality would more than double their growth rate. At the other end of the spectrum, the same decrease in inequality would reduce the growth rate of the rich (the top 1%) by 0.7 percentage point. The rich's average growth rate over the past half-century was 1.8%, so their growth would be cut by more than one third.

MEDIA COVERAGE

This study received considerable attention in the media; Washington Post ("The poor used to have the most opportunity in America. Now the rich do." on December 4, 2014); New York Times ("Is it bad enough yet?" on December 13, 2014); Forbes ("Inequality grows the incomes of the rich but not the incomes of the poor" on November 30, 2014); Twice in the Huffington Post ("What would the last 50 years look like without rapidly growing inequality" on October 10, 2014; "Democrats help the middle class – Why can't they win elections?", February 24, 2015); Three times in the Salon ("Income inequality's sick joke: A rising tide only lifts luxury yachts" on October 4, 2014; "Dems' scary electoral future: Why the progressive sales pitch is getting harder" on February 16, 2015; "Jesus would hate you all – and you didn't build that: The truth about the ultra-rich and their New York Times apologists" on March 26, 2015); And various smaller newspapers, the Seattle PI ("The superrich have hijacked our democracy" on December 14, 2014), the Nigerian Guardian ("How not to manage the economy" on January 6, 2015).

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