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JOSE FAJGENBAUM
AND IEVA VILKELYTE

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Chapter 7

Two Faces of Development—Rising Incomes Combined with Increasing Inequities and Policies to Address the Latter

Jose Fajgenbaum and Ieva Vilkelyte

'No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable.'
—Adam Smith

Introduction

Since WWII, the world has experienced unparalleled economic prosperity, as evidenced by economic, social and political indicators. Since the 1980s, the faster growth rates of Emerging Market and Developing Economies (EMDEs) than those of Advanced Economies (AEs) contributed to this prosperity and resulted in a narrowing of the income per capita gap across countries. At the same time, income inequality within countries has risen significantly in AEs and many EMDEs, reflecting both a decline in the income share of the lowest 40 per cent of households and a large increase in the income share of the richest households. This increase in inequality reflects a new wave of major technological changes that started in the early 1980s, such as the technological and digital/communication revolution and the financial services reform. These technological changes benefitted the skilled and the risk-takers, while leaving behind large swathes of the population. Other developments such as globalization, reductions in safety nets and declines in income tax progressivity contributed to the increases in inequality.

The unprecedented and synchronized shock of the COVID-19 pandemic accentuated inequality within countries and reversed progress in reducing inequality between countries, as shown by the latest IMF WEO. Moreover, the AEs are recovering to pre-pandemic output levels rather quickly while most EMDEs (except China) are taking longer to recover to those levels. Using the baseline scenario of the Centennial Growth Model (CGM), the third section shows that the income gap between countries will come down as EMDEs, as a group, start to grow again faster than the AEs. It also shows the increase in the number of poor caused by the pandemic and estimates of how long it will take to eliminate such an increase, by income group and region.

With the above as background, and in response to the question why inequality and especially growing inequality should be a concern for policymakers, the fourth section briefly reviews the literature, which points to the adverse effects of inequality on, inter alia, economic growth, social fabric including wide dissatisfaction and crime and political stability.

The fifth section discusses policies that could help reduce inequality and build an inclusive society, recognizing that equity issues are complex and intertwined with social values and moral views of fairness and social justice, and suggesting that individual countries (or regions) may have different perceptions of what is equitable. The goal is that policies go beyond just supplementing people's income through government transfers, they should seek to increase access to opportunities and thereby equalize income or vice versa. The menu of possible policies goes from improving the quality and access to education and health, starting at an early age, to removing gender discrimination in education and labour markets, to the provision of targeted but conditional transfers (like Bolsa Familia in Brazil). To help finance some of these policies there is a need to enhance the efficiency of government spending and to increase revenue to ensure fiscal sustainability. The section ends with a brief discussion on the roles of the private sector and the international community, and the sixth section concludes the discussion.

Developments and Trends Pre-COVID-19 Pandemic

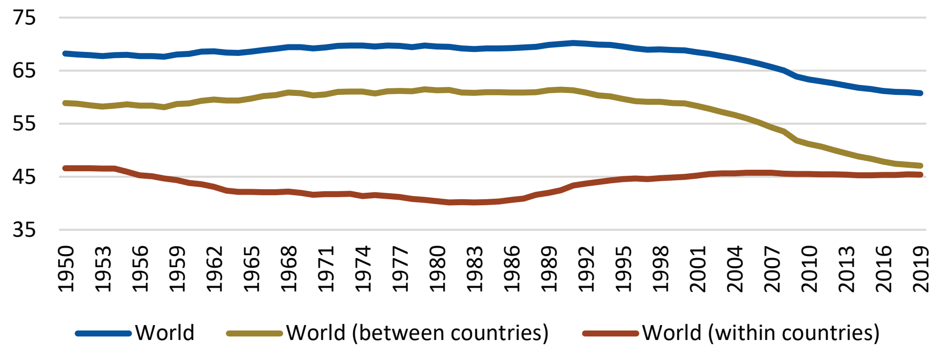
Global Inequality Trends

Multiple methodologies exist for measuring global and national income inequality, ranging from the GINI coefficient, a number between 0 and 1 (or 0 and 100 per cent) with zero representing perfect equality and 1 (or 100 per cent) indicating complete inequality, to comparisons of incomes shares of the top 1 or 10 per cent income earners versus the income earners at the bottom 10 or 50 per cent. This chapter primarily focuses on the GINI coefficient, utilizing data obtained from the World Income Inequality Database as it provides a comprehensive dataset covering 1950–2019.[1]

Inter-country Inequality

Using the GINI index as a key measure of income inequality, global overall inequality was relatively stable with very few fluctuations through most of the second half of the twentieth century and only began declining in the 1990s and has lasted through the first two decades of this century (Figure 7.1). This decline reflects a considerable drop in the disparity in per capita incomes

Figure 7.1: World GINI



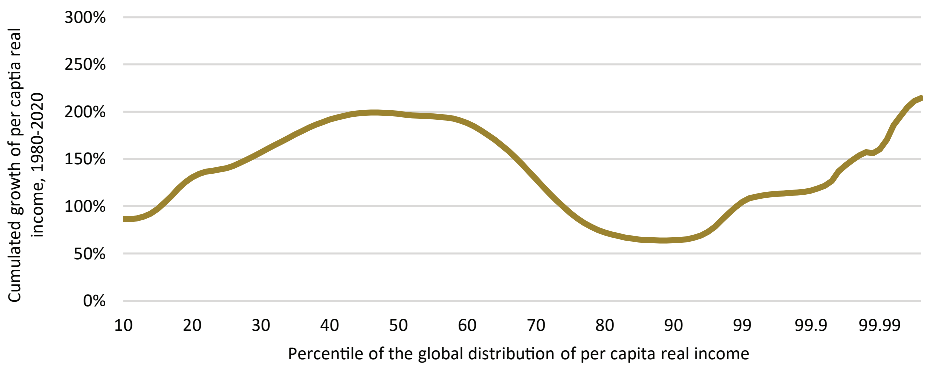
Source: UNU-WIDER 2021

1. Other sources include the World Bank's GINI Index, which utilizes PovcalNet data based on primary household survey data, and the World Income Inequality Database which utilizes a compilation of source data including the Luxembourg Income Study Database (LIS) as its main source, some regional sources (ECLAC and SEDLAC for Latin America and Eurostat for the EU), national sources and PovcalNet.

between AE and EMDEs that more than offset the growing trend in inequality within countries. Over most of these decades, EMDEs saw significant increases in their per capita incomes, with China and India having a particularly large impact. The beginning of a convergence of EMDEs per capita incomes with those of AEs has been key in the decline of the world GINI.

The high growth rates of EMDEs over the last several decades are reflected in the breakdown of world per capita income growth from 1980 to 2020 by income per centile group —the 'elephant chart'.[2] Globally, the bottom 50 per cent (mostly comprising the populations of EMDEs) had some of the highest rates of income growth during this period (Figure 7.2), translating into the large decline in inter-country inequality.

Figure 7.2: Total income growth by percentile, world, 1980-2020



Source: World Inequality Report 2022

Within-country Inequality

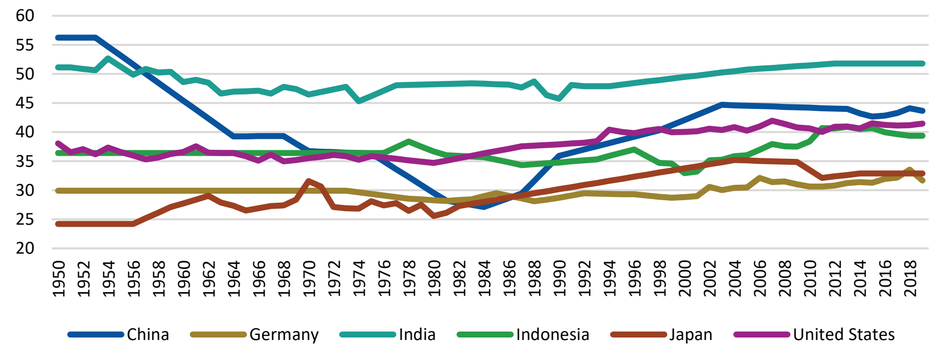
In contrast to inter-country inequality, within-country income inequality, the inequality most people perceive, has been on an upward trajectory since the mid-1980s (Figure 7.1). This has occurred both in EMDEs and AEs. Notably, some of the largest economies, such as India, China, and the United States, have faced and continue to face increasing inequality (Figure 7.3). In addition, 'there is a growing gap between low- and middle-income households, which is particularly pronounced in Finland, Israel, Sweden, Spain and the US'.[3]

The fast-rising incomes of the top income groups have contributed to this trend in both AEs and EMDEs. The share of income of the top 10 per cent of earners has dramatically increased in several large AEs and EMDEs (including China, Germany, India, Indonesia, Japan, and the United States) (Figure 7.4). For example, the top 10 per cent of earners receive 45 per cent of national income in the United States and nearly 60 per cent in India, compared to 35 and 32 per cent, respectively, in 1980. This trend is also reflected by the top 1 per cent of earners.[4]

2. The 'elephant chart' was first published in 2013 (Lakner and Milanovic 2013) and has been since updated by multiple sources.
3. https://www.oecd.org/economy/growth-and-inequality-close-relationship.htm
4. Although, this chapter focuses on income inequality, it should be noted that these trends are also seen in wealth concentration, the share of wealth controlled by the top 1 and top 10 per cent of wealth holders has increased since the mid-1990s. In China, India, and the United States the wealthiest 10 per cent now hold 68, 65 and 71 per cent of wealth compared to 40, 55,and 65, respectively, in 1995 (WID 2021).

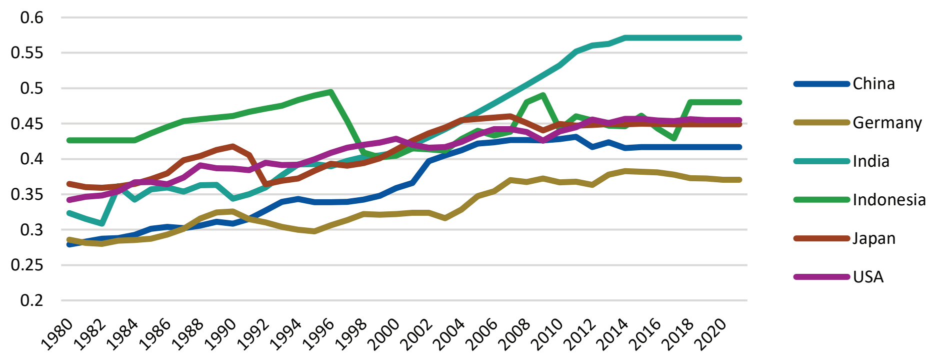
The global elephant chart (Figure 7.2) indicates that this trend is worldwide: the top 1 per cent of earners have had the highest growth rate during the past four decades and have captured almost 2.5 times as much growth as the bottom 50 per cent and have had significantly higher growth rates than the middle class of AEs, corresponding to those in the seventy-fifth to the ninety-ninth percentile, which fared the worst in terms of income growth (WID 2021).

Figure 7.3: GINI—Select countries



Source: UNU-WIDER 2021

Figure 7.4: Share of income earned by top 10 per cent of earners



Source: World Inequality Database 2021

Income inequality impacts many economic and social trends, such as social mobility, education, and life expectancy. For example, countries with higher income inequality also tend to have lower intergenerational economic mobility, indicating that there is a lack of equality of opportunity in countries with high inequality (Corak 2012). Additionally, higher inequality rates are also tied to larger gaps in educational levels and shorter life expectancies for different income groups.

There is not one explanation for why inequality within countries has increased since the mid-1980s, but there are several interconnected factors that have contributed to the increase:

- Technological change, which has negatively impacted low-skill workers and at the same time increased the demand for high-skill workers and, therefore, higher earnings;
- Financial sector reforms that involved a major transformation of the sector a shift to highly skilled workers;
- Decreasing the share of labour in GDP (Autor et al. 2017) as wages have not kept up with GDP, including because of a decline in unionization—and the increase of firms with large market shares;
- Low taxation of multinational corporations (Tørsløv 2018);
- Fiscal policies became less progressive, including reductions in income tax progressivity and in safety nets;
- International competition due to globalization has kept wages of the low-skilled, low.

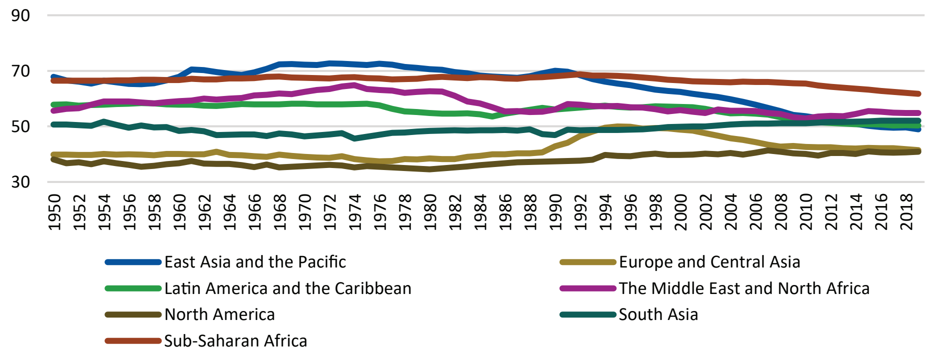
Regional Trends

Regional inequality trends followed the global pattern of staying relatively stable from post-WWII to the mid-1980s to early-1990s (Figure 7.5), after which they diverged.[5] East Asia and the Pacific experienced a significant decline, of nearly 30 per cent, in inequality over the last three decades. This can be largely attributed to declines in several populous countries in the region. Unlike the region as a whole, China has recently experienced an increase in inequality. While inequality had significantly declined in China from 1950 to the mid-1980s, these gains have been partially reduced in the past thirty-five years. The reduction has been attributed to 'widening of the rural–urban income gap, and the increase in income from property and assets, driven by the development of urban residential real-estate markets, the expansion of stock and capital markets, the growth of private enterprises, and other property rights' (Alvaredo and Gasparini 2015). Inequality in Latin America started a declining trend in the late 1990s with several reasons theorized as the cause, such as 'improved macroeconomic conditions that fostered employment, the petering out of the unequalizing effects of the reforms in the 1990s, the expansion of coverage in basic education, stronger labour institutions, the recovery of some countries from severe unequalizing crises, and a more progressive allocation of government spending, in particular monetary transfers' (Alvaredo and Gasparini 2015). The commodity boom during the 2000s to mid-2010s also played a key role, expanding labour and wages, and positively affecting other sectors of the economies (IMF 2018).

While having some of the highest inequality rates in the world, Sub-Saharan Africa has recorded a gradual decline in inequality since the 1980s, owing to improved macroeconomic performance and reforms, the impact of debt reductions under the HIPC and MDRI initiatives and the commodity boom mentioned above (Alvaredo and Gasparini 2015). South Asia has had lower income inequality compared to other developing regions; however, inequality has begun to gradually rise since the 1970s with various causes cited, including strong growth owing to structural reforms. The growing wage divide between rural-urban regions, industry-agriculture sectors, and low-skill and high-skill workers has contributed to increasing inequality in South Asia (Alvaredo and Gasparini 2015). Another important contributing factor is the educational attainment gap, which government policies have not sufficiently addressed.

5. Except for the Middle East and North Africa region, where inequality increased from 1950 through 1970, declined for the following two decades, and then was relatively stable.

Figure 7.5: Regional GINI



Source: UNU-WIDER 2021

The large increase in world inequality within countries in the early 1990s can partly be explained by the effect of the dissolution of the Soviet Union. Former Soviet States, particularly Russia and Ukraine, experienced significant increases in inequality in the early 1990s, which translated into the bump in Europe and Central Asia's GINI coefficient (Figure 7.5). This is also confirmed by PovcalNet data which indicates that the mean GINI 'grew from 26.4 in 1990 to 31.9 in 1996' and this increase was attributed to the 'process of privatization, which implied an increase in earnings dispersion in comparison to the more compressed wage structure of the state-owned firms' (Alvaredo and Gasparini 2015).

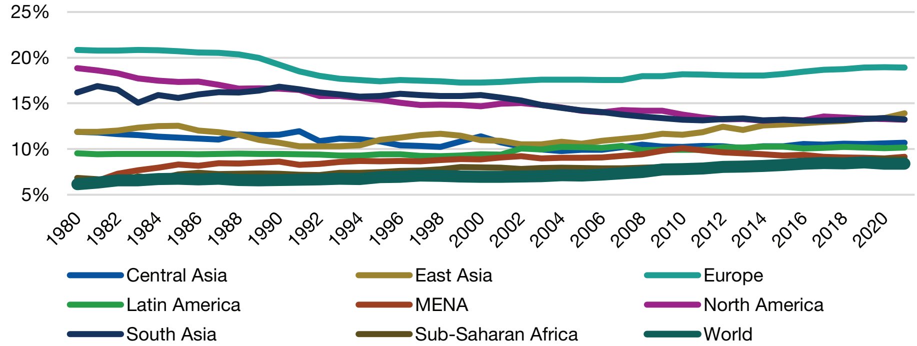
The sustained increase in global within-country inequality can also be attributed to the increase in inequality in AEs, particularly in North America and Europe. For example, 'all of the 9 advanced economies that are members of the G20 saw the GINI coefficient of disposable income rise between the early- to mid-1980s and 2013' (Dervis and Qureshi 2017). Several causes of this include 'globalization, technological change favouring higher-level skills and capital, structural changes in labour markets, the rising importance of finance, the emergence of winner-take-all markets, and policy changes such as shifts toward less progressive fiscal regimes' (Qureshi 2017).

Varying Methodologies, Similar Trends

Irrespective of the varying methodologies and data sources to measure inequality, they lead to similar conclusions and results regarding inequality—historical trends and its current state. Income share trends display similar trends to the GINI coefficient. For example, the income share of the global bottom 50 per cent has slightly increased since 1980 (Figure 7.6). Similarly, according to this indicator, Europe and North America have been the most equal (the bottom 50 per cent having the largest share of income compared to other regions) and Sub-Saharan Africa one of the most unequal.

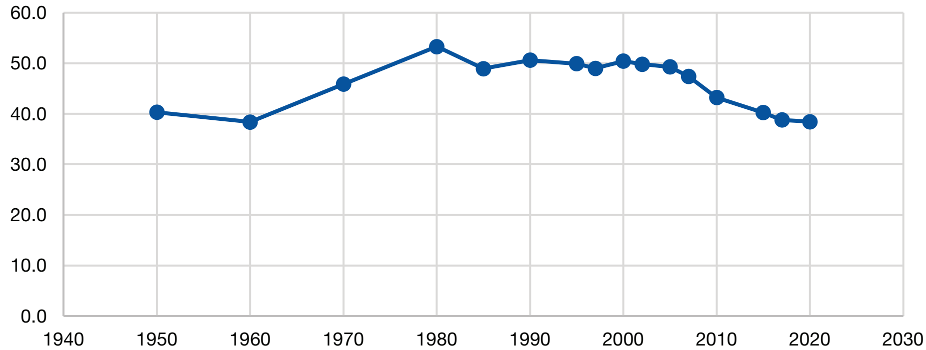
Additionally, comparing the average income of the 10 per cent to that of the bottom 50 per cent shows globally that inequality has declined over the past two decades, similar to the decline seen in the global inter-country GINI index over the last three decades (Figure 7.7).

Figure 7.6: Income share of bottom 50 per cent



Source: World Inequality Database 2021

Figure 7.7: T10/B50 ratio between the global average income of the top 10 per cent and the average income of the bottom 50 per cent



Source: World Inequality Report 2022

The Impact of the COVID-19 Pandemic on Inequality

The common perception is that the deep and synchronized shock of the COVID-19 pandemic accentuated global inequality because of its asymmetrical impact across and within countries.

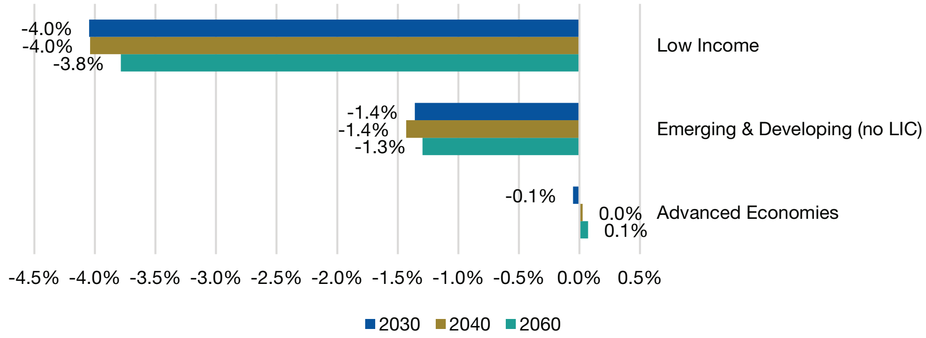
The Pandemic and Inequality Across Countries

The IMF WEO (October 2021) shows that the COVID-19 pandemic has widened the income gap between AEs and the lower income countries, and that the gap would be larger than pre-pandemic times for a number of years, reversing temporarily the convergence trend of recent decades. The IMF WEO estimates that the output loss during 2020–22, compared with pre-COVID-19 projections, would be some 3.1 per cent for AEs, 3.9 per cent for EMDEs, and 6.0 per cent for low-income countries. To an extent, the varying output losses reflect the EMDEs' (and particularly the low-income countries) more limited space to mitigate the impact of the pandemic through fiscal[6] and credit policies than the AEs have had, and their more limited capacity to mobilize resources to stimulate the economic recovery. As a result, the recovery paths of these groups of countries will vary, with the former group taking longer than the latter.

To illustrate the significant longer-term differences in per capita GDP losses relative to the pre-pandemic baseline by income groups and by regions, the Centennial Growth Model (CGM) is used. Of course, the scenario is tentative at best, given the greatly uncertain path of the pandemic and its effects.

Even by 2030 the low-income countries will have lost 4.0 per cent of per capita GDP, nearly three times the loss of the EMDEs (excluding the low-income countries) and significantly higher than the loss of AEs (Figure 7.8). Figure 7.2, in turn, shows that by 2030 the loss in income per capita in Latin America and the Caribbean, the Middle East and Northern Africa, Europe and North America will be the lowest (less than 1 per cent) followed by the other regions (1–2 per cent), except for Sub-Saharan Africa which is expected to lose as much as 7 per cent. Eventually, EMDEs are expected to resume their faster growth rates than AEs, thereby return to the convergence process that prevailed prior to the pandemic.

Figure 7.8: Change (per cent) in GDP per capita PPP by 2030, 2040 and 2060 due to COVID-19 by income group



Source: Centennial Group 2021

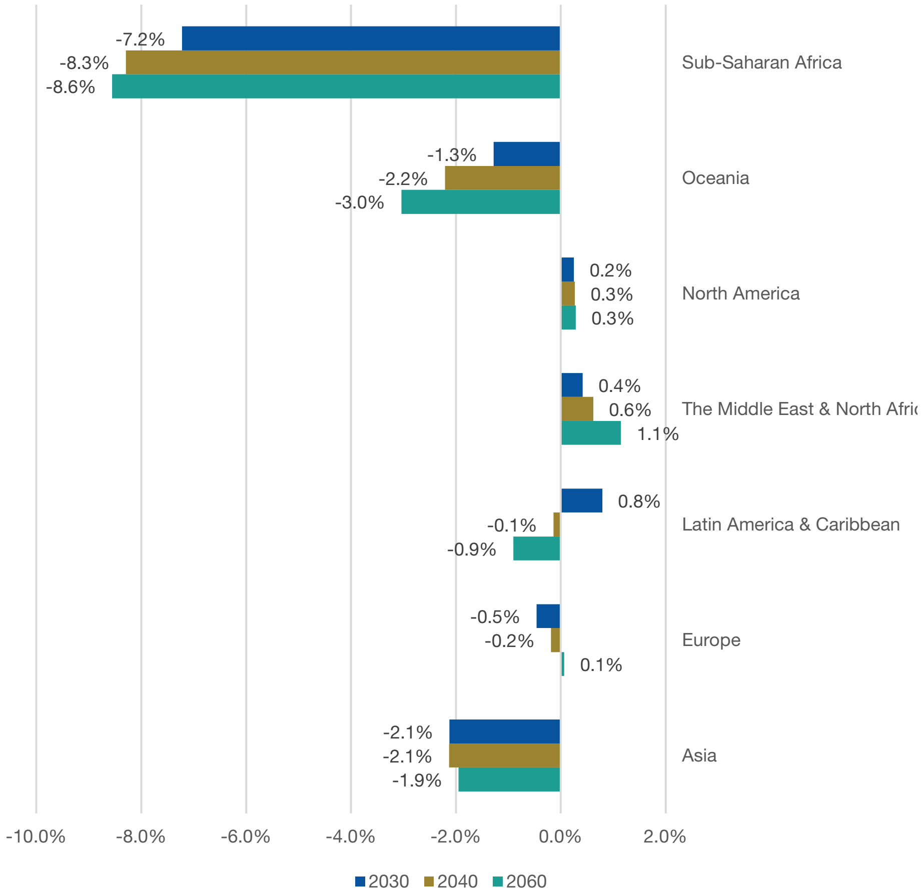
The Pandemic and Inequality within Countries

A recent IMF study estimated that the impact of COVID-19 on income shares by quintiles (without reflecting any distribution policies or other factors) raised the average GINI coefficient of EMDEs by 2.6 per centage points to 42.7, broadly comparable to the level in 2018 (IMF 2020).

However, despite the absence of actual data such as GINI coefficients to assess the impact of the pandemic on income inequality within countries, there is a general perception that because of the COVID-19 pandemic most countries have seen a worsening of inequality,

6. The mitigation efforts, the decline in activity, and the already high public debt burden pre-pandemic are expected to cause EMDEs' public debt to rise to an all-time high of 65 per cent of GDP at end-2021. A large number of low-income countries is facing high risks of debt distress or is already in debt distress. This severe debt burden has the potential of further slowing these countries' recovery.

Figure 7.9: Change (per cent) in GDP per capita PPP by 2030, 2040 and 2060 due to COVID-19 by region



Source: Centennial Group 2021

halting or reversing the improvements achieved by EMDEs during recent decades. This perception reflects the considerable appreciations that benefitted holders of financial assets and real estate (partly owing to very low interest rates), and the differing impacts the cycles of lockdowns and containment measures have had on various income groups. For example, these measures have had limited adverse effects on the incomes of workers with skills and able to perform their jobs from home (activities that saw small rises in unemployment), while the majority of those that have not been able to work at home lost their jobs and livelihoods mostly because they are low-skilled or work in contact intensive activities (informal sectors, tourism and other services). Moreover, these measures have had considerable adverse effects on micro, small and medium sized enterprises, and on women and youth (a large number of them become unemployed or underemployed).

School closures have had a major negative impact on the build-up of human capital of the many students who have limited or no access to online education. The UNICEF estimated that 'school closures affected 253 million students, potential causing losses in learning' (UNICEF 2020) and human capital, hampering income earnings in the future. A recent study shows that online learning has caused a drop in academic performance and exacerbated the equity gap (Meckler and Natanson 2020). Keeping children out of school has pernicious effects—academically, socially, and mentally—with potentially lasting consequences. Anecdotal evidence from Zambia in 2020 suggests that being out of school six months raises the risk of students not returning to school, teen pregnancy, child marriage, and child labour, particularly for children from poor households or households economically impacted by COVID-19. Keeping children out of school has caused mothers to quit their jobs in the absence of childcare; in addition, with schools closed, children have not benefitted from school feeding programs, adding to the demand for food at home at a time when household income dwindled.

The World Bank's High Frequency Household Surveys, which have been conducted in low- and some middle-income countries, confirm the above and other broadly expected developments. For example, there has been a reduction in educational participation across the board, and many countries in Sub-Saharan Africa show that students in rural and lower income households have been less likely to engage in learning activities. In Vietnam, informal sectors have been substantially impacted by work disruptions, as have lower income households because of outright job losses; those in the top quintile were more likely to experience a reduction in wages. In Lao PDR, 17.8 per cent of workers with less than secondary education either have lost their jobs or have been forced to switch their jobs. In Indonesia, micro, small and medium size enterprises have reported difficulties in repaying loans, paying rents and wages. Lockdowns in South Africa affected equally the urban and rural areas, but the latter have taken longer to recover. Owing to restricted mobility of migrant workers (due to containment measures), households experienced sharp declines in domestic remittances (by as much as more than 50 per cent in Chad and Zambia). Similarly, international remittances also dropped sharply, disproportionately affecting low-income households. However, in Lao PDR, households with a head who completed secondary education were less likely to report a reduction in both domestic and international remittances.

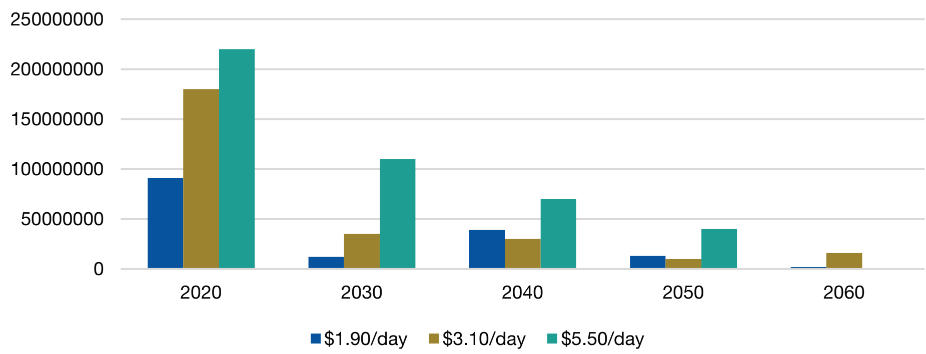
As mentioned above, to mitigate the effects of the pandemic, most governments implemented measures that reinforced safety nets and supported incomes, such as cash transfers, food assistance and tax reduction, thereby avoiding major humanitarian crises. In the case of low- and low-middle-income countries, these measures were enhanced by the swift assistance of the international community. This assistance included the suspension of the debt service payments to bilateral creditors falling due from May 2020 to December 2021 (the Debt Service Suspension Initiative (DSSI) of the G20) and the provision of significant disbursements of concessional loans.

A recent study by the United Nations University World Institute for Development (Olivera et al. 2021) shows that tax benefits and mitigation measures were well targeted and did provide some income protection to poorest households in five Sub-Saharan African countries. Another study, by N. Lustig et al., used macrosimulation to estimate the (positive) distributional consequences of mitigation policies implemented in four Latin American countries, based on the economic sector in which household members work (Lustig et al. 2020). This study shows that the larger the mitigation package, the larger the positive results. However, given fiscal space constraints, most packages were likely insufficient to offset the increase in poverty. Moreover, as most assistance was focussed on the poorest households, many lower-middle income households fell into poverty.

To convey a sense of the impact and the lasting effect of the pandemic within countries, the Centennial Growth Model (CGM) estimates the increase in extreme poverty (both by regions and by country income groups) in 2020 and the lasting impact through 2040. While increases in poverty do not necessarily imply increases in inequality, it is generally known that the impact of the pandemic, lockdowns and measures to contain the pandemic, and the global recession disproportionately affected the lower income households, women and the young, and made them extremely poor. Based on the premise that the higher-skilled and wealthy retained their livelihoods or even experienced considerable gains, as indicated above, it could be assumed that increases in extreme poverty are a proxy to higher income inequality.

Compared to the pre-COVID-19 baseline, the CGM estimates that the pandemic pushed some 90 million people worldwide into extreme poverty in 2020 (Figure 7.10) under the threshold of US$1.90 a day treshold, 180 million under the US$3.10 a day threshold, and 220 million under the US$5.50 a day threshold. As noted above, these increases wiped out the progress made over the last five to ten years. Moreover, they suggest that the 2030 Sustainable Development Goals (SDGs) on Poverty and Inequality are unlikely to be achieved because the number of extreme poor due to the projected recovery will decline only gradually; reversing the increase in the number of poor globally, would take nearly forty years, under the thresholds just mentioned (Figure 7.10). Thereafter, as total factor productivity and thus long-term economic growth is

Figure 7.10: Change in number of people living in extreme poverty due to COVID-19



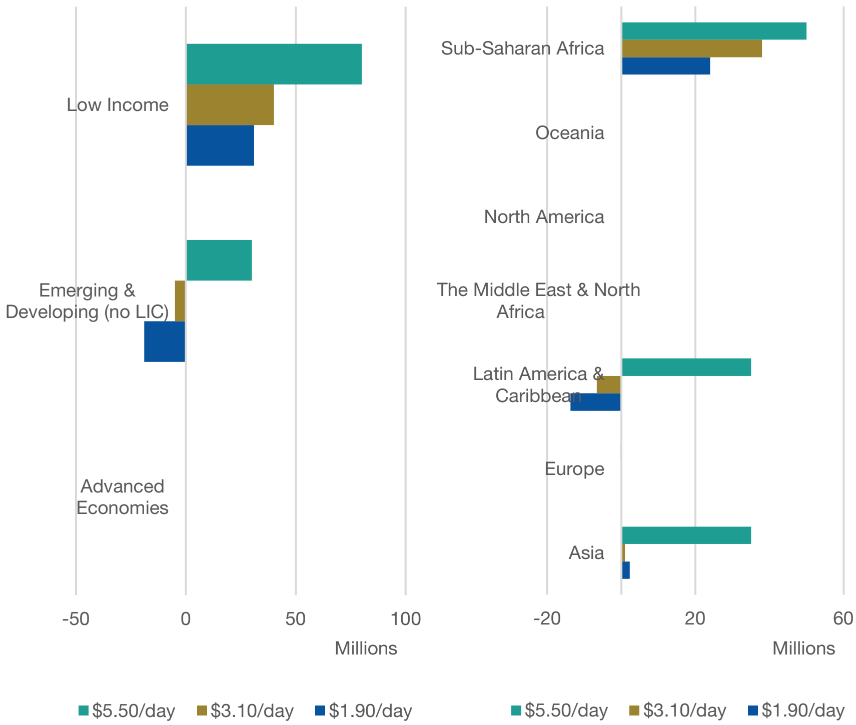
Source: Centennial Group 2021

assumed to be higher than envisaged under the pre-COVID-19 baseline, the absolute number of poor worldwide starts to decline.[7]

The worldwide increase in the number of poor due to the pandemic masks large differences when looking at income groups of countries or regions. The change in the number of people living in extreme poverty due to COVID-19 by 2030 and by 2040, respectively, broken down by country income groups and by regions (Figures 7.11 and 7.12).

In terms of poverty, low-income countries, particularly those in Sub-Saharan Africa, are most negatively impacted by the pandemic through 2030. By 2040, the impact is lessened, however poverty rates are still considerably higher in Sub-Saharan Africa and Latin America and the Caribbean, compared to a no-COVID-19 scenario. Extreme poverty paths by income groups and regions persist through 2060, according to the daily US$1.90, US$3.10 and US$5.50 thresholds. After a sharp increase in the number of extreme poor in 2020, the number of extreme

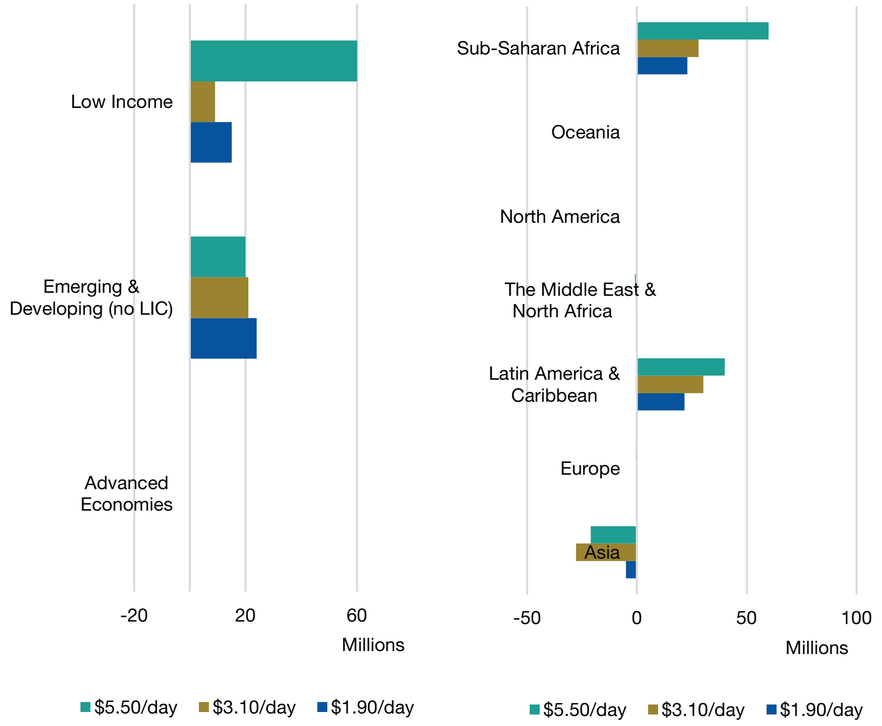
Figure 7.11: Change in number of people living in extreme poverty due to COVID-19 by 2030



Source: Centennial Group 2021

7. Growth and recovery prospects are subject to considerable uncertainty and downside risks, such as emergence of new COVID-19 variants, availability of COVID-19 vaccines, persistent supply chain problems, soft commodity prices, rising interest rates and widening spreads, and severe climate events, with potentially different country impacts.

Figure 7.12: Change in number of people living in extreme poverty due to COVID-19 by 2040



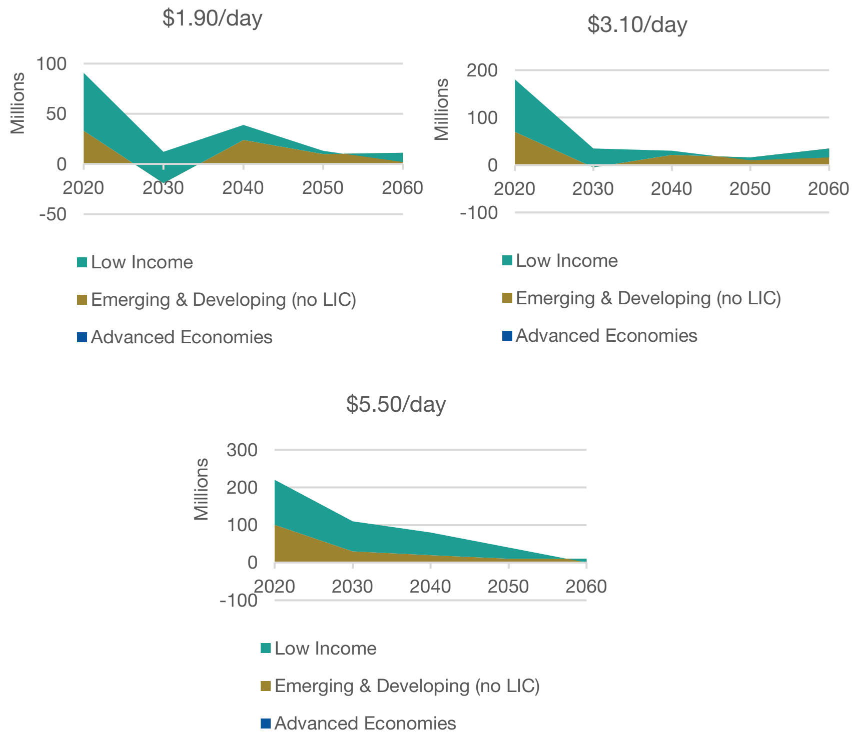
Source: Centennial Group 2021

poor (compared to a no-COVID-19 scenario) steadily decreases in all regions and country income groups. Figures 7.13 and 7.14 show that even by 2060 there will remain some 10 million extreme poor caused by the pandemic in low-income countries (mainly Sub-Saharan Africa), under the daily US$1.90 threshold, but no increase in the number of extreme poor caused by the pandemic in the other income groups or regions under the daily US$5.50 threshold.

Why Should Inequality, and Especially Growing Inequality, Be a Concern for Policy Makers?

With the previous two sections as background, this section briefly discusses why inequality or growing inequality should be policy makers' concern. In addition to ethical and solidarity considerations, the extensive literature on income inequality suggests several reasons, including adverse effects on economic growth; social fabric, including wide dissatisfaction and crime; and political stability. Underlying these effects is the fact or perception that the benefits of economic growth are not being shared equitably. In examining the channels through which inequality affects economic growth, research shows that inequality is associated with low human capital

Figure 7.13: Change in number of people living in extreme poverty due to COVID-19 by income group



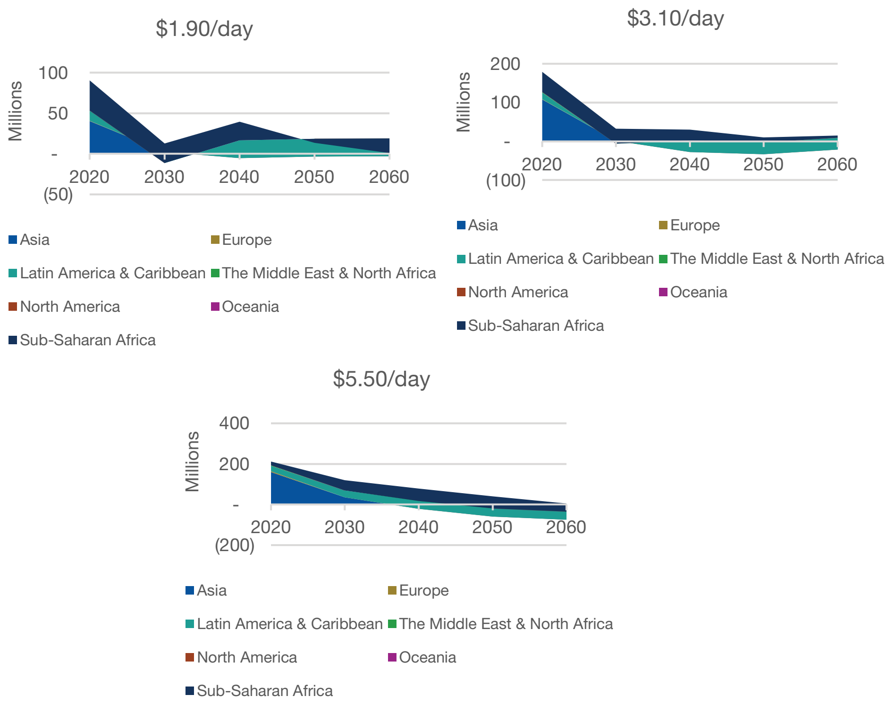
Source: Centennial Group 2021

formation and thus low growth. It also shows that very unequal societies tend to be politically and socially unstable, and have poor quality institutions, all of which are reflected in lower rates of investment and higher rates of corruption and cronyism (Easterly 2007). Although the adverse effects of inequality are discussed separately, many are closely linked and reinforce each other.

Economic Growth

After many studies with opposing findings regarding the relationship between income inequality and growth, the literature now leans more clearly towards the view that income inequality harms growth because of its association with poor human capital. Redistribution, inequality, and growth led to this change (Ostry, Berg, and Tsangarides 2014), as it identified human capital as the factor behind the negative relationship between income inequality and economic growth. The study finds that economic growth was slower, and periods of growth were shorter in developed countries with higher inequality and that human capital explains this process. Subsequently, based on a completed dataset that distinguishes between market and net (post tax and transfers) inequality, these authors together with Yakhshilikov (Ostry et al. 2018) confirm that lower inequality is robustly correlated with faster and more durable growth, that

Figure 7.14: Change in number of people living in extreme poverty due to COVID-19 by region



Source: Centennial Group 2021

redistribution appears benign in terms of its impact on growth, except when it is excessive, and that inequality seems to affect growth through human capital accumulation (OECD 2014). Along the same lines, Milanovic stresses the importance of human capital in development, and that human capital is now more important than physical capital (Milanovic 2011). Ravallion finds that a country with high inequality will take much more time to reduce poverty than one with low inequality. Interestingly, Herzer and Vollmer find that increased income inequality reduces economic growth, but growth itself increases income inequality (Herzer and Vollmer 2013). In this regard, *Forbes* finds that if country-specific effects were eliminated using panel estimation, income inequality has a significant positive relationship with economic growth (*Forbes* 2000), supporting Kuznets' theory that with economic development (especially due to technological changes and structural inter-sectoral reallocation of labour) (Milanovic 2016) inequality first increases and then decreases.

A study conducted by the OECD in 2014 compares the level of income inequality, economic growth, and education across its thirty-four member countries, and identifies education is a key pathway through which inequality affects growth adversely. Specifically, steep income disparities lead to lower educational achievement and lower quality of education for children of the lowest income households. Subsequently, in 2015, the OECD found that countries with decreasing inequality see faster economic growth than those with rising inequality (OECD 2015).

Education and Social Mobility

The just-mentioned study shows that large income disparities lead to lower educational attainment and lower quality of education for the children in the lower end of the income distribution (Perotti 1996), and that the higher income inequality is the higher are the chances that the economic status of parents be transferred to their children through lower education attainment, poorer skills and employment prospects. For instance, a child of a top quartile family is 45 percentage points more likely to complete college than a child of a bottom quartile family (Bailey and Dynarski 2011). The resulting lower human capital leads to lower social mobility. Put differently, many countries have seen an erosion of opportunities for lower income households, which hampers the potential for low-income parents to improve the economic and social position of their children. In turn, higher income parents have the resources to invest in the better education (and health) of their children and have better connections and superior job networks that improve their children's prospects. To a large extent, the endurance of this duality explains the view that inequality is highly persistent over time.

In 2012, Krueger developed the 'Great Gatsby Curve,' which plots a relationship between income inequality (as measured by the GINI coefficient) and intergenerational income immobility (as measured by the intergenerational income elasticity) in different countries of Europe or America (Kreuger 2012). The upward-sloping curve shows that whether you are rich or poor depends to a great extent on where you happen to be born. Corak confirmed that countries with more inequality at a point in time (e.g., Italy, the United Kingdom and the United States) experience less earnings mobility across generations than countries with lower inequality (e.g., the Nordic countries) (Corak 2013). He then discusses how the interaction between families, labour markets, and public policies structure a child's opportunities and determines the extent to which adult earnings are related to family background. Chetty et al. show a major decline in inter-generational inequality in the US: at age thirty, people born in 1940 had an near 90 per cent chance of out-earning their parents but for people born in 1980 this chance has declined to 50 per cent (Chetty et al. 2017). Hoff uses the relationship between inequality and mobility to estimate the number of generations that will take for a low-income family to reach the country's average income; of course, in countries with better upward mobility, the process will take fewer generations than in those with weaker upward mobility (Hoff 2020).

Health

Using data from twenty-three developed countries and the fifty states of the US, Wilkinson and Pickett found that health problems (e.g., obesity, mental illness, child conflict, drug use) and poor social indicators (e.g., life expectancy, educational performance, social mobility) are more prevalent in countries and states with higher inequality. This was based on an index of health and social problems derived from nine factors. They argue that inequality and social stratification can lead to depression, drug dependency, parenting problems, and stress-related diseases. A related study concludes that life expectancy (counting each person equally) in the top industrialized countries is lower in more unequal countries (r= -907) and in more unequal US states (r= -620) (Kaplan et al. 1996). Similarly, another study finds that national income inequality is positively related to the country's rate of schizophrenia (Burns, Tomita and Kapadia).While some researchers question the causality of these findings, there is a clear relationship. For example, the UNICEF index of child well-being in rich countries correlates with greater equality and not with income per capita (UNICEF 2007).

Social Cohesion

There is an inverse relationship between income inequality and social cohesion; put differently, equality and community are mutually reinforcing. People are more likely to trust each other in more equal societies. Indeed, Uslaner and Brown found a high correlation between the amount of trust in society and the extent of income equality (2005). Comparing the 1950s and 1960s with the period after 1965–70 in the United States, Putnam finds that in the first period social connectedness and civic engagement was at a high point as were equality and social capital (Putnam 2000). By contrast, during the last third of the twentieth century, inequality grew, and social capital eroded, and society became less connected socially and politically. This finding is consistent with Temple's conclusion that high inequality increases social and political instability, and therefore, lowers growth (Temple 1999). Stiglitz has argued that economic inequality has led to distrust of business and government (Stiglitz 2012). Inequality has adversely affected democracy, public policy, and the system of justice. The resulting disillusionment may lead to discontent and political instability.

Crime

Crime rates have been shown to be correlated with inequality. Homicide rates among US states and Canada provinces are highly and positively correlated with income inequality as measured by the GINI coefficient (Daly and Wilson 2000). Moreover, the temporal change in the GINI coefficient is a significant predictor of the temporal change in homicide rates. A World Bank study found a similar causal relationship worldwide (Fajnzylber, Lederman, and Loayza 2002). While these studies refer to violent crime or homicides, a study looking at the effect of inequality on property crime found a nearly zero relationship (Corvalana and Pazzonab 2019).

Environment

The effects of inequality on the environment are highly debated. While some argue that alleviating poverty can result in detrimental environment effects because, as poor people become wealthier, they increase carbon emissions. Others take the view that alleviating poverty will lead to progressions on the environment in terms of energy efficiency and urbanization. For instance, through urbanization, societies have a higher standard of living that can promote environmental health with better technology, education, etc. Research shows that biodiversity loss is higher in countries or US states with higher income inequality (Mikkelson 2007).

Political Outcomes

Following the Engermann and Sokoloff hypothesis, Easterly finds high inequality to be a significant barrier to prosperity, good quality institutions, and high-quality schooling, i.e., income inequality is a determinant of bad institutions and underdevelopment (Easterly 2007). It leads to poorer forms of social, cultural and civic participation. A recent study suggested that low social mobility reduces voter turnout among lower income groups (Wass and Hiilamo 2017). This may also allow the better off segments of society to capture legislation and institutions. Looking at interregional inequality, Ezcurra and Palacios find that inequality may lead to terrorism (2016). Milanovic finds that income inequality increases the likelihood of coups (Milanovic 2016), giving some credence to the argument that WWI was caused by inequality, as raised by J.A. Hobson, R. Luxemburg, and V. Lenin.

What Can Be Done to Build a Fairer and More Equitable Society?

Following the utilitarian principle of seeking the greatest good for the greatest number,[8] economic inequality is a problem that needs to be addressed. However, adopting policies to maximize the sum of individual utilities could harm the incentives to produce. This is a conflict, among others, that policy makers need to deal with when considering and implementing policies to reduce inequality and build an inclusive society. In addition, two further issues from the political economy point of view are critical: one is that some of policies to address inequality adversely affect the interest of important stakeholders and potentially influential interested groups, and the other, perhaps as important, is that many policies bear fruits in the medium to long run,[9] long after the term in office of policy makers. The idealists among them would go ahead and implement them anyway, while others are likely to wonder why they should spend their political capital on steps that would benefit their successors.[10] The complexity of these considerations and the difficult choices involved should not lead to inaction, especially because ‘inequality is bad for everyone in society’ (Ingraham 2018). The serious adverse effects of inequality discussed above suggest the need to address them without delay, even more so if they take long to bear fruits.

Equity issues are complex because they are intertwined with social values and moral views of fairness and social justice, including over inter-generational issues. In addition, individual countries (or regions) may have different perceptions of what is equitable (i.e., how much inequality is acceptable, given that some degree of inequality is desirable from the point of view of rewards to innovation and risk-taking), and which are the priorities and appropriate policies to promote equity depend on the initial circumstances (including institutional structures that create social barriers based on social status, gender, ethnicity, and age), preferences and needs of the individual country (region). There is no ‘one-size-fits-all’. Thus, policy makers need to pay particular attention to these values and views when considering the mix of policies that would promote equity or fairer access to opportunities and income.

Key features of successful strategies include understanding the constraints to reducing inequality, building support from key stakeholders and across the political spectrum, sequencing the reforms to yield benefits early on, and preventing administrative and budgetary bottlenecks given government implementation capacity. In term of contents, strategies to promote equity vary greatly. Some countries have used inequality reducing policies, including public resources to raise transfers to the poor, while others have focussed on levying highly progressive taxes. Yet others have taken an indirect approach, seeking to help low-income families by stimulating overall growth (a high tide lifts all boats approach). This would allow the problems mentioned

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8. According to the law of diminishing utility, the loss of economic welfare suffered by the rich when some of their resources are transferred to the poor is substantially smaller than the gain of economic welfare by the poor.
9. This raises inter-generational equity.
10. Another political economy issue is that politicians may agree on the need to tackle the inequality problem, but it may be difficult to find common ground on the solution.

in the fourth section to fester and lead to low and/or unsustainable growth; 'inequality and unsustainable growth may be two sides of the same coin' (Ostry and Berg 2014). Perhaps these diverging views are the reason why reducing inequality has proven to be so difficult; indeed, progress toward achieving SDG 10 has been limited. A combination of both approaches seems preferable because it would create a dynamic and more inclusive economy.

Irrespective of these circumstances, there is a growing need for countries (regions) to redouble their efforts at reducing inequality, particularly in view of the adverse effects and disruptions caused by the COVID-19 pandemic presented in the previous section, and the structural transformations being caused by the megatrends discussed elsewhere in this book. As bad as inequality had been before the pandemic, the post-pandemic world would experience greater inequality unless governments act (Stiglitz 2020). The goal is to address inequality at its roots, to implement policies that go beyond just supplementing people's income, they should equip them—starting from a very early age—with the capacity to access opportunities and prosper.

Following McCall (2016), there are three political and policy approaches to address problems of inequality and opportunity, each characterized by a particular mix of views concerning inequality of outcomes (i.e., income inequality) on the one hand and opportunity on the other.

- The equalizing opportunity approach places greater emphasis on equalizing opportunities rather than on equalizing incomes and goes so far as to actively oppose equalizing outcomes as a policy objective. Policies that promise or provide job opportunities to lift oneself by the bootstraps to achieve, for example, the American Dream (the idea that hard work is essential to get ahead). Samples of policies implemented in the US under this approach include universal education and affirmative action. This approach is identified with conservative parties.
- The equalizing outcomes approach places greater emphasis on equalizing outcomes than on equalizing opportunity. It typically sees the goal of equalizing opportunities as being met implicitly through government tax and transfer policies that reduce disparities in disposable income. Increasing taxes on the affluent as a method to divert funds from those that 'do not need' them to those who do, and thereby mitigate economic inequality; redistribution is too often seen as an end on itself. This approach is identified with liberal parties.
- The equalizing outcomes to equalize opportunity approach is in the middle of the political spectrum as it fuses concerns about both opportunity and outcome, it connects the problem of inequality to the problem of opportunity, seeing inequality as a barrier to opportunity. It takes the view that concerns about restricted opportunities appear to coincide with desires for less inequality. This approach moves from taxing for redistribution to taxing for opportunity. For example, by avoiding a diffuse set of social or public goods, Bill de Blasio (in the United States) campaigned successfully under the promise to raise taxes on the wealthy to fund universal preschool education. Similarly, President Biden's Build Back Better initiative in the United States includes raising taxes to fund opportunity enhancing programs. The recent so-called 'social investment' strategies in Europe call for a shift from the traditional outcomes-based agenda to one that seeks to harness the human capital potential of the entire population, regardless of social background.

This chapter broadly follows the latter approach, although many of the policies described below follow an equalizing opportunity to equalize outcomes approach. While the rest of this chapter focusses on the policies and measures that country and regional authorities could implement to address inequality, international cooperation plays an important role in assisting governments to achieve the SDGs, as well as in designing, implementing, and financing inequality reduction programs in areas such as education, health and infrastructure.

The following non-exhaustive list of potential policies does not imply a particular priority or order of policy implementation. As just noted, the priority given each of these policies should be carefully assessed and tailored to the circumstances and social values of the country or region; bearing in mind that many policies are mutually reinforcing, a multiprong approach is needed. As noted, policies addressing inequality and seeking inclusive growth need to go beyond just supplementing people's income through government transfers, they should seek increasing access to opportunities and thereby equalizing income.

- Invest in early childhood development. This is an essential policy to increase access to opportunities because 'the highest rate of return in early childhood development comes from investing as early as possible, from birth through age five' (Heckman 2012). Over this period the brain develops and builds the foundation of cognitive and character skills necessary for success in school, college, career, and live. Early childhood education raises cognitive skills and attentiveness, motivation, self-control, and sociability, all of which turn knowledge into know-how and people into productive citizens. Skill begets skill and motivation begets motivation. Early childhood development will give each child a reasonable opportunity to attain an economic place in society based on their talents, interests, desires, and efforts. Every child needs early childhood education, but those coming from disadvantaged environments, from families that lack education, need it the most to avoid the skill gaps that open early in life due to limited stimulus, poor nutrition, and health risks, which typically leads to social immobility. Heckman stresses that early childhood development is a cost-effective strategy to promote economic growth (thereby increasing fiscal revenue), and reduce the costs of remedial education, health, social services, and criminal justice (thereby lowering public spending).
- Enhance education quality and mitigate education inequalities. There is broad agreement on the importance of ensuring universal access to quality education. The required efforts deserve high priority because they translate into stronger human capital and access to opportunities, and thus greater social mobility. In 2019, G20 leaders restated its commitment to invest in human capital and promote inclusive and equitable quality education for all. To this end, key elements are strengthening the quality of education by bolstering teachers' quality and training and by removing any obstacles to education reform. Similarly, make public education free, including tertiary education for low-income families. These efforts take years to implement, and the productivity enhancing effects are seen with lags; their large economic and social effects could take decades.
    - Starting with early childhood development programs, as just mentioned, supplement them with universal pre-K. Develop support programs for at risk mothers and babies to address malnutrition and poor health. Support day care centres and pre-school programs to improve early development of cognitive and social skills, while stressing good nutrition and health.

- Strengthen primary and secondary education stressing the importance of quality of education in addressing the acute problem of learning poverty (World Bank 2019).[11] This calls for bolstering the quality and capacity of teachers and adopting policies to attract and retain them. Boost school funding to improve the availability of school inputs, especially in disadvantaged areas. This requires, in some countries, a reform of the current funding based on property taxes, which discriminates against schools in poor districts, where property values are lower than in affluent districts. Put in place a good system to track learning outcomes and assess the extent to which policies and programs contribute to students learning. These efforts should help close the gap in years of schooling between AEs and EMDEs (averaging three and a half and five and a half years) (IMF and World Bank 2020).
- Support appropriate tertiary education, as it provides high labour market rates of return. To this end, establish career guidance in secondary schools to ensure parents with low levels of education and their children understand the potential benefits of tertiary education; in addition, provide these students with means tested financial assistance (e.g., scholarships, grants such as the Pell Grants in the US, and reduced fees). Help raise completion rates by providing counselling and remedial instruction at an early stage. University-business partnerships could help design education programs that are well aligned with labour market needs.

While in many countries the much-needed quality improvement may not require additional spending,[12] in other countries there is a need to increase education spending, including school buildings, teaching material, and higher remuneration to attract good teachers, especially in remote, underserved areas. Additional resources may be needed to fund appropriately targeted assistance to disadvantaged students. In many countries, however, a better allocation of budgetary resources may also require shifting funding from tertiary to the earlier stages of education, as well as bolstering the capacity and efficiency of the ministry of education while improving its human management.

In a previous study based on the endogenous growth theory, the authors—together with J. Guzman—confirmed that concerted efforts to raise cognitive skills though improvements in the coverage and quality of education can have sizable long-term effects on both economic output and the distribution of income (Fajgenbaum, Guzman and Vilkelyte 2019).

- Improve health outcomes and reduce inequalities in health service delivery. Improving health outcomes is, together with enhancing education, a key factor in building human capital; it helps raise child learning and worker productivity. It improves growth prospects and income distribution by enabling continued access to opportunities. In fact, healthcare needs are highly unmet among low- and middle-income segments of the population in OECD countries (OECD 2018). In EMDEs coverage is very limited and inequitable, while its quality is poor (WHO and World Bank 2017). To address these problems, there is a need to boost the quality and capacity of health care facilities (especially in EMDEs), increase the number of healthcare professionals (promoting enrolment in medical education programs), encourage their supply to underserved

11. Defined as the inability to read and comprehend a simple text by age ten.
12. For example, Costa Rica spends more than 8 per cent of GDP on education, but students' attainment is rather poor.

areas, prioritize reliance on outpatient care (especially of expecting mothers, infants and young children), and enhance communication technologies. Focus on addressing major risks common but preventable among lower-income households through adequately funding research on microbial resistance, a key threat in most countries; intensify public and private efforts to eradicate communicable diseases, which are prevalent in EMDEs; and provide means-tested subsidies on medicines and boost competition among pharmaceuticals. Where appropriate, support comprehensive family planning programs.

- Broaden access to clean water and sanitation services. This is key to improving health, especially in poor urban and rural areas. Well targeted tariffs and subsidies would ensure equitable and sustainable service.
- Support vocational training and continuing education programs. These programs are critical to maintain workers' human capital that is competitive and up to date with new technologies, thereby raising workers' opportunities. They could include financial incentives, such as wage subsidies or sub-minimum wages, rebates of social contributions to employers so that they establish apprenticeship places and good quality adult training (earn-while-you-learn programs). Strong business-education partnerships should allow continuing education and other training programs to be well aligned with employer requirements.
- Provide lower income families with affordable but quality childcare. This could be government or privately provided, with means-tested subsidies. Ensuring that every working family can afford high quality childcare will facilitate an increase in labour force participation by women, and thereby raise the family's income and reduce inequality. Of course, it would also contribute to early children development.
- Promote gender equality in access to education and labour markets. There is plenty evidence of the important the role women play in health and education of their children that women's access to education would lead to better children education and health, and thus, on increased social mobility. In OECD countries, women's participation in the labour force is comparable to that of men, but they still earn 15 per cent less than mem for similar work. Gender disparities in middle- and low-income countries are grater, as women participation in the labour force is 49 per cent and 64 per cent, respectively, compared to 75 per cent and 77 per cent, respectively for men. The OECD estimates that a 50 per cent increase in the participation by women will increase output growth by 0.3 per cent reduce household inequality by about 2 GINI points (OECD 2015). 'The evidence suggests that greater gender equity and increasing female economic participation are associated with higher growth, more favourable development outcomes, and lower income inequality' (Jain-Chandra et al. 2015). Thus, there is a clear benefit from removing gender discrimination in education and in the labour market (amending laws and regulations to facilitate part-time, flexible work schedules, and gender-neutral family leave policies). These steps will help reduce the employment cost differential between women and men and enhance women's access to opportunities and income. Implementation of gender budgeting would help address gender inequality, including by ensuring funding for high quality childcare and parental leave policies.
- Provide means-tested conditional transfers. By increasing disposable income, these transfers help low-income communities to raise their economic activity while promoting

human capital build-up. Conditional transfers have been effective in many countries—including Brazil, Jamaica, Peru and Mexico—in improving income distribution and reducing poverty, while encouraging steps to enhance human development. Typical conditions result in better nutrition, greater school attendance and better health, including through periodic check-ups and vaccinations. These transfers would be even more effective if the country's safety net were improved.

- Alleviate spatial disparities. Increased public support for significant investment in infrastructure and services would lower accessibility gaps in regions and cities. These gaps constitute important barriers in accessing jobs, housing, education and health services, especially for the low-income population; transport policies could ease geographical mobility and improve connectivity. For instance, building access roads would significantly improve living conditions of remote farmers. Public support in the form of investment aid or loan guarantees could promote small business and activity in depressed areas.
- Increase participatory decision-making. This policy seeks to include the voice and perspectives of the poor in the decision-making, monitoring and evaluating of public policy on inequality.
- Establish a universal basic income. In contrast to the means-tested conditional transfers, the universal basic income (UBI) is a cash transfer of an equal amount to all individuals in a country. This idea has revived in recent years in response to potential effects of automation and artificial intelligence on jobs in future. It could replace inefficient public spending, such as fuel subsidies. While the UBI may have a positive impact on inequality outcomes and poverty, it could involve a heavy budgetary burden, turning it unadvisable in countries with low taxing capacity. A more general drawback is UBI's potential adverse effect on incentives to work. Instead of the UBI, Anthony Atkinson proposed several measures with similar goals (Atkinson 2021). Guaranteeing a minimum wage to those who seek employment, establishing a capital endowment (minimum inheritance) paid to all at adulthood, paying a Child Benefit to all children at a substantial rate and subject to income tax, and introducing a national participation income that complements existing social protection. He also envisaged an eventual EU-wide child basic income.
- Improve the functioning of key markets. Reform labour market legislation and regulations to reduce the ability of employers to use their market power and anti-competitive practices to set wages below workers' marginal productivity, especially regarding low-income workers. Clemens and Strain show that reasonable increases in minimum wages in the US had no or moderately positive effect on employment, while large increases reduced it by just over 2 per cent in the short-run (Clemens and Strain 2019). Interestingly, faced with large unfilled vacancies in the aftermath of the COVID-19 pandemic, low-income workers in the US are demanding higher salaries and better working conditions through informal bargaining and massive resignations (the Great Resignation). Serious consideration needs to be given to removing regulations that promote informality with a view to reduce the informal sector, especially in developing countries where it accounts for some 70 per cent of 'employment' with virtually no safety net. Assistance with affordable housing has proven helpful for low-income

families in searching and contracting rental housing and move from depressed areas to higher opportunity areas. A study on a large city in the US, conducted by Bergman et al. found that families benefitting from this assistance were 40 per cent more likely to move to high opportunity neighbourhoods than those that did not receive such assistance (Bergman et al. 2019). The study concludes that assistance to housing search could reduce residential segregation and increase upward social mobility. Addressing market power concentration, by reviewing mergers could benefit many stakeholders, including workers, buyers and suppliers.

- Ensure financial inclusion. This is critical to foster a more equitable income distribution. Evidence indicates that having access to saving accounts results in a higher degree of self-insurance against health and weather risks, and higher investment in education. These accounts help prevent theft and impulse-spending, and foster women empowerment (IMF and World Bank 2020). Greater small and medium enterprise (SMEs) access to financial services (e.g., digital payments, savings, credit, and insurance) tends to be associated with access to new technologies, increased employment, labour productivity and economic growth. Credit Bureaus could help reduce information asymmetries between borrowers and creditors and thereby improve SMEs access to credit. Introducing movable collateral registries would allow SMEs to borrow against their movable assets (which typically exceed their fixed assets). Reducing the cost of financial reporting by providing cost efficient accounting standards and training in simple financing management and information would encourage SMEs reporting (UNCTAD 2013).
  Fintech has been a major contributor to financial inclusion in recent decades, including rural households' access to payment services and SMEs access to small, short duration credit that financial institutions could not provide. The potential for further financial inclusion is large: about 100 million unbanked adults receive government payments and transfers in cash, while nearly seven out of ten of these adults have a mobile phone that could be used for digital payments. Improving connectivity infrastructure will help include the poor, women, and rural residents in the financial system.
- Address impact of climate change. Given that climate change hits the poor the hardest, it raises inequality further and hampers development. The World Bank estimates that climate change could push an additional 68 to 135 million people into poverty by 2030, and thus amplify inequalities (Guivarch et al. 2020). This suggests that policies to tackle climate change are urgently needed. For instance, policies to ensure that redistribution of the revenue from carbon prices would offset (or be higher than) the negative impact of climate change on the poor. Financial transfers between countries may reduce the burden of mitigation in poorer countries and increase participation in mitigation efforts.
- Boost fiscal space to reduce inequality. Some of the policies and measures discussed above require additional budgetary allocations. Although, preferably, the resources should come from improving expenditure efficiency and regressive spending, increasing revenue may be unavoidable to help achieve distributive objectives, consistent with fiscal sustainability. To cut or eliminate inefficient and regressive spending, consideration needs to be given to:

- improving the efficiency and efficacy of every expenditure line, including through strengthening public financial management (particularly transparency and accountability);
- replacing across the board subsidies that benefit more higher-income households (e.g., fuel or energy) by subsidies targeted at low-income ones; and
- restrain the growth of military spending.

To increase revenue, it is important to strengthen tax administration by modernizing the technology and raising the budgets and managerial autonomy of the respective agencies. Regarding tax increases, careful consideration is needed to avoid adverse effects on incentives to work and save. The same applies to corporate taxation in light of international competition.[13] Increasing the progressivity of personal income taxes (reversing some of the decline over the last decades) as well as broadening their base by taxing all types of incomes (e.g., fringe benefits) could lead to significantly higher revenue. This should be accompanied by rationalizing exemptions and deductions and removing tax loopholes. Increasing progressivity has the dual function of raising fiscal resources and reducing after taxes income inequality. IMF's Fiscal Monitor found that AEs with relatively low personal income tax progressivity have room to raise top marginal tax rates without adverse implications for growth (IMF 2017).[14] Furthermore, a recent study conducted by Lakner et al. shows that a relatively small reduction in the growth rate of the top earners is necessary to ensure that the income of the lowest earners grows substantially faster than the mean (Lakner et al. 2019).

Other tax measures include restricting the use of trusts to shelter assets and incomes, removing inefficient corporate income tax expenditures (some of which benefit high income recipients), removing tax avoidance and evasion opportunities, such as profit shifting, transfer pricing and interest stripping by multinational corporations (IMF), and raising taxation on goods with negative externalities (e.g., carbon emissions and cigarettes). Raising indirect taxes, such as the VAT, could be progressive when their proceeds are used to help reduce inequality, like financing conditional transfers or introducing or increasing an earned income tax credit. Taxation of natural resources also offers an efficient and equitable source of revenue. While many observers propose introducing or increasing taxes on assets, wealth, and estate, there is little consensus on the advisability of raising these taxes.

- Promote macroeconomic stability and structural reforms. Even if these policies are presented at the end, they are essential to sustain the growth of output and employment, lower poverty and improve income distribution. Ensuring economic stability is critical, as lower-income earners suffer disproportionality more than the rich during times of economic crises (typically accompanied by surges in unemployment). Thus, policies need to focus on maintaining low fiscal deficits consistent with debt sustainability, keep inflation low (as it affects the poor the most), implement strong prudential regulation and supervision of financial institutions, and attaining adequate fiscal space and international

13. Recent discussions and support of a minimum corporate income tax on multinationals are an important step in this direction.
14. However, the extent of the rise in top marginal rates should be carefully assessed because if progressivity were too steep it could cause unintended consequences, such as encourageing capital flight or lowering private investment and thus employment and growth.

reserves to help deal with potential adverse shocks. Important reforms could promote equality of opportunities and outcomes: for example, deregulating the economy, setting up strong and accountable institutions, including a well-functioning judiciary, removing discriminatory legislation, and curbing corruption. Moreover, '[b]road public support is likely to come for a wise and sustained course of adjustment and reform when the distribution of income and opportunities to attain economic advancement are seen as relatively 'fair' or at least not outrageously biased toward privileged groups' (Camdessus 1995).

While this chapter has so far focussed on what governments could do to build a fairer and more equitable society, there is significant potential role to play by the private sector. They include changing corporate managerial objectives toward (i) long-term profitability (rather the short-term increases in share values) with greater emphasis on investment and innovation; (ii) enhancing labour productivity by providing productivity-based wages and retention programs, while avoiding discrimination; and supporting the community, including by addressing negative externalities. In addition, the private sector could help build clinics, child daycare and education facilities, and finance their operations; it can also play an important role in the area of continuing education and training. Non-governmental organizations, through their activities, especially research and lobbying, help address important problems that affect the disadvantaged. And many charitable organizations like doctors without borders (MSF), the Bill and Melinda Gates Foundation, and the Carter Center do important work that helps address health and education problems, among others.

At the global level, bilateral and multilateral assistance should support recipient countries in these areas and by bringing awareness of policies that have been successful elsewhere. The recent SDR allocation could help finance the initial steps of these policies. The advanced and other rich countries could use part of the SDR allocation they received to help fund such policies; one way would be to capitalize the Multilateral Development Banks and thus increase their financing potential, perhaps by leverageing this capitalization.

Conclusion

The unprecedented and synchronized shock of the COVID-19 pandemic has intensified the increasing inequality within AEs, which started in the early 1980s, and within many EDMEs, which started subsequently. It has even reversed a declining trend in inequality within countries in other EMDEs. Moreover, in addition to the impact on health, the pandemic has led to an enormous increase in extreme poverty worldwide, despite major mitigation efforts, and it has led to school closures that have affected millions of students with limited or no access to online education, hampering human capital build-up and future earnings. The expected monetary policy tightening by the United States, and possibly soon after by the central bank of the UK, the ECB and the Bank of Japan is likely to further widen the inequality between AEs and EMDEs.

In these circumstances, policymakers need to act decisively and urgently to address inequality not only because of ethical and solidarity considerations, but also because inequality within countries may have risen to unsustainable levels (but masked by the ongoing pandemic). As already discussed, inequality leads to poor educational attainment and human capital formation among the lower income population, limited opportunity for social mobility, and poor health; hinders economic growth; weakens social cohesion, which could lead to dissatisfaction and mistrust, and increased violent crime rates; and tends to make societies politically unstable.

Equity issues are complex, as they are intertwined with social values and moral views of fairness and social justice, which suggest that individual countries (or regions) may have different perceptions of what is equitable (i.e., how much inequality is acceptable). Thus, the priorities and appropriate policies (and sequence) to promote equity depend on the initial circumstances of each country or region. Guided by the objective of equalizing opportunities to equalize incomes or vice versa and build an inclusive society, potential policies include early childhood development; enhancing education quality and health; promoting gender equality in access to education and labour market; providing vocational training and continuing education; providing means-tested conditional transfers; alleviating spatial disparities; ensuring financial inclusion; and addressing the impact of climate change. Clearly, many of these policies will require increased budgetary allocations. This could be achieved by raising the efficiency of government spending and by raising revenue through improvements in tax administration, a somewhat more progressive income tax, removing loopholes and exemptions, and raising indirect taxes.

The private sector should play an important role in reducing inequality, as should the international community, by supporting governments in their efforts to address inequality.