

World Development Report 2006

Equity and Development

Table of Contents

0. Overview: introduction and summary

Part I: How unequal is the world?

1. Inequalities within countries: people and groups

2. Global inequalities: countries and people

Part II: Does inequality matter?

3. Equity, well-being, and development

4. Inequalities and investment

5. Inequalities, power and conflict

Part III: Institutions and policies for greater equity and lower poverty

6. Equity and economy-wide processes and policies

7. Towards equity in assets, incomes and agency

8. Institutions and policies for global equity

Report Outline

0. Overview: Introduction and Summary

0.1 The average level of real income in the richest countries is 50 times that of the poorest. The richest tenth of the South African population enjoy levels of consumption per person almost 70 times those of the poorest tenth. In Brazil, whereas adults in the richest fifth of the population have 10.4 years of schooling on average, those in the poorest fifth have 3 years. In India, under-five mortality rates are 155 per thousand live births for the poorest twenty percent of the population (in wealth terms), compared with 54 for the richest quintile. Citizens of the world also experience profound differences in influence, access to legal systems, power and social status, whether at the level of individuals, between men and women, or between groups. Acute inequality in incomes, in health status, in educational outcomes and in other dimensions of welfare is a stark fact of life. Its resilience in individual countries and in the world is often seen as the sign of the failure of past and present economic systems to bring about development for all and the abolition of poverty.

0.2 This WDR will explore the relationship between equity and development strategy. In doing this it will build on and extend existing frameworks. Equity is a potentially important factor affecting both the workings of the investment environment and the empowerment of the poor—the two major lines of the World Bank’s poverty reduction strategy.¹ There are powerful links with the accountability framework for service delivery that was the central focus of the 2004 WDR. And the forthcoming social development strategy, that is organized around themes of social inclusion, cohesion and accountability is intimately concerned with issues of equity as we plan to use the term in this report.

0.3 What is meant by equity? Equity is explicitly about normative concerns of fairness and social justice. There are many moral approaches to this. We currently plan to organize primarily around a conception of equality of *opportunities*, or, more broadly, equality in the capability (or freedom) of different individuals to pursue a life of their choosing.² This will also take us to consider inequalities in *recognition*, where different groups (women, ethnic, caste etc.) face different opportunities owing to differences in their status, power and influence within a society. Equity in this sense generally does not imply equality in outcomes (such as in incomes or consumption). Even an exclusive concern with equity would lead to differences among individuals, since individuals differ in needs, preferences, efforts and talents. Moreover, a concern with equity and the means to achieve it has to be balanced against other objectives, such as respect for personal

¹ This strategic framework itself builds on the WDR 2000/01’s trilogy of “opportunity, empowerment and security. The investment environment is the focus of WDR 2005. See the references at the end for some of the key World Bank documents.

² See Sen (1992)

freedoms, or the provision of incentives for efficient resource use, entrepreneurship, innovation, saving and investment, with which there may or may not be tradeoffs.³

0.4 Why is equity central to poverty-reducing development? There are two fundamental reasons. *First*, inequalities in opportunity or capabilities can be a profound source of poverty, both within societies and across nations. Poor people are poor because of inadequate access to schools, health centers, roads, market opportunities, credit, effective risk-management mechanisms and so on. These are in turn typically associated with inequalities of voice or influence both in the shaping of policy and in its effective implementation. *Second*, reduction in poverty (in incomes, education, health etc.) is a product of both aggregate development and its distribution. The fact is that there are potentially important interactions between the policies and institutions for dealing with equity and such aggregate development processes, including both the level of economic growth and its distribution. This can sometimes involve tradeoffs, as noted above. But this is by not always necessarily the case, especially over time. At a national level all currently “developed” societies historically put in place policies and institutions to provide for equity, in areas that included education provision, risk management and equality before the law. This was at least consistent with the achievement of levels of prosperity unprecedented in human history. At a more micro level, some areas of lack of equity—for example customary restrictions on girls schooling, the household allocation of labor between men and women or access to credit—have been shown to be potentially bad for economic efficiency and growth. The central challenge for this report will precisely be an assessment of how equity affects poverty reduction via both its effects on distribution *and* on overall development processes, at local, national and global levels.

0.5 While the fundamental concern is with equity, empirical investigation will have to rely heavily on measurable inequalities in a variety of outcomes, backed by interpretation of the relationship with equity. Indeed, practically and operationally, the concepts of equity and equality overlap quite extensively. For instance, income differentials between rich and poor countries are roughly commensurate with differences in the opportunities and capabilities of their citizen. These are in turn both associated with and affected by inequalities in influence on global policies and developments. Likewise, analyzing empirically differences in opportunities and capabilities within a society requires considering the inequalities that shape individuals’ access to opportunities—education, health, parents’ wealth—and their outcomes—such as income and consumption.

0.7 The overall purpose of the WDR is to provide policy advice. But to provide the foundation for this, we need to document patterns of inequalities and the reasons why some inequalities may be of concern for development. Thus our approach is threefold. First, in Part I, we seek to describe patterns of inequality in a range of variables relevant to a concern with equity both at the national and global level—incomes, educational achievements, health indicators, power and influence. Then, in Part II, we highlight a set

³ This view is articulated by Cohen (1993), “(we) take for granted that there is something which justice requires that people have equal amounts of, *not* no matter what, but *to whatever extent is allowed by values which compete with distributive equality*” (Cohen, 1993, p.9, emphasis added).

of reasons why some levels of inequality in the preceding variables may be too high, whether for intrinsic reasons, or because they actually harm the attainment of other competing values, such as the absolute levels of material goods and services available in an economy. Finally, in Part III, we discuss policies that affect the relationship between equity and the development process, at a country and global level—including policies that could help reduce the levels of some intermediate inequalities—focusing especially on circumstances in which this is likely to form the basis for more rapid overall development and faster poverty reduction.

0.6 Both the second and third parts of the Report will pay particular attention to how inter-relationships between equity and overall development processes (of which aggregate economic growth is one) are likely to affect poverty reduction. One of the major themes that will be explored is that the common separation in thinking between growth (and policies that affect growth) and distribution (and policies that affect distribution) is both erroneous and counterproductive. Policies and institutional arrangements associated with equity in a society can have a fundamental influence on the overall development process.

Part I: How unequal is the world?

The First Part of the report will look at a wide range of inequalities that are associated with inequity in the world—between individuals and households, between genders, and between groups. This will be undertaken at both the country and global level.

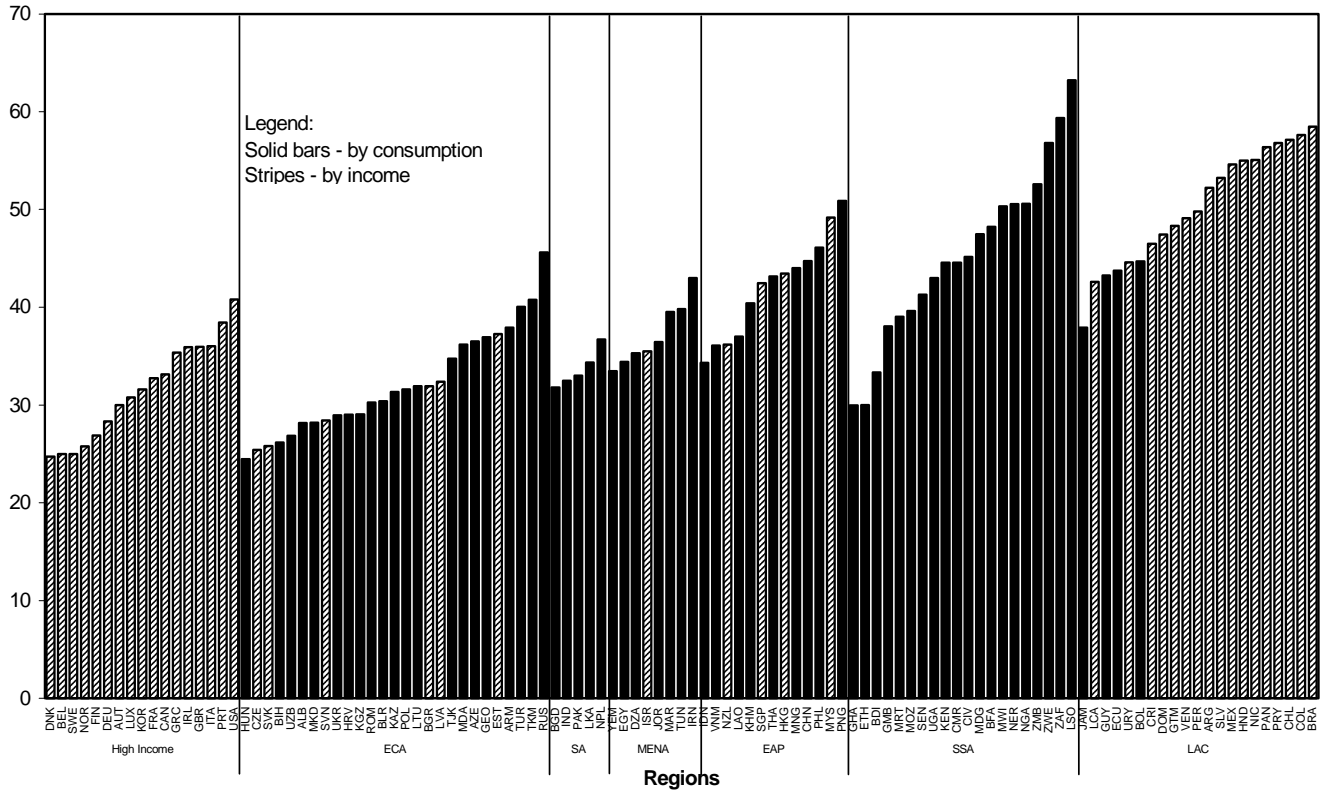
1. Inequalities within countries: people and groups

1.1 *Inequalities of opportunity and recognition within countries.* The chapter will be motivated by an illustrative discussion of the vast inequalities of opportunity and recognition that exist within countries. Examples will draw on individuals from households with different human and physical assets, between genders, from different castes/classes/ethnic or other social grouping, and from different geographic locations within countries. Inter-generational aspects of inequality will also be illustrated. Based on these examples, it will argue that such differences apply in varying degrees and forms to most countries of the world. It will also describe the empirical difficulties of direct measures of either opportunity or recognition, so the core empirical presentation has to be on measures of outcomes, that are products of the underlying processes and inequalities.

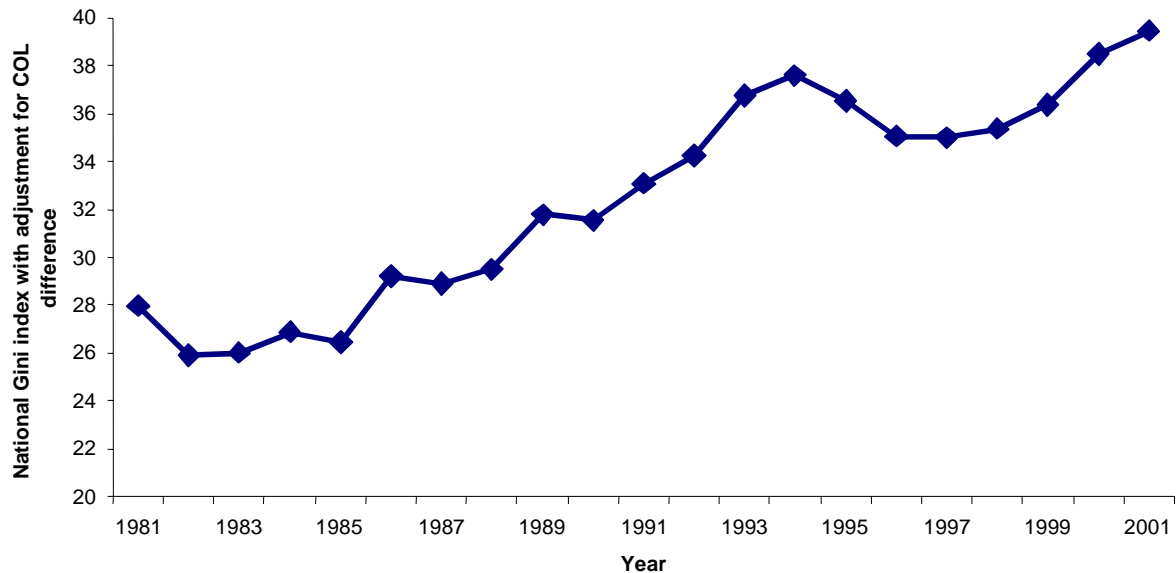
1.2 How does *consumption and income inequality* within countries vary across the developing world, and over time? This section will present levels and trends in inequality for as many countries as possible, across all regions. As many of these statistics as possible will come from the fully disaggregated household surveys. Where necessary, they will be complemented with indicators drawn from existing databases of inequality measures. Figure 1 illustrates for one summary measure: a comparison of scalar inequality measures of income or consumption across individuals (in this case the Gini

coefficient, and from the existing WDI database) across the developing world. There are large differences, both within and across regions.

Figure 1: Income and expenditure Gini coefficients, by country



1.3 To provide the context, the chapter will illustrate the long-run historical record for selected countries, featuring those countries that have experienced well-documented transitions (e.g. Scandinavia, the UK, US). It will then focus on the more recent experience of the developing world, providing a cautious assessment of what can be said from data spanning the last few decades. Figure 2 below provides an example, from China. Special attention will be paid to the severe comparability problems which plague the exercise, and which originate in the differences across questionnaires and survey methods, in the income and consumption aggregates consequently constructed and in how regional price deflation and economies of scale adjustments are made. The chapter will investigate the hypothesis that “inequality profiles”, or the patterns of inequality across different groups in the population, are more robust to these various factors than scalar measures, and use them for international comparisons too.

Figure 2: Two Decades of Income Inequality in China

Source: Ravallion and Chen (2004), "China's (Uneven) Progress Against Poverty", DECRG mimeo.

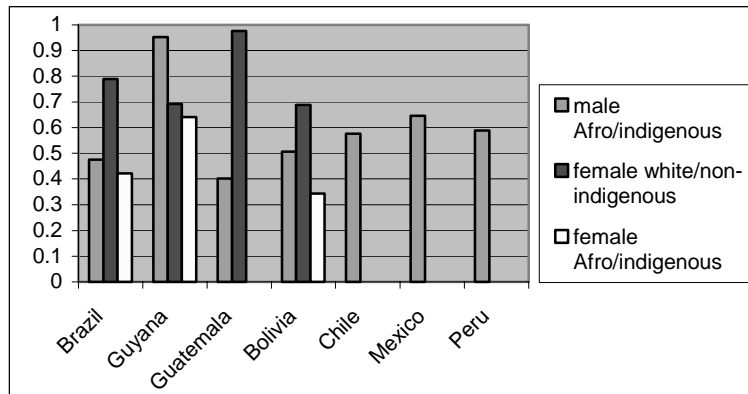
1.4 How are indicators of *non-income dimensions of welfare* distributed within countries, around the world? This section extends the analysis to a few key indicators of attainment in the areas of education and health status, and access to a variety of services, that is expected to include schooling, health services, electricity, water and sanitation. Many of these variables are part of the distribution of assets in the population, and so will have an influence on the distribution of capabilities—or the opportunity to pursue a life of people's choosing. In education, three indicators stand out: literacy, the distribution of years of schooling (both unweighted and weighted by returns), and, where available, measures of educational quality, usually from comparable test-scores such as those in PISA or TIMMS. Key indicators for health are life expectancy at birth and infant or child mortality.⁴ Typically, there are significant correlations between these indicators, on the one hand, and income or consumption levels on the other. These correlations and some of the underlying processes will be explored. Infant mortality, for instance, is often not only too high in the aggregate, but even higher among the income-poor. Finally, of fundamental interest to the rest of the report are inequalities in power, voice and influence. Also of concern are measures of personal safety and equality with respect to legal and justice systems. While the types of data in these areas differ from the more "standard" variables, evidence on these issues will be systematically explored (for example from case studies).

1.5 *Group-based inequalities.* Group-based differences often make a large difference to the well-being for individuals (as discussed in Chapter 3) and to the reproduction of inequalities within a society. These differences can be important between genders within

⁴ Changes in inequalities in such different measures of health status are not always positively correlated; this type of question will be examined for the various dimensions of well-being.

the same household or social stratum, and between ethnic, caste, racial or other social groups. As Figure 3 illustrates for some countries in Latin America, the differences can be large: with respect to wages, indigenous and Afro-descended males typically earn half or less of white males, with women in these groups earning even less.⁵ This section would briefly introduce why such group-based differences are often salient, and discuss the role of both quantitative and ethnographic or other “qualitative” techniques for analyzing the underlying processes. Some important—but not exclusive—dimensions along which societies experience such group-based social differences include racial, ethnic, caste and gender lines. How important are these factors in each region? Are there trends in their relative importance over the last one or two decades? The available quantitative evidence can be drawn from existing studies and from the inequality profiles constructed in Section 1.3. These would be complemented by selected examples from ethnographic work. Available evidence will be presented on how some of these (unconditional) differences divide into parts due to different patterns of human capital accumulation (education and experience), parts due to other personal characteristics, and parts due to differential market remuneration. Where these differences compound each other, the effects will be more profound.

Figure 3: Ratio of female and non-white male monthly wages to wages of white males



Note: Figures for Brazil refer to the comparison between Afro-descendants and white, and for Guyana to Afro-descendants and Indo-Guyanese. For all others the comparison is all non-indigenous to all indigenous. Statistics are not gender-disaggregated for Chile, Mexico, or Peru.

Source. De Ferranti et al (2004).

1.6 Another dimension which deserves special attention is that of location. *Spatial patterns* of inequality (and poverty) within countries are often of importance in their own right, as well as relevant to the political economy of policy-making. These patterns can also be identified as one dimension of the inequality profiles developed in Section 1.3, but in specific instances they may be refined to achieve a much greater level of disaggregation, including by recourse to “poverty mapping” techniques. Such spatially disaggregated information will be used to investigate patterns of spatial divergence or convergence across regions, and their correlates in patterns of individual and community

⁵ These differences do not control for characteristics: such groups typically have lower education levels, which is both a dimension of inequality in its own right, and a source of income differences in the labor market.

assets. A particular aspect of spatial differences concerns environmental conditions—there are often inequalities in the quality and security of both urban and rural environments that are correlated with other dimensions of household inequalities. It is expected that this will be examined through use of illustrative examples.

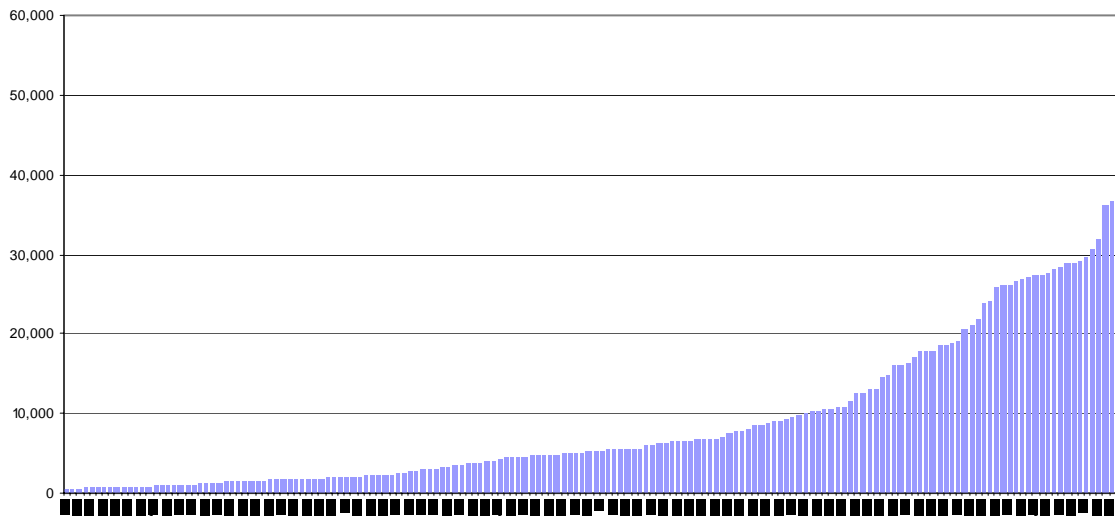
2. Global inequalities: countries and people

2.1 *Inequalities in global context.* If within-country inequalities are large, differences between individuals *across countries* are vast. This chapter will be motivated by indicators of difference in opportunities, by comparing life-chances for individuals born into different social positions in the world a generation ago: for example lower caste rural Indian v. middle class French; or poor Sierra Leoneans vs. Latin American elite. Differences in recognition are perhaps less immediately apparent in the international sphere, but are often relevant to one group—international migrants—and also affect portrayals of different groups in increasingly globalized cultural interactions. As with the previous chapter, the core empirical illustrations will be on outcomes.

2.2 The first part of this chapter will then summarize the recent literature on the world *income* distribution up until the 1980s, and if possible add the 1990s from the report's database (from Chapter 1). It is not meant to re-invent the wheel, and we will build on existing work in this area. We expect it to document a complex pattern of changes in inequality with significant differences if the unit of analysis is the country or the individual (both of which are of interest). At the *international* level (i.e. across *countries*), it is expected to document absolute divergence, albeit with important exceptions. Fast-growing developing countries—especially in East Asia, and recently South Asia—have been catching up with richer countries. But other parts of the world have been falling behind, both amongst low income countries (especially in Sub-Saharan Africa) and amongst many middle income countries (especially in Latin America, the Middle East and North Africa, and Eastern Europe and the Central Asia). At the level of global differences across *individuals*, Asia's equalizing influence is magnified by its large populations, especially because of the role of China and India. But this is again offset by the rising concern over lack of income growth amongst slow-growing countries—reflected in the increasing concentration of income poverty in Sub-Saharan Africa. (Chen and Ravallion, 2004).

2.3 As in chapter 1, the presentation of results will be tempered by explicit acknowledgment of the comparability problems. In this chapter, in addition to issues arising from the differences across surveys in the various countries, a large component of potential error arises through the estimates of PPP exchange rates. If possible, some form of robustness test with respect to assumptions in the estimation of PPPs will be presented. Figure 4 below, which draws on standard WDI data on Gross National Income from national accounts, is meant to be merely illustrative at the outline stage. While the final report is likely to rely more heavily on household survey data, the figure is nevertheless suggestive of the extent of the international differences in mean incomes.

Figure 4: Gross national income per capita across countries
(US\$ at PPP)

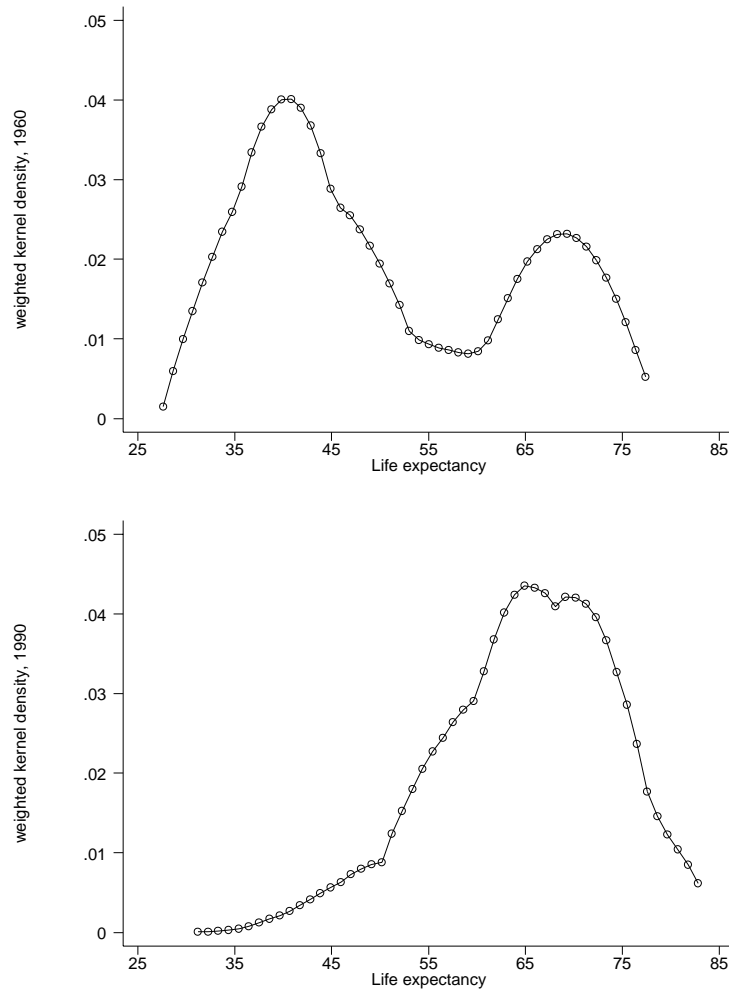


Note: PPP values given in current international US\$. Most recent data for each country for the 2000-2002 period.
Source: SIMA

2.4 The second part of the chapter will contrast the income dynamics with that for the evolution of the international distribution of *health and education* indicators. This can also be population weighted or unweighted (although intra-country distributions are harder to get for many health indicators). The preliminary evidence is that a contrasting picture appears to arise, with unconditional international convergence in mean years of schooling and life expectancy at birth, for instance. See Figure 5 below. However, as with incomes, any such convergence on *average*, may hide divergence for specific groups of countries: of particular concern is the recent dramatic reversal of gains in life expectancy in parts of Sub-Saharan Africa badly affected by the HIV/AIDS epidemic.

2.5 The third part of the chapter will delve, cautiously, into possible causes for the phenomena uncovered in the first two parts. One area of interest is economic globalization—in the sense of increasing participation in international flows of goods, trade and people. Is this correlated with greater income inequality, but greater equity in health outcomes? Do countries at the bottom of the distribution (including many in Africa) experience greater or lesser relative participation in the global economy? Is greater openness (in various markets) and the technological and organizational changes it induces, associated with greater or less inequality within countries? While the report will address these questions, it is unlikely that we can permanently settle a number of debates which are still ongoing, and we will present the discussion accordingly.

Figure 5: The distribution of life expectancy at birth across countries, 1960 and 1990
(kernel density)



Source: Araujo, Ferreira and Schady, work in progress. Data from Demographic and Health Surveys for _ countries.

Part II: Does inequality matter?

The Second Part of the report will examine the question of why and how some forms of inequality matter. It will discuss these questions in relation to the causal mechanisms that can lead to the perpetuation of inequalities, and will pay particular attention to case-studies illustrating the persistence of, or transitions in, inequality, to set the stage for the Third, policy-focused Part.

3. Equity, well-being and development

Inequalities of opportunities or of outcomes may matter for both intrinsic and instrumental reasons.

3.1 *Intrinsically*, people may judge some inequalities to be unjustified, that is to be unfair or unjust. This may apply, for example, when inequalities are unrelated to efforts, or associated with severe forms of deprivation for some individuals or groups relative to others. In other words, the political processes that lead to societal decisions may reflect a *social preference for equality*, such that a reduction in some aspects of social inequality are valued in their own right.⁶ As noted in the introduction, this is subject to assessment of tradeoffs with competing values, such as expansion of total production, or protection of individual or community rights. This section will briefly review some of these moral and philosophical arguments for lower inequalities, drawing on the academic literature, on faith-based perspectives and the explicitly stated views of governments. We will also examine some of the recent empirical evidence for and against an aversion to inequality, both from experiments and from surveys. It will note that inequality, like welfare itself, is multi-dimensional. And it will discuss group-based relativities, where people may care not only about their individual positions relative to a reference group (say, the mean), but also about the relative position of a group they belong to or identify with (say, a racial or ethnic group) to other groups within a society, and to the recognition that different groups receive in a society.

3.2 *Instrumentally*, inequality matters because of the powerful interactions between economic performance, inequalities and poverty. For the income dimension of well-being, this has been referred to as the growth-poverty-inequality triangle (Bourguignon, 2004), though similar considerations can apply to other dimensions of well-being. This can work both through effects on poverty for a given growth rate and, more fundamentally, for the relationship between inequalities and the overall development process.

3.3 *Empirically*, for a *given* growth rate, higher relative inequality generally implies a slower rate of reduction in absolute income poverty. As Table 1 below suggests, the growth elasticity of poverty reduction—the percentage decline in poverty for each percentage point in the growth rate—tends to decline with income inequality (and with the ratio of the poverty line to the mean). This table is based on simulations relying on a specific functional form assumption; the section will review actual empirical evidence for (or against) this claim. It will also discuss two phenomena about growth processes. First, the incidence of growth can vary widely, across countries and over time. Similar rates of growth in mean income are consistent both with massive gains for the poor, and with even absolute losses. Second, distributional dynamics appears to be characterized by substantial churning (or mobility). As the economy develops over time, people seem to “move up and down” in the distribution with some frequency. If these movements are real, rather than reflecting measurement error, they would be likely to affect welfare and

⁶ There may be sharply conflicting views within a society, of course—the sentence in the text refers to the outcomes of the political processes that underpin public decision-making.

welfare perceptions. If we can find evidence which is robust to measurement error, we would like to investigate it.

Table 1: The growth elasticity of poverty reduction under a log-normal assumption for the distribution of incomes or consumption

PL ^a \ Gini	0.3	0.4	0.5	0.6
.16	-6.2	-3.3	-2.0	-1.2
.33	-4.0	-2.2	-1.3	-0.9
.50	-2.8	-1.6	-1.0	-0.7
.66	-2.1	-1.2	-0.8	-0.5
.90	-1.4	-0.9	-0.6	-0.4
1.1	-1.0	-0.7	-0.5	-0.4

^a Poverty line as share of per capita GDP.

Source: López and Servén (2004).

3.4 In addition to affecting the poverty-reducing power of growth, there are important inter-relationships between inequalities and both efficiency and growth. These can work in either positive or negative directions. Some level of economic inequality is necessary to provide incentives for investment and effort (whether in education, work or purchases of fixed capital by private firms). Yet some forms of inequality can be detrimental to economic efficiency and growth in an aggregate sense. Indeed, the ways in which societies manage inequality—in terms of developing the policies and institutions that do or do not provide for equity, can have a profound impact on development paths. There are multiple channels of interaction, and theory would suggest no *general* relationship between economic inequality and growth. This general position will be introduced here, and developed in greater depth in the next two chapters.

3.5 In interpreting these instrumental processes, a simple framework will be introduced for the causal factors that affect *how* inequalities are generated and reproduced. This involves understanding the often circular causation between economic processes and social and political processes, with institutions (both formal and informal) playing a central role both in reflecting power structures and in mediating the joint processes of resource allocation and determination of distributions. Precisely because of the nature of these processes, it will be argued that the popular approach of examining links between inequality and growth in a cross-country regression context is likely to lead to weak, and potentially misleading results. To properly understand the linkages it will be necessary to pursue approaches based on microeconomic, historical and case study work, in ways that can identify the causal interactions.

4. Inequalities of assets and investment

4.1 The first reason why inequality is claimed to be detrimental to economic efficiency is through channels related to poverty, especially in terms of assets—which tends to be greater with higher inequality. If credit or insurance markets are imperfect, poor people may be shut out from profitable investment opportunities. Capital which exists in the economy, the argument goes, would have higher returns if used by these poor people than in their best alternative use. But market failures, arising from

information imperfections and commitment problems, prevent that capital from flowing to its most efficient use. Given the market failures, the behavior of the various actors may be rational, but the result is inequality in opportunities within societies that especially hurt the poor. The extent to which such interactions between inequality and market failures reduce overall efficiency will depend on institutions and policies. For example, the extent of poverty-induced underinvestment could be less with a deeper and better-developed financial system, for given levels of inequality. Similarly, specific interventions—such as provisioning of free or subsidized schooling—could reduce particular categories of under-investment.

4.2 Although the theoretical argument is best presented in terms of inequality of total wealth, empirical investigations of this claim have relied variously on incomes, meant to approximate asset disparities, or on specific assets, such as land or years of schooling. This chapter will review the empirical evidence from the cross-country regression literature. It will discuss the insights gained, but also the inherent shortcomings of that approach. It will then focus on the microeconomic evidence, including from historical case-studies, which may exist for the claim that economic efficiency losses are indeed being incurred as a result of the coexistence of poverty and capital market failures. The chapter will also discuss when such efficiency losses are likely to be purely static, or when they are likely to affect the overall growth rate of the economy via influences on investment. It will finally discuss the evidence from these studies on which institutions and policies may mitigate problems of underinvestment, in various different settings.

5. Inequalities, power and conflict

5.1 A second channel through which inequality is likely to affect aggregate development is via political interactions, that we might frame in terms of how societies manage distributional or inter-group conflict. The relationship between inequalities and conflict is complex, and intricately linked to institutional structures that manage or exacerbate potential conflicts. When some forms of inequality and institutions are associated with greater conflict (latent or violent) this is likely to be bad for aggregate development. This general argument conflates at least three separate mechanisms which may be at work, that may manifest themselves at various levels, from international to households. The chapter reviews the evidence for each of them in turn.

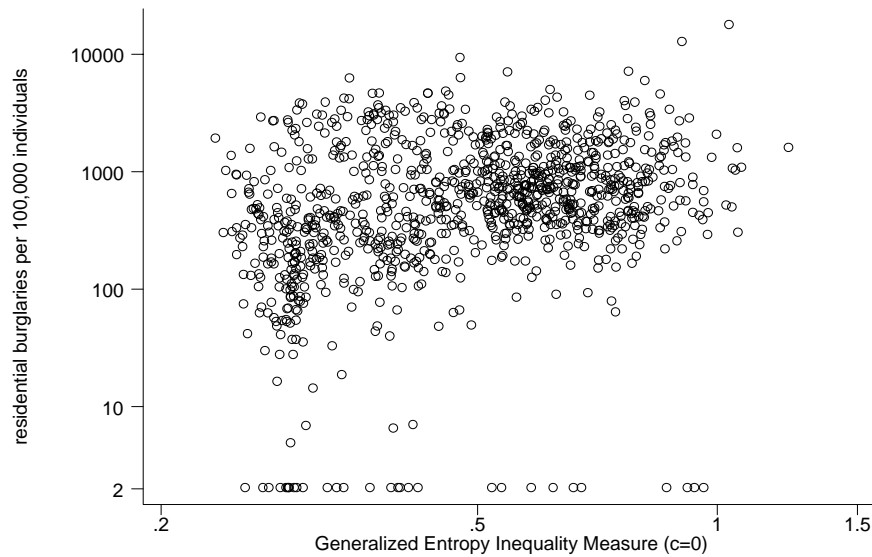
5.2 High inequality can lead to *latent social conflict*, which manifests itself through political struggles for public resources. Inequality may mean that different social groups have different interests, and the outcome of the political process through which those interests are reconciled may lead to reduced aggregate outcomes. This may happen because political processes (electoral or otherwise) seek to effect redistributions, but may do so in ways that have high economic costs, for example through creating disincentives to work or to save. Once social costs and benefits are taken into account, political outcomes may generate levels of unproductive government spending which are too high. It may also happen for precisely the opposite reason: political processes might be insufficiently redistributive, with powerful groups capturing economic privileges from budgets or financial systems. This can either lead to lack of action in areas that could

bring greater equity *and* greater efficiency (for example investments in public education) or the perpetuation of institutional structures that favor particularly powerful groups at costs to aggregate performance (for example via connected lending, high levels of protection and outright corruption). One particularly costly domain in which distributional conflicts can play out is the generation of macroeconomic crises and the choice of financial and fiscal responses to them.

5.3 Institutional structures are again likely to be highly relevant here, when political processes become crystallized in institutions that are inequitable and inefficient, or when there are poor institutional mechanisms for the resolution of social conflicts. Some interpretations of Latin American history are consistent with the view that elites systematically underinvested in subordinate groups and shaped formal and informal institutions that perpetuated such underinvestment. It is also consistent with a high cost for aggregate development of such distributional conflicts. This section will review the conceptual arguments and, more importantly, review the empirical evidence, including from historical studies. (See, for example, the analysis in a series of papers by Acemoglu, Johnson and Robinson and the historical work by Engerman, Sokoloff and co-authors on Latin America. See De Ferranti et al, 2004 for a summary and references).

5.4 Under some conditions, inequality can be associated with *open social conflict*, when it erupts into its most destructive form: violent conflict and civil war. This section will develop the theme that such violent conflicts are the product of the *interaction* between economic factors (such as incentives for looting natural resources), inter-group relativities, and institutional structures for managing conflict. While the section will be primarily concerned with the potential role of (some form of) inequality as a cause of conflict, and consequently lower growth, it will also look at the distributional consequences of conflict. Social conflicts, and the governance and institutional breakdowns associated with these, are typically associated with high levels of expropriation or looting. These may in turn lead to greater deprivation for (at least some of) the poor.

5.5 Finally inequality can be associated with *diffuse social conflict* that often manifests itself through high crime rates and widespread personal violence. There is some evidence from both cross-country and within-country studies, that high inequality is correlated with high crime rates. The simple correlation between local-level inequality measures and the residential burglary rates in South Africa, which are plotted in Figure 5, for instance, is positive and significant (at the 1% level). There is also evidence, including from recent investment climate surveys, that crime and violence have significant costs, both direct and indirect. Indirect costs include increased insecurity, and a consequent discouragement of investment. The evidence on correlations between inequality and crime and violence will be presented, as well as evidence from the literature on the processes that determine this type of violence. As in other areas, it is likely that particular kinds of inequalities, including those associated with social exclusion, interact with other factors—e.g. job opportunities, socialization processes, the functioning of police systems—to determine levels of violence.

Figure 6: Inequality of income and residential burglaries per capita in South Africa

Both variables are in logarithms. Observations where residential burglaries were equal to zero have been replaced by the smallest values in the sample.

Source: Demombynes, G., Özler, B., (2003).

5.6 The above mechanisms have been introduced at the societal level. There are also important questions of power and conflict *within* households, where gender differences are particularly salient. Power differences may again manifest themselves both in inequitable and potentially inefficient resource allocations (such as under-investment in girls' schooling) and, in some cases in open violence, especially in the form of wife-battering. While these take place within the home, they are connected with broader societal phenomena, including the status of women, the workings of the marriage market, ownership of household assets and access to labor opportunities.

Part III: Institutions and policies for greater equity and lower poverty

The main implications from Part I of the report are likely to be that (a) the world is a vastly unequal place, in global terms, and (b) in many countries, inequalities in either incomes or other indicators are also very high. The lessons from Part II of the report are that some forms of inequality can be a bad thing, for two reasons. First, because there is increasing evidence that people in many cultures have a preference for social equality. Whether this inequality aversion is driven by religious or moral concerns or by philosophical preferences, lies beyond the scope of our judgment. And second because, even if one decides to ignore these social preferences, high levels of wealth inequality can make both overall development (including economic growth) and poverty reduction harder to achieve.⁷

⁷ As already emphasized, these potentially adverse effects of inequality need to be balanced with a recognition that (a) some amount of inequality can have beneficial impacts through the provision of

These considerations mean that attention to equity is likely to be an important socio-economic goal both within countries and globally. However, it is a separate matter to assess whether particular *policies* are good for both equity and efficiency. In general there will be tradeoffs at the policy level, which need to be assessed on a case by case basis. Given the existence of tradeoffs, policy choices will depend on the preferences (e.g. for equity) of each society. In addition, *even if* a particular policy does lead both to reductions in productive inefficiency and to lower inequality, it will typically be the case that there will still be some losers. That is: there may be an important class of changes that both reduce inequality and expand aggregate resources⁸, but which are *not* Pareto-improving. Mechanisms for compensating such losers, if and when this is deemed appropriate, will once again depend on political and other institutions. The policy and institutional choices are manifold, and solutions depend as much on social preferences as on technical criteria. Since it would be impossible for a global report to try to offer specific answers to these various dilemmas, we seek only to map the tradeoffs for different classes of policies, at a general level, with specific illustrations

The report will argue that the common distinction between growth-oriented policies (such as trade or macroeconomic policies) on the one hand, and redistributive (or poverty-targeted) policies on the other, is misguided. Such a distinction fails to recognize that typically both categories of policies have equity and efficiency effects. However, this does *not* imply that every policy, or institutional arrangement, has to balance both efficiency and equity concerns individually. It is the overall *mix* of policies that matters. Sometimes a growth-enhancing policy will have inequitable effects that can be most effectively be dealt with by complementary policies or institutional arrangements in another domain. Part III of the report turns to considerations of such policies, under three headings: (i) distributional dimensions of economy-wide processes and policies; (ii) policies designed specifically to reduce inequalities in the distributions of assets, incomes and agency (or effective influence) in society; and (iii) policies and institutions that can address international equity at a global level.

It is anticipated that one of the conclusions of Part II will be that the pattern of agency and the structure of formal and informal institutions in a society plays a central role in the choice and implementation of policies, and the extent to which inequalities are deleterious to aggregate development processes. We have not yet resolved how to present the policy dimension of such considerations of agency and institutional structure, as it affects political and societal processes—including, importantly, questions of gender. Since these pervade all policies, our current preference is to deal with these issues primarily in the context of discussions of proximate social and economic policies, rather than devote a self-standing chapter to the issues.

incentives to work and save, and (b) certain policies that might be required to reduce inequality below certain levels may infringe on freedoms we would rather preserve.

⁸ This is related to a concept known in economics as the Kaldor-Hicks criterion. Nicholas Kaldor and John Hicks suggested, in 1939, that State A might be preferable to State B if those who gain from the move from B to A can compensate those who lose (regardless of whether they actually do).

6. Equity and economy-wide processes and policies

6.1 *The incidence of economic growth.* Aggregate economic growth is almost always beneficial for poor people. But, as noted in chapter 3, the power of economic growth to reduce poverty depends on its incidence, and this does vary widely, both across countries and over time. There is also evidence that progressive distributional shifts can be a powerful aide to growth, in reducing poverty (López and Servén, 2004). This section would review what we have learned about what makes growth more or less pro-poor, from a number of cross-country and country-specific studies, and seek to shed light on empirical regularities about institutions and policies which may improve the incidence of growth. This will include any evidence on the relationship between growth and gender, group-based and spatial differences. Complementing the work of WDR2005, one of the themes is how inequality and its derivatives interact with the “investment climate”. As already noted, a general theme is that the common separation between growth and distribution processes is not a helpful way of thinking about development: both in practice and in theory, distributional processes lie at the center of resource allocation and asset accumulation processes.⁹

6.2 *The incidence of economic fluctuations and macroeconomic policy changes.* This section will revisit the question of the distributional impact of recessions, devaluations, interest rate changes, financial and banking crises, and other macroeconomic phenomena. In particular, it will explore the interactions between inequalities, public finance and financial sector policies, and how they affect both the likelihood of crises occurring, and the allocation of losses across groups when crises do occur. Are crises different in countries that are more unequal in terms of incomes, or are the key factors institutional structures for managing distributional conflicts and the extent of social cohesion? In addition to these contextual considerations, specific policy options for making the allocation of the burdens of crises less regressive, through budgetary policy and financial sector regulation, will be discussed.

6.3 *The incidence of systemic economic reforms.* In addition to the long-run determinants of growth and distribution, and to the inter-relationships between inequality and short-term volatility, a separate question concerns the distributional consequences of systemic policy reforms. These include, for instance, liberalization of trade or of the capital account, privatizations and financial sector reforms. These changes can cause both long-term distributional shifts and substantial gains or losses for particular groups or individuals within the distribution. (As in other sections, this would again cover different cuts on the distribution, including gender, group and spatial issues to the extent data allows). In addition to reviewing the evidence on the distributional effects of policy reforms, the section will have two special foci. First, it will argue for explicit attention to be paid to issues of ‘horizontal equity’ across groups and individuals, with a case for creating compensatory mechanisms for likely losers before a reform is undertaken (where compensation is justified on equity or political economy grounds). Second, it will

⁹ Which is evidently not a new idea. Classical economists like Smith and Marx understood this well. In the first half of the 20th century, it was also a central concern of economists such as Kaldor, Kalecki, Robinson, Sraffa and others.

examine the particular case of financial sector reform, in light of the potential role of financial deepening and sound regulation in reducing problems of underinvestment of poorer groups as well as overall efficiency. This would explore the two-way relationship between inequalities in a society (especially inequalities of power and wealth) and the extent to which financial systems are biased toward connected lending and associated inequities and distortions.

7. Towards equity in assets, incomes, and agency

Chapter 6 argued that it is a mistake to separate growth and distributional processes, and that even policies that are not commonly associated with inequality are likely to have some distributional consequences. However, there is a class of policies that are particularly concerned with effecting changes in distributions, across households, genders, groups or geographic areas. These are assessed in this chapter, both for their likely effectiveness in achieving more equitable distributional outcomes, and for their influences on efficiency. While policymakers may be interested in greater equity in the fundamental distribution of opportunities, the instruments for furthering this goal involve interventions in quite specific areas. We classify interventions into those affecting assets (notably education, land, housing, access to credit and public services), current incomes (via taxes and transfers), labor market outcomes, and agency or influence. Each of these will be briefly discussed in turn, always paying attention to both equity and (good or bad) efficiency effects, including those discussed in chapters 4 and 5. There is particular interest in the relationship between public policies and investments and the pattern of spatial development. This will either be explored under the particular areas of public action or in a subsection that pulls together the interactions between policies across space.

7.1 *Assets.* An assets-based approach is likely to be at the core of a distributional strategy aimed both at greater equality of opportunity and at reducing the underinvestment associated with high inequality. The focus will be on four areas.

- *Education policies and institutions.* Over the long run, education is probably the most important asset affecting the distribution of productive opportunities, as well as differences in agency between individuals, between genders and groups. The potential for major equalization in both the level and quality of education will be explored.
- *Health and health finance.* Health and nutrition are both of intrinsic value and instrumental to economic productivity. Not only is health status unequally distributed (chapter 1), but also health shocks are sources of financial inequalities. This subsection would highlight the potential for equity-increasing policies to reduce the cost of such health shocks.
- *Land markets and land reform.* Both land distribution and land market functioning can have large effects on distribution, especially in rural areas. This section would examine options for reform, from the perspective of both distribution and efficiency. (This will draw primarily on World Bank, 2003). In urban areas, housing is an important asset for the poor, and policies to correct

market failures and increase the security of property rights in this area will be discussed.

- *Access to infrastructure.* Infrastructural services—roads, railways, electricity, telephony, water, sanitation, etc.—are important to the distributional pattern of growth, notably through the extent of spatial integration. Empirical work is beginning to show the distributional benefits of infrastructure expansion. However, service provision is often embedded in existing unequal political and institutional structures (e.g. clientelistic patterns of job and service provision), and reforms need to be designed to tackle these. This would include discussion of the conditions under which privatization can be equalizing or disequalizing.

In some of these areas, such as basic education and health, rights-based approaches may be valuable ways of achieving greater equity. The report would explore empirical evidence on whether the explicit pursuit of economic and social rights is effective in achieving improvements in well-being of poorer groups in these dimensions. (See Drèze, 2004, for an argument that such approaches can be useful in mobilizing public action in the cases of education and basic food in India).

7.2 *Taxes and transfers.* An assets-based strategy is likely to be a medium to long-term endeavor. Many societies also seek to change the current distribution of income through taxes and transfers—with large effects on inequality having been documented in OECD countries. This section would examine policy options for greater equity in both tax policy and redistributive transfers in developing countries, paying particular attention to efficiency, administrative and political economy factors. For example, conditional cash transfers, such as *Bolsa Família* in Brazil and *Oportunidades* in Mexico appear to contribute to reductions in current poverty levels, while also having positive efficiency effects on human capital accumulation, through subsidizing school enrollment and visits to health clinics.

7.3 *Labor market policy.* Historically labor conditions have been one of the major domains of distributional struggle. Institutions (notably unions) and policies (such as minimum wages, policies affecting worker income security, and labor standards) will be examined for their impact on basic conditions of work and on the dignity of workers, wage distributions and the distribution of provisioning for income security. The effects of restrictions on the freedom of movement of workers within countries (such as domestic migration) will also be considered here.

7.4 *Agency and influence.* Greater equality of effective influence, or agency, is desirable for intrinsic reasons, and also for the shaping and implementation of policies in all other areas. This is a function both of overall political organization in a society and socio-cultural factors that tend to perpetuate inequalities, especially between genders and groups. This section would examine how shifts in accountability relationships in a society (see WDR 2004 on services) can increase equality of agency, both via formal structures and via the role of direct participation and “empowerment” in increasing the effective influence of subordinate groups. This will include attention to the potential for changing the “terms of recognition” of different groups in a society. One focus is expected to be

the role of legal or justice reforms that provide greater equality before the law, as a complement to other means to achieve greater equality of agency.

8. Institutions and policies for global equity

The final chapter considers the scope for international public action for greater equity. Starting from the discussion on international inequalities from Chapter 2, this would discuss the potential role of policies and institutions in the global arena (including of OECD nations and the multilateral institutions). This would include discussion of whether policies influencing the extent and pattern of globalization can be shaped to lead to greater global equity. It is currently planned to cover four areas.

8.1 *International policies on trade and property rights.* Distributional dimensions of trade have been extensively analyzed and discussed in recent years, including by the World Bank. An important message of past work, that will be presented here, is that policies of protection of labor-intensive goods—especially agricultural products—are a source of greater global inequality. There will also be a discussion of the assignment of intellectual property rights in areas such as pharmaceuticals. The vexed issue of property rights over the world’s common environmental resources—such as a stable climate, clean oceans and the ozone layer—may also be discussed here.

8.2 *International migration* is a very old phenomenon, but it has recently been receiving more attention, notably in rich countries. This section would examine the existing evidence on the distributional effects of international migration on international inequalities, on distributions within both sending and receiving countries, and the extent to which greater migration can be a source of reduced global (between-person) inequality. It would also address questions of group-based interactions—including indignities and abuses faced by illegal migrants, and inter-group tensions that can emerge in receiving countries.

8.3 *International capital flows and aid.* In principle, capital and grant flows should be sources of reductions in inter-country inequality, with ambiguous effects on within-country distributions (though much aid is increasingly oriented to within-country poverty reduction.) The literature on these effects would be briefly summarized and one or two issues selected for focus. Two candidates are: the international dimension of loss allocations in crises; and the potential tradeoff in the inter-country aid allocations between those with greater poverty—especially Low Income Countries under Stress--and those with greater likelihood to use aid effectively.

8.4 *International dimensions of influence and recognition.* The main question on the table is whether poorer groups in the world have equitable influence in international decision-making, whether via their representation by governments or other means.

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¹⁰ This reference list only includes the few articles or books specifically referred to in this outline. There is, of course, an enormous literature on the issues that will be covered. For a list with a Latin American orientation, see the bibliography in De Ferranti et al (2004).

Team:

The core team will be co-directed by Francisco Ferreira and Michael Walton, and will comprise Peter Lanjouw, Tamar Manuelyan Atinc, Marta Menéndez, Berk Özler, Giovanna Prennushi, Vijayendra Rao, Michael Woolcock (all of the World Bank), Abhijit Banerjee (Massachusetts Institute of Technology) and James Robinson (Harvard University). Specific inputs will be provided by Caridad Araujo, Shaohua Chen and Ana Revenga. Research assistance will be provided by Claudio Montenegro and Jeffery Tanner. Rebecca Sogui manages the WDR office and Eva Santo-Domingo manages its budget. We thank Alexandru Cojocaru for assistance in preparing this outline.

The team will consult periodically with a Panel of Advisers, presided over by François Bourguignon, and consisting of Professors Arjun Appadurai, Abhijit Banerjee, Angus Deaton, Naila Kabeer, Martin Ravallion and James Robinson.

In addition to formal interactions with the governments of members of the World Bank, via the Board of Executive Directors, there will be a variety of consultation activities. This will include interactions with academics, civil society, the private sector and other interested groups in both developing and developed countries, via meetings and electronic means. Christopher Neal is heading up the WDR consultation effort, working closely with the co-directors.

Within the World Bank the team will interact extensively with sectoral networks (for example on pro-poor growth with PREM, on questions of social development and equity with the Social Development family) and with regional teams.