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Breaking Out of Inequality Traps: Political Economy Considerations

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This Note is based on presentations and comments by François Bourguignon, Frances Stewart, Léonard Wantchékon, and Nancy Birdsall (chair) at the 2008 PREM Conference session on “Political Economy of Inequality: Implications for Inclusive Growth,” and focuses on actions that the World Bank may pursue to promote more inclusive growth.

Inequality is a growing concern in both developing and developed countries, and in countries with growing economies as well as those that are stagnating. There is considerable agreement that high levels of inequality, which preclude large segments of society from participating at their full potential, can undermine growth and political stability. If the instability escalates to serious conflict, further negative repercussions for both growth and poverty can arise, potentially reversing years of development.

To explore the linkages between inequality and the political economy constraints to inclusive growth, this 2008 PREM Conference session focused on the following questions:

- Does inequality affect the quality of economic and political institutions?
- What political conditions are conducive to effectively addressing high levels of inequality?
- What role can the World Bank play in these sensitive political issues?

Inequality of what?

Since inequality is multidimensional with economic, social, and political aspects and can have many different interpretations, it is

important to clarify the type of inequality that we are discussing. Typically, we talk about the inequality of outcomes such as welfare (for example, per capita consumption). But considering that outcomes are dependent on a number of factors, including exogenous circumstances, individual effort, and available opportunities, it has been argued that it would be better to focus on the equitable access to the resources necessary to improve one's well-being rather than the equality of outcomes per se. As emphasized in the *World Development Report 2006: Inequality and Development*, reducing the “inequality of opportunities,” possibly through the “redistribution of influence, advantage, or subsidies away from dominant groups,” may be an appropriate policy objective for poverty reduction, especially because equity-enhancing redistributions can often be efficiency increasing. Granted, this is not an easy task.

It is also important to distinguish vertical inequalities (between individuals) from horizontal inequalities (between groups). Horizontal inequalities—for example, in wages or service provision—may be rooted in discrimination by gender, race, or some other group identity. When these differences

are perceived as unjust, such inequality can provoke resentment and increase the potential for conflict.

Furthermore, horizontal inequalities can be self-perpetuating. For instance, when women are denied the right to vote, their ability to tackle gender inequality is diminished. Despite the fact that the between-group component in inequality decompositions rarely accounts for more than 15 percent of total inequality, Ravi Kanbur (2006) points out that addressing between-group inequalities is important, in particular when the horizontal inequalities tend to preserve the structure of overall inequalities.

Significant inequalities can undermine the quality of institutions important for development. Inequalities in political influence may result in a suboptimal allocation of resources and a smaller pool of investors and innovators—compromising efficiency and weakening economic growth. High inequality is associated with lower poverty reduction from growth, for instance, due to discrimination and exclusion (World Bank 2005).

Inequality traps

In an inequality trap, the structure of inequalities contributes to stabilizing a welfare distribution over time such that the rich stay rich and the poor stay poor. Although an alternative distribution might exist where society as a whole is better off and inequality is lower, shifting to it can be difficult as a number of factors may be interacting to maintain the status quo. For instance, the vested interests of groups benefitting under the status quo, differential accumulation of assets, asymmetries in social capital, and discrimination may perpetuate group inequalities and create barriers to equality-enhancing reforms. Although one could design a number of policy interventions for reducing inequalities, their adoption and implementation often pose the biggest challenges.

To illustrate the concept of an inequality trap, let's suppose that wages in a society are determined by the quality of schooling and

that a private school education is superior to that of public schools. Rich families opt to enroll their children in the private schools, and poor families send their children to the inferior public schools as they cannot afford the private schools, and nor can they borrow money easily. Also suppose that political influence in funding decisions for public schools is a function of wealth; that is, the rich possess greater political power in such decisions. Since the rich do not directly benefit from the public schools in this case, they could very well advocate for a small budget for public schools and keep public educational quality low, thereby perpetuating the cycle (Bourguignon et al. 2007).

As the example above illustrates, the forces that preserve a low-level equilibrium are often political in nature. Groups that have enjoyed advantages in the past are likely to resist policies that would increase their tax burden or introduce greater competition for opportunities in education or higher-level jobs—and such groups often have considerable political clout. Or simply because of deep-rooted historical discrimination, *de jure* and *de facto* antidiscriminatory practices may differ considerably.

Democracy does not guarantee lower inequality

Perhaps surprisingly, having a democratic system or transitioning to such a political regime does not necessarily mean that the issue of inequality will be tackled. Possible reasons are, among others, elite capture of political institutions, corruption and poor governance, lack of political commitment to equity- and efficiency-enhancing reforms, opposition from groups that risk substantial losses, fragmentation of the majority, and deeply rooted historical discrimination.

Even in democratic societies, political power is often not equally distributed and elite capture of political institutions and decision-making processes can occur. Araujo et al. (2008) provide evidence that in more unequal communities of Ecuador, Social

Fund projects with benefits exclusively for the poor (for example, latrines) are less likely to be chosen by the community, suggesting that political power is positively correlated with socioeconomic status. In other cases, the minority group cannot win the necessary support for reforms, or the majority is fragmented (for example, voting along ethnic lines or other subgroups of the deprived majority). Also, the incentives of politicians may not necessarily be aligned with those of society as a whole.

After all, what are the electoral and other incentives that politicians face? In an effort to secure votes and support, politicians often resort to clientelism at the expense of seeking to provide public goods. If politicians choose policies based more on their short-term political appeal rather than on the growth or poverty reduction impacts, it may be difficult to break out of an inequality trap. The lack of political commitment to equity-enhancing reforms tends to preserve the status quo.

Furthermore, weak governance can undermine the implementation of reforms or programs that require a well functioning bureaucracy. Benjamin Olken (2006) recently examined the welfare effects of corruption in a subsidized rice distribution program in Indonesia. He estimated that about one fifth of the rice disappeared and found that “corruption was sufficiently large to turn an otherwise welfare-enhancing program into a program that may have been welfare-reducing on net.”

Is there a way out?

As François Bourguignon explained in his presentation, getting out of an inequality trap requires a redistribution of elite privileges, which produces winners and losers in the process. In principle, if there is an aggregate gain, that is, an expansion of the pie resulting from this redistribution, even the short-term losers could be better off in the long run. In Spain, economic transformation and growth in the 1960s and 1970s defused social conflict, broke down perceptions of a

zero-sum game, and made the prospects of higher incomes and social mobility credible. Within this context, democratization succeeded following Franco’s death in 1975, and progressive and redistributive policies were adopted, improving access to infrastructure and education, health, and social services (World Bank 2005).

Our knowledge about how to promote changes out of inequality traps is still limited. A survey of the literature provides mixed results as to which political reforms work, where, when, and why. Lacking an empirical consensus, we are not in a position to recommend particular political reforms for the sake of greater equity. Moreover, there are limits on how much the World Bank can advocate for particular political reforms.

However, as a first step, we have some insights into the political conditions that may offer a window of opportunity for reform. Frances Stewart has classified the political conditions under which equity-enhancing reforms have been adopted in the past (box 1).

We also know of the various types of equity-enhancing policies that countries have implemented in the past. Frances Stewart categorized equity-enhancing policies as (1) integration, (2) direct, or (3) indirect policies. Integration policies strive to promote unity and greater societal integration. Direct policies redistribute opportunities and benefits in favor of particular groups. Affirmative action is an example. Indirect policies, while

Box 1: Political Conditions for Equity-Enhancing Reform

- Mobilization of deprived majority (South Africa, Fiji)
- Protest by the minority (United States)
- Agreed need for political stability (Nigeria)
- Ideology of universal rights (India)
- External pressures (Northern Ireland)

Source: Frances Stewart’s presentation.

not explicitly targeting any group in particular, tend to benefit certain (disadvantaged) groups. Examples of indirect policies are progressive taxes, antidiscrimination laws, and universal access to services.

A basic policy option in poor- and high-inequality environments where there are many gaps in services is to promote the universalization of public services and to attempt to improve the minimum quality of such services. Such indirect policies may improve nonincome poverty measures in the short term and facilitate greater opportunities in the long term. Although targeted interventions may reduce inequality more, indirect policies are more likely to be politically palatable.

As a second step, we can consider what would make indirect approaches to enhancing the equality of opportunities more attractive as platforms for politicians. Since any reform that changes the distribution of opportunities will produce winners and losers, the question becomes: how do we get the short-term losers with strong political influence to believe that they can be better off in the long term? If information about intertemporal tradeoffs is credible and convincing to potential short-term losers, it may be possible to break out of the inequality trap. However, this is not a trivial task, both in terms of the analytical challenge and of building trust and conviction among stakeholders.

One way of going about this is to try to align the electoral incentives that politicians face more closely with the broad collective and longer-term interests of citizens. If politicians believe that a campaign based on clientelism is superior to one focusing on broad-based policies, we would see clientelism prevail. However, even where clientelism is quite entrenched, there is the potential for shifting toward sounder and more broad-based campaign platforms and policies. In a recent experimental impact evaluation of voting behavior in Benin, political campaigns with broad-based policy platforms—including enough specificity to highlight their

Box 2: Impact Evaluation of “Good Policies” on Electoral Appeal in Benin

Léonard Wantchékon investigated the roles of expert information and public deliberation on voter behavior in Benin. By enlisting the top four candidates for the 2006 presidential election and randomly selecting villages into control and experimental groups, he was able to show that broad-based policies are viable substitutes for traditional clientelist campaign strategies.

Evaluation design: (1) A conference was held where the top four candidates discussed policy options with experts. (2) Policy messages were designed based on conference proceedings (for example, free primary education and free medical coverage for children with malaria). (3) In treatment villages, teams campaigned using these messages that promised broad-based policies. In control villages, teams monitored campaign activities.

Findings: Voter turnout, trust in the candidate, and likelihood to vote for the candidate were greater when campaigns were based on well designed broad-based policies.

Source: Léonard Wantchékon's presentation.

relevance to constituents—were more effective than traditional clientelist approaches (box 2).

What role for the World Bank and other external agents?

Despite the political sensitivities associated with many equality-enhancing reforms, the panel offered several ways in which the World Bank and other external agents can contribute:

- Provide technical assistance on the distributional impact analysis of reforms, and encourage wide public dissemination of results to stimulate open debate.
- Promote more equitable and antidiscriminatory practices, and set norms for policies to decrease horizontal inequalities.
- Support information campaigns that may improve public deliberation, and provide policy makers with sound policy advice with which they may design better

policies and build stronger substantive platforms that move away from clientelist practices.

- Identify the specific nature of the political economy constraints that tend to perpetuate low-level equilibrium.

Further Reading

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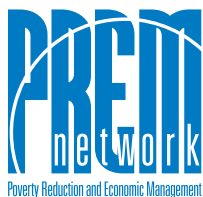
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