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THE IMPACT OF INCOME INEQUALITY ON ECONOMIC GROWTH: A COMPARATIVE ANALYSIS BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

Abstract: this article outlines the income inequality that has emerged as a critical issue in both developed and developing countries, influencing economic growth trajectories in a complex way. This paper examines the interplay between income inequality and economic growth, analyzing key mechanisms, such as investment in human capital, social cohesion, and political stability. While income inequality has nuanced effects in developed countries, often fostering growth through innovation and investment, it is more likely to impede growth in developing countries by exacerbating poverty and limiting access to essential resources. This research highlights the policy implications of these findings, offering strategies to mitigate inequality's adverse effects while fostering sustainable growth.

Key words: income inequality, developed countries, developing countries

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ВЛИЯНИЕ НЕРАВЕНСТВА ДОХОДОВ НА ЭКОНОМИЧЕСКИЙ РОСТ: СРАВНИТЕЛЬНЫЙ АНАЛИЗ МЕЖДУ РАЗВИТЫМИ И РАЗВИВАЮЩИМИСЯ СТРАНАМИ

Аннотация: в этой статье рассказывается о неравенстве доходов, которое стало серьезной проблемой как в развитых, так и в развивающихся странах и оказывает сложное влияние на траектории экономического роста. В данной статье рассматривается взаимосвязь между неравенством доходов и экономическим ростом, анализируются ключевые механизмы, такие как инвестиции в человеческий капитал, социальная сплоченность и политическая стабильность. В то время как неравенство доходов оказывает неоднозначное воздействие на развитые страны, часто стимулируя экономический рост за счет инноваций и инвестиций, оно, скорее всего, будет препятствовать экономическому росту в развивающихся странах, усугубляя бедность и ограничивая доступ к основным ресурсам. В данном исследовании освещаются политические последствия этих выводов, предлагаются стратегии смягчения негативных последствий неравенства при одновременном содействии устойчивому экономическому росту.

Ключевые слова: неравенство доходов, развитые страны, развивающиеся страны.

Income inequality can be defined as the unequal distribution of income within a population that has significant implications for economic growth. The relationship between inequality and growth varies across contexts, shaped by institutional frameworks, labour market dynamics, and access to resources. Based on the empirical data for most economies, the relationship between inequality and growth is complex.

At low-income levels, inequality tends to boost economic growth by increasing physical capital investment [1]. As income levels increase, human capital becomes more important than physical capital, and inequality tends to impede economic growth by affecting human capital accumulation such as a person's education level, problem-solving abilities, communication skills, good health and the ability to adapt to new situations [2]. Developing countries with advanced institutions and diversified economies often experience different growth-inequality dynamics compared to developing nations, where structural challenges and resource constraints prevail. The most commonly used summary measure of economic inequality specifically in terms of income is the "Gini coefficient", which is directly linked to the Lorenz curve [3]. The Gini coefficient is defined as the area between the Lorenz curve and the 45-degree line, divided by the total area under the 45-degree line. The Gini coefficient is independent of the size of the economy and the size of the population [4].

Countries with relatively high levels of economic growth and security are considered to have developed economies [5]. The term "developed country" is often used to describe countries with developed economies or developed markets, which can lead to scenarios in which a given country is considered developed in one sense by one institution, but not in another sense by another institution [6]. For example, the United Nations classifies Turkey as a developed country thanks to its 2021 Human Development Index (HDI) of 0.838. (Turkey is also a member of the G20, a group composed of countries with the largest economies in the world) [7].

For households in 2019-20, the Gini coefficient for equivalised disposable income was 0.324, relatively steady from 2017-18 (0.328), and slightly higher than 2003-04 (0.306). For example, in 2020, Australia had the 17th highest level of income inequality among the 34 OECD countries for which data was available [7,8].

Based on Figure 1, the Lorenz curves of the developed and developing country groups are plotted. The curve close to the equality line belongs to the developed countries while the other one belongs to the developing countries i.e. lower Gini coefficients (more equity in income distribution) creates higher per capita income (or economic growth) [9,10]. In other words, optimal income distribution increases per capita income and reduces inequality [11,12].

There are two causal relations between income distribution and economic growth. According to the explanation from Kuznets, the positive and negative relationship between income inequality and economic growth depends on the stages of development.

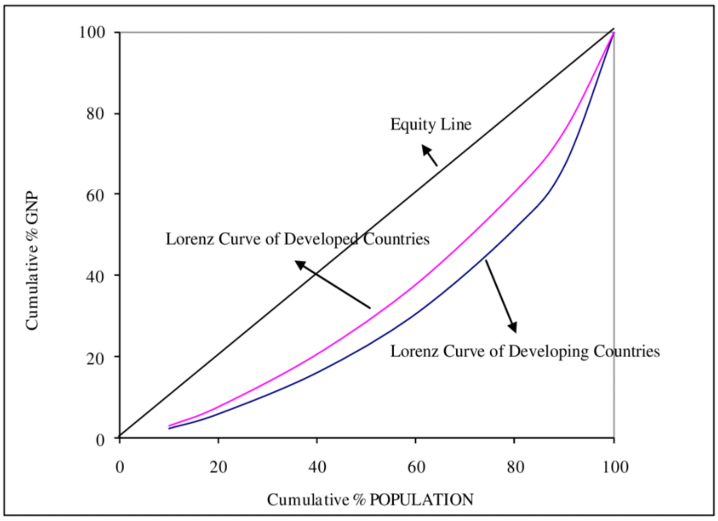

Figure 1: Lorenz Curves of Developed and Developing Countries

To illustrate, countries in the early stage of development periods have both rising per capita income and income inequality. But, at the later stage of development, countries have low income inequality with high per capita income [11,13].

Countries with developing economies are often helped by globalisation to reach improved levels of income and increased standards of living [17]. According to Figure 2, there may be a negative relationship between income inequality and economic growth both in developed and developing countries. Also, there may be positive relationships in both developed and developing countries.

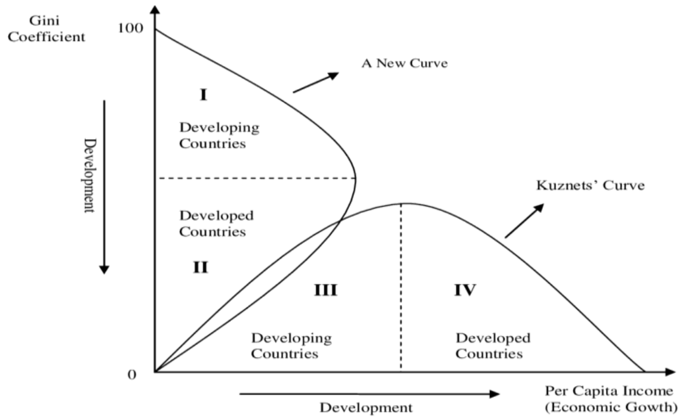

Figure 2 - Comparison of Two Inverted U Curves

The International Labour Organisation (ILO) defines the concept of a minimum wage as "the minimum amount of remuneration that an employer is required to pay wage earners for the work performed during a given period, which cannot be reduced by collective agreement or an individual contract". This means that minimum wages must have the force of law [14].

Figure 4 illustrates that in a much larger share of countries (84%) minimum wages are statutory, which means that they are set by governments, with or without consultation with the social partners. In a number of those countries, statutory minimum wages coexist with higher collectively agreed minimum wages in particular industries or enterprises.

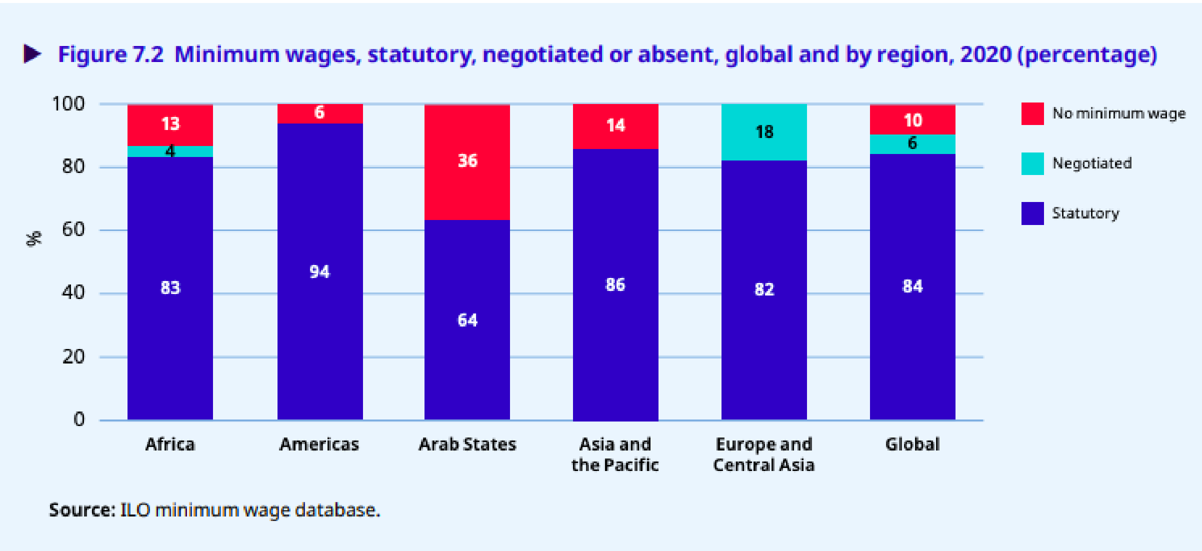

Figure 3 - Minimum wages, statutory, negotiated or absent, global and by region, 2020 (percentage) [14]

One of the drawbacks of income inequality on economic growth is high inequality can affect capital accumulation by inhibiting investments. For instance, all the things that go into the production process for consumer goods such as the manufacturing equipment at a product factory, or buildings that house businesses along with the equipment that businesses use to supply goods and services to consumers [15,16]. Moreover, inequality may hinder the accumulation of human capital by increasing the fertility rate of the poor and lowering their average level. In addition, high inequality can lead to the redistribution of income and turmoil in the socio-political environment, affecting investment and hindering capital accumulation.

Income inequality's impact on economic growth is context-dependent, with developed and developing countries experiencing divergent outcomes. While developed nations can leverage inequality for growth under certain conditions, developing countries face significant barriers that impede progress. Bridging the inequality gap through targeted policies is essential to fostering sustainable growth and achieving broader economic development goals. No single roadmap exists on how to narrow the gap between the rich and poor, but governments have the toolkit to make a difference.

Policymakers will need to accept and follow through on several approaches. This includes taxes and spending programs that need to be more progressive. Policymakers face decisions on whether to focus on the government's revenue side via a tax system in which the wealthy pay more of a share or on public spending for programs that benefit the lower and middle classes. Either way, a legitimate goal would be to expand access for lower-income citizens to quality education, healthcare, and other fundamentals for living and working in society. Moreover, governments that rely only on proven policy solutions may have limited scope. To overcome this, they need to try and test new and innovative policies to confront complex problems, especially the displacement of jobs by technology and the effects of climate change [17,18]

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