

# POVERTY & INEQUALITY

## Persistent Challenges and New Solutions



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Management & International Studies

Globalization TrendLab 2013

**Poverty & Inequality**  
Persistent Challenges and New Solutions

Based on a conference organized by the Joseph H. Lauder Institute of Management & International Studies and the Penn Lauder Center for International Business Education and Research at the University of Pennsylvania, sponsored by Santander Universities, and distributed worldwide through the Knowledge@Wharton network.

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# Executive Summary

**P**overty and inequality around the world have evolved in disparate ways over the last two decades. The number of people living below the poverty line has been cut in half, primarily due to robust growth in the emerging economies. Meanwhile, poverty is on the rise in both Europe and the United States, especially among children. While inequality across countries is on the decline, inequality within countries has grown in both the developed and the developing world, with the notable exception of Latin America. In developed countries, deindustrialization, lower levels of unionization, declining wage shares of national income and the financialization of the economy are largely responsible for the increase in inequality. In developing and emerging economies, unbalanced growth between the cities and the countryside, and within urban and rural areas, is mainly behind the trend. As a result, a rising global middle class of consumers, centered in China and India, is developing, although in most countries the uppermost segment of the income distribution is also growing relative to the rest.

Patterns of poverty and inequality have complex origins in culture and the social structure, and are also driven by shifting dynamics in the labor market, the healthcare sector and the financial system. Political shifts, especially regarding the role of the government in the economy and the welfare state, have fundamentally redrawn the global map of poverty and inequality, and hold the key to the solution of some of the most worrying trends, especially those having to do with children, disconnected youth (those out of work and not in school), and future inter-generational conflicts over scarce resources. Solutions to the problem of poverty and inequality range from those focused on a wholesale transformation of the social structure to those advocating opportunity-driven, cost-effective interventions, especially at the crucial points in time when people make life transitions across educational levels, from school to work, or from job to job. We also discuss the virtues of an approach based on development goals compared to one based on standards, and the promise of entrepreneurship as a path out of poverty. We make a series of specific recommendations aimed at ensuring that poverty and inequality enter a new phase of decline around the world.

# The Shifting Global Map of Poverty and Inequality

**D**uring the last two decades, the global picture of poverty and inequality has changed considerably, often in paradoxical ways. Poverty, defined as the number of people below a certain level of income needed to cover basic necessities, is on the decline for the world as a whole due to rapid economic growth in China, India and Brazil because of their size compared to the world's population and their economic growth. Drawing the poverty line at \$1.25 a day (expressed in 2005 purchasing power parities), there were 1.9 billion poor people in the developing world in 1990, a number that came down to 1.3 billion by 2008. Thus, the proportion of people living in extreme poverty dropped from 52 percent in 1981 to 40 percent in 1990 and 22 percent in 2008. In East Asia, the proportion plummeted from 77 percent in 1981 to 14 percent in 2008.

“We are witnessing the first decline in global inequality since the 1820s,” notes the World Bank’s Branko Milanovic, one of the most influential experts on global poverty and inequality. “It’s a massive rebalancing between East and West, and between South and North driven by the growth of the emerging economies.” While “the number of poor people has been cut in half over the past 20 years,” he adds, “there is still enormous inequality as well as poverty in the world.” Most people in extreme poverty nowadays live in South Asia (570 million) and Sub-Saharan Africa (396 million). East Asia is home to 284 million and Latin America to less than 50 million.

Thus, it seems as if David Dollar and Aart Kraay were right when they published their famous 2002 article, “Growth Is Good for the Poor.” Reducing the argument to just one variable, however, is misleading. In addition to economic growth, gender is an important variable accounting for the

reduction in poverty rates in the developing world. Since the 1970s, gender has become part of the overall theoretical, empirical and policy debate about poverty and inequality, thanks to the work of Ester Boserup at the United Nations. In some parts of the world, important, though hardly universal, improvements in women’s education, health, legal rights, equality of roles and socioeconomic status have led to a reduction in poverty and inequality. In the Middle East and Sub-Saharan Africa, however, progress continues to be rather slow.

While the developing and emerging world has witnessed a reduction of poverty rates, Europe and the United States have experienced just the opposite, taking into account, of course, that the poverty lines used in rich countries are about ten times as high as the poverty lines used in poor countries or the World Bank’s absolute poverty line. In November 2012, the U.S. Census Bureau estimated that 16 percent of the population, and almost 20 percent of children, live in poverty, the highest levels since the early 1960s. Poverty thresholds are defined with regard for different sizes and composition of households. For instance, in the U.S., for a family of four, including two children, the threshold is \$23,283 in annual income. The European Commission estimates that 16 percent of its population, and 19 percent of children, are in or at risk of poverty, and that 17 percent of Europeans suffer from material deprivation, i.e. “their living conditions are severely affected by a lack of resources.”

The impact of these trends on children has reached alarming proportions, which do not bode well for the future. According to Carolyn Miles, CEO of Save the Children, “about 23 percent of kids in the U.S. are living below the poverty line.” And the bad

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## “We are witnessing the first decline in global inequality since the 1820s.”

– Branko Milanovic

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news is that the problem in the U.S. is likely to get worse given current budgetary pressures. Poverty hits people all over the world. “Poor kids don’t vote, and have very little political power, if any,” she adds. “Poor kids are 18 months behind wealthier peers on average by age four in terms of reading skills,” Miles notes. In more ways than one, “poverty and inequality manifest themselves in virulent ways among children,” observes Emily Hannum, Professor of Sociology at Penn.

The retrenchment of the welfare state on both sides of the Atlantic has much to do with the recent rise in poverty rates, in the same way that “the expansion of the social safety net has historically contributed to poverty reduction,” argues Evelyne Huber, Professor of Political Science at the University of North Carolina, Chapel Hill. However, there are deeper and older roots. “The migration of manufacturing jobs to other parts of the world has generated a decline in the share of income accounted for by labor,” argues Paul Osterman, a Professor at the MIT Sloan School of Management. “Meanwhile, jobs created in the service sector have proved to be much more heterogeneous in terms of skill level, stability and pay than those in manufacturing.” Huber points out that in Latin America growth in manufacturing jobs has historically led to lower inequality.

The rise of informal employment in developed countries is another important background factor, argues Saskia Sassen, Professor of Sociology at Columbia University, who is also concerned about “the financialization of the economy and the breakdown of the mass production/distribution/consumption economy in Europe and the United

States that provided much stability to the social structure in the post World War II era.”

While poverty implies a certain absolute degree of destitution and lack of access to resources, income inequality is a relative concept. Rapid growth in the emerging economies has led to convergence in income levels across countries, thus reducing inequality. This process started in the 1990s, fueled by China’s rise as a manufacturing and exporting power. Excluding China, income inequality across countries started to drop globally at the turn of the 21st century, while it had increased more or less steadily since the end of World War II.

While poverty in developing countries and income inequality across countries have declined, income inequality within countries has risen in many parts of the world. The distribution of income in China, India, the Philippines, Egypt, Kenya, Germany, Poland and the United States, to name but a few countries, has widened (or become more unequal) over the last two decades. It has also increased in Sweden, albeit from a very low level of inequality. By contrast, in Brazil, Mexico and Turkey, inequality is lower than ten years ago. The causes for these changes are complex. As in the case of poverty, the retrenchment of the welfare state and budgetary crises in several rich economies partially account for the increase in inequality and in poverty. At the same time, countries like Brazil have launched large programs of income redistribution aimed at improving health and educational standards among the poor. Its Bolsa Familia program, for instance, covers 25 percent of the population.

Perhaps the most significant factor behind the recent spike in inequality globally has to do with technological change, according to a recent IMF study. New technology tends to favor skilled workers over unskilled ones. Financial globalization was also found to contribute to inequality, though not as strongly. Still, the financialization of the economy has proved destructive in advanced economies, and also in some developing and commodity-exporting countries. Trade, by contrast, seems to have reduced inequality within countries, although it is hard to tell whether the positive effect comes from trade per se or from the economic growth that it has generated in emerging economies. In general, “integration into the global economy has helped reduce poverty around the developing world, and it has also cut income disparities across countries,” observes Jack Goldstone, Professor of Public Policy at George Mason University.

Much of the global increase in income inequality has taken place in China and India, which combined, account for nearly one third of the world’s population. In these countries, rural-urban dynamics are important determinants of the new emerging patterns of inequality. “Urbanization has added complexity to the global picture of income inequality,” observes Sassen. Rural-urban migration has not only been a process driven by opportunity, but also by the displacement of people due to large-scale land acquisitions for industrial crops, food crops, mining and access to water.

In China, the Gini index of income inequality in rural areas rose from 0.21 in 1978 to 0.37 in 2006, and in urban areas from 0.16 to 0.34. Inequality between urban and rural areas has expanded from 0.18 in 1978 to 0.28 in 2006. In India inequality in rural areas has remained relatively constant, while in urban areas it has increased, though not nearly as fast as in China. As Sassen observes, “urban people, especially the elites, have become much more connected to similar people in other countries than to their compatriots in rural areas,”

a trend that is likely to further exacerbate the disparities. As Devesh Kapur, Professor of Political Science at the University of Pennsylvania, suggests, “there’s no denying that the growth of cities is a major source of economic, social and political rebalancing around the world.”

The exception to the general pattern of increasing income inequality and rural-urban disparities is Latin America, one of the most urbanized parts of the world. Income inequality has been consistently reduced over the last decade and a half, especially in the two largest economies, Brazil and Mexico. Still, levels of inequality throughout Latin America remain the highest in the world, with Gini coefficients above 0.50 in several countries, including Brazil, compared to China’s 0.46, India’s 0.37 and Egypt’s 0.32.

If income inequality poses grave challenges, the recent evolution of the distribution of wealth shows an even gloomier picture. While in the year 2000 the top 10 percent of households in the world accounted for 67 percent of the income, they owned 85 percent of the wealth. Both income and wealth inequality tend to reduce the incentives for economic growth, and they are a key background factor behind financial crises, including the one that started in 2008. They also contribute to a growing rural-urban divide, and to gender, ethnic, and other types of social disparities. According to Gail Fosler, president of The GailFosler Group LLC and formerly president of The Conference Board, “people in the higher income groups allocate more of their income to savings, and that contributes to wealth inequality and disparities in capital formation,” which, in her view, pose even more formidable challenges than income inequality per se.

The rise in income and wealth inequality in many developing, emerging and developed countries poses a series of challenges. If economic growth is one of the main ways of reducing poverty, one must be concerned with the possibility that growth

will stall in the wake of rising inequality. As William Easterly has argued, high inequality can be detrimental to growth because it undermines the quality of institutions and discourages schooling, or to use Amartya Sen's framework, it undermines the formation and expansion of individual capabilities. In sum, poverty and income inequality are close

cousins but not identical twins. Patterns across and within countries have diverged in recent decades. Moreover, the social and psychological cost of poverty, especially among children, is much greater than those associated with income inequality, although too much disparity is morally wrong and can undermine incentives in a market economy. ■

# Jobs, the Quality of Jobs, and Inequality

**E**conomists and sociologists have long contended that the labor market and the occupational system constitute the backbone of social stratification and income distribution. For instance, Osterman argues that “there are many ways of looking at the issues of poverty and inequality, and that the state of the labor market is one useful way of thinking about them. “The proportion of working people in poverty-level jobs is about 20 percent to 25 percent in such a rich country as the U.S.,” he notes. “Therefore, full employment is only part of the solution as witnessed by the fact that during the 1990s, a very strong labor market -- just under 20 percent of adults -- was in low-wage poverty level jobs. Improving education is necessary but not sufficient either.” The key, in his view, is “to improve the quality of jobs, to help companies upgrade the skills of the workers they employ.”

International experiences when it comes to the creation of “good jobs” show that it is not only possible to remain competitive in the global economy with high wages but that nurturing workers’ skills and paying them well is one way of being competitive. “The transformation of the German economy over the last decade and the rise of South Korea as a global producer of high-end goods are frequently mentioned as examples to emulate,” notes Mauro Guillén, director of the Lauder Institute.

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“We have a better-educated female workforce, for instance, but women continue to be paid less than men.”

– Jerry Jacobs

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Mauro Guillén

Osterman also calls attention to other variables that may mediate the relationship between the quality of jobs and inequality. “Slowing population growth and the retirement of the baby boom generation is going to create a labor shortage.” This, he suggests, “will encourage employers to use labor more creatively.” In addition, he observes, “population aging will promote job growth in sectors like healthcare, which tends to employ people with middle to high skill levels.”

The overall trend concerning labor markets and their impact on inequality, however, is not evolving in a desirable direction. The wage share of GDP has declined in the developed world over the last several decades. In the United States, Germany and Japan, it has declined since the 1970s, except for two brief periods in the early 1980s and the late 1990s. William Spriggs, chief economist at the AFL-CIO and a Professor at Howard University, observes that “total employee compensation has grown less than productivity” for several decades. In addition to wage stagnation, he argues, “pay discrimination by gender and ethnicity has contributed to rising inequality.” Thus, he echoes Osterman in saying that “human capital formation

is part of the solution, but it is not the entire solution... We have a better-educated female workforce, for instance, but women continue to be paid less than men.” Jerry Jacobs, Professor of Sociology at Penn, argues that “it’s important to understand the structure of inequality,” adding that inequality patterns will shift depending on “trends

about women and minorities joining the workforce, and the kinds of occupations they gravitate towards.” He raised the question of how structural shifts in inequality will interact with a labor force in the U.S. that is projected to be increasingly diverse with respect to gender, race, and ethnicity. ■

# The Middle Class in Production and Consumption

**W**age stagnation in the developed world accompanied by the expansion of manufacturing employment in developing and emerging economies is bringing about a tectonic change in the global class structure and in the consumer markets of the future. After all, the population of Europe, the United States and Japan enjoyed rising standards of living precisely as a result of the shift from agricultural to industrial employment. Stable and well-paying manufacturing jobs created a middle class, one that served as the foundation for the world's first mass consumption markets. It is no secret that the rise of the middle class was a key characteristic of the growth of the market economies during much of the 20th century, and that this phenomenon contributed to political as well as economic stability.

The map of the middle class is shifting precisely due to changing patterns of economic growth, demography and inequality around the world. According to a recent OECD study, the number of middle-class people in the world will surpass the number of poor people for the first time in the year 2022. In most statistical analyses, the middle class is defined as people with more than \$10 but less than \$100 dollars per day to spend. Whereas nowadays more than half of middle-class people live in the European Union and the United States, by 2050 most of them will live in India and China. India is projected to be home to the largest middle class in the world thanks to rapid demographic growth and lower income inequality than in China.

The recent expansion of the middle class in China, India and Brazil has created a new consumer market which will in due course make these countries less dependent on exports for their



Jack Goldstone

economic growth. By 2030 emerging economies will account for 70 percent of global spending by the middle class, and the size of the middle-class consumer market in emerging economies is expected to exceed 30 trillion dollars annually. In parallel, the number of rich people is also growing fast in emerging economies, creating a vibrant market for luxury goods.

Meanwhile, increasing income inequality and poverty rates in Europe and the United States are squeezing the middle class. “Capital’s share of income has grown at the expense of labor’s,” says Goldstone, “and this means that the middle class in the rich countries has suffered.” We are witnessing “the hollowing out of the middle class,” adds Milanovic, which has been both the foundation and the main beneficiary of economic growth and prosperity. In addition, the middle class will be affected by yet another growing manifestation of inequality, one that promises to create much friction between generations. “Population aging will drain resources from the working middle class,

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– Saskia Sassen

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which pays a majority of the taxes in both Europe and the United States.” This will likely reduce middle-class demand for durable goods and housing, thus constraining economic growth, given that around 70 percent of GDP is accounted for by consumption.

Milanovic is no fan of the term “global middle class,” which he finds exceedingly vague, because it often includes people in emerging economies who may be “middle class” by local standards but who would be considered rather poor by Western standards. The term “middle class” conveys a feeling of relative financial ease and at least little or no vulnerability to falling into poverty. This however is often not the case with people included under such an “umbrella” definition of “global

middle class.” Besides, “the experience of being middle class is very different around the world,” states Michèle Lamont, Professor of Sociology at Harvard, as it is filtered through culture and other systems. Still, there is no denying that the combination of wage stagnation in developed countries and rising incomes in emerging economies, compounded by the very large size of their populations, will dramatically alter the global distribution of consumption and its impact on economic growth. “The middle class of the 20th century was a tissue that connected the poor to a possibility of upward mobility,” notes Sassen, “and in this sense strengthened the support for liberal democracies. The thinning of that middle class is much more than just that thinning; it has major implications for having a working democracy.” ■

# Health and Personal Wellbeing

**P**overty and inequality often have ill effects on health and personal wellbeing, with the potential of creating a vicious cycle in which income disparities lead to deteriorating health, and this in turn perpetuates inequality. Health has been on the development agenda at least since the 1980s. Economists, sociologists and other social scientists have documented that people’s labor force participation and productivity depends on their health status. However, as Goldstone notes, health may help development, but it is equally true that development helps health, especially when it comes to controlling endemic diseases. Still, “both rich and poor countries have to wrestle with major inequalities in health,” notes Scott Burris, a Professor of Law at Temple University.

Terry McGovern, Professor of Population and Family Health at Columbia University, says that problems of inequality in the healthcare sector are rampant, “from infrastructure issues to service quality, and from shortages and access to high costs.” In its current state, healthcare is a major generator of inequality. There is a “medical-poverty trap,” she argues, a self-perpetuating cycle that begins with poor health among the poor, and leads to fewer and worse labor market opportunities and reduced income. “Education, income, living conditions, housing, and sanitation all affect health, and health in turn affects them,” McGovern states. And there are other health-related issues that frequently get lost in debates about healthcare reform. “In several African countries, gender-based violence causes more deaths than cancer, malaria and road accidents combined.”

The organization of healthcare is crucial to gaining an understanding of patterns of inequality. “The healthcare system does not exist in a vacuum,”



Terry McGovern

suggests Nitsan Chorev, Associate Professor of Sociology at Brown University. “One must also examine how it interacts with other parts of the economy.” In her research in various countries around the world, she has shown that importing pharmaceuticals into developing countries, for instance, could benefit local manufacturing so to create more wealth as well as help address health problems. It is important, though, to set up the right conditions in terms of incentives. “One way of reducing inequality is to use foreign aid to promote self-reliance,” she says.

There is nothing more central to the individual than his or her health status. In contemporary societies, health has become not only important in this sense, but actually has come to occupy a central position in a wide range of crucial debates, from the link between population pressures and global warming, to the fiscal sustainability of the welfare state and the impact of healthcare spending on economic growth and competitiveness. Inequality and poverty are two additional areas deeply affected by health and healthcare dynamics. ■

# Financial Inclusion, Poverty and Inequality

**A**nother part of the economy that tends to generate and shape patterns of inequality is the financial sector. At the present time, some 5 billion people, or 70 percent of the world's total, are excluded from the formal financial system. According to the World Bank, the global map of financial exclusion closely mirrors the global geography of poverty, with Sub-Saharan Africa, the Middle East and South Asia as the hardest-hit regions. Spanish-speaking Latin America is also considerably under-banked, with about half of the population operating outside the formal banking system. Brazil, which is home to large state-owned and private domestically-owned banks, fares much better than the rest of its region. There are also millions of unbanked adults in developed countries, including 20 million in the U.S.

Small businesses, which tend to be important sources of household income in developing countries, often operate without formal banking relationships. In a recent report, McKinsey & Co. estimates that up to 250 million micro-, small- and medium-sized enterprises in Africa, Asia and Latin America are either un-served or under-served by formal financial institutions, a gap worth some 350 billion dollars annually. Research on entrepreneurship has shown that small businesses lacking access to formal credit channels, for example, tend to experience lower growth and survival rates.

The idea of financial inclusion is relatively recent. It involves the argument that if people do not participate, or are not in a position to participate, in the formal financial system, they may be locked out of opportunities, and their income and socioeconomic wellbeing might be compromised. A large number of nonprofit organizations have joined the World Bank and the International



Alpesh Chokshi, Nancy Hite, and David Roodman

Monetary Fund in their efforts to promote the development of innovative approaches to financial development that fit the needs of low-income and poor people. Among the various components of microfinance being promoted around the world, microcredit gained the earliest prominence, but more recently, careful empirical studies have questioned microcredit's potential to deliver miraculous results. Insurance, pension plans, deposit accounts and money transfer services are all areas in which microfinance has thrived in recent times.

There is considerable debate, however, as to whether financial exclusion is a major contributor to inequality, or if inequality generated by other sources leads to financial exclusion because traditional banks and financial institutions do not find poor customers profitable. Financial inclusion also has the potential to increase inequality, if microcredit borrowers have imperfect self-control and foresight, and if their interest payments increase returns to wealthier savers and investors. The evidence suggests that, in addition to lower incomes, people without a bank account have more unstable incomes. "To say that someone survives on two dollars a day is inaccurate," says

David Roodman, senior fellow at the Center for Global Development. “Most poor people in developing countries make three dollars one day, a couple the next and none at all for the rest of the week.”

Microfinance started “as a frustration,” according to Roodman. People and policymakers became increasingly exasperated about the slow rate of progress in making formal financial services available to a wide segment of the population in developing countries. In his view, there is a belief that “microfinance can solve a wide range of problems. There are many claims and counterclaims about microfinance.” One important question is what qualifies as success. “When people say microfinance works, sometimes they mean lifting people out of poverty; other times they have freedom in mind, or yet other times a Schumpeterian transformation that may be conducive to development,” says Roodman. Research is not definitive on this issue, and this should be no surprise. “Credit amplifies risks. Some people do well when they get credit, while others don’t.”

Roodman agrees with Nancy Hite, a Professor at the Fletcher School of Tufts University, in that financial inclusion and microfinance may help overcome such an important problem as income volatility. “Financial inclusion helps stabilize incomes,” she says. But the benefits of microfinance should not be exaggerated. “My concern is whether too much money is going into microfinance,” notes Roodman. “The key challenge is to build institutions so that new credit does not create bubbles and is put to work in an economically and socially desirable way.”

One of the paradoxes in the recent growth of microfinance has been that it has proved to be most scalable when large companies are involved in its organization and delivery. A case often presented as a success story is that of m-Pesa in Kenya. Launched in 2007 by Safaricom, a subsidiary of Vodafone, this mobile payments

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service is presently used by virtually every adult in the country, while traditional banking services are only available to 16 percent of them. M-Pesa presently accounts for 70 percent of all financial transactions in Kenya. Critics charge, however, that this remarkable experiment is in no way about microfinance, but about a big company making outsized profits and facing little competition.

The proliferation of mobile payments and banking platforms has changed the landscape of microfinance in the developing and emerging world, areas in which the traditional banking and telecommunications infrastructures never developed. Alpesh Chokshi, president of the Global Payment Options group at American Express, believes that a quiet revolution is taking place. Mobile phones have spread much faster than any other type of device, and it is the most common way of going online in developing and emerging countries, where there are 80 mobile phone subscriptions per 100 people. Microfinance services offered through mobile phones can revolutionize the world of banking. “Banks are slow, traditional and charge high fees,” Chokshi says. “With mobile phones, we can do something about each of these problems, and we can improve access and reduce cost.” He believes that for-profit companies can do good while doing well if they embrace this revolution. “Companies like ours can leverage digital platforms and mobile phones as a consumer access device to dramatically scale up the number of customers we can serve.”

The potential benefits of financial inclusion are not limited to the economic sphere. Hite argues that “financial inclusion can bring about beneficial social and political outcomes as well.” She has undertaken field experiments in a wide variety of developing countries in Asia and Latin America, showing that “people who are financially included may become more socially empowered and politically engaged.” Microfinance gives people the freedom to opt out of clientelistic local politics. In other words, financial inclusion has the potential of increasing social capital and improving the quality of civic life under the right conditions. Given the deficits in terms of governance and the quality of democratic life in many countries around the world, Hite’s research offers some promising prospects. She cautions, though, against the possibility that microfinance may “increase the velocity of transactions in the community as

opposed to enabling economic activity.” In her work, she explores conditions under which both informal and formal types of microfinance may become usury and/or politically coercive. She believes that new schemes for financial inclusion often need to be supported and constrained by regulation so as to avoid such negative effects. Chokshi agrees, suggesting that “transparency and a level-playing field” are essential.

While financial inclusion through microfinance programs has great potential, Hite and Roodman warn against “thinking about financial access as panacea.” Microfinance enables access and can reduce transaction costs, but wholesale reductions in poverty and inequality will require much more than access to financial services, as Jeremy Tobacman, a Professor at the Wharton School, reminded us. ■

# Politics, State Capacity and Inequality

**T**he role of the state in compensating for the inequalities and shocks brought about by the free unfolding of market forces is well established, and it manifests itself not only through financial regulation and healthcare spending, but more broadly through an array of policy interventions and programs. Much of the debate centers around the appropriate level of intervention and the best tools to accomplish it, although opposition to all kinds of state-led efforts to redress poverty and inequality has grown steadily in both Europe and the United States. Still, Kapur is categorical: “The state is a central actor in the fight against poverty and inequality.”

Huber, who has undertaken extensive research on this issue, argues that the political dynamics surrounding state programs to reduce poverty and inequality are different in developed and developing countries. She notes that “within the OECD, pre-tax income inequality among households headed by an employed adult is lower in countries with higher levels of union density, and longer during periods in which the Left runs the government. [In addition], it has risen in the wake of declines in manufacturing employment.” A growing number of households headed by a single female with dependents has also contributed to growing inequality. In turn, generous transfer payments to single mother households and to the unemployed counteract these trends; overall transfer generosity is the single strongest predictor of reduction in inequality from pre-tax and transfer to final disposable income inequality. In Latin America, by contrast, the main driving force has been the consolidation of democracy. She has found that “democracy reduces inequality because it opens up a chance for parties to play a role, which frequently leads to redistributive policies and higher spending on health and education.”



Carolyn Miles and Sanjay Reddy

She warns, however, that “it takes a long time, perhaps two decades or more, for the effect of democracy to take place. The minimum wage has also been found to reduce inequality in Latin America.

Guillén wonders, though, whether the effect of left-right politics and democratization has been tempered by shifts in the relative power of the various ministries within the state apparatus. “With globalization, the executive branch of government has become increasingly aligned with global corporate and financial interests,” notes Sassen, “and become less accountable to the people; in contrast, the legislature, the branch where we the citizens have a strong standing, has lost power and has lost its compass, which does not help us democratize our economies.” The executive branch of government has also seen changes. As Susan Strange once argued, in most countries around the world, the labor, health and education ministries have lost power at the expense of the finance ministry and the central bank. Osterman agrees in that “under Presidents Kennedy and Johnson, the labor secretary was influential in policymaking.” Much has changed, however, over the last half century. “President Obama’s last

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“Ensuring that the everyday institutions of government work for the people makes a big difference.”

– Michael Woolcock

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appointment in his first term was the secretary of labor, and his next to last in this term is also the labor secretary. This parallels the shift of power within companies, away from production and sales and towards finance,” he notes. Spriggs, who served as Assistant Secretary for the Office of Policy at the United States Department of Labor in the Obama Administration, suggests that the power shift within the state has changed public discourse and what issues are on the agenda. “Today the minimum wage is a highly partisan part of the agenda, whereas under Eisenhower, the only debate was about the size of the increase. Now the debate narrative around the minimum wage is all about profit maximization, not supporting consumer demand. The dominant narrative is not pro-labor.” He further argues that “there is a global phenomenon of labor-management dysfunction, which is making matters worse,” with governments no longer acting as effective referees. Huber notes, however, that the power shift has been more pronounced in countries in which commitment to social policies was weaker to begin with.

Besides politics and power, the effectiveness of the state when it comes to dealing with poverty and inequality depends on its capacity to act. “Do we need a conference to figure out that state stability and capacity are essential to reduce poverty and inequality?” asks Phil Thompson, a Professor at the Massachusetts Institute of Technology. “Think about Haiti, where without the 30,000 UN troops, the country would go through a meltdown.” Michael Woolcock, lead social development

specialist at the World Bank, argues that “the functionality of government and its ability to implement are very important,” especially when it comes to health, education and social protection. Chorev concurs: “State capacity is central to the success of health initiatives and programs.”

“Ensuring that the everyday institutions of government work for the people makes a big difference,” notes Woolcock. “In many countries, 50 percent of teachers do not show up for work on any given day, and even when teachers are physically present, too many are not actually teaching students. There is a broad spectrum of state capacity around the world. Increasing the capability to engage the issues is very important.” Huber concurs with this assessment and observes an interesting pattern in Latin America. A key problem facing progressive governments in this region is teacher unions, which tend to resist new programs and initiatives. Kapur points out that in India, this type of negative effect is more important in public schools with politicians unwilling to discipline unionized teachers who were part of their vote banks, preferring to sacrifice the interests of children. Osterman further argues that “it is not only about making teachers show up, but what and how they contribute to children’s learning.”

Sanjay Reddy, who is on the economics faculty at the New School University, suggests that poverty and inequality are related to the social and political stability of countries, which in turn are dependent

on state structures. “It would be logical to think that excessive poverty and inequality should increase the chances of political protest and contestation,” he states. “Amartya Sen, however, has noted that famine often comes together with little social upheaval. Extreme deprivation does not necessarily lead to social protest.” Reddy uses the example of India’s Maoist guerrillas, which are active in about one third of the country’s districts and are supported by tribal peoples whose concerns are not accommodated by the established political structures, to show that the state itself can

become a failure if it does not address poverty and inequality. “India’s Naxalite movement is but one example of the socio-political effects of inequality across the developing world, including high growth emerging markets,” notes Jason Jackson of the Lauder Institute and the Wharton School. He adds that high levels of crime and violence that disproportionately affect the poor in many urban centers in Latin America “are further manifestations of these asymmetric distributional outcomes that are often lost in the wider positive growth stories.” ■

# Poverty, Inequality and the Law

Discussions of poverty and inequality often enter the realm of the law. “Legal arrangements have major implications for patterns of inequality,” says David Kennedy, Professor of Law at Harvard, who has written extensively on the global legal environment and advised governments and international organizations on issues having to do with global governance. The law is, in part, shaped by outward circumstances such as the economy, politics and social structure, and it reciprocally affects those variables. Most crucially, “the law shapes bargaining power, the velocity of transactions and the legitimacy of different economic practices.” If Huber, Osterman and Spriggs are correct in their emphasis on grand political bargains to arrest the trend towards increasing inequality, then one must surely incorporate legal aspects into the analysis.

The law directly influences equality, at least of rights if not outcomes. In the economic sphere, for instance, women’s rights continue to trail men’s in many countries. A recent World Bank report covering 128 developed and developing economies found a considerable degree of legal discrimination against women in areas that thwart employment opportunities and entrepreneurship. For instance, in 45 countries women as of 2009 did not have the same legal capacity to act or engage in economic transactions as men, in 49 countries women were prevented from working in certain industries, and in 32 countries they did not have equal inheritance rights. Equal legal rights were found to result in better labor market opportunities and outcomes, and in a greater percentage of businesses owned or managed by women.

When it comes to labor legislation, not all countries have ratified the basic conventions concerning freedom of association, forced labor, child labor and employment discrimination. In fact, only two thirds have ratified all the conventions. Enforcement at the local level is even



Saskia Sassen, Jack Goldstone, David Kennedy, Branko Milanovich, and Witold Henisz

less uniform. Meanwhile, the last two decades witnessed a rapid increase in the legal protection of the property rights of shareholders. “The law has become increasingly skeptical of workers’ rights when expressed collectively and increasingly friendly towards capital, and this is especially true in trade agreements,” says Spriggs.

Kennedy argues that, “while economic and financial realities have turned global, legal and government structures exhibit a considerable degree of compartmentalization.” The center-periphery structure that characterizes global economic relationships, coupled with the law, tend to “perpetuate old patterns of inequality in a rapidly changing world,” he says, adding that “the alchemy by which inequality becomes routinized through the vernacular of experts and hardens as law is tough to unravel, but the effects are everywhere on view.” Sassen points out that “legal systems are resistant to change, mostly by design. Today, the law can no longer govern the quickly evolving global economic and financial system, even as the latter ensures that new laws are made to enable its operations.” For Kennedy and Sassen, this state of affairs tends to reproduce preexisting patterns of inequality. ■

# What Is to Be Done about Poverty and Inequality?

**T**he preceding analysis of the evolving global map of poverty and inequality, its manifestations in the labor market, healthcare and the financial system, and its political, social, cultural and legal roots provide the foundations for an agenda focused on effective ameliorative actions. “There are many tools that can, and should be used, to address inequalities,” notes Burris. And, as just discussed, “the law can be used as a lever in promoting social and economic development.” The debate about the virtues and the costs of different interventions and programs is rather intense.

One school of thought emphasizes that poverty and inequality are reflections of the structure of society, and thus one needs to change the structure to improve the outcomes. Molly Smith, executive director of Prathan USA, an organization that helps place Indian children into schools, argues that the politics of destitution and the politics of access to critical resources are key, and that they are the consequences of the failures of social structures. “Poverty is primarily the consequence of the way society is organized.” She believes that grassroots organizations have the potential to change the dynamic through their own actions and by influencing policy.

Elizabeth Clay Roy, the deputy director of Opportunity Nation, a national campaign to expand economic opportunity and mobility, concurs. “Economic mobility is as important as inequality.” In fact, recent Pew studies document that there is less mobility in the U.S. than most industrialized countries,

especially for low-income Americans. Influencing policymaking and politicians is crucial, but “there’s no one silver bullet” that can induce wholesale change in the prevailing social structure. Sociology has recently emphasized the intricate relationship between culture and social structure. Poverty is not only about tangible conditions, but also about culture, though not in the sense that poor people espouse the wrong cultural values or norms, as in the wrong-headed argument that poverty reveals a lack of self-reliance. The sociology of culture can actually help unveil how poor people are stigmatized in ways that perpetuate their condition, so that it becomes structural. Lamont argues that there is a complex relationship between culture and poverty. “The repeated experience of poverty has a very negative impact on people who suffer from it.” At question is “the ability of societies to provide for their stigmatized poor populations,” she notes. But cultural research also shows that “societies or groups that have a deeply ingrained identity often have reduced rates of suicide or other negative health outcomes.” Cultural repertoires that



Scott Burris, Nitsan Chorev, and Michèle Lamont

strengthen collective identity have a positive impact on social resilience and help improve mental health outcomes, Lamont observes. “African societies are resilient because of traditional social capital,” according to Goldstone, which helps reduce some forms of inequality, while at the same time it exacerbates other types of inequalities, especially those along gender or ethnic lines.

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## “Economic mobility is as important as inequality.”

– Elizabeth Clay Roy

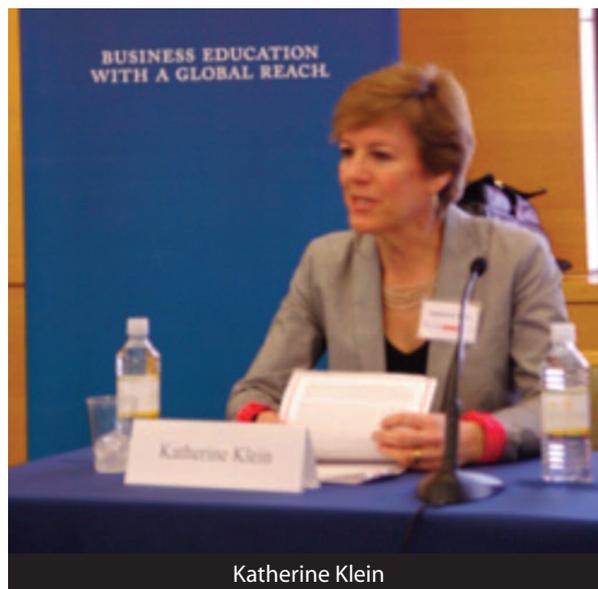
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Briggs and Molly Smith concur in that understanding the effect of culture is of fundamental importance when it comes to designing policy interventions. But Huber counters that “power structures and political coalitions” are more determinant. After all, Witold Henisz, a Professor of management at The Wharton School, and Huber ask, “Where does culture come from?” Guillén points out that culture plays an independent role both at the macro and at the micro level. Some societies are more tolerant of inequality than others. Lamont’s research clearly shows that culture can perpetuate patterns of inequality.

A second school of thought argues that, instead of focusing on the large issues around the effect of social structure, setting specific goals is an important first step in the process of fighting poverty and inequality. Katherine Klein, a Professor of Management and Vice-Dean for Social Impact at The Wharton School, concedes that structures and systems are important to understand, but that “goals need to be set so as to focus attention and action.” The Millennium Development Goals (MDGs) adopted by the United Nations in 2000 are one such example. They have been subjected to considerable criticism

from several angles. McGovern, for instance, argues that “MDGs are useful but they may conceal micro occurrences of inequality.” Reddy admits that MDGs are useful because they help focus the attention on important issues such as poverty, education, gender equality, health and sustainability. “But they have focused the attention of elites and not necessarily of the general public, and sometimes they become justifications for bureaucracies to continue doing business as usual.” Moreover, there is considerable disagreement over how progress towards goals is measured.

A third line of argument holds that standards, not goals, must be set, adopted and enforced. Osterman argues that the historical evidence overwhelmingly supports the contention that labor standards lead to reductions in poverty and inequality. Thus, “we must modernize standards so that they are always up to date, on a par with shifting realities in the workplace and in labor markets.” Ultimately, he notes, “the solution is political in nature,” an analysis that Spriggs shares. “The good news is that there is a growing global consensus today about some minimum standards,” he says. The ongoing economic crisis represents a stark reminder that labor standards and regulations are important for



Katherine Klein

the long-term health of the economy. Yet, many governments, especially in Europe, continue to respond to the rapidly deteriorating macroeconomic landscape by curbing labor rights and standards. And in many countries, government gridlock, posturing, incompetence or corruption limit implementation and compliance with standards.

Beyond adoption, “it is important to keep track of whether actual practice on labor standards follows the rhetoric,” says Hite. Osterman concurs, and wonders what the best way is to enforce standards. At the top of his list are the state and labor unions. But their dwindling resources and ability to act prompt him to consider civil pressure, community organizing and commitments by companies, though without duplicating state efforts or inviting governments to give up their responsibilities. Huber underlines that if the strategy revolves around adopting and enforcing standards, then “politics become paramount.” She notes that “the decline of union density in Europe and the U.S. is associated with rising wage dispersion and inequality. Spriggs agrees, adding that “in the U.S., the National Labor Relations Board has languished due to political pressures and maneuvers aimed at making it ineffective.”

A fourth line of reasoning focuses on the crucial points in time at which people fall behind, sometimes never to recover. For instance, Fosler offers the important insight that “inequality is not a continuous problem, but a step function, and this has to be reflected in policy interventions.” As an example, she argues that “high proportions of young people don’t make it through high school, let alone college, and they find it difficult to make the transition from school to work or from one job to the next.” Roy adds geographical segregation to the mix. “Zip code oftentimes is more of a determinant of opportunity than GPA.” Her work at Opportunity Nation focuses on the



Michèle Lamont and Terry McGovern

“disconnected youth,” the 16-to-25 year-olds who are not in school and not working. She has found that this phenomenon “is the best predictor of a state’s ranking in terms of economic opportunity.” Her policy recommendations focus on “creating a smooth path from high school to college, and then from school to jobs.” Goldstone agrees, especially in the global context. “In the future, we need to increase the opportunities available to, and the productivity of, young people in developing countries, which make up the majority of the world’s population.”

A fifth approach to combating poverty and inequality argues that one must seize the opportunities to make improvements as they present themselves. “Oftentimes,” says Thompson, “we just fail to act when we can make a difference.” Based on his experience as Director of the Mayor of New York’s Office of Housing Coordination, he argues that “missed opportunities to make progress abound. We could start with the Civil War and reconstruction, but let’s focus on 1974, when New York City went bankrupt,” he observes. “In the wake of it, the city’s finances came under the control of a committee of bankers, and many anti-poverty programs were abandoned. Another

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– Jack Goldstone

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was in the 1980s, when the Reagan Administration cut social programs. Another example took place in the wake of Obama’s election in 2008, when he asked for support to push healthcare, labor law and immigration reform, and received commitments from various progressive interests and groups, which later simply dropped the ball.” Given this historical pattern of missed opportunities, he concludes that “we do not lack opportunities; what we lack is the ability to mobilize for policies to fight poverty and inequality.”

A sixth perspective on poverty and inequality reduction focuses on entrepreneurship, which, according to Fosler, “has to be part of the answer.” Osterman agrees, adding that it “must be scalable.” Spriggs cautions against “the myth of small business” as a job creator, which in his view gets in the way of updating labor regulations and standards, at least in the U.S. In Germany, by contrast, research has documented that small- and medium-sized enterprises, which are very competitive in foreign trade, tend to create good jobs. In developing countries, the debate over entrepreneurship and inequality centers on what Hite calls the “myth of the entrepreneur who, by being financially included, would lift him or herself out of poverty, regardless of the political and social context.” In any event, entrepreneurship cannot be a substitute for government programs in all areas and under all circumstances. Thus, government cannot recuse itself from its responsibilities. As Osterman noted in the case of the U.S., it remains to be seen whether entrepreneurship as a way out of poverty can be scalable to make a real difference. The seventh and last perspective on policy

interventions argues that pragmatic considerations should help focus action on the low-hanging fruit. Craig Smith, a Professor of Business Ethics at INSEAD, asks how one should allocate resources to help the largest number of poor children, for instance, “knowing we may not be able to help all of them in the short term, especially the most inaccessible in the geographical sense.” He recognizes that this approach raises ethical issues, but that one must prioritize. Reddy suggests that “moral philosophy has a role to play in poverty and inequality reduction efforts.” Miles agrees, but points out that most of the time her organization, Save the Children, does not have to make that choice because the cost of many interventions is actually quite low.

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The challenges involved in reducing, and eventually eradicating, poverty and inequality are massive and complex. We have discussed the importance of unpacking patterns of poverty and inequality in different parts of the world, and for different age and gender groups, realizing their origins in the dynamics of the labor market, the healthcare sector, education and the financial system, and considering the legal, political and cultural underpinnings. In light of the seven perspectives as to how to address poverty and inequality, we would like to advance an agenda for action focused on the following points:

- Striking a new political bargain among stakeholders, including business and labor, tradable and non-tradable sectors, and

between the real economy and the financial economy with a view to reducing inequality within countries.

- Restoring labor market institutions as master pillars of the economy, including technical and vocational training, collective bargaining, employers' and workers' organizations, and other forms of employer and labor representation.
  - Strengthening state capacity, not only in the area of legal security, but also in work, education, health and social wellbeing.
  - Recalibrating the use of labor standards to foster the creation of skilled and well-paid jobs, and a more robust enforcement based, not only on state and labor union strength, but also on community organizing and commitments by business corporations.
  - Rethinking and refocusing the public policies aimed at empowering the poor and providing a social safety net at a time of fiscal pressure.
- Addressing the unique challenges faced by young people in developed, emerging and developing countries by focusing on the transitions from one level of the educational system to the next, from school to work, and from job to job.
  - Updating legal institutions in view of the more interconnected nature of economic, financial and social life, and creating new institutions that can handle global problems.
  - Reconfiguring the relationship between cities and rural areas at a time when over half the population lives in the former but is dependent on food and other supplies from the latter.
  - Experimenting with regulations to prevent exploitative lending practices and promoting new, scalable ways of facilitating saving and payments for poor people and small enterprises. ■

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# Poverty & Inequality

## Persistent Challenges and New Solutions

Patterns of poverty and inequality have shifted around the world in the wake of the migration of manufacturing jobs and the rise of the emerging economies. In this white paper, we examine the challenges involved in reducing, and eventually eradicating, poverty and inequality by analyzing their patterns in different parts of the world, identifying their origins in the dynamics of the labor market, the healthcare sector and the financial system, and considering their political and cultural underpinnings. We make a series of specific recommendations aimed at ensuring that poverty and inequality enter a new phase of decline around the world.

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