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## Is There a 'New Consensus' on Inequality?

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DISCUSSION PAPER SERIES

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*London School of Economics and IZA*

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## ABSTRACT

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# Is There a ‘New Consensus’ on Inequality?<sup>1</sup>

Thirty years after the “Washington Consensus”, is there a new policy consensus that addresses the problem of inequality? This paper argues that there is widespread acceptance that multiple, interrelated and mutually reinforcing inequalities exist – in income, wealth, education, health, power, and recognition – and that these inequalities are generally “too high”. There has also been a significant shift towards a shared view that these inequalities matter, both intrinsically and because of their instrumental effects on economic efficiency and political institutions. There is much less consensus, perhaps surprisingly, on what the actual levels of income inequality are, and there are common misperceptions about their trends. In policy terms, there is something approaching a consensus regarding the desirability of various “pre-distribution” policies, ranging from early childhood development to investment in better teaching. In certain quarters, there is also agreement that sharper antitrust regulation, freer labor unions, and more progressive taxation is needed in most countries. But much less is known about how to provide the poor with genuine opportunities to break the cycle of intergenerational transmission of disadvantage in a durable way.

**JEL Classification:** D31, D63, H20

**Keywords:** inequality, redistribution, policy consensus

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## Introduction

The word “inequality” does not appear – even once – in “What Washington Means by Policy Reform”, the 1989 book chapter where John Williamson laid out the ten topics which he saw as defining a “Washington consensus” for policy reform following the Latin American debt crisis (Williamson, 1989). “Poverty” appears once in the 5,806-word document. Some thirty years later, it is difficult to imagine the same being true of any attempt to summarize a set of policy instruments needed to address current problems, in Latin America or anywhere else. Indeed, in the present attempt “to build a *London Consensus* around which new ideas can coalesce, and which can become a ‘user’s guide’ for leaders and policy makers [...]”<sup>2</sup> an entire chapter – one of only fifteen – was commissioned on the topic.

The 1980s probably marked the nadir of attention to distributional issues in both mainstream economics and development policy. The pressing global issues of the day were quintessentially macroeconomic: how to adjust to the dramatic terms of trade shocks arising from the oil price shocks of 1973 and 1979, and the subsequent stagflation in richer countries and debt crises in poorer ones. In the US and the UK, Ronald Reagan and Margaret Thatcher held sway. The (first?) Cold War was approaching its conclusion, and inequality had been a concern identified squarely with the losing side. There were individual exceptions in the Western mainstream, of course, but the broad “consensuses” of the day decidedly did not include a preoccupation with inequality.

This began to change gradually in the 1990s<sup>3</sup>, but it was the global financial crisis of 2008-09 and the rise of the 1% movement in the United States that changed the discourse in the leading Anglo-Saxon countries, which, for better or worse, largely set the intellectual and policy agendas in Economics. Popular books by leading mainstream economists – e.g., Stiglitz (2012, 2015), Piketty (2014) – became major bestsellers. The leading International Financial Institutions (IFIs), which had played a major role in shaping the Washington Consensus, also incorporated inequality into their discourse: the World Bank’s *World Development Report 2006* highlighted the extent and costs of inequality and argued that it was a drag on development. A decade later, the IMF agreed (Berg et al., 2018 and Ostry et al. 2019).

Does any of this mean that there is a new consensus on inequality that could now be summarized, be it in London or elsewhere? In what follows, I briefly examine some of what we now know about the nature, levels, and trends in inequality (Section 1); the current thinking on whether it matters at all (Section 2); and some prominent ideas on policy responses (Section 3). I argue that there is a rising, if as yet incomplete, consensus that inequality matters: that it is a legitimate concern for analysts and policymakers alike. Perhaps surprisingly, there is actually no consensus on many of

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<sup>2</sup> This is an excerpt from the letter by Besley and Velasco introducing the project to invited participants, in 2022.

<sup>3</sup> See, e.g., Atkinson (1997) and Kanbur and Lustig (1999).

the basic facts about inequality, largely because different data sources tell different stories and are seldom easy to combine.

In the policy space, I briefly describe three broad policy domains with documented potential in reducing inequalities: pre-distribution (investing in children and youth before they enter the labour market); market regulation (with applications in the product, labor and capital markets); and redistribution (taxing richer people to redistribute cash or opportunities to poorer ones). I argue that policies in all these areas have important roles to play, and probably more is needed in most countries. But I also suggest that, when one contemplates the depth and intergenerational durability of deprivation around the world, even this rich menu seems vastly inadequate, and that more research and innovation is needed to find truly transformational interventions.

### **1. The nature, levels, and changes in inequality.**

One thing there is broad agreement on is that inequality is neither a unique nor a unidimensional concept. While most of the discussion focuses on inequality of incomes, there is also inequality in wealth; in educational achievements; and in health outcomes. There are inequalities in political power and participation; in agency and social recognition; and in opportunities for future achievement. These multiple inequalities are interconnected in complex ways, and matter for different reasons. While it is impossible to do justice to that entire landscape here, below are some basic facts on which there is broad agreement – and some issues on which there are not. Specifically, I list three points on which I argue there is a measure of consensus, and two areas where the facts themselves remain contested.

First there is broad agreement that, with rare exceptions, inequalities in income and wealth are judged to be high in all but a handful of countries. Figure 1, drawn from the World Bank's World Development Indicators as captured in 2023, shows the income shares of the richest and poorest deciles of the distribution of income (or consumptions expenditure) for the 50 countries for which data was available.<sup>4</sup> The column of numbers to the right of the country names presents the ratio of one to the other, ranging from 4.7 – 4.9 in Armenia, Belarus, and Slovenia to 46.4 in Colombia.

Analogous measures for wealth distribution are even more extreme. In a study of 15 advanced economies using data from the Luxembourg Wealth Study, Pfeffer and Waitkus (2021) report top 5% net wealth shares ranging from 23% (in Slovakia) to 70% (in the United States). The corresponding Gini coefficients are 0.49 and 0.90. The median wealth share was 39%, for Luxembourg, with a Gini of 0.66.

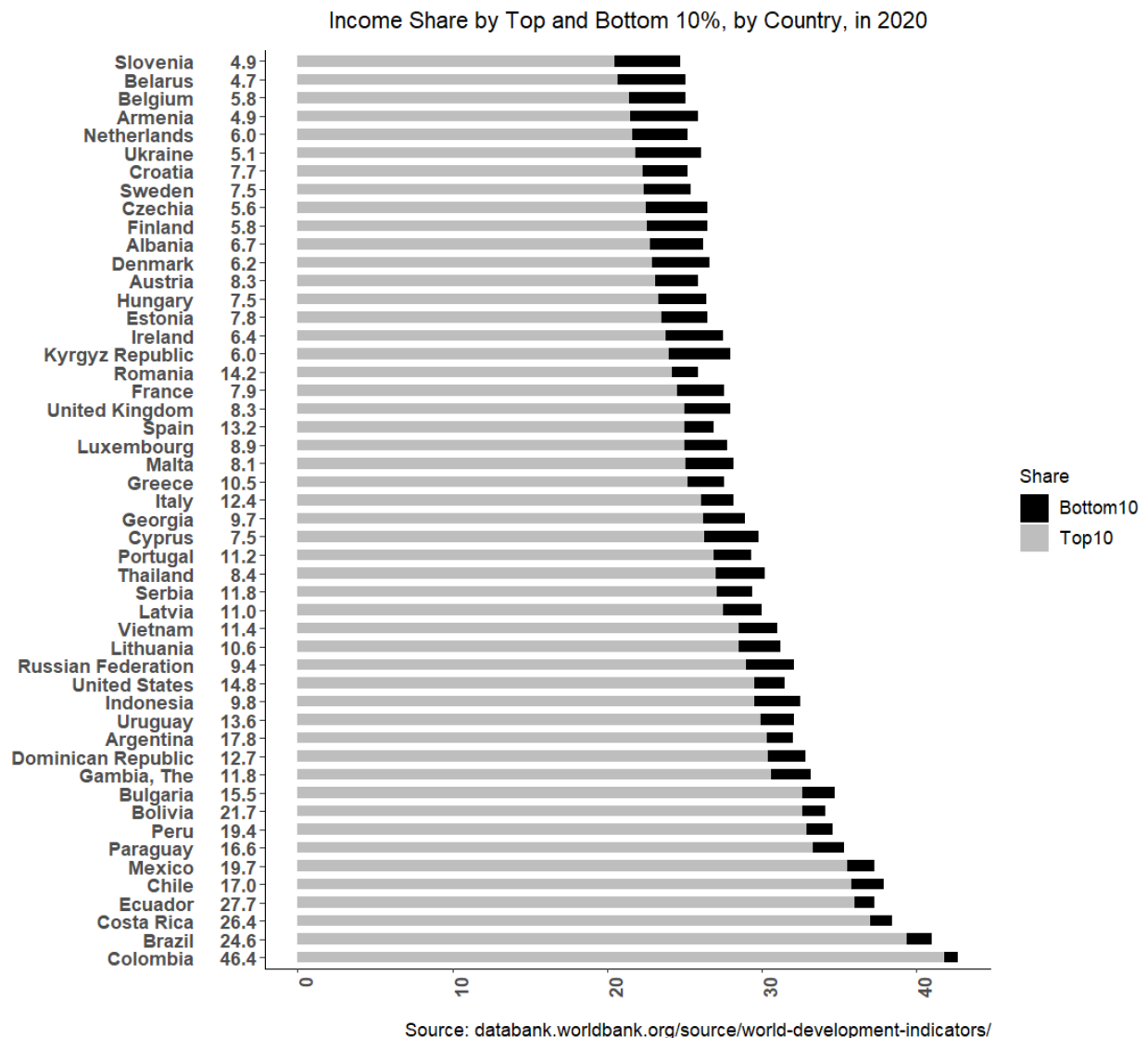
Second, income and wealth inequality do not come alone. They are associated with pronounced inequalities in other life domains, such as education and health. Perhaps the most prominent

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<sup>4</sup> I follow the common (mis)usage of the word decile, to mean “tenth” of the distribution.

such association is the so-called wealth gradient of health, which depicts associations between better health outcomes and higher income or wealth. In 1980, for example, the life expectancy of men in the top 5% of the United States family income distribution was 25% greater than for those in the bottom 5%. (Rogot et al. 1992; Deaton, 2002). In Latin America, infant mortality is strongly associated with household wealth across various countries, as shown by Bancalari et al. (2023).

**Figure 1: Top and bottom decile income shares for fifty countries in 2020.**



Educational outcomes are also associated with family background. The OECD's Programme of International Student Assessment (PISA) publishes comparable test results for fifteen-year-olds from 79 countries (in 2018) around the world. The scores are standardized so that distributions

have a mean of 500 and a standard deviation of 100 (for the OECD). In the PISA 2018 dataset, the difference in mathematics test scores between children with at least one parent having completed tertiary education and those for whom neither parent had completed at least upper secondary school was as high as 79 in Korea, 74 in Peru, 73 in Chile, and 66 in the United States. (Fernández et al. 2023).

Less tangible but equally important dimensions of a person's agency and well-being are also unequally distributed and correlated with economic status. This is easiest to document for measures of political power and activity, such as voting behaviour. In the United States, voter turnout is strongly associated with family income: In the 2016 presidential election, for example, turnout was 48% for those living in households with annual incomes less than \$5,000 and 86% for those earning more than \$150,000, with the relationship largely monotonic in between (Akee, 2019).<sup>5</sup> When additional sources of political power, such as the ability to contribute to campaign finance, are taken into account, the association between political and economic power becomes even greater.

Third, it is also widely accepted that some inequalities are more salient than others, such as those between men and women, across different racial groups, or different caste or religious groups. Gender inequalities remain pervasive, although not always in the ways one expects. Across most – if not all – countries, men continue to command a wage premium over women, both unconditionally and conditionally on observed characteristics. In the richer economies of the West, this remains true despite remarkable progress in recent decades, and appears to be increasingly explained by child penalties (Kleven et al., 2019). In education, on the other hand, the picture is considerably more mixed. In most rich countries – and in many others – access to and completion of tertiary education are now considerably higher for women than for men, and this reflects superior achievement by females in secondary schools as well. This is true in general, despite the fact that boys and men remain overrepresented in the STEM subjects (Reeves, 2022). Racial inequalities also abound, particularly but not exclusively in countries that experienced long histories of slavery, such as the United States, Brazil, or Haiti. As with the broader societal inequalities discussed above, this is true not only for wages and incomes, but also in terms of educational attainment, health outcomes, political participation, incarceration rates, etc. These between-group – or horizontal – inequalities are important because membership in these groups is salient in the formation of individual identity.

Let us now turn to two areas where there is less agreement, and certainly no consensus. Perhaps surprisingly, the first of these concerns the exact levels of income inequality in almost any country. Although I argued above that there is broad agreement that these levels are high, it turns out that

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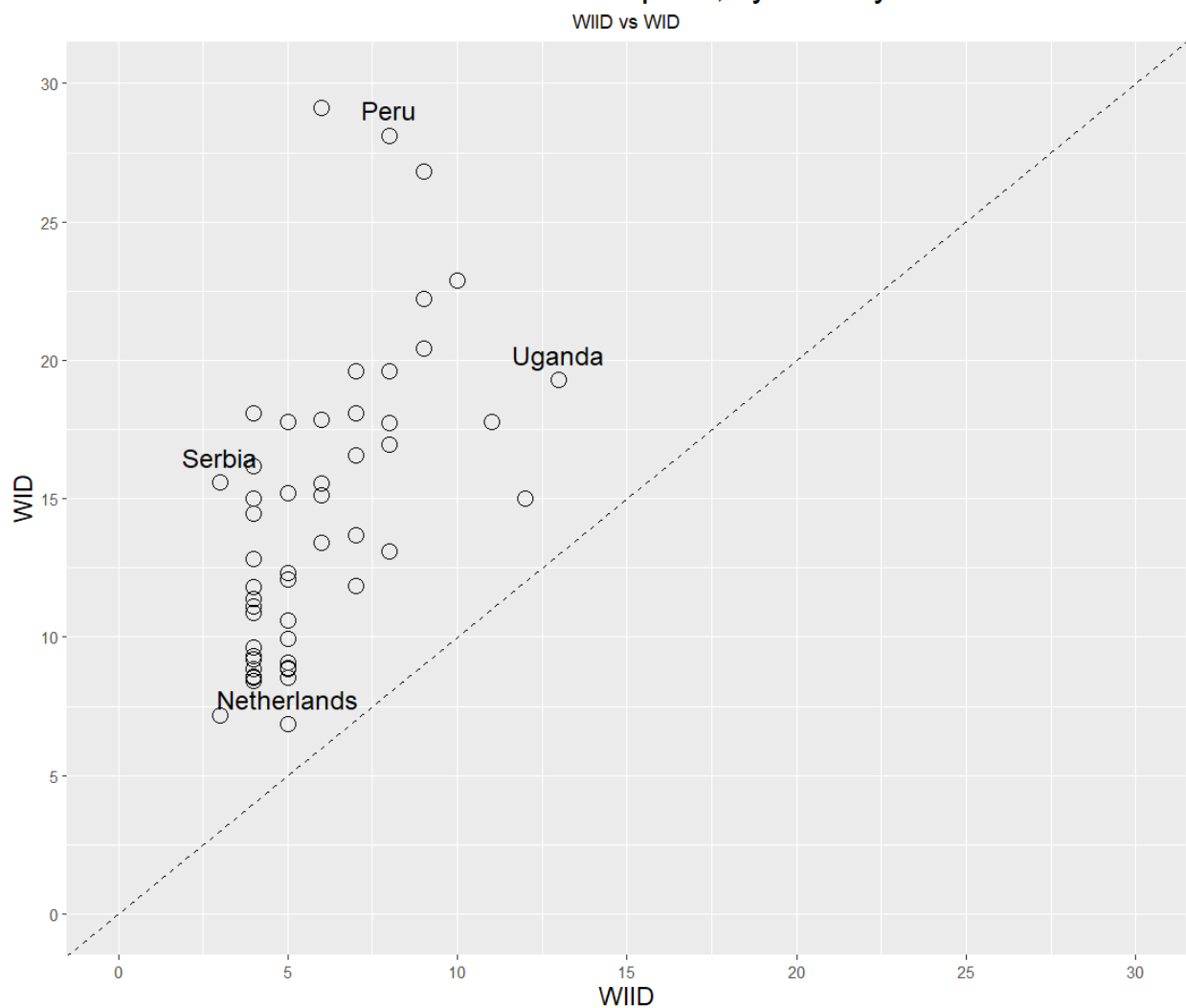
<sup>5</sup> See also Leighley and Nagler (2014) for a more detailed analysis, which confirms that, despite closures in the race and gender voting gaps, the income gradient in voting in the US has persisted since at least the 1970s.



different authors and institutions will report different – and sometimes substantially different – indicators of inequality for the same country-year combinations. To illustrate these stark differences, Figure 2 below plots the income share of the richest 1% of the population for 53 countries in 2020. On the horizontal axis is the share reported in the World Income Inequality Database (WIID) of UNU-WIDER (in their preferred “WIID companion” series) while the vertical axis captures the share reported by the World Inequality Database (WID) of the World Inequality Lab at the Paris School of Economics. These are all the countries for which data were available in both series.

**Figure 2:**

### Income Share of Top 1%, by Country



Source: wid.world/data and UNU-WIDER/WIIDcomp. All data for the year 2020

There is a clear and systematic pattern of lower shares from the WIID than from the WID. The average share reported in the WIID is 5.9, whereas in the WID it is 14.3. For Peru (Serbia), the WIID sees the top 1% earning 8% (3%) of total income, whereas the WID sees the same group earning 28% (15%). These colossal differences are due largely to the sources from which the original data is obtained. Whereas most of the observations in the WIID come from household surveys of one kind or another, most of the data reported by the WID comes from administrative tax data, although some of it is for tax data combined with survey data. Most importantly, most of the WID data attempts to further incorporate income imputations to match national accounts aggregates.

The key challenge is that there is no general agreement that one source or method is unambiguously superior to another. Reliance on administrative tax data, pioneered by Piketty (2003) and Piketty and Saez (2003) has a number of advantages: (i) it is much better than surveys at capturing very high incomes; (ii) datasets are typically much larger; and (iii) in some countries, the data go back a long way, permitting a long time-coverage. But it also has disadvantages: (i) the unit of observation is the tax unit, rather than the individual or the household, which are usually the more economically meaningful units; (ii) many fewer covariates are present in the data, which is a problem for many kinds of analysis; and, perhaps most importantly, (iii) it is only informative of the subset of the population that declares income taxes.

For many rich countries, with well-developed tax and statistical systems with near universal coverage, this third disadvantage is not particularly binding, and the advantages of fiscal data over surveys may outweigh the disadvantages – at least in pure measurement work where covariates are less important. In most countries, however, tax reporting is far from universal and highly selective. Across Latin America, Africa and developing Asia, informal sectors are large, often employing more workers than the formal, tax-paying sector. In these countries fiscal data on its own cannot hope to provide representative pictures of the income distribution or measures of inequality.

Recognizing this, researchers have sought to combine information from tax and survey data, to try and deliver a more integrated and comprehensive picture (e.g., Blanchet et al., 2022) This is ingenious and important work, but it is far from assumption-free. Inequality estimates thus generated come with substantial uncertainty attached to them, and the magnitude of this uncertainty is itself difficult to quantify. This uncertainty only grows when researchers seek to impute income so that survey aggregates (using expansion factors, of course) match those of either the household account or the national income estimates from the system of national accounts (SNA), as additional assumptions must then inevitably be made to distribute incomes that are not observationally attached to any household.

To be clear, both the expanded use of tax data and attempts to construct distributional national accounts are important innovations that have transformed the field of inequality measurement over the last two decades or so. But, for most countries and certainly those in the developing world, they have not yet reached a point where one can be completely confident of the summary inequality estimates that they generate. On the other hand, they have highlighted serious shortcomings with standard household surveys, particularly on the measurement of top incomes. The result, in these countries, is one of increased uncertainty: We now know that we probably underestimate inequality by looking only at surveys, but may or may not overestimate it through the various incremental assumptions made when combining survey and other kinds of data. The result is a world of “inequality bands”, where one is tempted to take survey-based estimates as lower-bounds, and DINA-based estimates as (plausible) “upper bounds”, with ‘true’ inequality somewhere in between.

There is a second, rather unrelated, reason for uncertainty about the actual levels of inequality in our societies, namely the persistent neglect of intra-household inequality in most reported statistics. The reason for this neglect is clear: most household surveys and administrative data sources contain information on individual incomes and/or aggregate household consumption, but information on individually disaggregated consumption is exceedingly rare, leading to the frequent assumption of perfect sharing within households. Although that assumption underpins virtually all national-level statistics mentioned above, it has been found to be entirely inadequate whenever tested. Using one of those very rare surveys that do collect individual-level information – in this case on food intake in the Philippines – Haddad and Kanbur (1990) found that ignoring intrahousehold differences could lead to underestimates of overall inequality by as much as 30%. Using a collective household model, Lise and Seitz (2011) find that overall inequality in the UK could be underestimated by between 25% and 50% if inequality within households is ignored. These are clearly very large differences, and their frequent omission from the public debate adds to our uncertainty about the true levels of inequality.

A second area where there is perhaps less agreement than meets the eye is the popular assessment of recent inequality trends, particularly within countries. There is, of course, a consensus that inequality has (massively) increased in the United States, regardless of the data source. According to the latest WIID estimates (which themselves come from LIS – harmonized household survey data), the US Gini coefficient for pre-tax household per capita income has risen from 37.5 to 41.5 between 1987 and 2020. The latest estimates from the WID indicate an increase in the pre-tax national income share of the top 1% from 13% to 18%, over the same period. The indicators differ – as would the levels for the same indicator - but the direction of travel is clear. An agreement on trends also holds for most developed countries, whether inequality has recently been rising (as in the UK until 2000-02) or not (as in France). Indeed, if one takes an average across developed countries, inequality has generally been on the rise over the last 30-40 years.

The problem arises when, as often happens, the press and others generalize from this important, but small, set of countries to the rest of the world. Among developing countries, there is much greater heterogeneity in terms of inequality trends, particularly in the 2000s. Of course, inequality rose in a number of poor countries too but, on average, “[t]he available evidence suggests that [...] the levels of national income inequality in the developing world increased in the 1980s and 1990s, and declined in the 2000s.” (Gasparini and Alvaredo, 2015). This was particularly true in Latin America,<sup>6</sup> but not exclusively: Looking at 87 countries between 2000 and 2015, and using household-survey based inequality estimates, World Bank (2016) found that inequality rose (by more than one percentage point) in 22 countries and fell (by more than one percentage point) in 45 countries.<sup>7</sup> You would not have guessed this nuanced picture from the inequality coverage in the US and UK press, which frequently extrapolates from the experience of their own countries to the world as a whole.<sup>8</sup>

## **2. Does inequality matter?**

Does any of this matter? Whether inequality is high or low; has gone up or down; is measured this way or that? After all, as recently as 2004, in a much-quoted passage, Robert Lucas, a Nobel laureate in Economics, wrote that “[of] all the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution” (Lucas, 2004). It turns out that it is in the answer to this question that the consensus has shifted the most since the 1980s. While there are always outliers, the dominant view in Economics (and among policymakers) today is that excessive inequality is “a bad thing”, for at least three reasons.

First, inequality – and some forms of inequality in particular – matter directly and intrinsically to people. This became clear even to the most hard-nosed economists through the lab experiments on preferences for fairness, conducted by various authors in the 1990s and 2000s. The experiments used games such as the Ultimatum Game, in which one player is randomly selected for the role of Proposer while a second is the Responder. The players are allocated a sum ( $S$ ) of (real) money. The Proposer proposes a division of the sum, and the Responder can only accept or reject the offer. If the offer is rejected, both payoffs are zero. If it is accepted, the division is implemented and players keep the payoffs. Players are told that the games won’t be repeated and do not know each other’s real identities.

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<sup>6</sup> On the decline in inequality in Latin America in the 2000s, see López-Calva and Lustig (2010).

<sup>7</sup> It changed by less than one percentage point (up or down) in the remaining 20 countries.

<sup>8</sup> Nor would you necessarily guess from the broader public debate that global inequality – between all individuals in the world (but still assuming perfect sharing within households) – declined between the 1990s and at least the mid-2010s, although there is relatively little disagreement in the scholarly literature. We have no space to explore that literature in this paper but see Lakner and Milanovic (2016) for a prominent example.

The single Nash equilibrium of this game is for the proposer to suggest  $S - \varepsilon$  ( $\varepsilon > 0$ , but as small as possible) and for the responder to accept. Yet a number of studies found a substantial share of offers far above some minimal amount  $\varepsilon$  and, even more importantly, a number of low offers that were rejected. Such a rejection is interpreted as “altruistic punishment”, whereby one player gives up real financial resources in order to punish the other for unfair behaviour (Hoffman et al., 1996; Fehr and Fischbacher, 2003). Variations on this behavior have been documented across a large number of societies, both ‘advanced’ and ‘traditional’ (Henrich et al., 2004). Other studies have found that certain animals, such as capuchin monkeys, are also prepared to forgo food they normally consume to protest against what they see as an unfair allocation by the experimenter (Brosnan and de Waal, 2003). Subsequent work that attempted to distinguish between different sources of inequality – such as luck versus effort – finds that people are likelier to offer compensation for inequalities for which people cannot be held responsible (such as a randomly allocated wage rate), as opposed to those they can control (such as the number of words they type correctly or how long they choose to work on a task). See, e.g., Cappelen et al. (2010).<sup>9</sup>

Second, there is much evidence to suggest that inequality – when combined with various market imperfections – implies that some efficient investment projects are not undertaken, reducing allocative efficiency and, most likely, economic growth. While I would not claim that there is a “consensus” that this is true, it is in my view now the preponderant view in the profession. The original theoretical arguments go back to Stiglitz (1969) and Loury (1981). In the 1990s, a set of influential papers included Galor and Zeira (1993), Banerjee and Newman (1993) and Aghion and Bolton (1997). Convincing empirical support is provided by Hsieh et al. (2019), who argue that the expansion of professional opportunities to women and non-white men in the medical and legal professionals in the United States accounted for a substantial share of productivity growth in those industries. The argument that inequality in productive opportunities is particularly detrimental to efficiency and growth is also consistent with the finding that inequality of opportunity is negatively associated with economic growth across 26 US states between 1970 and 2000 (Marrero and Rodriguez, 2013).

Third, there is growing acceptance that high inequality may also hurt a society through the quality of its political institutions – which can in turn matter both intrinsically and because of the effects of those institutions on economic outcomes. The basic idea that high wealth inequality may lead to the capture of the state and its institutions by a small elite, whose interests may not be aligned with those of the majority and who may, therefore, choose policies that not optimal from the viewpoint of society more broadly goes back all the way to Plato’s *Republic*. In modern economics,

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<sup>9</sup> There is also plenty of more observational, survey-based evidence that inequality and well-being are inversely related, e.g., Alesina, di Tella and MacCulloch (2004) or Luttmer (2005). Yet another research strand argues that certain goods – such as houses or cars – are “positional”, in the sense that there are negative externalities from their consumption simply from direct comparisons (Frank, 2005). Under fairly weak assumptions, such negative externalities tend to rise with inequality.

theoretical models linking economic inequality, political inequality and worse economic outcomes have been put forward by Alesina and Rodrik (1994), Persson and Tabellini (1994), Bénabou (2000), Bourguignon and Verdier (2000), and Acemoglu and Robinson (2000), to name a few. Economic historians, such as Engerman and Sokoloff (1997), have argued that this mechanism underpins the different political and economic outcomes of North and South America: initial factor endowments shaped different degrees of “initial” wealth inequality, which in turn affected political institutions through, e.g., different paths for the expansion of education and the franchise, and these in turn led to different qualities of economic governance.

### **3. What is to be done?**

#### *3.1. The family curse*

In order to productively discuss policies to “tackle inequality”, it is essential to first understand the inequality-perpetuating forces that they would be up against. After all, if people prefer fairness and inequality can hold societies back and prevent them from reaching their full economic potential, why is it nevertheless as ubiquitous as described in Section 1?

One answer, of course, is the aforementioned interaction between economic and political inequalities. The models discussed by Bourguignon and Verdier (2000) and Bénabou (2000) are all about stable high-inequality equilibria that will persist, despite the possibility of richer and more egalitarian alternatives. In essence, they are stories of power built on wealth, which is then used to choose policies that preserve that unequal distribution of wealth, even if the potential gains to others in alternative equilibria might exceed the losses of the powerful.

But there is another, possibly even deeper reason why inequality is so persistent or, in Charles Tilly’s words, “durable”, and that is the remarkable degree to which families are able to transmit advantage – or disadvantage – across generations.<sup>10</sup> Parents bequeath their genes, of course, so that high-ability parents may be more likely to beget high-ability children. Parents also bequeath human capital directly, during childhood and possibly beyond. At the critical early-childhood phase, between the ages of 0 and 5, families are either the sole or the principal source of human interaction for infants, providing both the nutritional and the stimulation inputs we now know to be so critically important for future brain development.<sup>11</sup> The children of more educated parents are known to develop larger vocabularies and other measures of cognitive skill development earlier than those of their less educated peers (see, e.g., Paxson and Schady, 2007).

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<sup>10</sup> See Tilly (1998). See also Haveman and Wolfe (1995) for a review of the various paths through which child achievements are influenced by parental characteristics.

<sup>11</sup> See Cunha and Heckman (2007) for an influential model of the production function of human capital, which emphasizes inter-temporal complementarities and the role of early childhood.

In light of the early advantage conferred upon children by better-off families, one might look to school as the great equalizer, from age 6 or 7 onward. Yet school quality differs markedly within most countries and, once again, richer families are typically better able to send their children to the best schools, with the best teachers and peers, than poorer families. The mechanisms may differ across settings: in the United States, it operates through local financing for public schools and residential sorting, whereby house prices rise in the vicinity of better schools, concentrating richer families in the neighborhood and further raising school funding from local property taxes. (Fernández and Rogerson, 1998). In Latin America, it often operates through a Tybout-style opting out of public services. Richer families are prepared to pay for better private schools, while poorer ones must send their children to lower-quality public schools. Richer and more powerful families are then less inclined to support higher taxes to fund better-quality public education, and the cycle persists (Ferreira, 2001; de la O et al, 2021).

The cumulative build-up of advantage in the production of both cognitive and socio-emotional skills throughout childhood and adolescence, life's primary formative phases, would likely be sufficient to ensure a great deal of intergenerational transmission of inequality. Yet, it is plainly not the only mechanism at work. There is evidence that, beyond the advantages that superior education affords in the labour market, parents are also able to intervene directly in the job matching process. Richer families will typically have high-value professional networks facilitating recommendations, internships, and other entranceways to employment. Corak and Piraino (2011) even document the existence of inter-generational transmission of employers.

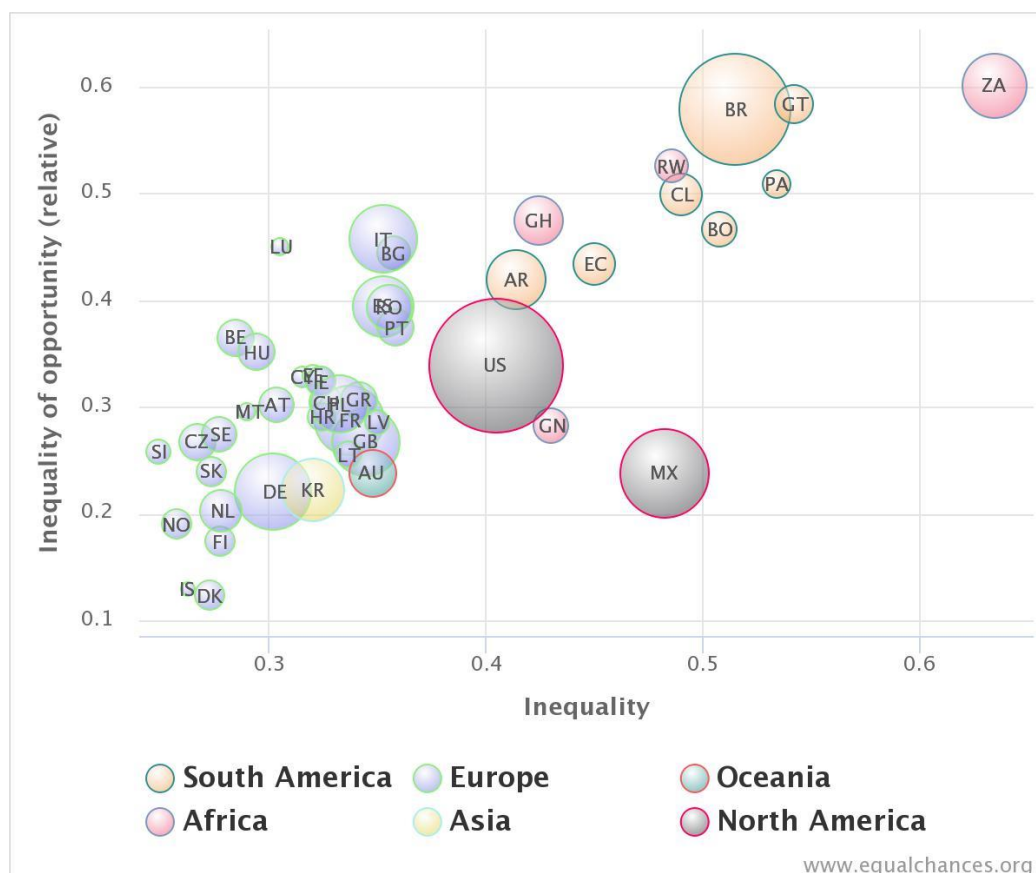
Furthermore, this discussion has so far focused on human capital, perhaps the kind where the advantage of the rich might be expected to be lowest. Through inter-vivo transfers or bequests, the rich are obviously able to transmit a great deal of their wealth to their children as well, perpetuating inequality in that domain. Finally, there is overwhelming evidence that families are often able to bequeath political power to their descendants too. This is true not only in the obvious case of (old and present-day) monarchies. It is true of great political dynasties, such as Kennedys or the Bushes in the United States, or the Trudeaus in Canada. And the persistence is often very long-lived: Stone (1975) documents that no fewer than 31 presidents and 285 members of parliament of Costa Rica descend directly from Don Juan Vázquez de Coronado y Anaya, born in 1523, who was Spain's main conqueror of the part of Central America which is now Costa Rica.

These mutually reinforcing channels for the intergenerational transmission of advantage can be summarized in rather dry intergenerational mobility or inequality of opportunity statistics. Using rank-based measures, Chetty et al (2014a) find that a 10 percentile increase in parental income is associated with a 3.4 percentile increase in the child's adult income, a 6.7 percentage point increase in college attendance rates and a three percentage-point reduction in teenage pregnancies (leading to birth) for girls. Brunori et al. (2023) find that 59% of income inequality in

the child's generation in Brazil can be accounted for by inherited circumstances such as race, gender, place of birth and family background.

There is a multitude of such estimates for many countries, which it is not my purpose to review here. Taken together, though, they point to two facts, First, the various mechanisms just outlined have a clear and measurable effect on income and wealth: on average, the children of richer and more educated families are themselves richer and more educated than their peers. Second, when one looks at the pattern across a large number of countries, there is a strong positive association between income inequality (measured, say, by the Gini coefficient) and intergenerational persistence (measured, say, by the intergenerational income elasticity). This association, first documented by Corak (2013) was baptized the “Great Gatsby Curve”. Figure 3 below – which updates one from Brunori et al. (2013) – is a version of such a curve. It plots the share of overall inequality accounted for by pre-determined circumstances such as family, place of birth and family background (on the y axis) against the cross-sectional Gini coefficient on the x-axis. Clearly, more unequal places also tend to have less intergenerational mobility and more inequality of opportunity.

**Figure 3: An inequality of opportunity “Great Gatsby Curve”**



Source: Updated from Brunori et al. (2013)



### 3.2 Against the family tide

Those seeking to reduce inequality have often seen the un-equalizing forces of “the market” as the enemy.<sup>12</sup> In my view, the task is even harder: as argued above, the great inequality-reproducing institution is actually the family – simply because everyone wants to provide their children with the best possible opportunities, but families with greater resources of all kinds do so more successfully than those with fewer. As a result, a broadly equal provision of public services to all families – while likely to be an improvement in much of the world – is simply not enough to fully eliminate the transmission and production of inequality.<sup>13</sup> If one is convinced by the arguments summarized in Section 2 for trying to lower inequality, but remains mindful of potential equity-efficiency trade-offs, is there a consensus on the policies to be pursued?

The array of potentially relevant policies is vast since, in general, any policy affecting some people’s incomes differently than other people’s, will affect inequality. It would be impossible to do justice to all of the policy options in a full-sized book, let alone in this short essay. In what follows, I try merely to provide a heroically brief summary of some of the current thinking about policies that might successfully reduce inequality, at low or no efficiency costs. In broad terms, and without any hope of being exhaustive, one might divide the policy space into three large sub-spaces: first, policies that affect people’s earning potential before they enter the labour market; second, policies that affect the way (product, labour, and capital) markets work; and third policies that redistribute incomes – or wealth – “ex-post”.

My reading is that there is a greater measure of consensus about the first group, often described as “*pre-distribution*” policies. Pre-distribution refers to public investments intended to enhance the human capital accumulation of the least advantaged – in part to make up for the greater private investments of better-off families discussed above. The need is not trivial: in a Lancet article, Grantham-McGregor et al. (2007) estimate that, at that time, over 200 million children in developing countries were not reaching their development potential, owing to four main causes, namely stunting, iron deficiency, iodine deficiency, and lack of cognitive and social-emotional stimulation. Pre-distribution policies focus largely – although not exclusively – on education, health, and early childhood development.

Early childhood interventions range from simple nutritional programmes, such as the INCAP programme in Guatemala in the 1970s (Maluccio et al., 2009), to center-based stimulation and intellectual development programmes such as the Perry Pre-School project in Ypsilanti, Michigan and the Abecedarian programme in North Carolina. Sometimes, they combine both a nutritional

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<sup>12</sup> Markets can, of course, reinforce inequalities, e.g., by providing high and increasing (i.e., convex) returns to education, or higher financial returns to larger investments. They can also reduce inequalities, e.g., by eliminating monopoly profits through competition.

<sup>13</sup> As shown by Heckman and Landerso’s (2021) comparison of social mobility in Denmark and the United States.

and a stimulation component, as in the well-known Jamaican Study of Grantham-McGregor et al. (1991), where stunted children were divided into one control and three treatment groups, all of which were benchmarked against a comparison group of normal-weight children at baseline. One of the treatment arms received only a nutritional supplement, while another received a stimulation treatment. The third received both the supplement and the stimulation treatment. The latter group almost caught up with the comparison group in terms of cognitive measures 24 months later. Even more impressively, perhaps, their wages were significantly higher than those of the control group, and statistically indistinguishable from the comparison group, twenty years later (Gertler et al., 2014).

Beyond early childhood, there are of course innumerable pro-poor education interventions, from busing in the United States and school vouchers in Chile or Colombia, to targeted interventions to provide anything from school uniforms to computers and tablets to under-privileged students in Africa. In a comprehensive survey of such interventions in the developing world, Kremer et al. (2013) found that complementary input provisions interventions had a mixed record at best, and were generally less successful than programmes aimed at improving teaching and pedagogical methods. There is support for the primacy of teaching as the key input into the school-based learning production function from Chetty et al. (2014b) for the United States, and Araujo et al. (2016) for Ecuador. If there is an overarching policy message on “pre-distribution” policies, it is that they *can* work and, when they do, they can make a real difference to the children who benefit. However, as is often the case, they are not guaranteed to work, and the details of design and delivery matter a great deal.

There is rather less agreement about the second broad policy category, which consists of interventions directly intended to change the ways markets work.<sup>14</sup> Examples include antitrust regulation, policies towards unions, and minimum wages. Regulation aimed at preventing the excessive concentration of market power has always been important for a well-functioning market economy, but probably never as important as it is now. There is credible evidence that some of the increase in the capital shares of national income that we have observed in recent decades, particularly in developed countries (Karabarbounis and Neiman, 2013) is attributable to a marked rise in pure economic profits arising from market power (e.g., Barkai, 2020). This reflects rising monopoly power, particularly among very large firms, which enables them to extract markups over and above the hypothetical competitive market price. De Loecker et al. (2020), for example, estimate that aggregate markups in the US have risen from 21% above marginal cost in 1980, to 61% more recently.

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<sup>14</sup> Of course, taxes, subsidies, and transfers also affect the ways markets work, but I will consider the bulk of taxation and redistribution under the third heading below.

In addition, it seems that market power by dominant firms is not restricted to product markets. Markdowns in wages have been detected increasingly frequently, just as have markups in prices. These markdowns manifest when wages fall below the marginal productivity of workers and reflect the presence of monopsony power in local labour markets. One way to offset such imbalance between large employers and individual employees is, of course, to permit or even support the work of labour unions, which have a longstanding record of success in defending the labour share in the economy as a whole (see, e.g., Young and Zuleta, 2018). Minimum wages too can support workers' bargaining power by providing an effective floor and, when set at an adequate level, can help reduce inequality. See Engbom and Moser (2022) for an analysis of the rise in Brazilian minimum wages between 1996 and 2018.

Finally, the third broad category of anti-inequality policies concerns redistribution through the fiscal system, using taxes, subsidies and transfers as the main instruments. Such policies have a long history, going back at least to Bismarck and Beveridge in the early and mid-20<sup>th</sup> Century, respectively.<sup>15</sup> Their fiscal reforms gave rise to the so-called "welfare states" said to characterize much of Europe today. Countries so described generally have rates of income taxation sufficient to finance not only public schooling but also to subsidize (partially or fully) the costs of health care, provide basic old-age pensions and a variety of other income supplements to those unable to derive sufficient income from employment, either temporarily or more permanently. In addition to public pensions and unemployment insurance, these programmes include child and family benefits, earned income tax credits, food stamps, subsidized school meals and many others. It would be impossible to do them justice here, and indeed there is an entire paper in this "London consensus" project dedicated to the welfare state (Barr, 2023).

When Welfare States have been generous and also succeeded in providing high-quality public schooling, as in Finland and Scandinavia, they have certainly contributed to keeping inequality levels lower than elsewhere. Denmark, Finland, Iceland, and Norway form a cluster of countries closest to the origin in Figure 3 above, with income Gini coefficients below 0.3, and less than 20% of that associated with inequality of opportunity. Just "North" of them in the graph, the Netherlands, the Czech Republic, Slovakia, and Slovenia, which have similar levels of income inequality but slightly higher measures of inequality of opportunity, also have actively redistributive fiscal systems.

Even in developing countries, where inequality is typically greater and redistribution typically weaker, social protection programmes have been shown to contribute to reductions in poverty and inequality, at least during the last fifty years or so.<sup>16</sup> The late 1980s saw the introduction of some non-contributory pension schemes with a greater reach into the informal sectors, such as

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<sup>15</sup> Incipient precursors go back much further, and include, for example, the Poor Laws in England in the early 1600s.

<sup>16</sup> See, e.g., Ferreira and Robalino (2011) for the case of Latin America.

the *Aposentadorias Rurais* in Brazil. In Asia, public work and food transfer schemes were more common. From the 1990s onward all of these were complemented, in many countries, by conditional cash transfer programmes, which were targeted to the poorest households and provided small payments on condition children were enrolled in and attending school.<sup>17</sup> These targeted cash transfers often replaced subsidies on specific goods, such as basic foodstuffs or fuel, which were typically both less redistributive and more distortionary.

Obviously, this short discussion does not cover every policy within those three broad areas, nor are three areas themselves exhaustive. Where should we list agricultural extension services aimed at raising the productivity of poor farmers? Or investments in public transport which can open up a range of new job opportunities for people living far from city centres? Or the supply of solar energy to remote, off-grid villages, where children study by candlelight and women collect firewood for cooking? The scope of policies that can help reduce inequality is truly vast, and highly context dependent.

Nor is it necessarily the case that the policies discussed are those on which there is greater consensus. One can certainly find economists who would argue against minimum wages or any kind of government regulation. But these are at least some of the policies which are (a) potentially quite important, and (b) for which there is growing support in the modern scholarly literature. There is, as previously mentioned, broad agreement that pre-distribution policies such as early childhood development programmes and investment in better teaching are socially desirable. The sense is that the combination of the aggregate productivity gains obtained from the additional human capital formed among recipients with whatever value one places in greater equity is likely to outweigh any incentive costs incurred in raising and spending the cash that these programmes costs. There is also growing acceptance, at least in some quarters, that higher and more progressive taxation may have to be part of the solution in large parts of the world, including the United States and most of Western Europe. Saez and Zucman (2019), among others, have noted that income tax rates are now considerably less progressive than they were in the 1950s, 60s and 70s, and suggested that a return to higher rates would be advantageous.

Yet, when one considers not only the egregious wealth at the top, but also the depth of deprivation at the bottom of the distribution, it is hard to avoid the sense that even this rich policy menu is inadequate. Among the (formerly) coal mining communities of the Appalachians or in the poorest counties of Mississippi (in the United States), or among isolated indigenous communities of the Bolivian Andes or the Afro-descendants of Colombia's Pacific Coast, or along Nigeria's northern border with Niger, or among the Adivasi of Jharkhand, the poor and deprived

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<sup>17</sup> The exact nature, extent and enforcement of conditions varied across countries, but the school enrollment ones were the most common. See Fiszbein and Schady (2009).

number in their billions. By and large, their predecessors have been in similar positions for generations.

In these places, early childhood stimulation campaigns and new teaching methods financed by higher taxes on the rich will be welcome. But it seems unlikely that they will make a serious dent on the systematic deprivations – relative and absolute – that they live with, within a couple of generations. Unlike those who would fight inequality merely by bringing down the billionaires, those who would also like to see the world's poor raised to a life with dignity and opportunity must do more than raise taxes or train better teachers. There are some promising leads, in remote corners of the public policy space. There is evidence that the so-called Graduation or Ultra-Poor programmes, sponsored by BRAC in Bangladesh and other poor countries, succeeded not only in raising the incomes of very poor rural self-employed people, but that they raised them above some critical poverty trap, enabling them to access more profitable occupations, so that the gains persisted many years after the programme transfers ended (Bandiera et al. 2017).

More such transformational programmes are needed, but not only in isolated rural settings in the world's poorest countries – where some meaningful progress can arguably be achieved at relatively low cost. They are needed everywhere else where poverty persists across generations. What would be the equivalent to Graduation programmes that might work in the *villas miseria* around Greater Buenos Aires; in the banlieues of Paris; in inner-city Baltimore; or the poor neighbourhoods of Jakarta or Manila? Even after we have succeeded in returning income tax rates to the levels of the 1960s, or in persuading voters that inheritance taxes are a good idea, how should we spend those resources to break the intergenerational transmission of disadvantage at the bottom of the distribution(s)? I see no consensus – and too little research – on that.

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