

Guidelines Inequality Diagnostics¹

Introduction to the guidelines

Inequality has gained increased priority in global development agendas, with UN member countries committing to ‘leave no one behind’ (LNOB) in pursuing the 2030 Sustainable Development Goals (SDGs). Nonetheless, it is recognised that incorporating inequality effectively into national development strategies requires a deeper understanding of its country-specific causes and consequences, past efforts to address it, and the range and feasibility of potential solutions.

This guideline aims to provide structure for a diagnostic assessment of national inequality in partner countries of the German Development Cooperation (GIZ). Key causes and linkages are highlighted for analysis along with various approaches to reducing inequality at national level. Importantly, the focal areas mentioned are not exhaustive, and each diagnostic will emphasise different aspects according to local significance. Optional questions to be addressed in an inequality diagnostic are listed in Appendix A.

Part A – Analysis of inequality trends, causes and consequences

The first section of the diagnostic should provide an overview of how, and under which conditions, inequality has evolved. This involves outlining trends in national development (such as economic growth and productivity, poverty, demographic change, and the political climate), and examining the level and characteristics of inequality nationally. Given its complex and context-specific nature, a detailed assessment of inequality dynamics should include a mix of monetary, non-monetary and multi-dimensional indicators which are locally relevant and for which sufficient and reliable data are available.²

Common statistics for measuring inequality, generally based on income data, include the 90/10 percentile ratio and Palma ratio, the Gini coefficient and the Theil index.³ Further aspects to consider are the inequality of opportunities versus the inequality of outcomes, as well as horizontal (between group) and vertical (within group) inequality, since they can have different determinants and varying implications for society and policy. Appendix B offers a table of recommended indicators and an explanation of inequality concepts and indicator typology (see also Haughton and Khandker, 2009).

1. Causes and drivers of inequality

The potential causes and drivers of inequality are numerous and often intertwined, so are challenging to identify in isolation and must be considered holistically.⁴ Three major factors, namely i) labour market developments, ii) taxes, transfer and remittances, and iii) spatial and social access to (public) services and discriminatory policies are proposed here, given their relatively

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² To ensure validity, the most recent and accurate figures should be used, and diagnostics should remain consistent in the measures used when drawing comparisons across population groups or regions.

³ These are useful for their minimal data requirements, cross-country comparability and ease of interpretation, though where permitted, more detailed statistics can yield greater information on the nature of inequality.

⁴ See Klasen et al (2016) for a full literature review on the structural causes of inequality.

broad scope, links with other macroeconomic trends such as globalisation and crises, and position as key leverage points for policy.

1.1 Labour market developments

Labour market developments are a key mechanism in the link between economic growth and structural change on the one hand, and (poverty and) inequality on the other hand.⁵ Employment is a major determinant of incomes and consequently of income distribution.⁶ Studying the transmission of labour market adjustments into changes in the distribution of (per capita) household incomes requires information on changes in economic activity and employment status, how people move across labour market segments and who moves, how remuneration of employed persons changes, and how these changes affect the incomes of particular individuals, households and populations groups. Diagnostics should examine factors affecting the links between the labour market and household income distribution, including the size of the working-age population, age- and gender-specific labour force participation rates, unemployment, and human capital (in particular education and experience).

- 1.1.1 What is the national employment structure in terms of economic sectors (agriculture, manufacturing, services) and employment status (wage employment versus self-employment)?
- 1.1.2 What is the size and composition of the working-age population? What is the labour force participation rate and unemployment rate of specific (age, gender, education and/or ethnic) groups?
- 1.1.3 What are the average earnings of specific labour force fractions (such as wage earners and non-wage earners) and different socioeconomic groups? How are non-labour incomes (such as transfers) distributed among and between specific groups?
- 1.1.4 What is the employment share of informal workers?
- 1.1.5 How has the labour market developed or transitioned with regard to questions 1.1.1 to 1.1.4?

1.2 Taxes and transfers, remittances

Substantial amounts of resources are reallocated annually through taxes, transfers and remittances, giving these flows the potential to both reinforce and to mitigate inequality. A country's tax and transfer system holds considerable scope for influencing the distributive capacity of a state; remittances can be influenced to a lesser extent by national governments, but may present a relevant factor for studying and understanding inequality dynamics.

Taxes

The effectiveness of taxes for reducing inequality depends on the combination of instruments used and the degree of enforcement and compliance. Diagnostics should observe a few important features of the national tax system to evaluate the causal link with inequality, namely, the types of taxes levied (income, property or consumption)⁸, the respective tax rates, the degree of progressivity, and the level of regulation and avoidance. Two important questions are whether tax structures match concentrations of wealth and income and whether the correct incentives

⁵ See e.g. Thévenot (2017).

⁶ Employment itself is the result of the interaction between demand and supply in the labour market. The interaction may be different in different sectors of the economy. The labour market can be dual or segmented. Access to the formal (wage) labour market may furthermore be limited.

⁷ We suggest breaking down labour statistics for Section 1.1 by gender, age, ethnicity and educational attainment.

⁸ Income taxes are levied on individual earnings, generally apply to workers in the formal sector, and vary in their degree of progressivity. Flat tax rates benefit higher income brackets due to the decrease in the marginal utility of income. Property taxes are levied on real estate, real property or realty and generally take the form of an ad valorem tax, which depends on the property value. Consumption taxes are levied on goods and services, and most commonly take the form of a value-added or a sales tax; but also other forms, such as excise taxes, exist.

are set to balance revenue collection with growth and productivity. Questions on income taxes are included in this guideline; questions regarding property and consumption taxes are optional and listed in Appendix A.

Income taxes

- 1.2.1 To what extent are public revenues raised through income tax collection? How large is the current tax base and the tax-to-GDP ratio?
- 1.2.2 Which workers are obliged to pay taxes, and what tax rates do they face? In case a progressive tax system is in place, how many steps does it have (and at what income levels) and how steep is it? What is the gap between the lowest and highest tax bracket?
- 1.2.3 How does this tax system reflect the labour market structures mentioned above and how does this affect the level of inequality?⁹
- 1.2.4 If tax credit schemes are in place, what are the eligibility criteria for receiving them and how generous are they?
- 1.2.5 How does the Gini coefficient (or another inequality metric) change pre- and post-tax?
- 1.2.6 How centralised is the tax system? Who is responsible for collecting taxes and enforcing tax laws?
- 1.2.7 How stringent are tax laws against non-compliance, and how strongly are they enforced? To what extent are corruption, exemption, avoidance etc a problem in [country]?
- 1.2.8 How has the [country's] income tax system developed with regard to questions 1.2.1 to 1.2.7?

Transfers

Transfers within countries can take a variety of forms (see Causa and Hermansen, 2017). Social welfare transfers directly redistribute tax revenue, while subsidies decrease the costs of specific (basic) goods and services such as healthcare or education. Subsidies may be available to the overall population or to individuals or households that meet specific criteria, such as those below an income threshold or the unemployed. If well designed and targeted, transfers can alleviate poverty and decrease inequities; however, if they benefit population groups that are already better off¹⁰ or are not invested in productive assets, they can reinforce inequality.

- 1.2.9 Which social assistance and welfare transfers are in place in [country]? Who are the target beneficiaries, what is the amount received (the absolute value and the portion of household income) and over which period? To what extent are these transfers reliable?
- 1.2.10 Is the targeted population indeed those receiving the transfers? Which inclusion or exclusion errors exist due to stringent eligibility criteria, uneven coverage or other reasons?
- 1.2.11 Which kinds of subsidies exist? Which population groups benefit from these subsidies?
- 1.2.12 To what extent have transfers and subsidies affected the socioeconomic position of the bottom 40% and contributed to changes in certain types of inequality?
- 1.2.13 How have the [country's] social transfer system and subsidy programs developed with regard to questions 1.2.9 to 1.2.12?

Remittances

Remittances, or migrant transfers, can present a substantial share of household income for certain population groups in certain countries. The source of remittances (whether an industrialised or developing country) determines the stability of receipts, while the characteristics of recipients (i.e. who can access migration opportunities), the cost of sending money (often through informal operators) and how remittances are spent (whether used for productive investment or

⁹ In countries with a high share of informal or subsistence workers or a large agricultural sector, taxes on labour are unlikely to raise the revenue necessary to reallocate national wealth efficiently.

¹⁰ An example of this is a petrol subsidy, which benefits car owners who are often wealthier than non-car owners.

consumption), influence their ability to reduce (poverty and) inequality in destination countries.¹¹

- 1.2.14 What is the annual volume of remittances and how does this fluctuate? What is the ratio of remittances to GDP? What is the reach and diversity of remittance sources?
- 1.2.15 What is the relationship between remittances and income inequality in [country]?
- 1.2.16 How are remittances distributed among the population? Do they contribute a higher share of income among poorer or richer quantiles of households?
- 1.2.17 What are the costs of sending remittances? How is the remittance market structured and how does the remittance market affect the frequency and volume of remittance transfers?
- 1.2.18 How have remittances developed with regard to questions 1.2.14 to 1.2.17?

1.3 Spatial and social access to (public) services and discriminatory policies

The analysis of (public) services is crucial for understanding inequalities of opportunity, since the level of provision significantly influences the distribution of physical and human assets which expand capabilities, especially in regions where access to credit is limited. Public services span a broad range of sectors including health, education, infrastructure and amenities (electricity, sanitation), the justice system, public transportation, social welfare and assistance. This guideline prioritises social access and discriminatory policies with a focus on education, health and infrastructure due to their direct impact on wellbeing and their importance for long-term growth; questions for spatial access, which could be relevant for countries with pronounced urban-rural differences or concentrated regional development, can be found in Appendix A.

Social access

Social access refers to the freedom and ability of certain demarcations (such as religious or ethnic groups or a certain gender or class) to access opportunities for wellbeing and mobility. In contrast to discriminatory policies, which consist of official laws and regulations, inequalities in the access to services function through more subtle mechanisms and are linked to culture and history through norms, prejudices and persistent marginalisation, as well as to income through the ability to pay. This aspect is further relevant in the context of LNOB.

General

- 1.3.1 To what extent is access to public services (healthcare, education, infrastructure) equal in [country]? If access is not equal, how does access vary between different groups (in terms of breadth and depth)?

Education

- 1.3.2 How does school enrolment and attendance vary by [demarcation] among children?
- 1.3.3 For which education levels are tuition fees enforced? How expensive are those fees? Are subsidies available for children from low-income households?
- 1.3.4 What are the major constraints for those who lack sufficient access to education?
- 1.3.5 What is the variation in capacity and quality of schools nationally? (Number of teachers, number of places for each age group relative to the size of the corresponding population group, quality differences between public and private education).
- 1.3.6 How has access to schooling changed with regard to questions 1.3.2 to 1.3.5?

Health care

- 1.3.7 To what extent do disparities exist in the quantity and quality of healthcare provision between different population groups by [demarcation]?
- 1.3.8 What are the main obstacles for those lacking access to (sufficient) healthcare?
- 1.3.9 How has access to health care developed with regard to questions 1.3.7 to 1.3.8?

¹¹ Dependence on foreign income makes recipients vulnerable to external shocks, exchange rate fluctuations and seasonality.

- 1.3.10 What is the level of infant mortality and average life expectancy by [demarcation]?
 1.3.11 How have infant mortality and average life expectancy changed by [demarcation]?

Discriminatory policies

Discriminative legislation can exist with regard to e.g. race, ethnicity, religion, political opinion, sexual orientation, age, disability or gender.¹² Discrimination directly drives inequality of opportunity (and indirectly inequality of outcomes); negative discriminatory policies create barriers to employment opportunities or public services through segregation or the removal of rights; positive discrimination includes quotas or preferential treatment which offer an advantage to specific groups. Positive discrimination is often contested, because in striving to create stronger equity it violates the fundamental principle of equality. Such issues must be evaluated in context, since they may be tolerated and even required to reverse long histories of negative discrimination.

- 1.3.12 Which, if any, formal (negative) discriminatory policies are currently in place in [country]? Which ones existed in the past and when were they removed?
 1.3.13 What are the direct and indirect consequences of these policies, for the affected groups and society as a whole? What are the persisting effects of past discriminatory policies?
 1.3.14 How are productive assets, including land, information, technology and financial resources, distributed by gender, religion, ethnicity (e.g. rights to ownership, access to credit)?
 1.3.15 Which explicit policies and laws have the underlying objective of reaching equality (positive discrimination)? How effectively are these enforced? To what extent do they reduce certain types of inequality?
 1.3.16 Which, if any, official complaint mechanisms exist for reporting incidences of discrimination? Are they well-known/well-articulated publicly? How are complaints managed and dealt with?

2. Consequences of inequality

Inequality can affect societies in a multitude of ways, both economically and socially, and has both short- and longer-term consequences for development. Often, these link back to causes, making inequality a self-reinforcing phenomenon. Diagnostics should address questions related to the impact of national inequality on poverty and long-term economic growth, as well as questions related to social conflicts and political instability.

2.1 Poverty and long-term economic growth

Poverty is indirectly affected by inequality through channels of income and access, which determine the ability to meet basic needs. Ravallion (2001, 2014) shows that high inequality, measured by the Gini coefficient, dampens the effect of aggregate growth on poverty reduction and exaggerates the increase in poverty when average incomes fall.¹³ Various studies find that strong overall inequality, or inequality found at the bottom end of the distribution, have a more detrimental effect on economic growth, especially in developing countries where credit systems, labour markets and the public sector can be less effective (see Barro, 2000; Voitchovsky, 2009). Conversely, a strong middle-class can boost aggregate demand and production and provide a wider tax-base for public investment.¹⁴

¹² This guideline recommends focusing on gender, religion and ethnicity, which are the most widespread and observable forms of discrimination, though other demarcations (e.g. age), may be more relevant in certain countries.

¹³ Similarly, lower levels of inequality can act as a buffer when incomes fall and boost the capacity of economic growth to lift households and individuals out of poverty.

¹⁴ See e.g. Murphy, Shleifer and Vishny, 1989; Zweimüller, 2000; Foellmi and Zweimüller, 2006.

- 2.1.1 What is the level of the Gini coefficient (or another inequality indicator) and has it shown an increasing, stable or decreasing trend?
- 2.1.2 How has poverty (measured through e.g. the poverty headcount, poverty gap, multi-dimensional poverty index or other nationally-used poverty indicators) developed?
- 2.1.3 How has economic growth developed?¹⁵
- 2.1.4 What is the statistical relationship between inequality and various indicators of poverty and economic growth in [country]?

The link between inequality and macroeconomic instability often unfolds in the long-run through financial sector mechanisms such as restricted or unsustainable borrowing and default on loans (Atkinson and Morelli, 2011; Stiglitz, 2015). Formal credit constraints limit the ability of low-income households to invest in assets with high rates of return, leading to economic losses and persistent inequality.¹⁶

- 2.1.5 What are the conditions for accessing credit? Does access to credit differ between groups?
- 2.1.6 To what extent do credit constraints prevent low-income household from, for example, accessing (higher) education, starting a business or owning a home?
- 2.1.7 Which, if any, informal credit markets exist in [country]? To what extent do they alleviate borrowing pressures and dampen the positive feedback between inequality and growth?

A final aspect to consider, which exacerbates credit constraint mechanisms, regards fertility. In countries with a large portion of low-income households below the poverty line, families tend to be larger, reducing the average expenditure per child (Perotti, 1996). This leads to a large unskilled or low-skilled work force, which increases the returns to education for a small educated elite and exacerbates current and future mobility and inequality.

- 2.1.8 What are the current and past trends in population growth and fertility in [country]?
- 2.1.9 How does fertility vary between lower and higher income quantiles? Is high fertility in [country] associated with high inequality, or does it stem from other cultural factors?
- 2.1.10 How strong is the relationship between household size and average spending per child on, for example, education? At which income quantiles is this relationship significant?

2.2 Social conflicts and political instability

As well as generating economic inefficiencies and slowing economic growth, inequality (especially when highly visible) can affect society deeper by sparking group conflict, civil unrest and political instability. A growing sense of unfairness, such as restricted access to opportunities, tends to reduce levels of trust and cooperation among (deprived) citizens, which has been shown to lower rates of technology adoption and frequencies of business transactions (Ostrom, 1990), and lead to increasing crime rates (Rosenfeld, Baumer and Messner, 2001). Additionally, lobbying has the potential to undermine the rule of law if (elite) interest groups avoid responsibility for harmful actions (e.g. pollution) and evade tax obligations (Stiglitz, 2016), resulting in weakened institutions, rent-seeking behaviour and corruption. The socio-political impacts of inequality in return affect growth and development through uncertainty and decreased confidence, showing the interrelated nature of issues surrounding inequality.

- 2.2.1 What information exists that captures levels of trust and participation in the population (e.g. World Values Survey) or the level of support for redistributive measures (e.g. Gallup Poll Social Series)? Have these factors worsened or improved with changes in inequality?

¹⁵ The economic impact of inequality also depends on the (initial) level of development, since different factors are more important for growth at different stages of growth.

¹⁶ This is the case especially when public services are limited (see e.g. Perotti, 1996; Bourguignon, 2018).

- 2.2.2 Which groups hold a disproportionate amount of economic or political power? How have they influenced decisions and how has their lobbying affected groups with less voice/agency?
- 2.2.3 How has institutional strength developed according to the Worldwide Governance Indicators (WGI) of the World Bank (namely, voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law, control of corruption)?
- 2.2.4 What patterns are shown regarding (petty and violent) crime rates in [country]? What is the observed relationship with inequality trends?

Part B – Inequality in the political discourse and strategies

3. Inequality in the political and societal discourse

In forming strategies or recommendations for reducing inequality in partner countries, it is necessary to understand the current debate surrounding it. The diagnostics should examine the extent to which inequality reduction features in the political and societal discourse in [country], and the aspects of inequality that are referred to in that discourse. This indicates the general willingness to address inequality, as well as potential challenges for implementation.

- 3.1 How frequently are inequality-related issues discussed among politicians and other relevant stakeholders? Who features most often in these discussions (e.g. politicians, lobby groups, civil society) and where do these discussions take place (through which media platforms)?
- 3.2 What is the tone of discussion? How big of a problem is it considered, and are discussions based around taking action or simply generating awareness?
- 3.3 Does the discourse emphasise more inequality of opportunity or inequality of outcome; vertical or horizontal inequality; absolute or relative inequality?¹⁷ What is the reasoning for this?
- 3.4 To what extent does the political and societal discourse in [country] pay attention to the causes, drivers and consequences of inequality? What linkages are made with, for example, growth and structural change, taxes and public services, poverty and intergenerational mobility?

4. Existing policies and strategies in national partner countries

Globally, policy makers consider the reduction of inequality a priority policy area (UNDP, 2013). It is valuable to learn whether a similar urgency is felt among partner countries of the German DC, plus whether and how this is reflected in national policy documents and processes. A related question concerns the alignment of donor policies with partner country policies. This information helps to avoid replicating ineffective policies, identify flaws in policy design or implementation, and generate stronger cooperation with the GIZ around this subject.

4.1 National policies

In answering the following questions, diagnostics should refer to [country's] National Development Plan and other key public documents which promote the national agenda and define policy goals. Supplementary publications can be sourced from local institutions including think tanks, universities and NGOs who have knowledge and experience in local inequality.

- 4.1.1 Which types of inequality are addressed in [country's] national policy documents? To what extent does this reflect national trends in inequality?
- 4.1.2 Do documents explicitly cite the causes and consequences of inequality nationally (and aim to address them)?
- 4.1.3 Which (redistributive) policies or other interventions are currently part of [country's] strategy? Which aspects of inequality do they tackle and through which mechanisms? What are the specific policy targets?
- 4.1.4 What types of inequality do existing studies cover and which policies to reduce inequality are evaluated in these studies? What are the findings of such policy evaluations?
- 4.1.5 What is the degree of interaction, trust and transparency between the national government and knowledge-based institutions?
- 4.1.6 Do policy documents the literature on inequality trends? Are recommendations incorporated into subsequent strategies?

¹⁷ Here one can also consider gender inequality or regional inequality. A combination of these two types of inequality is also possible, see e.g. Argaw (2017).

4.2 Donor strategies regarding [country]

Bilateral and multilateral donors usually formulate annual strategies for their cooperation with partner country governments and implement their strategies together with the national governments (and non-governmental organisations) in partner countries.

- 4.2.1 To what extent do donor policies align with government policies, particularly those on reducing inequality?
- 4.2.2 Which, if any, conditions must be met for donor support that can have implications for (different types of) inequality?
- 4.2.3 How are agendas set by donors regarding policies to reduce inequality? What forms of agreement do partner and donors countries have surrounding commitments to inequality reduction?

Part C – Policy options for reducing national inequality

A vast number of policies exist with the potential to alleviate growing inequality, however, not all of them are feasible or relevant in every context. Diagnostics should highlight policies which directly address the main types, root causes and ultimate consequences of inequality in [country] (Part A) and reflect on past experiences regarding (un)successful policies (Part B). In prioritising interventions, policy makers must further consider the current and future capacity of the state, the stage of development and the nature of existing institutions (UNRISD, 2010; Klasen et al, 2016; ILO, 2017), which collectively determine the policy environment.¹⁸

5. Redistributive policies

Redistributive policies are designed to reallocate productive assets towards poor or marginalised groups with the direct aim of promoting equality. Diagnostics should compare the resource requirements and socio-political suitability of alternatives such as public services, welfare transfers and land reforms when forming recommendations.

5.1 Revenue mobilization

Collecting revenue is a key function of governments in addressing inequality. It is deemed important for state building by increasing financial self-sufficiency, fostering ownership and boosting the capacity for pro-poor investments (European Parliament, 2014). Following section 1.2, suggested reforms should reflect the structure of the domestic economy (including the public sector) and patterns of ownership and expenditure.

- 5.1.1 Which potential reforms may yield the largest expected increase in the tax base? [E.g. raising tax rates, altering the degree of progressivity or changing the type of taxes levied].
- 5.1.2 How could autonomy and accountability be increased at different levels of government? Is there any duplication of activity which could be centrally coordinated?
- 5.1.3 What is the scope for increasing the administrative (property registers, up-to-date databases), technological (notably IT) and (skilled) labour capacity of the public sector?
- 5.1.4 Which, if any, labour market distortions does the current tax system create (e.g. in employment or productivity)? Which incentives could reduce the degree of distortion?

Governments often face issues of corruption, weak fiscal capacity and pressure from economic actors with significant power. The UN estimates that the annual revenue loss for developing countries due to ineffective or inefficient tax systems is three times the amount they receive in foreign aid (European Parliament, 2014). Diagnostics should therefore analyse revenue leakage as a potential leverage point.

- 5.1.6 What is the estimated “tax gap” in [country] (the difference between actual and potential revenue collection)? How has the tax gap evolved in the past?
- 5.1.7 How could tax laws and standards be changed to prevent non-compliance, corruption, etc.? [E.g. stringency, clarity, enforcement]. Could this yield greater increases in revenue than altering the tax system itself?
- 5.1.8 Which tax agreements, such as commitment to global standards for transparency or fighting corruption, does [country] participate in and what is the scope for new agreements?

¹⁸ This guideline emphasises redistributive and macroeconomic policies due to their broad scope and applicability across multiple contexts. In some cases, other policies (e.g. positive discrimination or spatial policy) may be necessary to reverse trends of marginalisation and unequal opportunity.

5.2 Social protection for the poor

Social protection policies decrease the vulnerability associated with *being* deprived (i.e. social assistance and poverty alleviation) as well as *becoming* deprived¹⁹ (i.e. social insurance) (Devereux and Sabates-Wheeler, 2004). Examples of social protection include subsidies for housing, healthcare or education, early childhood development programs; benefits for maternity, disability, unemployment or work-related injury, social pension schemes for the elderly, and (un)conditional cash transfers. This group of policies seek to fulfil basic needs and grow the capabilities of poorer households by facilitating investment in human capital, smoothing consumption and strengthening agency (Barrientos and Hulme, 2009).

- 5.2.1 To what extent do existing social protection programs address the main sources of inequality in [country]? Which alternative programmes may better reflect local causes and drivers?
- 5.2.2 What is the breadth and depth of coverage of [policy]? Which changes in eligibility criteria or policy design could reach target groups more effectively and avoid fragmentation (multiple policies covering the same group) or exclusion?
- 5.2.3 Which, if any, spillover effects are generated by social protection programs for the wider community? How, and through which mechanisms, do these externalities impact inequality?
- 5.2.4 How is funding sourced for these programs? Are they fully state-funded, aid-reliant, or do employers and employees contribute? What is the scope for reforming the funding structure?

5.3 Public investment

Public investments provide infrastructure and resources which the private sector is either unable or unwilling to deliver. If well-selected and designed, public investments can disproportionately benefit the poor and vulnerable by generating employment opportunities, improving access to markets and credit, and directly raising living standards.²⁰ Although large investments put upfront pressure on fiscal systems, their socioeconomic payoffs can ease fiscal budgets and stimulate growth in the long-term, and break intergenerational cycles of poverty and inequality through upwards mobility.

- 5.3.1 To what extent do current public investment programs address the root causes and drivers of inequality in [country]?
- 5.3.2 Do public investments effectively reach the most vulnerable demographic, geographic or socioeconomic groups? If not, which groups do not benefit or benefit proportionally less from existing public investments?
- 5.3.3 What are the costs (upfront and maintenance) and benefits (short- and long-term, direct and indirect) of prospective investments in [country], including potential impacts on inequality?

6. Inclusive economic growth

Policies which stimulate aggregate economic growth can benefit the poor by increasing the overall volume of assets for redistribution. To this extent, policies with non-equalising objectives, such as those to increase competition or productive efficiency, can achieve equalising outcomes (ILO, 2017).

¹⁹ This could involve providing information on how to invest, monitoring spending, or placing conditionalities on transfers (e.g. unemployment benefits depending on the recipient actively seeking work).

²⁰ Examples of public investments include healthcare and education programs; water and sanitation facilities; (rural) roads, electrification, transportation and telecommunications infrastructure.

6.1 Macroeconomic policies

Macroeconomic management helps to stimulate aggregate growth and maintain stability. Controlling inflation, interest rates and exchange rates reduces the risk of shocks which tend to exacerbate inequality, since poorer households have fewer buffers to protect their livelihoods (World Bank, 2016), while structural policy can support the development of specific regions or sectors with a high percentage of poorer households, such as labour-intensive industries or rural areas. As well as national policies, governments can increase their international cooperation to create a global economic environment which is compatible with reducing inequality (UNRISD, 2010).

- 6.1.1 To what extent do current macroeconomic policies complement efforts to reduce inequality? Do they aim to minimise aggregate economic volatility and stimulate domestic investment?
- 6.1.2 Which sectors and regions are promoted and supported by current structural policies? Do they have a large proportion of poor workers and, if not, which sectors lend themselves more to inequality reduction?
- 6.1.3 Which, if any, bilateral or international agreements does [country] participate in to combat inequality? What is the scope for strengthening these partnerships or forming new ones?
- 6.1.4 Which monetary reforms would yield substantial benefits for low-income households in [country]?

6.2 Labour policies

While macroeconomic policies can help to grow the economy, labour market policies can translate growth into opportunity, especially for lower-income households (World Bank, 2016). Two types of labour policy can be implemented to combat inequality. The first is a group of passive interventions involving changes in legislation around minimum wages, minority inclusion and occupational safety. The second is a set of active programmes aiming to reverse the negative effects of structural change by improving the earnings capacity of poor workers and increasing access for the unemployed. These include employment services such as counselling or job matching; active labour market policies such as skills training; and direct employment generation through SME support.

- 6.2.1 To what extent do national policies address the drivers of labour market inequality in [country]?
- 6.2.2 Which distortionary effects do current labour policies have on labour market outcomes such as employment or productivity? How does this impact the scale and nature of inequality in [country]? How can these effects be minimised whilst reducing inequality?
- 6.2.3 In the case of active labour market policies, can vulnerable groups access the available support, trainings and services? If not, what are the main obstacles, and how can they be reduced?
- 6.2.4 Which other labour policies would improve socioeconomic outcomes and opportunities of the bottom 40%?

Part D – Opportunities for inequality reduction

7. Key sectors for inequality reduction for German Development Cooperation (DC)

Bilateral or multilateral donors can help to reduce inequality in partner countries, both directly via (co-)financing specific development programmes and indirectly through technical guidance and agenda-setting. The appropriate form of assistance depends on the information from Parts B and C above regarding the current state of discourse and the interventions required to mitigate national inequalities. In cases where the strategies of the DC and partner country are aligned, donor contribution may involve financial support to increase access to social services and lower disparities in income or wellbeing²¹, or expert consultation to formulate and/or implement more concrete projects aimed at reducing inequality. Questions to be addressed are:

- 7.1 Which types of support (if any) does the (German) DC currently provide for reducing inequality in [country] that could be continued or expanded?
- 7.2 Which (new) priority sectors do the national government of [country] and DC agree on to be promoted with the aim of reducing inequality and reaching the bottom 40%?
- 7.3 Which national redistributive policies described in Part C could be supported by (German) DC in the form of (general or sectoral) budget aid or project aid?

Where donor and national practices lack alignment, or where inequality reduction has not, to date, been a priority in partner [country], DC could take place in the form of either (harmonised) donor support with conditionality that aims at reducing inequality, capacity-building to improve public sector management, and generating stronger partnerships and cooperation around inequality-reduction.²² Relevant questions are, in that case:

- 7.5 In which areas would capacity-building in the public sector be most relevant for addressing the issue of inequality? [E.g. knowledge and training, streamlining of administrative systems and better public (social) expenditure management].
- 7.6 Which sectors lend themselves to achieving the LNOB principle and could benefit from the development of best practices, new growth strategies and financial aid?
- 7.7 In which sectors would attaching conditions to (harmonised) budget support be feasible and most effective for reducing inequality, and what would these conditions be?
- 7.8 From which institutions is cooperation most important for reducing inequality, and to what extent can the DC coordinate and encourage such participation?

²¹ Financial support relates to both the funding of projects (e.g. infrastructural projects such as public schools and hospitals), as well as budget support for the relevant institutions (e.g. the education and healthcare ministries) who deliver the service.

²² Support may be conditional upon certain criteria (such as greater transparency or fiscal discipline) to increase the effectiveness and minimise the risks involved in the provision of aid. However, donor requirements should not compromise the ownership of [country] over their own development plans or place unnecessary pressure on administrative systems, and should further reflect local needs and development objectives.

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