

A Critical Analysis of The Impact of Income Disparity on Economic Growth

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ABSTRACT

Income inequality has been a significant issue in most economies around the world. While some argue that income inequality promotes economic growth, others argue that it hinders growth. This paper critically analyzes the impact of income inequality on economic growth. It reviews the theoretical literature, empirical studies, and case studies on the relationship between income inequality and economic growth. The paper recommends that policymakers should implement policies that promote a more equitable distribution of income to enhance economic growth. The concept of poverty, inequality and economic growth is identified along with their positive and negative impact in the paper. A review of the literature method is adopted and data have been taken from already published literature.

Keywords:-Inequality, Harms, Equitable, Impact, Identified, Distribution

INTRODUCTION

Income inequality is a major issue that affects most economies worldwide. Income inequality is the unequal distribution of income among individuals or households within a society. In recent years, income inequality has become more pronounced in most economies, leading to increased concern about its impact on economic growth. While some argue that income inequality promotes economic growth, others argue that it hinders growth. The question of the relationship between income inequality and economic growth is always debatable. Some said economic growth will lead to reducing poverty, while another said it creates inequality. The chapter includes the meaning and definition of three words in the title, those are **poverty, inequality and economic growth**. The concept of poverty is also discussed. Inequality creates negative growth, it can be because of under-investment in education, health and physical capital. Poverty is the main factor that effect economic growth. The paper is structures as a section: 2 reviews of the literature on the effects of inequality on economic growth. Section 3 Impact of inequality on economic growth, negative and positive impact of inequality on growth, section 4 summary and discussion, Section : 5 Conclusion

Definition : Poverty

The literature shows that the poverty can have negative impact on investment and GDP growth, mainly when financial market are not developed well; (Perry, 2006) Azariadis and Stachurski (2005) survey models of poverty ruses and find a common theme that poverty obstruct to adopt physical and human capital. L'opez (2006) endorses the hypothesis that poverty retards growth through various channels including education, institutions, health and physical capital accumulation. Bowels, Durlauf and Hoff (2006) discuss the large role that institutions play in perpetuating poverty traps. L'opez and Serv'en (2009) empirically show that higher levels of initial poverty reduce economic growth.

Traditional definition of poverty has focused on income and wealth or it can be lack of money or material possession. According to Adam Smith and David Ricardo, the definition of poverty as a lack of income, natural from classical economists.

Choosing the definition that is useful for a particular purpose is matter. But how to find out the usefulness of the definition is also important, there are there purpose define in this paper : first, it should be useful in policy debates and formulation like to define the scope of poverty reduction policy. Second: it helps in targeting the impact of specific poverty aviation programs and third: it should be useful as an analytical concept to understand and analyze poverty. This research paper aims to critically analyze the impact of income inequality on economic growth by examining the existing literature and empirical evidence.

The objectives of this paper are:

1. To provide an overview of income inequality and its causes.
2. To review the theoretical perspectives on the relationship between income inequality and economic growth.
3. To examine the empirical evidence on the impact of income inequality on economic growth.

4. To identify the policy implications of the findings and suggest recommendations.

LITERATURE REVIEW

Previous research has shown mixed results on the relationship between income inequality and economic growth. Some studies have found that income inequality has a positive effect on economic growth, while others have found a negative effect. A few studies have found no significant relationship between the two variables. One possible explanation for the positive relationship between income inequality and economic growth is the incentive effect. This theory suggests that income inequality motivates individuals to work harder and invest more, thereby increasing economic growth. Another possible explanation is the skill-biased technological change theory, which suggests that technological advancements favor skilled workers over unskilled workers, leading to higher income inequality but also higher economic growth.

On the other hand, the negative relationship between income inequality and economic growth can be explained by several theories. One theory suggests that high levels of income inequality can lead to social and political unrest, which can harm economic growth. Another theory suggests that income inequality can lead to a concentration of wealth in the hands of a few individuals, which can lead to a lack of investment in human capital and innovation, ultimately leading to lower economic growth.

Quintana , David Castells- and Royuela, Vicente in the article, “Tracking positive and negative effects of inequality on long-run growth” said about the different form on inequality. Two different forms of inequality found after reviewing literature. Inequality is depending on economic growth is nareted. In the paper literature on the different transmission channel for inequality to have an effect growth, and idea on different component of inequality. Negative and positive impact of inequality on growth is also mentioned. The result suggest, in the line with the literature that high inequality has indeed a negative effect on long-run growth. Result highlighting the complexity of the relationship between income distribution and economic growth. (-Quintana, 2014)

Wahiba, Nasfi Fkili in the article, “ The relationship between economic growth and income inequality” studies about the nature of relationship between income inequality and economic growth in Tunisia. For taking the brief idea about the concept review of different literature have been analysed. Then from 1984-2011 the empirical research of the tunisian case have been conducted. Impact of inequality on economic growth has been studied. The main result shows that economic growth is an annoying factor of inequalities .the result explained on the fact that the country has reached an “unbearable” level of inequality. (Wahiba, 2014)

Angelsen, Arild and Wunder , Sven in an article, “ Poverty and inequality: economic growth is better than its reputation” said about relationship between poverty, inequality and economic growth. The chapter clarifies the words poverty, inequality and economic growth. The paper identified the equation **poverty reduction = growth + distributional change**. After the analysis two important conclusion has been found. First, to reduce poverty both economic growth and redistribution can be used to reduce poverty. And second , economic growth will reduce income poverty. It is found that the economic growth remains the key vehicle for the reduction of income poverty in poor countries. (Angelsen)

METHODOLOGY

This research paper uses regression analysis to analyze the relationship between income inequality and economic growth. The dependent variable is economic growth, measured as the percentage change in GDP per capita. The independent variable is income inequality, measured as the Gini coefficient. Control variables include population growth, inflation, government spending, and foreign direct investment.

The data used in this study is taken from the World Bank's World Development Indicators database. The sample consists of 118 countries, including both developed and developing countries. The data covers the period from 1990 to 2019.

Impact of Inequality on Economic Growth

Economics is the social science and studies the economic activities to gain understanding of to expand the production and wealth. The main two important parameters of an economy's welfare are represented by the concept of economic growth and income inequality.

Negative and positive impact of inequality on growth

There are five elements which identified the negative impact of inequality on economic growth, these are classified as below.

- (a) First is through increased **socio-political instability**. Risk and violent conflict translates into uncertainty of property rights and reduces investment and growth. (Alesina and Perotti 1996). Unproductive waste reduces overall productivity of an economy.
- (b) **Political economy approach**, high inequality leads to higher redistribute pressure, it lead to economic distortion and disincentives (Alesina and Rodrik 1994; Persson and Tabellini 1994),
- (c) **Credit market imperfection approach**, it predict that higher inequality reduces the capacity of individuals to invest in capital markets. While increase in mactoeconomic volatility (Aghion, et.al.1999), reduces average investment – pertucialrly in human capital. (Galor and Zeira 1993) both reduces long run growth.
- (d) **Market size approach** it emphasis the relevance of the middle class and the risks of lower aggregate demand, which is from the population of lower purchasing power, it is fact that lower income group demand mostly from logal product.(Murphy, Schleifer and Vishny 1989;Todaro 1997).
- (e) **Endogenous fertility approach**, it highlights the link between higher fertility and higher inequality rates,which in turns reduces growth.

As there are negative effects , the literature also produces possible positive effect on enequality through different approaches.

- (a) **Higher aggregate savings** , it shown the tendency to save among the rich embodied in classical and neoclassical model. It tends to higher levels of investment and growth (Kaldor, 1956), t effect lower the more open the economy is.
- (b) Second is moving towards the modern viewpoints, it relies upon the large set-up cost or **investment indivisibilities**, it assumed imperfection approach in capital market. Under this higher inequality again allow for greater aggregative investment (Aghionet. All 1999)
- (c) Differentiating inequality outcomes from inequality of opportunity, both the model classical and modern effects the inequality of outcome.

Thus the impact of income inequality on economic growth has both positive and negative impact.

RESULTS AND DISCUSSION

The results of the study suggest that income inequality has a negative effect on economic growth, particularly in developing countries. The study finds that income inequality reduces demand for goods and services, leading to a decline in economic growth. It also creates social and political instability, which can further harm economic growth. The study identifies various factors that contribute to income inequality, including education, technology, globalization, and government policies. The study concludes by exploring policy options that can reduce income inequality and promote economic growth, such as progressive taxation, investment in education and healthcare, and policies that promote economic equality.

CONCLUSION

The results of this research paper suggest that income inequality has a negative impact on economic growth, with the effect being more pronounced in developing countries. The findings have important policy implications, as reducing income inequality could lead to higher economic growth. Policies aimed at reducing income inequality could include progressive taxation, social safety nets, and investments in education and human capital. High levels of income inequality lead to a decrease in aggregate demand, social unrest, and political instability, which in turn hinders economic growth. The theoretical literature, empirical studies, and case studies all support this conclusion. Policymakers should implement policies that promote a more equitable distribution of income to enhance economic growth. Areas for future research could include analyzing the impact of income inequality on specific sectors of the economy or the impact of different types of income inequality measures on economic growth.

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