



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■

UNDERSTANDING THE
RELATIONSHIP BETWEEN

POVERTY AND INEQUALITY

OVERVIEW REPORT
SUMMARY

John Hills, Abigail McKnight,
Irene Bucelli, Eleni Karagiannaki,
Polly Vizard and Lin Yang with
Magali Duque and Mark Rucci



Centre for Analysis of Social Exclusion

Research at LSE ■



JOSEPH
ROWNTREE
FOUNDATION

CASE REPORT No. 119 LIP PAPER 10
JANUARY 2019



UNDERSTANDING THE RELATIONSHIP BETWEEN POVERTY AND INEQUALITY

OVERVIEW REPORT

SUMMARY

John Hills, Abigail McKnight, Irene Bucelli, Eleni Karagiannaki, Polly Vizard and Lin Yang with Magali Duque and Mark Rucci

In this report we summarise the findings from a series of papers that explore the relationships between poverty measured in various ways and inequalities in people's incomes. This programme of research was motivated by the question of whether it is possible to separate concerns between poverty and inequality – is it in fact possible to be concerned about poverty but to be indifferent to inequality? As a corollary, does tackling poverty also require policies to reduce inequality?

We review the philosophical debate, identifying a number of different standpoints. For some, inequality between people is the prime concern, with poverty one of its consequences. For others, poverty and ensuring that everyone meets some kind of minimum standard is the starting point. Inequality for some from these points of view would be of concern just for instrumental reasons, if in some way it leads to or exacerbates poverty, but not in its own right. In many cases, though, our concerns with poverty and inequality are not mutually exclusive. We can hold that both poverty and inequality are relevant for human deprivation, and that whether you start with a concern for poverty or a concern for inequality, they are *both* violating human dignity. They can also stand in mutually *reinforcing* relationships and hinder other social goals. A pluralist approach incorporates different justifications: one can *prioritise* poverty (as the most important determinant of deprivation, or reflecting human rights or humanitarian concerns) while also allowing that inequality matters, both in itself and instrumentally, because it worsens poverty.

This implies that for some perspectives at least there is a core empirical issue: whatever the underlying reasons for our concerns, is there empirical evidence that in practice poverty and inequality are linked? Here there are two competing propositions:

- i. That high inequality is associated with high rates of poverty, in a way that suggests either that there is a causal relationship of some kind, with higher inequality *leading to* greater poverty, or that the same factors drive both, so that tackling one is likely to mean reducing the other.
- ii. That high inequality is good for poverty reduction, measured against a fixed standard, at least, through the beneficial effects of the incentives it creates leading to economic growth, benefiting poor people in *absolute* terms, even if they are left behind *relative* to others.

In all of this, precise definitions matter. In the empirical analysis summarised in the report we look at a variety of ways in which one can measure income inequality, using measures which put more or less weight on inequalities in different parts of the distribution, and at different ways of measuring the extent of poverty, both monetary measures and those which incorporate wider measures of deprivation. We also test some of the relationships found by examining whether changes in poverty are associated with changes in inequality, a stronger test than just looking at associations at one moment.

Using a variety of inequality measures matters, because any observed relationship *could* simply be the mechanical result of the definition used. In particular, the main measure of relative poverty published by the UK government and used widely in international comparisons, is a count of how many people have incomes below a certain proportion (60 per cent commonly) of the median, or middle, income. There is, in fact, no necessity for this measure to be linked to *overall* income inequality – there could be no-one with an income very far below the national median, for instance, at the same time as there being considerable inequality in the top half. But it would be unsurprising to see a close relationship between relative poverty measured this way and measures of inequality in the bottom half of the income distribution.

That said, what the empirical evidence shows is an association between higher income inequality and higher poverty that is *not* the result of a mechanical or arithmetical link of this kind. In headline terms, looking first at income-based measures of relative poverty:

- Over the last fifty years in the UK there is a clear positive empirical association between income inequality and relative income poverty. Years with comparatively low inequality had lower relative poverty, and those with high inequality had higher poverty rates.
- This is true using a variety of inequality measures, looking at the UK over time. Overall there is even a (weak) positive correlation between inequality at the very top of the income distribution, measured by the share of income received by the top 1 per cent, and relative income poverty.
- However, the patterns of association have not been constant over time. During the 1970s and the 1980s the different series for income inequality and relative poverty did move closely together. But the falls in relative poverty from the early 1990s to 2010 were not matched by similar falls in income inequality. Whatever the underlying long-term relationships between inequality and poverty rates, policies and other factors can make a difference from year to year.
- Looking across European Union and other industrialised countries, higher income inequality, measured in a variety of ways, is associated with higher relative poverty. We simply do not observe countries with high income inequality and low relative poverty: achieving that seems to have eluded the policy-makers in many countries.

- Furthermore, *changes* in inequality over time in a country are associated with changes in relative poverty, although the relationship is weaker than when comparing levels in a single year, and in some countries the two have moved in opposite directions. This relationship remains strong and statistically significant, even controlling for factors such as initial inequality and the rate of income growth.
- However, looking across industrialised countries we found no consistent pattern in how the income shares of the very top of the distribution (top 1, 5 and 10 per cent) relate to relative poverty rates.

We also look at aspects of poverty beyond income-based measures to examine the link between a country's level of income inequality and how this may relate to the way its most deprived individuals experience poverty across multiple dimensions of life:

- Using indicators of material deprivation and multi-dimensional poverty also shows significant associations between levels of poverty and income inequality in different European Union countries, suggesting that these are not the result simply of measuring poverty in only monetary terms.
- These results apply controlling for a wide range of micro- and macro-level variables and differences between countries. The relationships we found are not simply the result of the other underlying factors which are separately associated with both poverty and income inequality, thus creating an apparent association between them.
- However, this analysis does not show a statistically significant relationship between *changes* in inequality and *changes* in material deprivation or multi-dimensional poverty measures, looking at the narrow period between 2007 and 2011 for which we have data. This does not necessarily contradict the observation that material deprivation and multi-dimensional poverty are linked to income inequality at a point in time, as there may be longer lags than four years (or less) between the two (and this particular period overlapped the onset of economic crisis).

We also look at the evidence for the competing proposition – that income inequality may be good for poverty reduction, at least against fixed standards, for instance through increasing growth.

- However, looking at recent European experience we found that changes in inequality are positively associated with changes in poverty against an *anchored* standard – increasing inequality implies a *slower* reduction (or *faster* increase) in poverty even against a fixed standard. High initial inequality and growing inequality appear to hold back reductions in poverty rates against a fixed line. This goes against the prediction that greater inequality would help speed poverty reduction against a fixed line.
- One tradition in economics suggests that there is a trade-off between equality and growth, stressing the positive effects of the incentives for work, investment and risk-taking that go with wider inequalities. However, other economists have suggested a series of ways in which inequality can damage growth.

- The competing theoretical relationships between poverty, inequality and growth suggest that this is an empirical question. But here the evidence is also divided, with some studies suggesting that inequality helps growth, but many finding the opposite, depending on the precise models, selection of countries, and measurements used. The equivocal nature of the evidence suggests that the positive links we find between greater inequality and greater poverty should remain the main focus, rather than concerns that lower inequality would hold back growth.
- The evidence supports the idea that the relationship between inequality may be non-linear, with very low levels and high levels of inequality both damaging growth, but for a wide range in between the effect of changes in inequality being roughly neutral. This implies that the positive links between greater inequality and greater poverty would remain the main concern in most countries, rather than dangers that lower inequality would hold back growth and so the real incomes of those in poverty.

Given that the evidence does suggest that higher inequality *is* often associated with higher poverty, we therefore examine why there should be such a relationship, examining evidence put forward in the literatures from different fields. We find a variety of proposed mechanisms, which we explore under seven headings:

- a. Linked drivers: especially in the labour market, including discrimination: the same factors may lead to both poverty and inequality, even though the relationship is not causal.
- b. Inequality at one time – and especially in one generation – may reinforce both inequality and poverty in the next, as unequal life chances make it harder for some to build their livelihoods than others. If higher income inequality leads to lower income mobility, poverty becomes more entrenched and persistent.
- c. Limits to redistribution: even if market incomes, before state transfers, are unequal, tax-financed welfare states can break the link between that and poverty, but there may be limits to what redistribution can achieve.
- d. Perceptions and attitudes: what drives policy responses to poverty and inequality will ultimately depend on the public's perceptions and knowledge of them. If inequality is associated with less knowledge of how others live, popular demands for something to be done about poverty may be reduced.
- e. Geographical polarisation may reinforce all three of the previous mechanisms. Opportunities for poor people will be reduced, if they are distant from work or have access to lower-quality education. Local resources in part determine the quality of local public services, and the more so as national equalisation systems are reduced. Geographical polarisation or even segregation between groups will further limit knowledge of how others are living, increasing stigma and reducing empathy.

- f. Politics and the influence of the affluent: both media control and political party funding are often dominated by those with the greatest resources; the greater the resources of the richest, the more the political agenda may reflect their interests, acting against effective action to reduce poverty. High inequality and feelings of lack of involvement and connection may lead to lower turnout amongst those who have most to gain from redistributive policies. Also important will be who sets the agenda for the legal institutions that constrain markets, and people's ability to exercise the rights that such institutions give them.
- g. Crime, punishment and criminal justice have also been put forward as routes through which inequality may worsen problems of poverty and its persistence. Increased inequality affects incentives to commit crimes, and punitive preferences of the public and politicians, with reduced resources for rehabilitation.

The range of potential drivers of the observed relationship imply that public policies matter and that this is not just the obvious ones, such as social security, taxation and within the labour market including anti-discrimination legislation. What happens across education, housing, regional investment, policy rhetoric, and factors that affect culture and social norms, and democratic safeguards will also be important. However, the relative importance of different items within such an agenda for tackling poverty would reflect what we have seen empirically, notably the apparent importance of inequalities across the income distribution as a whole, rather than specifically inequalities right at the top (although there may, of course, be other reasons for worrying about them).

The evidence we present suggests that for those whose primary concern is with tackling poverty, it is hard to do this in countries such as the UK without simultaneously reducing inequalities, given the strong associations we see between them empirically, and the ways in which inequality can itself act as driver of poverty. At the same time, for those for whom both poverty and inequality are concerns, the links between them suggest that policies to tackle either can have a double dividend.

ABOUT THE PROGRAMME

This paper summarises the main report from the Improving the Evidence Base for Understanding the Links between Inequalities and Poverty programme, funded by the Joseph Rowntree Foundation (JRF). The Joseph Rowntree Foundation has supported this project as part of its programme of research and innovative development projects, which it hopes will be of value to policy-makers, practitioners and service users. The facts presented and views expressed in this report are, however, those of the authors and not necessarily those of JRF.

DISCUSSION PAPERS FROM THE PROGRAMME

Inequality, poverty and the grounds of our normative concerns

LIPpaper 1 by Irene Bucelli

The relationship between poverty and inequality: Concepts and measurement

LIPpaper 2 by Lin Yang

The empirical relationship between income poverty and income inequality in rich and middle income countries

LIPpaper 3 by Eleni Karagiannaki

Multidimensional poverty and income inequality in the EU

LIPpaper 4 by Lin Yang and Polly Vizard

Understanding the relationship between inequalities and poverty: resource constraint mechanisms

LIP paper 5 by Lin Yang

Understanding the relationship between inequalities and poverty: mechanisms associated with crime, the legal system and punitive sanctions

LIP paper 6 by Magali Duque and Abigail McKnight

Understanding the relationship between inequalities and poverty: dynamic mechanisms

LIP paper 7 by Magali Duque and Abigail McKnight

Understanding the relationship between poverty, inequality and growth: a review of existing evidence

LIP paper 8 by Abigail McKnight

The net effect of housing-related costs and advantages on the relationship between inequality and poverty

LIP paper 9 by Lin Yang

LIST OF AUTHORS

Dr Irene Bucelli, Visiting Fellow, CASE

Ms Magali Duque, Research Assistant, CASE

Professor John Hills, Richard Titmuss Professor of Social Policy and Chair of CASE, London School of Economics.

Dr Eleni Karagiannaki, Assistant Professorial Research Fellow, CASE

Dr Abigail McKnight, Associate Director and Associate Professorial Research Fellow, CASE

Mr Mark Rucci, Research Assistant, CASE

Dr Polly Vizard, Associate Director and Associate Professorial Research Fellow, CASE

Dr Lin Yang, Research Officer, Centre for Analysis of Social Exclusion, LSE (until June 2018)

<http://sticerd.lse.ac.uk/case/>

This report was produced by:
Centre for Analysis of Social Exclusion
The London School of Economics and Political Science
Houghton Street
London, WC2A 2AE

For further information on work of the Centre,
Please contact the Centre Manager, Jane Dickson on:
Telephone: +44 20 7955 6679
Email: CASE@lse.ac.uk
Website: <http://sticerd.lse.ac.uk/case/>

CASE Report 119 Summary, ISSN 1465-3001
Copyright © CASE