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THE IMPACT OF INCOME INEQUALITY ON ECONOMIC GROWTH

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Abstract: The current article examines the relationship between income inequality and economic growth using the Gini coefficient to measure income inequality and the GDP per capita to measure economic growth. The study shows a complex relationship between income inequality and economic growth, and the impact can vary depending on the specific context of a country. However, the results suggest that high levels of income inequality can have a negative impact on economic growth, as it limits access to education, healthcare, and other social services for low-income individuals, which can impede their ability to be productive members of the workforce. Additionally, when a large portion of wealth is concentrated in the hands of a small group of people, it can lead to reduced consumer spending, which can slow economic growth.

Keywords: income inequality, economic growth, Gini coefficient.

Introduction

In recent years, income inequality has become a pressing issue in many countries worldwide. The gap between the rich and the poor continues to widen, and many experts are concerned about the potential impact of this trend on economic growth. In the current study, we will explore the relationship between income inequality and economic growth using the Gini coefficient to measure income inequality and GDP per capita to measure economic growth. Additionally, we will review the literature on the topic to gain a deeper understanding of the potential impact of income inequality on economic growth.

Previous studies have found a negative relationship between income inequality and economic growth (Čiegis & Dilius, 2019; Hailemariam & Dzhumashev, 2020; Anyanwu et al., 2021; Mu et al., 2022). A study by Brueckner & Lederman (2018) argues that high levels of inequality can lead to lower economic growth, especially in the long run. The study also found that reducing inequality can help promote more robust and sustainable growth.

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Moreover, in high-income countries, the negative impact is even more significant. Similarly, a study by the Organisation for Economic Co-operation and Development (OECD, 2015) and some later studies found that income inequality can have a negative impact on economic growth by limiting access to quality education (Deutschmann, 2019; Sehrawat & Singh, 2019; Sari & Rudi Purwono, 2021), healthcare (Sari & Rudi Purwono, 2021; Ci, 2022), and other social services for low-income individuals, leading to wasted potential and lower social mobility. Additionally, when a large portion of wealth is concentrated in the hands of a small group of people, it can lead to reduced consumer spending (Gnangoin et al., 2019; Agrawal T. & Agrawal A., 2022) and lower investment flows (Le et al., 2021; Fazaalloh, 2019), which can slow economic growth.

On the other hand, some argue that income inequality can be a necessary byproduct of a functioning market economy and provide incentives for individuals to work hard and innovate, ultimately leading to economic growth (Majeed, 2016). A study by Scholl & Klasen (2019) found that income inequality can be positively associated with economic growth in some cases, particularly in transition countries.

In general, the literature suggests a complex relationship between income inequality and economic growth, and the impact can vary depending on the specific context of a country. However, the majority of studies suggest that high levels of income inequality can have a negative effect on economic growth.

Results

In recent years, income inequality has become a pressing issue in many countries worldwide. The gap between the rich and the poor continues to widen, and many experts are concerned about the potential impact of this trend on economic growth.

First, it is essential to understand the concept of income inequality. It is typically measured by the Gini coefficient, which ranges from 0 to 100, with 0 representing perfect equality (everyone has the same income) and 100 representing perfect inequality (one person has all the income). A higher Gini coefficient indicates greater income inequality.

According to Eurostat data, the Gini coefficient for the EU member states is presented in Figure 1. As of 2021, in Bulgaria, the Gini index is 39.7, which is the highest within the EU. It is an increase from 33.2 in 2010, suggesting that income inequality in Bulgaria has been rising in recent years. On the other hand, the average level of income inequality in the EU during the last ten years has been stable. The Slovak Republic and Slovenia have the lowest income inequality among the member states.

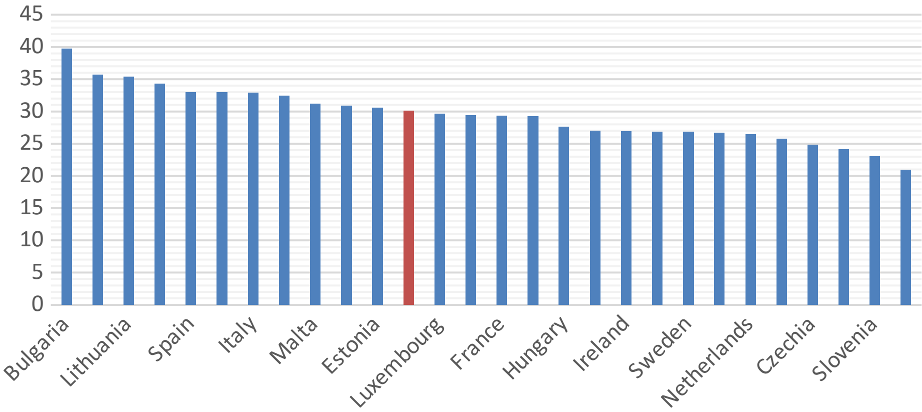

Figure 1. Gini coefficient in EU member states, 2021.
Source: Eurostat database

To examine the relationship between income inequality and economic growth, we have built a scatter based on the Gini coefficient and GDP per capita growth on average during the past five years. Figure 2 represents the interconnection between these two variables.

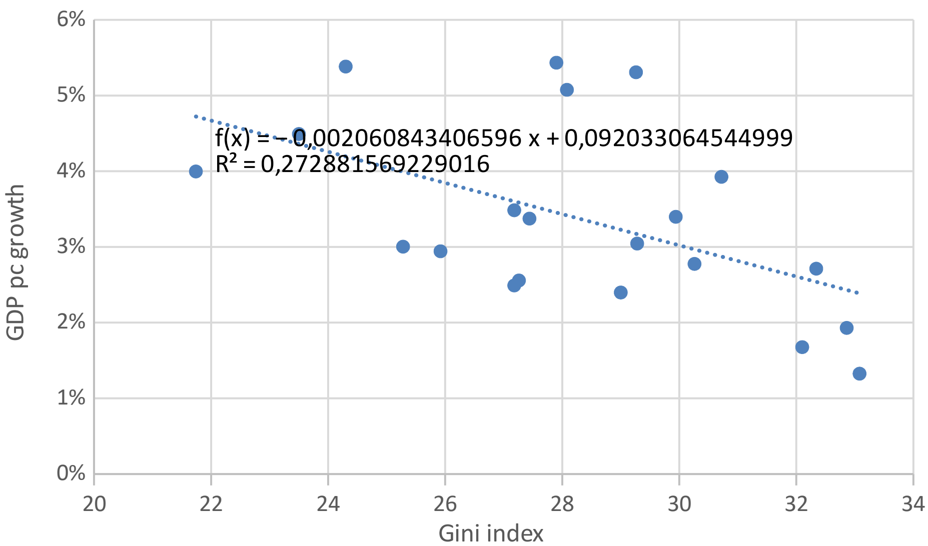

Figure 2. Gini coefficient and GDP per capita average annual growth in EU member states, 2017-2021.
Source: Made by the author based on the Eurostat database

Using data on the EU member states, we can see a strong negative relationship between the Gini coefficient and GDP per capita. The regression analysis shows that an increase in Gini index by 1 point can lead to a decrease in economic growth

by 0.2%. The correlation between these two variables is -0.52, suggesting a moderate negative relationship between income inequality and economic growth.
It is important to note that correlation does not imply causation, and other factors such as policies, institutions, and global economic conditions also play a role in determining a country's economic growth. However, the analysis suggests that income inequality can have a negative impact on economic growth.

Conclusion

Income inequality is a complex issue with many factors that can affect economic growth. While it can be argued that income inequality can provide incentives for individuals to work hard and innovate, ultimately leading to economic growth, the available data suggests that high levels of income inequality can hinder economic growth. This can be due to a number of factors, such as reduced access to education, healthcare, and other social services for low-income individuals, which can limit their ability to realize their potential. Additionally, when a large portion of wealth is concentrated in the hands of a small group of people, it can lead to reduced consumer spending and investment flows, which can slow economic growth.
Furthermore, institutions and government policies play a crucial role in shaping the relationship between income inequality and economic growth. Progressive taxation and transfer programs can help to redistribute wealth and mitigate the negative effects of income inequality on economic growth. Therefore, policymakers need to consider the potential impact of income inequality on economic growth when making economic decisions and developing economic strategies.
While there is no one-size-fits-all solution, a combination of policies, such as progressive taxation, targeted social programs, and investments in education and healthcare can help promote greater income equality and stronger economic growth.

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