

Reducing income inequality by economics growth in Georgia

Batumi Shota Rustaveli State University

Faculty of Economics and Business

PhD student in Economics

Nino Kontselidze

Abstract

Nowadays Georgia has difficult social, economical and political situation. Today, the richest 10 per cent of the population in Georgia earn 16 times the income of the poorest 10 per cent. However, the rise in overall income inequality is not (only) about surging top income shares: often, incomes at the bottom grew much slower during the prosperous years and fell during downturns, putting relative income poverty on the radar of policy concerns. This paper explores whether such developments may have an impact on economic performance

In the paper will be discussed Kuznets curve and its effect on the Georgian economy. In the paper will show Georgian economic situation by macroeconomic indicators, analyze, decisions and recommendations.

Introduction:

Elucidating a clear connection between economic growth and income inequality is arguably one of the most important economic questions of our day. There was much interest in income inequality in developing countries in the 1960s that diminished as these countries were faced with more pressing issues including declining growth rates and debt problems (Gillis, 1992). With increasing financial globalization and recent important sociopolitical developments, the relevance of the question is experiencing a resurgence that is not likely to diminish in the future. A probable endogeneity in the relationship, exacerbated by pronounced identification issues and numerous measurement concerns, raises the difficulty of attaining an incontrovertible answer. Consequently, there is neither a theoretical consensus nor consistent empirical evidence that would lead to the conclusion of a strong, or weak, relationship that is positive or negative. In seminal work, Kuznets (1955) showed that since the beginning of the nineteenth century, the process of economic growth had reduced income inequality in most countries by increasing per capita income, which came hand-in-hand with labour movements from the agricultural to industrial sectors. He showed that the

process led to a gradual increase in income inequality at the early stages of development, and as economic growth continued, it gradually led to reductions in income inequality – the famous Kuznets' inverted U-shaped curve. Since Kuznets, an abundance of theoretical models have been advanced. However, many of the competing theories have offsetting effects leading to an ambiguous net effect of inequality on economic growth. Empirical lessons are not much better as they tend not to be robust. For example, Benabou (1996) and Perotti (1996), among others, find increases in inequality tend to be associated with lower economic growth, whereas Forbes (2000) predicts the opposite. Many of these competing theories may be classified under three broad categories: sociopolitical, savings rates and tech spillovers and credit market asymmetries. Income inequality may have some sociopolitical implications if it serves to incentivize behaviours that are disruptive to economic activity such as crime, political instability and revolution – thus, these might lead income inequality to detract from economic growth. Insofar as political unrest might lead to revolution, or the toppling of regimes, governments might engage in some redistribution of resources from the rich to the poor (see Perotti, 1993; Alesina and Rodrik, 1994; Persson and Tabellini, 1994 among others) to mitigate the possibility of regime change. If a greater degree of inequality leads to greater redistribution for political purposes, and this redistribution generates more distortions, it may lead to reductions in economic growth. However, if higher income inequality incentivized the type of redistribution that served to allocate idle resources from the rich to poorer (but more productive) agents, then this redistribution could generate a positive relationship between higher inequality and economic growth. There is some mixed evidence that low-income individuals tend to have a higher marginal propensity to consume than high-income individuals. If that is the case, then a redistribution from high-income to low-income individuals might serve to lower the aggregate saving rate in the economy. Thus, a rise in income inequality might lead to higher levels of domestic investment that would foster economic growth. Another avenue for this mechanism is that of technological advances. If technological improvements serve to reduce set-up costs for investment (e.g., reductions in price of computing reduce barriers to entry in computing-intensive activities) and this leads to higher investment by lower-income agents (with lower individual saving rates), then this could induce a positive relationship between higher degrees of income inequality and economic growth. Finally, in an economy with credit market asymmetries, credit avenues may not be widely open to both high- and low-income individuals. With limited access to capital markets, the undertaking of investment opportunities will depend, to some degree, on individual holdings of assets and levels of income. In an economy where credit is highly constrained to wealthy individuals, a redistribution of assets and income from the 'idle rich' to the 'productive poor' might raise the average productivity of investment. In this case, a reduction in inequality might foster higher economic growth. On the other hand, in an economy where productivity gains require high levels of human capital, investment requires steep set-up costs, or firms' profitability is only sustainable beyond a certain size of company, then – with limited access to capital markets – any of these factors present clear

advantages to agents with high income or a high concentration of assets. In this case, higher-income inequality might favour economic growth. Much of the empirical literature on the relationship between income inequality and economic growth focuses either on purely developed economies or on large panels with a larger share of developed than developing economies. Two important examples are Barro (2000) and Forbes (2000). Thus, classification economies as high-income developing countries (HIDCs) and low-income developing countries (LIDCs) – according to both the World’s Bank classification. Because, a priori, there may be wide differences across the two groups of countries in terms of institutions, openness in capital markets, aversion to redistribution policies, culture and so on, it is possible for this relationship (between income inequality and economic growth) to differ across income groups. Firms in HIDC economies may enjoy higher levels of collateral, and therefore more robust access to capital markets, than companies in LIDC economies, which may be faced with more constrained access to credit markets according a preview of datas, we find that the relationship between inequality and growth seems significantly positive for HIDC and significantly negative for LIDC.

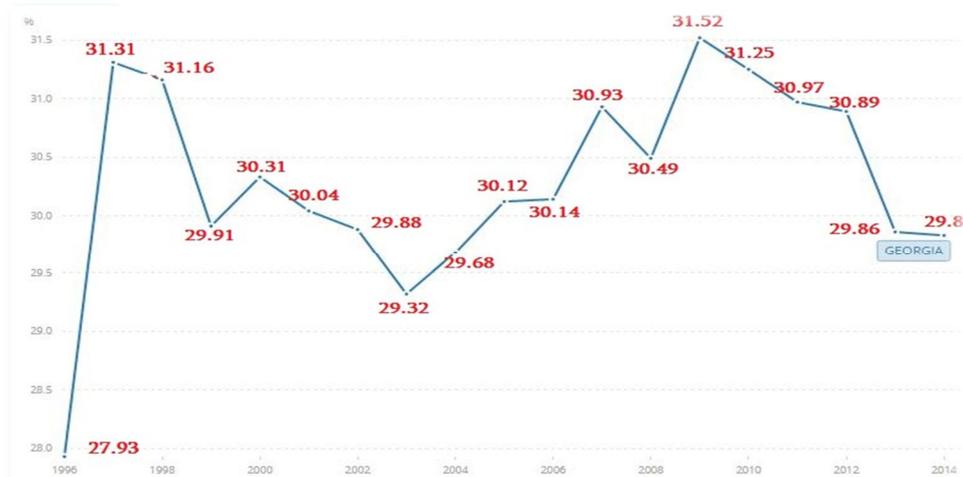
Case of Georgia

Given the need of rigorous study of inequality and the effects on growth, I initially make a brief summary of inequality studies for Georgia.

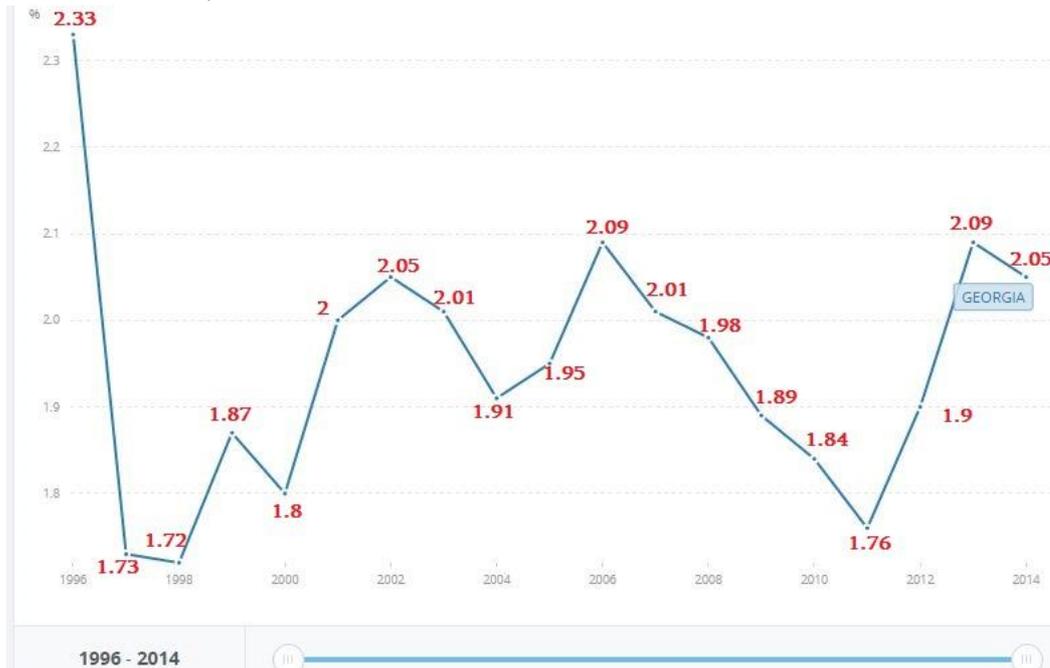
From World Bank, Development Research Group data, based on primary household survey data obtained from government statistical agencies and World Bank country departments, I have investigated the evolution of some indicators.

The income shares held by highest and lowest 10% income groups of population, could be seen in figure 1, panels *A* and *B*. The data include the period 1996-2014. We can observe that the share income for the high 10% income groups are in between 27-32% and for the low 10% income groups are between 4-1%, this marking a high difference of income between the two declines and a very small percentage of income spent for the last 10% of the population

Figure:1 a) Income share held by highest 10%



b) Income share held by lowest 10%



Source: <http://data.worldbank.org/indicator/SLDST.FRST.10?locations=GE>

According to data, the GINI index by total inflows from 2006 till 2008 was the same 0.47, but in 2009-2011 it increased and was 0.48. How surprised must be in 2013 it decreased and was 0.43. The same result we have in 2014. In 2015 it was 0.44.

| GINI COEFFICIENTS | | | | | | |
|-------------------|-------------------------------|------------------------------------|-------------------------------|--|---|------------------------------------|
| | By total incomes ¹ | By total cash inflows ² | By total inflows ³ | By total consumption expenditures ⁴ | By total cash expenditures ⁵ | By total expenditures ⁶ |
| 2006 | 0.45 | 0.53 | 0.47 | 0.40 | 0.47 | 0.42 |
| 2007 | 0.46 | 0.53 | 0.47 | 0.41 | 0.48 | 0.43 |
| 2008 | 0.45 | 0.53 | 0.47 | 0.41 | 0.49 | 0.44 |
| 2009 | 0.46 | 0.53 | 0.48 | 0.42 | 0.49 | 0.44 |
| 2010 | 0.46 | 0.52 | 0.48 | 0.43 | 0.50 | 0.46 |
| 2011 | 0.46 | 0.52 | 0.48 | 0.42 | 0.50 | 0.46 |
| 2012 | 0.43 | 0.49 | 0.46 | 0.41 | 0.49 | 0.45 |
| 2013 | 0.42 | 0.46 | 0.43 | 0.40 | 0.47 | 0.44 |
| 2014 | 0.41 | 0.46 | 0.43 | 0.40 | 0.48 | 0.45 |
| 2015 | 0.42 | 0.47 | 0.44 | 0.40 | 0.48 | 0.45 |

¹ Total incomes include cash incomes and transfers and non-cash incomes
² Total cash inflows include cash incomes and transfers and other cash inflows
³ Total inflows include cash inflows and non-cash incomes
⁴ Total consumption expenditures include cash consumption expenditures and non-cash expenditures
⁵ Total cash expenditures include cash consumption expenditures and cash non-consumption expenditures
⁶ Total expenditures include cash expenditures and non-cash expenditures

Source: <http://www.geostat.ge>

In 2015 Gross Domestic Product (GDP) of Georgia at current prices totaled GEL 31 691.6 mil., up 8.7 percent y-o-y. In the same period the real growth of GDP amounted to 2.8 percent and the deflator increased by 5.8 percent y-o-y. As a result of annual adjustment, the 2014 Gross Domestic Product (GDP) of Georgia at current prices totaled GEL 29 150.5 mil., up by 8.5 percent y-o-y. In the same period the real growth of GDP amounted to 4.6 percent and the deflator increased by 3.8 percent y-o-y. In 2013 adjusted data of Gross Domestic Product (GDP) of Georgia at current prices totaled GEL 26 847.4 mil., up 2.6 percent y-o-y. In the same period the real growth of GDP amounted to 3.3 percent and the deflator

decreased by 0.7 percent y-o-y. In 2012 the annually adjusted Gross Domestic Product (GDP) of Georgia at current prices totaled GEL 26 167.3 mil., up 7.5 percent y-o-y. In the same period the real growth of annually adjusted GDP amounted to 6.2 percent and the deflator grew by 1.2 percent y-o-y. In 2011 the annually adjusted Gross Domestic Product (GDP) of Georgia at current prices totaled GEL 24 344.0 mil., up 17.4 percent y-o-y. In the same period the real growth of annually adjusted GDP amounted to 7.2 percent and the deflator grew by 9.5 percent y-o-y¹.

As statistic data shows GNI has growing tendention according 2011. In 2010 GNI per capital USD was 2542.0 \$ and in 2011 it increased by 23 %. IN 2012 also it increased by 11% compare to 2011. In 2013 it was increased just 1%. In 2014 It was increased by 3 %. In 2015 GNI it increased 0.36%.

Gross National Income (GNI)

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|---------------------------------------|---------|---------|---------|---------|---------|---------|
| Gross National Income (GNI), mil. GEL | 20102.8 | 23631.7 | 25925.6 | 26340.7 | 28882.5 | 30884.8 |
| GNI per capita, GEL** | 4531.3 | 5287.7 | 5764.3 | 5874.6 | 6431.9 | 8316.5 |
| GNI, mil. USD | 11277.2 | 14016.1 | 15700.5 | 15835.3 | 16356.1 | 13604.6 |
| GNI per capita, USD** | 2542.0 | 3136.1 | 3490.9 | 3531.7 | 3642.4 | 3663.3 |

Source: <http://www.geostat.ge>

To summarize our data from 2010 till 2015 we have such economic picture according our main macroeconomic indicators: Gross Domestic income increased. Also Gross Domestic Product has growth tendency in this time interval. GINI index had decrease tendency from 2010 till 2014, but in 2015 it increased only 0.01. So Kuznets curve hypothesis is relevant for discussion of the Georgian experience.

Conclusion

The literature highlights the importance of studying the inequality in all its aspects, the relationship with economic growth in order to formulate efficient economic policies to reduce disparities. Economic growth is determined by the success of policies to reduce inequality between different social groups and regions of a country.

¹ source: http://www.geostat.ge/?action=page&p_id=118&lang=geo)

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