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TRICKLE ALONG NOT TRICKLE DOWN? INEQUALITY AND THE LEWIS MODEL OF ECONOMIC DEVELOPMENT

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SUMMARY

What did Arthur Lewis say about inequality and what public policy should do about it? This brief gives an overview of the thinking of Lewis on inequality and on the role of the state in shaping the inequality dynamics of economic development.

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About the GPID research network:

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is an international network of academics, civil society organisations, and policymakers. It was launched in 2017 and is funded by the ESRC's Global Challenges Research Fund.

The objective of the ESRC GPID Research Network is to build a new research programme that focuses on the relationship between structural change and inclusive growth.

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THE DEVELOPER'S DILEMMA

The ESRC Global Poverty and Inequality Dynamics (GPID) research network is concerned with what we have called 'the developer's dilemma'.

This dilemma is a trade-off between two objectives that developing countries are pursuing. Specifically:

1. Economic development via structural transformation and productivity growth based on the intra- and inter-sectoral reallocation of economic activity.
2. Inclusive growth which is typically defined as broad-based economic growth benefiting the poorer in society in particular.

Structural transformation, the former has been thought to push up inequality. Whereas the latter, inclusive growth implies a need for steady or even falling inequality to spread the benefits of growth widely. The 'developer's dilemma' is thus a distribution tension at the heart of economic development.

Lewis and inequality

What is the role of inequality in the Lewis model? Lewis did not ignore inequality. Indeed, he (1954, p. 147) highlighted the high visibility of inequality,

> *between the few.. and the great mass.. who live in quite other worlds.*

Lewis also wrote on horizontal inequality in terms of class, gender, and ethnicity. Inequality was of importance to Lewis to the extent that it had an impact on output growth. Lewis generally discussed rising inequality in terms of functional distribution of income rather than household or individual distribution, as that was central to the model. A rise in the share of capital drives growth but does not necessarily imply a change in the within-labour share. If there were a larger share of profits in national income this would mean more resources for capital formation but as Lewis (1954, pp. 157, 158) noted

> *[t]he central fact of economic development is that the distribution of incomes is altered in favour of the saving class.*

When the Lewis turning point is reached and surplus labour is exhausted wages would rise and the functional distribution of income would move in favour of labour though this would slow or end the transition. At which point labour markets would be unified – not dualistic.

Lewis, the state and inequality

Lewis posited that the state could substitute for a capitalist class (where no such class was of a significant size) in order to deal with what he referred to as 'the sociological problem of the emergence of a capitalist class' (1954, p. 159). Further, the state needs to play a strong role in disciplining the capitalist class when it does exist, or guiding the emergence of such a class. The role of the state was also important because during the Lewis transition inequality may rise and public policy intervention is needed because,

> *To tax its developed sectors and subsidise its underdeveloped sectors is one of the most powerful ways that a government can use to ensure the benefits of development . . . The moral for policy makers is of course not to rely on trickle down to benefit the traditional sector, but to attack the problems of that sector directly* (1979, pp. 212, 216)

A Lewis framework for analysis of growth and distribution

Lewis (1976) presents an explicit framework to consider this relationship between growth and distribution, noting a starting point in which

> *Development must be inegalitarian because it does not start in every part of an economy at the same time.*

Lewis (1976) discusses the relationship between economic development and distribution as one based on within and between sector inequality. He argued that the growth of the modern or capitalist sector, or the 'enclave sector' as he calls it in that paper, has good and bad impacts on the traditional sector (p. 27). Notably, the enclave may enrich the traditional sector by buying commodities and services from it; providing employment to those in the traditional sector; sending remittances; selling goods and services cheaper; and by developing infrastructure, public goods and, through an example of new ideas and institutions, the enclave sector can modernize the traditional sector. Whether development leads to widening inequality depends, he argued, on whether the enclave is able to respond to the new economic opportunities (e.g. price changes or the demand for labour). In short, inegalitarian development is not the failure of 'trickle down' vertically from rich to poor but the failure to trickle along or spread horizontally the benefits from enclave to traditional sectors.

Lewis (1979, pp. 212–15), too, drew attention to several possible ways the modern sector might benefit the traditional sector: provision of employment; sharing physical facilities; modernization of ideas and institutions (Lewis cites new technologies introduced, girls attending school, land tenure systems changing, for example); and through trade (if the modern sector depends on the traditional sector for part of its needs, for example, for food or raw materials, the expansion of the modern sector will rely on the expansion of commodities in the traditional sector, but the traditional sector could be damaged by buying imports from the modern sector or abroad).

Lewis and the redistributive role of the state

Again, the role of the state is highlighted by Lewis (1976, pp. 30–5) who posited that distribution in the enclave depends on the pattern of growth and a set of factors, many of which are 'susceptible to public control' (p. 35), notably the distribution of property, economic structure (in terms of firm size and the capital intensity of production and dependence on foreign resources) and the speed of growth which has the potential to alter 'the relative quantities of the factors of production, and the derived demands, and therefore the distribution of income'. Further, the traditional sector may see income stagnate because the enclave may be predatory (e.g. driving people off their land); products may compete with traditional trades; the wage rate in the enclave may be too high and raise the price of labour above its marginal productivity; because of geographical polarization (the enclave attracts best brains and capital); because population growth accelerates due to improved public health reducing the death rate; and/or excessive migration from the countryside.

What did Lewis conclude?

Lewis argued for a policy 'trickle along' to address inequality through public policy. He noted that whether the modern sector enriches or not the traditional sector 'probably depends most on whether the government coerces or helps the traditional sector, and on the nature of the enclaves' (meaning the modern or capitalist sectors). In short, broad-based economic development requires, counter-intuitively, highly activist in the traditional sectors – generally, but not always, rural and agricultural policy, and public investments to constrain the divergence between and within sectors.

References

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