Education and Income Inequality Reconsidered: A Cross-Country Analysis of Data from 1960-2000

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Abstract: Recent comparative inequality studies have addressed not only income but also other dimensions such as education and health inequality. Education has been believed to play a critical role in the nexus of inequality and growth. This study examines whether education distribution has an effect on income inequality. It empirically analyzes the relationship between education inequality and income inequality using quinquennial panel data from 100 countries for 1960-2000. The results show that education inequality and income inequality have a nonlinear, inverted-U-shaped relationship. This relationship appeared more consistently in developing countries. These findings suggest that educational opportunities should be more equally provided for better income distribution, especially in developing countries.

Keywords: education inequality, income inequality, education Gini, comparative inequality studies, panel analysis

INTRODUCTION

Income inequality and its effect on economic outcomes have been major sources of concern for many scholars. Some argue that income inequality is actually favorable to economic growth, since it can work as a conduit for capital accumulation and investment (Forbes, 2000). Others argue that reducing inequality promotes economic growth for two reasons: (1) inequality tends to promote a higher level of redistribution in

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democratic societies, which in turn could reduce the incentives for investment (Alesina & Rodrik, 1994; Perotti, 1992; Persson & Tabellini, 1994), and (2) imperfect capital markets with inequality will prevent human capital accumulation by the poor majority (Galor & Zeira, 1993, Perotti, 1996).

A recent attempt to reconcile these two schools of thought argues that the relationship between inequality and growth is not linear. Rather, in the early stages of development, physical capital accumulation is the primary source of economic growth, and inequality enhances growth by channeling resources to individuals whose marginal propensity to save is higher. But in later stages of development, physical capital is replaced by human capital as the engine of growth, and increasing equality reduces credit constraints on human capital accumulation and thus can prompt the growth process. Therefore, inequality is accompanied by growth in developing countries, while greater equality is accompanied by growth in developed countries (Galor & Moav, 2006).

Education also seems to play a critical role in the nexus of inequality and growth. As Deininger and Squire (1996) noted, lack of financial credit constrains educational investment and weakens the poor. It is also argued that constraints on borrowing to pay for education are the main reason that income inequality is negatively related to economic growth (Checchi, 2003). These studies suggest that inequality affects economic growth through an interaction between imperfect credit markets, asset inequality, and human capital accumulation (Castelló & Doménech, 2002).

Many governments invest in education, especially primary education, since it has been recommended as an effective policy tool for reducing poverty and income inequality (Nielsen, 1994; Sylwester, 2002). However, following the rapid expansion of school enrollment in developing countries, there has been disillusionment with the apparent failure of education to provide the expected rapid results (Hall & Midgley, 2004). As a result, early optimism about education as a social policy instrument diminished. In addition, educational expenditure by developing countries slowed in the 1980s due to structural adjustment programs introduced by the World Bank and International Monetary Fund, which made economic liberalization (for example through privatization or deregulation) a condition of new loans and encouraged governments to reduce spending on education and social programs.

However, international efforts in the 1990s, such as Education for All and the World Summit for Children, focused attention on basic education again. These efforts continued in the Millennium Development Goals (MDGs), which emphasized universal primary education and other forms of social development for poverty reduction. In spite of these efforts, many developing countries are still far from achieving universal primary education, especially in South Asia and sub-Saharan Africa. Even though the MDG targets for primary education have been relatively well achieved overall,