When is there a Kuznets curve?

Abstract

This paper investigates when is there a Kuznets curve, that is, under which conditions economic growth is associated with a decline in income inequality. This question is important because it is related with the need for government intervention in the economy. If growth is associated with a decline in inequality, then governments should care only about stimulating growth. If, on the other hand, inequality does not decline with growth, governments should intervene, to ensure that aggregate growth benefits everyone.

The conditions that are in focus are the labour market institutions, the market power of companies, social benefits and taxes. All these can shape the relationship between income growth and its distribution.

The analysis is done on a sample of 26 ex-socialist countries from Eastern Europe, during the post-socialist years. These countries had very similar characteristics when socialism collapsed, but very different experiences with the transition afterwards, which makes them a suitable group for analysing the relationship between GDP and inequality.

Heterogeneous panels techniques, also known as panel cointegration techniques, are used in the analysis. These techniques are appropriate in case of non-stationary panel data, such as the data in this study.

Findings suggest that inequality (before government redistribution) declines with economic growth when labour markets are more regulated, anti-monopoly policy is more effective and taxes are higher. Taxes seem to be the single most important factor.

Therefore, the Kuznets hypothesis is valid only when certain economic institutions are present. In order to ensure that everyone benefits from the economic growth, governments should regulate labour markets, control companies' market power and adopt higher taxes.

Keywords: inequality, income, growth, Kuznets