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Assessing Potential Effects of Development Cooperation on Inequality

Summary

With inequality reduction now being officially and broadly recognised as a key development objective with its own Sustainable Development Goal (SDG 10), there is a need for simple, economical and quick methodologies with which to focus on this area and assess progress. This paper presents such a methodology, which allows a rough assessment of the potential impacts of development cooperation on income, consumption and wealth inequality.

This is important, as a rigorous causal analysis of the contribution development cooperation makes to reducing a partner country's inequality is complex and costly. First, the relative contribution of targeted development cooperation programmes and projects to the economies of partner countries tends to be small (though admittedly not in all cases). Second, a myriad of factors contribute to changes in inequality in any given country, and assessing the impact of all of them is a complex, imprecise, time-consuming and resource-intensive exercise.

The proposed methodology therefore makes use of SDG 10's focus on the poorest 40% of the population to assess whether development cooperation in a given partner country has been directly targeted at them.

This Briefing Paper presents a simple methodology to support donors or multilateral development cooperation institutions in assessing, addressing and mainstreaming inequality in their operations. The first step of the methodology recommends that development agencies identify a country's needs in terms of inequalities as a basis for providing support for policies and interventions to address them. The second step consists of making sure that inequality has been taken into account in key strategic documents. Subsequent steps aim to assess whether the design and implementation of specific programmes, projects and budget support operations targets inequalities.

In the case of projects and programmes, the recommended assumption is that if their direct beneficiaries are in the bottom 40%, then these projects and programmes can be considered to address inequality. For the sake of simplicity and practicality, this does not account for general equilibrium or indirect effects. In the case of budget support of any kind, any indication of the distributional profile of government expenditure in the area of support can be used as a proxy for the support's distributional profile.

As a complement to this, it may be possible in many cases to analyse whether the subnational geographic allocation of funds corresponds to the location of the national bottom 40%. Despite many good reasons why funding should not always go to poorer areas, this information may provide important insights.

A key limitation of this approach is that disregarding indirect or general equilibrium effects does not establish any causal link between targeting and macroeconomic effects on inequality. Yet it does allow an assessment of the degree to which portfolios (or parts of them) are potentially addressing inequality, thereby providing important feedback for development actors.

Introduction

Inequality used to be viewed in development cooperation as something "political", something that belongs to the "domestic politics" domain of partner countries. The result often was that donors and international development agencies shied away from action in this area. A burgeoning empirical literature of the inherent links between inequality, poverty and economic growth has arguably led to the downfall of this tenet (Cuesta, Negre, Revenga, & Schmidt, 2020; World Bank, 2016). This is nowhere more visible than in the change from the Millennium Development Goals to the Sustainable Development Goals (SDG), with the latter incorporating for the first time an internationally agreed goal on reducing high inequalities (SDG 10).

Despite this positive development, and the broad incorporation of inequality reduction into goals, strategies and programmes in development cooperation, it is difficult to gauge how much inequality reduction is really at their core. So far, there are no established economical and practical methodologies to assess the potential effects that development projects, programmes or portfolios may have on inequality in a given partner country.

This briefing presents a simple methodology to support donor or multilateral development cooperation institutions in assessing, addressing and mainstreaming inequality in their operations. Its aim is to help address inequality in assessments, in the development of country strategies, the conduct of policy dialogue, the management and evaluation of programmes/projects, and in the development and management of budget support operations. The main advantage behind it is that it provides useful information at low cost, in short time and with little need for specialised knowledge.

Level of inequality and its drivers

Before assessing whether some programmes or projects may potentially have an effect on inequality, this methodology proposes, as a first step, to assess the level of income and/or wealth inequality in the country and, when feasible, the key drivers behind inequality trends. Inequality can take many forms, and different distributions of incomes may present similar values in standard summary inequality measures such as the Gini coefficient. For this reason, it is advisable to also include analysis of income shares by quintiles or by top percentiles. All this can be done by using available data and databases (see Box 1 below), along with existing country-specific studies or assessment reports (e.g. SDG progress reports). The tools suggested in Box 1 are explained in detail below.

If only limited data are available, donors should consider promoting and perhaps funding the collection of data as well as the development and implementation of statistical tools to strengthen knowledge on inequality (and poverty). Along with this, it may often make sense to support national statistical offices so as to strengthen local data collection capabilities and help the country consolidate a strong data production infrastructure. The importance of good quality and frequent data to feed policy decisions cannot be stressed enough.

Box 1: Databases and tools to assess inequality

Databases for country poverty and inequality assessments:

- PovcalNet for country, regional and global poverty and Gini estimates
- World Bank's Poverty and Shared Prosperity reports for shared prosperity data (SDG 10.1)
- World Development Indicators build on PovcalNet and expand into a large number of additional indicators
- World Inequality Database for information on top incomes shares

Suggested tools for assessing inequality:

- Distributive analysis: World Bank's Systematic Country Diagnosis (SCDs)
- Programmes/projects: the Equity Tool
- Budget support: the Commitment to Equity analysis
- Subnational allocation: geographic targeting of the bottom 40%

Source: Author

Inequality as a focus of existing policies and programmes

One obvious area where inequality can be addressed in a partner country is in policy dialogue. Addressing inequality in the various dialogue platforms at national and regional levels presents an opportunity to engage with partner governments on potential means of addressing high inequality and of opening the discussion to interested parties from civil society. This also enables coordination among donors in facilitating outcomes and impact in this area. The question is therefore whether this issue has been or can be raised within the policy dialogue with the government of the partner country.

Another obvious focal area should be the prioritisation of policy interventions proven to address inequalities. There is a substantial body of evidence on policies that can reduce inequality while having positive or no negative impact on economic growth. Donors and partner countries may want to prioritise, in national development plans and cooperation agreements, such policy interventions. The relevant question here is whether this prioritisation has taken place or can take place for specific programmes or projects.

Finally, it is necessary to check whether inequality is explicitly taken into account in strategies and (joint) programming documents. Inequality should ideally also be a core element of national development plans and strategies and of the sectoral strategies of partner and donor countries, development agencies and banks. Checking whether inequality is mentioned is an obvious first step in this review. This simply indicates whether inequality has been taken into account in strategic and programmatic documents and the extent to which inequality reduction is an explicit goal.

Designing and managing programmes and projects to reduce inequality

Any type of programme or project can potentially have an impact on inequality, regardless of whether this is intentional or not. Finding the direct causal connections between action and outcome in terms of distributive impact, however, is often a difficult or time- and resource-intensive endeavour. This can render the attempt to rigorously assess the effect of development interventions on inequality a challenging enterprise.

A practical way of partially getting round this challenge is to provide a first assessment of potential impacts on inequality, without accounting for indirect and general equilibrium effects. This can easily be done by looking at the direct beneficiaries of projects and programmes, whenever this is possible. If direct beneficiaries are in the lower part of the national income distribution, for example in the bottom 40% (to follow SDG 10), then we can safely say that the project/programme does have an inequality focus. By doing this, we are, for the sake of simplicity, ignoring any spillover and indirect effects on people beyond the beneficiaries, although it is very often the case that these exist and are very much desired.

Box 2: Equity Tool
Equity Tool is a survey with a limited number of questions per country that can be applied to beneficiaries in order to estimate the wealth quintile they belong to with sufficient precision. This provides an economical and relatively quick method to identify whether the bottom 40% are being targeted.
Source: Author

Finding out whether direct beneficiaries belong to the poorest 40% of the population does not require a large, expensive and lasting survey. Indeed, the recent development of readily available online tools provides the opportunity to use a set of questions tailored to every country, which can identify the national income/wealth quintile a citizen belongs to. And this can be minimised to some 12 to 15 questions with a reliability of around 85%. This provides a quick and inexpensive way of identifying whether direct beneficiaries belong to the bottom two quintiles, which would indicate that inequality is being addressed by such projects or programmes. Obviously, this does not tell us anything about the direction or magnitude of change of overall inequality in the country. Yet it provides an indication of the contribution of such projects or programmes to inequality.

Designing and managing Budget Support operations addressing inequality

General Budget Support is considered mostly fungible, which is why it may not be so useful in this case to look at direct beneficiaries. Furthermore, it tends to be too general to allow for the identification of direct beneficiaries. In this case, one can look instead at the overall distributional incidence of the government and, in concrete terms, how government expenditure benefits the lower part of the income or wealth distribution.

If a recent Commitment to Equity (CEQ) analysis has been done on a country, then there will be an incidence profile for government expenditure that can be used to assess how any budget support will be targeting the bottom 40%. From the CEQ analysis one can obtain an indicator of whether the bottom 40% are disproportionally benefited. If so, any budget support operation can be considered to be addressing inequality in as much as government expenditure disproportionally benefits the lower two quintiles.

Box 3: The Commitment to Equity (CEQ) assessments
CEQ assessments provide an overview of the disaggregated impact of taxation and social expenditure. The overall distributional impact of the government on the economy is assessed in terms of the combination of both the fiscal system as a whole and other policies implemented by the government that may impact inequality.
Source: Author

The suggestion here is twofold. First, an analysis of the government's overall distributional incidence can provide valuable inputs to the policy dialogue with the partner country. For countries with a high level of and/or an increasing trend towards inequality, the distributional incidence of the entire fiscal system may be a key element of the dialogue, even more so when this is regressive. In these cases, technical cooperation aimed at increasing fiscal progressivity may be a pertinent consideration. Second, in the case of budget support in particular, it is the distributional incidence of expenditure that needs to be looked at, based on the CEQ exercise. This assumes that budget support follows the same incidence as expenditure as a whole, or of social expenditure in particular if the support was linked to it.

In the case of sectoral budget support, if an incidence profile of this sector has been carried out within the CEQ exercise, as is common practice, then the same incidence profile can be adopted for the provided support. That is, any funding of this sector is considered to have the same distributional incidence as that of the sector itself. Also, cases where budget support provides a substantial and additional share of a government's sectoral expenditure may require complementary, more in-depth, incidence analysis and identification of potential direct beneficiaries.

Geographic targeting

In addition to the steps proposed above, whenever sub-national allocation data is readily retrievable from the documentation of programmes, projects, or operations, then it may be possible to produce a geographic targeting assessment (Öhler, Negre, Smets, Massari, & Bogetić, 2019). Such assessment provides an overview of whether the allocation pattern corresponds to the areas with a higher number or proportion of people belonging to the lower income groups. That is, it indicates whether funds were disproportionately allocated to poorer regions or regions with a larger share of poorer people. In spite of the fact that there is a good number of reasons why geographic allocation needs not match the geographic distribution of the poorer segments of society, this assessment provides an informative overview that can complement the analysis suggested above.

Conclusions

The methodology proposed here allows an assessment to be made of whether all (or part) of the portfolio of a given donor or multilateral agency in a partner country is directly addressing inequality. This, in turn, can help to better identify possible roles for development cooperation in implementing SDG 10 on inequality reduction in a very practical way.

The methodology proposed provides a step-by-step guide for development institutions to either strengthen their focus on inequality or assess potential effects of their portfolios (or parts of them) in one or more partner countries.

Overall, although this framework is far from an exact assessment or even an evaluation proper, it provides a useful tool that enables efforts to tackle inequality in development cooperation to be methodologically reviewed and their focus improved.

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Dr Mario Negre
Senior Researcher 2012-2020
"Transformation of Economic and Social Systems"
German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE)

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Tulpenfeld 6 · 53113 Bonn · Germany · Tel.: +49 (0)228 94927-0 · Fax: +49 (0)228 94927-130
die@die-gdi.de · www.die-gdi.de · twitter.com/DIE_GDI · www.facebook.com/DIE.Bonn · www.youtube.com/DIEnewsflash
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