# A Conceptual Study on Income Inequality and Economic Growth in Bangladesh

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**Abstract**
Reducing income inequality through economic growth remains a debatable issue in economic development literature and has long been the subject of extensive research. The relationship between these two factors is complex and dynamic, with the direction and strength of the relationship varying across countries and over time. Bangladesh as a developing country keeps a commendably steady growth of GDP in the recent decade. While it is believed that the growth trajectory pours its benefits in curbing income inequality, in reality, the poorer become the poorest, and the richer become the richest over the decade in Bangladesh. Therefore, the debate over economic growth and income inequality has become a great controversy. Numerous studies in Bangladesh have investigated the connection between economic growth and income inequality, but the results have been inconclusive. While some research has revealed a link between income inequality and economic growth, other studies have not identified any notable association. The issue of income inequality in Bangladesh is further complicated by the country's ongoing efforts to reduce poverty, which has resulted in both positive and negative impacts on income inequality. The lack of consensus in the literature highlights the need for continued research in this area. In light of these findings, the purpose of this conceptual paper is to review the existing literature on the relationship between income inequality and economic growth in Bangladesh. This paper provides a comprehensive overview of the various theories and empirical studies that have been conducted in this area, including the latest findings and research gaps. The paper concludes by highlighting the need for further research in order to better understand the complex and dynamic relationship between income inequality and economic growth in Bangladesh.
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## 1. Introduction

Income inequality and economic growth have been a topic of ongoing research and debate for many decades (Acemoglu et al., 2015). While some economists argue that income inequality is an essential component of economic growth (Firebaugh, 1999). Others believe that high levels of income inequality can lead to economic stagnation and increased poverty (Galor and Zeira, 1993). The issue of income inequality is particularly important in developing countries such as Bangladesh, where economic growth is often seen as a means of reducing poverty and promoting development (World Bank, 2021).

In Bangladesh, income inequality has been a major concern for many years, with the country facing significant challenges in reducing poverty and promoting economic growth (Hasan et al., 2022). Despite significant progress in reducing poverty in recent years (World Bank, 2021), income inequality remains high in Bangladesh, with a large proportion of the population still living in poverty (Bansal, et al (2021). The country's ongoing efforts to reduce poverty and promote economic growth have had a complex impact on income inequality, with both positive and negative effects (Çalışkan, 2015).

Studies in Bangladesh on the relationship between income inequality and economic growth have produced mixed results (Hasan et al., 2022). While some studies have found a positive correlation between income inequality and economic growth (Hossain et al, 2018), others have found no significant correlation (Islam and Islam, 2015). In some cases, high levels of income inequality have been associated with increased poverty and reduced economic growth (Ahmed et al., 2016), while in other cases, high levels of income inequality have been associated with increased economic growth and reduced poverty (Mawdsley, 2015).

The complexity of the relationship between income inequality and economic growth in Bangladesh highlights the need for further research in this area (Hossain et al., 2018). In order to better understand the relationship between these two factors, it is important to consider a range of factors, including the impact of government policies (Hasan et al., 2022), technological change (Çalışkan, 2015), and the role of the private sector (Mawdsley, 2015).

The relationship between income inequality and economic growth in Bangladesh is a complex and dynamic one (Ahmed et al., 2016), and requires continued research in order to fully understand the nature and extent of this relationship (Hossain et al., 2021). This background study provides a comprehensive overview of the existing literature on this issue (Hasan et al., 2022) and highlights the need for further research in order to better understand the relationship between income inequality and economic growth in Bangladesh (World Bank, 2021).

## 2. Review of the Related Literature

### *2.1 Conceptualization of the Income Inequality*

Income inequality pertains to the uneven apportionment of wealth or income among individuals or households in a society (Alvaredo, 2011). This measure is commonly gauged by the Gini coefficient, which is a value that oscillates between 0 and 1. The index of 0 represents absolute parity, while a score of 1 represents complete disparity (Banerjee & Duflo, 2011).

Income inequality has been a topic of much research and debate in the economics literature. Some researchers argue that income inequality can have a positive impact on economic growth by incentivizing individuals to work harder and invest more in education and skills (Kuznets, 1955). However, other researchers argue that income inequality can have a negative impact on economic growth by reducing demand for goods and services, decreasing investment and consumption, and limiting social mobility and opportunities (Atkinson et al., 2011).

According to Banerjee and Duflo (2011), in countries with low and middle-income, such as Bangladesh, income inequality can hinder economic growth since it restricts access to critical services like education and healthcare. As a result, the connection between income inequality and economic growth is a multifaceted and complicated concept that has been the subject of substantial research and discussion in the economics literature. Hence, additional research is required to improve our understanding of the relationship between income inequality and economic growth, especially in low- and middle-income countries like Bangladesh.

### *2.2 Conceptualization of the Economic Growth*

The World Bank (2021) describes economic growth as a rise in the aggregate production of goods and services in a country, which is frequently assessed by its Gross Domestic Product (GDP). GDP is the most commonly employed metric to evaluate the overall output of an economy and compare the economic performance of different nations.

In the economic literature, there are different perspectives on what constitutes economic growth. Some economists argue that economic growth should be measured by the increase in real GDP per capita, which accounts for population growth and inflation (Solow, 1956, as cited in Barro & Sala-i-Martin, 2004). Others emphasize the importance of broader measures of well-being, such as human development, that go beyond just GDP (United Nations Development Programme, 2021).

Despite these differing perspectives, the concept of economic growth remains an important metric for policymakers and economists alike as it provides a general indication of a country's economic performance and progress. As such, it is a crucial area of research and analysis, particularly in the context of developing countries like Bangladesh.

### *2.3 On Linking the Economic Growth and Income Inequality*

According to the economics literature, there is a significant debate regarding the correlation between income inequality and economic growth. Economist Simon Kuznets (1955) proposed the "Kuznets curve" hypothesis, which suggests that income inequality can have a favorable impact on economic growth by stimulating people to work harder and invest in education and skills. Nonetheless, some researchers have questioned this theory and instead argue that income inequality has an adverse impact on economic growth (Atkinson et al., 2011).

In the context of Bangladesh, one study found that income inequality has a positive impact on economic growth (Chowdhury & Hossain, 2018) while another study found that there is no clear relationship between the two variables (Hossain, 2012). However, these studies have largely focused on the cross-sectional relationship between income inequality and economic growth, and have not examined the causal relationship between the two variables.

In low- and middle-income countries, such as Bangladesh, income inequality can be a major constraint on economic growth, as it can limit access to education, healthcare, and other services that are essential for economic development (Banerjee & Duflo, 2011).

Bhattacharya and Saha (2020) conducted a panel data analysis to investigate the correlation between income inequality and economic growth in emerging economies. They discovered that there is a positive relationship between income inequality and economic growth, implying that an increase in inequality can lead to increased economic growth. Similarly, Shin (2012) performed a literature review of studies that evaluated the effect of income inequality on economic growth. They concluded that the relationship between income inequality and economic growth is complex and varies depending on the type of inequality and the stage of economic development.

De Dominicis et al. (2008) performed a meta-analysis of studies to assess the connection between income inequality and economic growth. They discovered that an increase in inequality is linked to a decrease in economic growth. In contrast, Topuz (2022) evaluated the relationship between income inequality and economic growth in a panel of developing countries. He summarized that the higher levels of inequality can lead to lower levels of economic growth, indicating a negative correlation between the two variables.

Amri (2018) provides a causal review of the connection between income inequality and economic growth. She suggests that while income inequality can hinder economic growth, it can also be a driver of growth if it leads to more incentives for innovation and investment. On the other hand, Gregorio and Lee (2002) investigate the link between income inequality and growth using cross-country data. They found that income inequality is negatively linked to economic growth, but the correlation is not statistically significant.

Bourguignon and Morrison (2002) provide a perspective on the relationship between income inequality and economic growth from the perspective of new growth theories. They argue that while income inequality may be detrimental to economic growth in the short run, it can be beneficial in the long run by promoting innovation and investment. In the same vein, Benabou (1996) provides a theoretical analysis of the relationship between income inequality and economic growth. He argues that income inequality can lead to lower economic growth by reducing investment in human capital and reducing the incentives for innovation.

The study by Ravallion (2001) analyzes the relationship between income inequality, economic growth, and poverty reduction. The study suggests that economic growth can reduce poverty, but at the same time, it can increase income inequality. The second study by Azariadis and Drazen (1990) examines the relationship between income inequality and economic growth across countries. They find a weak relationship between income inequality and economic growth, with no clear evidence of a positive or negative relationship.

Mannan (2017) found a positive relationship between economic growth and poverty reduction, but income inequality has increased over time. Lin (2003) also found that economic growth has had a positive impact on poverty reduction, but income inequality has increased over time. Nuruddeen and Ibrahim (2014) discovered a bidirectional causal relationship between income inequality and economic growth. The review concludes that the relationship between income inequality and economic growth in Bangladesh is complex and multifaceted and requires further research.

### *2.4 Causes of Income Inequality*

Income inequality can increase during periods of rapid economic growth for a number of reasons. Some of the most commonly cited reasons include:

1. Skilled-biased technological change: Rapid technological advancements can increase the demand for highly skilled workers while reducing the demand for less-skilled workers. This can result in higher wages for skilled workers and lower wages for less-skilled workers, leading to an increase in income inequality (Banerjee & Duflo, 2011).
2. Capital-biased technological change: Rapid technological advancements can also increase the demand for capital, which is often concentrated among a small number of individuals or firms. This can result in higher returns for capital owners, leading to an increase in income inequality (Atkinson et al., 2011).
3. Market concentration: During periods of rapid economic growth, a few dominant firms may capture a large share of the market, leading to an increase in their profits and a concentration of wealth among a small number of individuals or firms (Banerjee & Duflo, 2011).
4. Weak labor protections: During periods of rapid economic growth, the bargaining power of workers may be weaker, leading to lower wages and an increase in income inequality (Atkinson et al., 2011).
5. Inadequate social safety nets: During periods of rapid economic growth, the poor may not have access to adequate social safety nets to protect them from economic shocks, such as job loss or illness. This can result in the poor becoming even poorer while the rich become even richer (Banerjee & Duflo, 2011).

There are several reasons why the rich can become even richer and the poor can become even poorer in the midst of economic growth. To address this issue, policymakers may need to implement policies that promote equitable growth and ensure that the benefits of economic growth are widely shared, such as strengthening labor protections, providing access to education and training, and implementing social safety nets for the most vulnerable populations.

## 3. Methodology of the Study

The authors of this conceptual paper aim to investigate the relationship between income inequality and economic growth in Bangladesh by using a theoretical framework that incorporates existing literature on these topics. The theoretical framework is built upon various concepts, such as market power and skill-biased technological change theory, which are relevant to the context of Bangladesh. The authors suggest that income inequality and economic growth are interconnected and changes in one can impact the other. They propose that a lack of adequate social safety nets in the context of rapid economic growth can lead to an exacerbation of income inequality. The authors used secondary sources, including government statistics, academic studies, and relevant reports, to gather information on income inequality and economic growth in Bangladesh.

## 4. Theoretical Framework

The relationship between income inequality and economic growth is a complex and multifaceted issue that has been widely studied in academic literature. There are several theories that have been developed to explain this relationship, including the Kuznets Curve, the Dual-Economy Theory, the Neoliberal Theory, the Human Capital Theory, and the Institutional Theory.

The Kuznets Curve, which was developed by Simon Kuznets in the 1950s, posits that as a country develops and its economy grows, income inequality initially increases and then decreases. According to this theory, income inequality is a natural part of the process of economic development, and that it eventually decreases as the economy matures and social welfare programs are put in place. This theory has been widely debated and has received both support and criticism from scholars (Campano & Salvatore, 1988; Martínez-Navarro et al., 2020).

The Dual-Economy Theory, first proposed by W. Arthur Lewis in the 1950s, suggests that there are two separate economies within a country: a modern, dynamic sector and a traditional, stagnant sector. The modern sector is characterized by high levels of productivity, technology, and wage growth, while the traditional sector is characterized by low levels of productivity and wage growth. This theory suggests that income inequality is a result of the gap between the two sectors and that it can increase as the modern sector grows faster than the traditional sector.

The Neoliberal Theory, which has gained prominence in recent decades, argues that income inequality is a result of market forces and that government intervention can only make the problem worse. According to this theory, economic growth is best achieved through free markets, low taxes, and minimal regulation. This theory has been widely debated and has received both support and criticism from scholars (Stiglitz, 2012; Galbraith, 2008).

The Human Capital Theory posits that income inequality is a result of differences in human capital, or the knowledge, skills, and abilities of individuals. According to this theory, individuals with higher levels of human capital earn higher wages and contribute more to economic growth (Stiglitz, 2016). This theory has been widely used to explain the relationship between income inequality and economic growth, although it has also been criticized for neglecting the role of institutional factors (Sen, 1995).

Finally, the Institutional Theory argues that income inequality is a result of the institutional structure of a country, including its laws, regulations, and social norms. According to this theory, income inequality can increase or decrease depending on the specific institutions and policies in place. This theory has received widespread support from scholars and has been used to explain the relationship between income inequality and economic growth in a wide range of contexts (Rodrik, 2000; Acemoglu & Robinson, 2006). Several theories offer different perspectives on this relationship. It is important for policymakers and researchers to consider the different theories and empirical evidence when analyzing this relationship and developing policies to address income inequality.

## 5. Research Gaps

The relationship between income inequality and economic growth has been widely debated in academic literature, with mixed results and research gaps remaining. According to Ostry, Berg, and Tsangarides (2014), inequality can impede economic growth by reducing the purchasing power of the poor and limiting their ability to invest in human capital. Galor and Zeira (1993) suggest that income inequality can impact economic growth by affecting the allocation of resources and reducing incentives for human capital accumulation. Banerjee and Duflo (2003) review the available evidence on the relationship between income inequality and economic growth, finding mixed results and limitations in the existing data.

Despite the extensive research on this topic, there are still gaps in the current literature. A clear consensus on the direction of the relationship between income inequality and economic growth is yet to be established, as some studies have found that higher levels of income inequality lead to lower economic growth while others have found the opposite. There is also a need for more evidence-based research that focuses on specific countries and regions. Additionally, the impact of specific policies and institutions on income inequality and economic growth is still understudied (Ostry et al., 2014).

While much has been learned about the relationship between income inequality and economic growth, further research is necessary to better understand the mechanisms driving this relationship and to identify effective policies and institutions that can help to reduce income inequality and promote economic growth.

## 6. Conclusion

Income inequality is a complex issue that can have a significant impact on economic growth. On the one hand, some degree of inequality can be a positive force for economic growth as it provides incentives for innovation and investment. Wealthy individuals and businesses have the resources to take risks and invest in new

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technologies and ideas that can drive economic growth and create new jobs. They can also help to fund research and development, which can lead to breakthroughs in science and technology that can spur economic growth.

On the other hand, excessive income inequality can have negative consequences for economic growth. When income is highly concentrated among a small group of individuals, there is less money circulating in the economy. This can lead to decreased demand for goods and services, which in turn can lead to lower economic growth. Furthermore, inequality can lead to social unrest and political instability, which can be detrimental to economic growth.

Policies aimed at reducing income inequality can help to promote more inclusive economic growth. Progressive taxation, for example, can help to redistribute wealth from the richest individuals and businesses to those who are less well-off. Social welfare programs such as food stamps and unemployment insurance can provide a safety net for individuals and families who are struggling to make ends meet. Investing in education and infrastructure can also help to reduce inequality by providing individuals with the skills and opportunities they need to succeed in the modern economy.

While some degree of income inequality may be necessary to promote economic growth, excessive inequality can be harmful to the economy and society as a whole. Therefore, policies that promote more inclusive growth by reducing inequality can be beneficial for the long-term health and sustainability of the economy.

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