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Economic Growth and Unequal Wealth Distribution: A Dynamic Approach

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Abstract: This article surveys various equity-based arguments from Marx to Rawls, in favour of income redistribution by means of public policy. Political explanations, the role of luck versus merit and the problem of the legitimacy of wide income differentials, are also discussed. The article argues that income and wealth inequality, due in great part to luck, is an inseparable part of economic growth, and even necessary for political freedom. A survey of data published by the United Nations shows that most people today enjoy higher per capita incomes than in 1975, during which time the world's population almost doubled. The article claims on the basis of this data that the world has entered a new phase in economic development, during which productivity growth surpasses population growth on a broad scale. People are becoming richer, but income disparities persist because they are an intrinsic part of the growth process.

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The unequal distribution of wealth and income is a constant source of irritation in any society. In traditional societies, inequalities in material riches are simply part of life and may go largely unquestioned for generations. One is born into a particular social class and can expect little change in the course of a lifetime. Wealth and status are not a matter of personal effort or achievement, but are determined by the lottery of birth and blood-lines. This may have served as a form of enforced legitimation in the past, but is not acceptable in modern societies.

However, modern societies also generate inequalities of wealth and income. How legitimate are they in societies where all are in principle equal before the law and where privilege is supposed to be a thing of the past? On what grounds should we strive for a "better" (i.e. more equal) distribution of income? What might be the cost of achieving such an objective? Are we moving towards a less privileged, more equal society, based largely on merit and personal effort where such differences in wealth as might subsist could be considered entirely just?

Possible answers to some, I fear not all, these questions will be discussed in what follows. A first section will be devoted to some of the more important theories of inequality and the merits – or not – of income re-distribution. A second section will look at some data on the link between economic growth and income inequality. A third section will attempt a dynamic interpretation of economic history with regard to the distribution of income and a fourth and final section will offer some tentative conclusions.

1 Theories of inequality

1.1 The Marxist interpretation of inequality

This view is discussed not because it is past history, but because it is based on an untestable hypothesis and is therefore not a matter for scientific discourse, but rather belief pure and simple. And many people still believe in it. According to the Marxist view, all social relationships are based on power. The employer exploits the worker, the landlord exploits the tenant, the business firm exploits the customer, the doctor exploits his patient, etc. This is a very persuasive view of the world because it explains and exonerates all personal failures. It denies all progress since Roman times. The Enlightenment never

happened. All is "false consciousness" [1]. Power and privilege are all. In fact we have never left traditional society and we need to break its bonds by violent revolution before emerging from the chrysalis, so to speak, as fully-fledged "modern man". If you believe this, dear reader, read no more. You are prisoner of your beliefs and can go no further in your understanding of how the world works.

1.2 The Enlightenment view

To those who believe that the Enlightenment did produce a change, allowing for a more open, more competitive and more meritrocratic society, sheer power and privilege of birth is no longer society's main organizing principle. The moment there is competition "exploitation" in the Marxist sense cannot exist. The employer has to compete with other employers in the market place for talent. A person's wage is a market price, determined by supply and demand, not just a matter for arbitrary decision by a powerful boss. The land-lord has to compete with other suppliers of accommodation, including tents and caravans. The firm is in competition with other companies and cannot charge simply what it pleases for any old defective product, and expect to survive. There are plenty of alternatives. Competition is all that is needed.

1.3 But what about luck?

If income inequalities were truly a question of merit in a competitive world, then they might perhaps be legitimate. But who can deny the role of luck? If I am lucky enough to be born in Western Europe of reasonably prosperous parents, I will start out in life ahead of the pack, through little merit of my own. If well-meaning social engineers (of which there are plenty) decide that we should create a more just society by correcting partially for this factor by imposing heavy death duties on the estates of wealthy parents, what is to be done about the sheer luck of intelligence, genes or happy circumstance?

[1] See i.a. Michel FOUCAULT, *Le Pouvoir psychiatrique: Cours au Collège de France 1973-74,* Gallimard, Paris, 2003. Foucault is a leading contemporary proponent of the modern Marxist view, and believes that we are all manipulated by hidden power structures. Roger SCRUTON, a contemporary philosopher of a different persuasion, surveys modern Marxists in *Thinkers of the New Left*, Longman Group Ltd., Harlow, 1985.

In fact, we cannot correct for luck, and we shall see in a moment that it is an essential part of what makes modern society relatively free and prosperous. The reason why we cannot correct for luck is that counteractive measures land us in dangerous territory. They inevitably violate people's sense of property rights. The principle of "finders keepers" is a deeply ingrained part of the human psyche. What I find (by luck, perseverance or intelligence) is mine by right, and belongs to no one else. The unlucky person who finds nothing *ab initio* must persuade me to part with what I have justly acquired by offering something in exchange – work, goods or money. The transaction must be voluntary, or the transfer is not legitimate.

To correct for luck through social policy implies a violation of these principles of just possession[2]. It involves using force to take from someone who enjoys legitimate possession, and to give to someone who has offered nothing in exchange and, as we all know, two wrongs do not make a right...

In practice, all modern societies try to resolve the problem of luck *versus* merit by taxing highly successful people exceptionally severely. But anyone can see that this is unjust, for it does not resolve the question of what part of income, in a particular case, is due to merit and what to luck, even supposing that this could actually be ascertained. Progressive taxation is therefore necessarily unjust, and one cannot even say that it is on the whole more just than, for example, a flat tax, for one cannot simply make rash generalizations about the source of above-average incomes.

1.4 Maximin: The Rawlsian condition

According to John Rawls[3]unequal income distribution is legitimate if (a) it incites people to greater effort, (b) the poorest gain the most from the process of economic growth (the "maximin condition" and (c) democracy is not endangered. Of these cumulative conditions the first and last are easily met, but what about (b)? In point of fact, on condition the process of economic growth is considered in its entirety, this condition is also easily met, for economic growth has allowed billions of people to live rather than die an early death, hence the world population explosion of the 20th century. If life is worth

[2] See David HUME, « Justice and Property » in *Treatise of Human Nature* (1737).
[3] John RAWLS, *A Theory of Justice,* Harvard University Press, Harvard, 1971.

living, and is preferable to death, then we must acknowledge that economic growth has radically improved to lot of the least fortunate. We shall see below that many poor people today even enjoy rising standards of living, and that we are new engaged in the second stage of economic growth, where average *per capita* incomes rise above subsistence level. Whether this can continue indefinitely until all 6-7 billion of us enjoy the same (high) level of real income is a separate question which will not concern us here, for this would lead us into entirely speculative territory.

1.5 Diminishing marginal utility

Neo-classical economics supplies a seemingly irrefutable argument in favour of taxing the rich and giving to the poor: the principle of diminishing marginal utility as applied to income. Thus 100 EUR in the hands of a wealthy person is neither here nor there to them, while the same 100 EUR in the hands of a poor person greatly adds to their welfare. Therefore, institutionalized transfers from rich to poor improve social welfare. The logic is irrefutable in a static sense, if we agree – for the sake of argument – that the utilitarian calculus is acceptable. But even the utilitarian calculus fails if we consider the secondary and tertiary effects of income re-distribution, in other words, their dynamic implications. Of these there are many. Here are just a few:

Income re-distribution is never just a case of taking a mere marginal 100 EUR from the rich and giving it to the poor, but of taking a wholly disproportionate share of high incomes to feed the ever-growing needs of the state-sponsored redistribution system. This systematic creaming-off of higher incomes is justified in the name of equity, or social justice, not marginal utility. Far from not feeling the loss of their income, the seriously wealthy spend a great deal on tax advice, and largely succeed in avoiding (often perfectly legally) what they consider to be punitive taxation on what they believe is rightly theirs.

The end results of this are many: a) the very rich do not pay the high marginal taxes theoretically aimed at them, b) the middle classes pay most of the taxes, c) the disincentive effects are huge[4], d) thus reducing the economic input of large numbers of energetic and gifted people and e) reducing the job opportunities for the less gifted. In the end, it is the

[4] According to Martin FELDSTEIN "Tax Avoidance and the Deadweight Loss of the Income Tax", *The Review of Economics and Statistics*, November, 1999, the US loses two dollars of real output for every extra dollar of taxes collected at federal level.

latter who suffer the most from income re-distribution, the exact reverse of the Rawlsian condition.

On a purely ethical plane, social engineers should never forget Confucius' story of the fish: give a poor man a fish, he eats for a day; teach him to fish, he supports himself for the rest of his life. State handouts are like giving a poor man a fish a day. He becomes dependent on (and subservient to) the source of fish. Any sensible adult would prefer to have a job and enjoy the security and pride of providing for themselves and their families. By depriving the poor of jobs, income re-distribution confiscates their freedom and dignity. Some even get fooled into doing nothing with their lives.

1.6 Debt towards society

I have often heard honest socialists say that the wealthy owe a debt to society, and that progressive taxation is the correct way of paying it off. The argument goes as follows. Without society, I am nothing. I can achieve nothing. So, if I am successful in my business ventures, I "owe" society a share in my success. A modified version of the argument goes like this: the rich have more to lose than the poor in the breakdown of law and order, so they should be prepared to pay more for its preservation.

In my humble opinion, these are woolly arguments and/or rash generalizations. They do not give us a rule for deciding on what society's share might be. The successful business has paid all its bills, taxes and wages, has robbed no one, and has obliged no one to buy its product at a price which covers all costs and leaves a profit. In what sense does this individual "owe" anything more to anyone? Profit is exactly that which is theirs. They discovered it: it did not exist before, and they have created it. Finders keepers.[5] We pay taxes so that government keeps law and order, and protects our property. These are public goods in the sense that all benefit from them, and all should, in justice, pay for them in equal part. We cannot assume that the poor have less of a stake in law and order than the wealthy, indeed I can think of several plausible arguments which go the other way. We cannot go around asking people by how much they benefit from law and order, and charge according to each individual's marginal utility, just as a seller of

[5] See in particular Israel KIRZNER, *Competition and Entrepreneurship,* University of Chicago Press, Chicago, 1973.

shoes cannot charge different prices for the same shoes according to the intensity of the desire of his customers to possess them. He has to sell to the enthusiastic buyer, as to the marginal customer, to the rich and to the poor, at the same price. A poll tax (everybody pays the same absolute amount, like for a pair of shoes) is the only just way to pay for public goods like law and order, and furthermore it provides a simple and clear rule to be followed.

Note that this question should be kept distinct from the issue of income re-distribution as a matter of social justice, which was dealt with under point (5).

1.7 Enlightened self-interest

There is a neo-Marxist argument in favour of income re-distribution which goes something like this: the capitalist class has reached an underlying consensus that it is safer for them in the long run to agree to progressive tax systems for the sake of social peace. Income differentials resulting from raw market forces are simply not acceptable or legitimate in modern society, and the alternative to income re-distribution would be revolt, arbitrary expropriation and social unrest, which are far worse than heavy taxes.

This type of argument may indeed explain the post World War II consensus between Left and Right to build the Welfare State across the whole of Western Europe. However, it is not a philosophical justification of income re-distribution. It is purely opportunistic and depends on the circumstances. If circumstances change, the underlying consensus will change too. In fact, if it becomes apparent that income re-distribution causes high unemployment and low incomes for the poor, and increases the probability of social strife, intelligent capitalists might think again...

1.8 Market failure?

Without going as far as Marxism, many people agree with one of the basic tenets of neoclassical economics: the market is fine as far as it goes, but it needs constant adjustment, regulation and supervision because it is inherently imperfect. In particular, it cannot be relied upon to ensure everyone a job and a decent standard of living. According to this view, government must step in to supply jobs, housing, health, education, support

in old age, etc. The market failure hypothesis stands in contrast to the efficient market hypothesis, which states that markets are efficient enough for most purposes and that it is government intervention which is prone to failure.

It ought to be a matter of simple empirical verification as to which hypothesis is confirmed by the facts. However, the interpretation of the facts is in dispute. For the moment, the market failure hypothesis is dominant and explains the current craze for high taxation and ever-growing government regulation. The results, however, are disappointing: high unemployment, low growth, prisons operating at well over capacity. For the market failure people, this is evidence that even more government action is needed; for the efficient market people, that less is required. The debate continues.

1.9 The moral imperative?

Even if we agree that inequalities in material condition are a natural part of life, are we not morally obliged to come to the help of our fellow human beings in distress? Most people would immediately reply in the affirmative, although some might limit the extent of their generosity to fellow citizens, or their own immediate neighbourhood, rather than accepting responsibility for the whole of humanity.

But the real question is who should be responsible. If the state is entrusted with the distribution of alms to the poor, the action loses all moral value, since the agents of the state do not give away their money, but that which has been taken, by force, from others. It is not a voluntary process on the part of the donors (an inadequate term for which I cannot find an alternative). The recipients, for their part, feel no gratitude. The normal pattern of reciprocal social obligation breaks down and is replaced by resentment and false claims.

The moral imperative to succour those less fortunate surely exists, but it cannot become a task to be undertaken by the state. It must remain voluntary and preferably individual it if is to retain its moral value. One might be able to justify succour to the poor at the lowest possible local government level, on terms agreed upon by the community.

1.10 Justice and property rights

A defence of inequalities based on property rights takes the debate onto an entirely different level. Thus for Locke[6] the right to material property is only one aspect (but an inherent and inseparable aspect) of individual property rights which encompass the right of possession over one's own body, one's right to freedom of thought and conscience, and the right to the fruits of one's own efforts. Interference by others with any one of these freedoms is a violation of property rights in the broadest sense and is felt to be deeply unjust. Conversely, I have no right to interfere in other people's property rights. According to Locke, this rule makes for social harmony.

David Hume takes the argument one step further and with regard to material possessions claims that justice in possession is ensured if (a) possession is stable and recognized, (b) possessions are transferred from one to another by mutual consent and (c) contracts freely entered into are executed in good faith by the parties. According to these rules, I can only acquire someone else's property by gaining their consent, usually by offering something in return. Voluntary exchange is the usual way of acquiring things. If these rules are followed, the resulting distribution of "things" is legitimate.

Further elaborations of the rules of just conduct in exchange are developed by Hayek[7] and de Jasay[8]in a negative fashion: catalaxy results in orderly social relationships as long as exchange is free from privilege, fraud and violence.

For these thinkers, the role of the State can safely be limited to the protection of property rights in the broadest sense. If the rules are just, and enforced, the results are just. An on-looker to a transaction has no right to any part in the resulting creation of wealth.Can someone claim compensation for the loss of an opportunity to exchange? Suppose a competitor drives me out of business, or reduces my profits. Can I justly claim compensation for loss of income? The answer is no. One of the rules of the game is that there should be no privileges. Each player takes his or her chance in an open and competitive environment. In the end it is competition which ensures legitimacy.

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[6] John LOCKE, *Essay concerning the true original, extent and end of Civil Government*, 1690.

[7] F.A. von HAYEK, *Law, Legislation and Liberty*, Vol. 2, *The Mirage of Social Justice,* University of Chicago Press, Chicago and London, 1976.

[8] Anthony de JASAY, *The State*, Liberty Fund, Indianapolis, 1998 (first edition Blackwell Ltd. 1985).

Does forced compensation by the state become legitimate if it is decided upon by a pre-agreed, politically legitimate democratic process? To this question we now turn.

1.11 The politics of income re-distribution

Having briefly summarized various strands of thinking with regard to the distribution of material possessions, it seems to me difficult to come down firmly in favour of compulsory re-distribution by the state from a philosophical point of view. It is lacking in moral content, it violates individual property rights in the broadest sense, it is inefficient and degrading, and possesses no safe limitation of state action. In short, there is no acceptable theory of re-distribution compatible with freedom, dignity and justice.

On the other hand, there is a very convincing explanation of re-distribution based on the politics of majoritarian representative democracy. It is always in the short-term interest of the 51% majority to tax the remaining 49% minority. There is therefore a permanent built-in constituency in favour of re-distribution in any democracy. Add to this government failings and political realities, and we can see why organized interest groups soon become the principal beneficiaries of state sponsored re-distribution. Privileges, which were supposed to disappear in the modern age, return. So does keeping to the democratic rules make re-distribution legitimate? The answer is surely negative. The tyranny of the majority, or the tyranny of special interests, cannot confer legitimacy on a decision concerning property, no matter what decision rules are followed. Legitimacy can only be guaranteed by following the principles described above. Politics and property do not go well together.

1.12 Unequal income distribution and freedom

We now come to the most important element in our discussion. At any one time, a modern economy is in the process of adapting to change. Some sectors are expanding, others declining. All members of society participate in this process, some on the winning, and some on the losing side. The game never ends, so opportunities are constantly renewed to inspire the latter to do better next time. This renewable game of competitive exchange is so much more rewarding than the old game of tradition, privilege and oppression that

it has produced the wealth of the modern era. But for the process to work, the chance of success must be balanced by the risk of failure at all times. This dual incentive system is needed not only to motivate people to follow the sign-posts to success and avoid the indicated danger zones. It is essential as a guide to an uncertain and unknowable future. Price signals encoded in economic success and failure distill all the dispersed knowledge available in real time at any one moment[9]. New information is constantly absorbed. No one can know but a small fraction of all existing information, and it is essentially unknowable in the whole, or to any of the economic agents who are actually taking decisions. However, economic agents acting on the basis of the partial information encoded in price signals, and using their own specific knowledge, are in fact acting in a coordinated manner, despite their inherent ignorance. F. A. von Hayek received the Nobel Prize in Economics for having discovered the coordinating function of the price mechanism. It allows us to be forward-looking in an uncertain world. Without it, our economy would become static and predictable, as it used to be in traditional societies. And what is static and predictable is very soon taken over by one tyrant or another.

Income inequalities and the uncertainties which attend all human endeavour are therefore an indispensable part of our freedom. As Hayek says[10], it is our inevitable ignorance of so many essential matters which forces us to rely on chance to see us through. We need the liberty to explore all possible avenues, in order to find solutions to problems. We cannot use liberty just for those situations where we know it will work. Partial liberty is worthless. The economy would grind to a halt and fall easy victim to whatever great tyrant came along. This is the nature of the link between uncertainty, competitive markets, wealth creation and liberty.

Consequently, income inequalities are part of our liberty and wealth, and have to be endured – or enjoyed. Empirical evidence suggests that the latter is more appropriate. To this question we now turn.

[9] F. A. von HAYEK, « The Use of Knowledge in Society » *American Economic Review*, Vol. XXXV 1945, pp. 519-30, reprinted in *Individualism and Economic Order*, University of Chicago Press, Chicago & London, 1948.

[10] F. A. von HAYEK, *The Consitution of Liberty*, Routledge, London, 1960.

2 Empirical evidence

Although unequal income distribution is essential to the process of economic growth, a modern society based more on merit than on privilege turns out – unsurprisingly – to be less unequal than traditional, autocratic or totalitarian societies. Societies, as they move from a traditional to a modern form of government, begin to enjoy economic growth. But the process has to start somewhere. In the very first stage of transition from traditional to modern, only one economy starts to move. Historically, this was England of the late Restoration period. A gap in prosperity opens up between the first mover and all others, and inequality between individuals and nations grows. The process is the same between as within societies. To begin with, only a few pioneers move ahead, and income disparities grow. Prosperity nevertheless spreads outwards, employment grows and opportunities open up, gradually touching ever larger numbers of people. At this early stage in the process, growth takes the form of a decline in infant mortality and a larger population. There are actually more poor people than ever before, and the gap between rich and poor is large and growing. The situation looks hopeless if one takes a static view. But if we look back, we see many babies surviving infancy who otherwise would have died, and if we look forward, there comes a time when productivity improvements begin to show up as actual growth in average *per capita* incomes, instead of just population growth. Economic historians place this moment around 1815 in Great Britain, but it came later to the rest of Western Europe and North America,[11] and for the rest of the world we can say that it only began to occur on a large scale in the 1980s.

In the data which is presented below, we shall be mostly using the United Nations composite relative Index of Human Development (IHD), since this is more comprehensive than mere GDP *per capita.* It aims to capture social indicators like life expectancy and literacy as well as standard wealth creation *per capita.* The higher the index, the more prosperous the country is, with 1.0 being the maximum. At the time of writing, this place is occupied by Norway, with an index rating of over 0.9.
Table 1 shows the demographics of growth from 1975-2002. The world's population almost doubled, from 4 to 7 billion, confirming that a great deal of productivity growth

[11] T.S. ASHTON, « The Standard of Life of the Workers in England 1790-1830 » in F.A.HAYEK, *Capitalism and the Historians*, Phoenix Books, University of Chicago Press, 1954, pp. 123-155

went into improved life expectancy, as is to be expected in the first stage of economic growth. However, real GDP *per capita* also grew in the developing world (see Table 2), not very fast as yet, but enough to suggest that many countries had embarked on the second stage of the growth process, i.e. where productivity growth starts to outstrip population growth. It is significant that the highest per capita income growth rates were registered by the poorest countries (see Rawls' maximin condition above). It should also be noted that the developing countries most advanced on this second stage in an absolute sense, those which the UN describes as being "medium income" countries, contain the bulk of the world's population. This suggests that we are not dealing with a few isolated examples, but that growth in material welfare is a widespread, general phenomenon.

Table 1

Demographics of economic growth, 1975-2002				
	Populations concerned (millions & %)			
	1975		2002	
	(millions)	(%)	(millions)	(%)
"High" IHD countries	972	24	1,282	18
"Medium" IHD countries	2,678	67	4,759	67
"Low" IHD countries	354	9	1,022	14
Total in sample	4,004	100	7,063	100
World population	4,068		7,197	
Source: UNDP, Human Development Indicators 2004, T.5 "Demographic Trends"				

Table 2

Average real GDP per capita annual growth rates, 1975-2002	
	%
High income countries	2.1
Medium income countries	1.4
Low income countries	2.2
Source: UNDP, Human Development Indicators 2004, T.13 "Economic Performance"	

It is true that these results are heavily influenced by the extraordinary economic development of India and China, which overwhelms the experience of many smaller countries which are not developing at all. However, if growth is a dynamic process which spreads partly through trade and partly through imitation, the fact that these two giants appear to have achieved the second stage of economic development will soon have a measurable impact on their neighbours and trading partners. Anecdotes of China investing in raw material extraction in Africa, for example, are an example of how growth can spread outwards, in this case particularly quickly since China is such a large new player in the game.

We should note from Table 2 that the high income countries also experienced rapid per capita income growth. This means that the per capita income gap between the rich and the poor did not narrow during the period under examination, but that most grew richer all the same.

Table 3 shows how the IHD has evolved since 1975 for "high", "medium" and "low" countries. It shows that medium level IHD countries enjoyed the largest increase, followed by the poorest countries. Rich countries have hardly progressed at all, but that is to be expected, given the composite nature of the index. In these terms, the period 1975-2002 has been one of rapid catch-up growth for the developing world as a whole.

Table 3

Index of Human Development, 1975-2002			
	IHD 1975	IHD 2002	Growth of IHD 1975 = 100
"High" IHD countries	0.830	0.850	102
"Medium" IHD countries	0.504	0.682	135
"Low" IHD countries	0.352	0.445	126
Source: UNDP, Human Development Indicators, T.2 & T.5, own calculations			

This fact is confirmed by Table 4, which shows a substantial narrowing of the gap between the "high" IDH and other countries during the period considered. Thus in 1975 the IHD index for medium level countries stood at 61% of the index for rich countries,

while by 2002 their status relative to rich countries had risen to 80%. The relative status of "low" IDH countries, in the meantime, had risen from 42% to 52%.

Table 4

The gap narrows, 1975-2002		
	1975	2002
"High" IHD countries	100	100
"Medium" IHD countries	61	80
"Low" IHD countries	42	52
Source: same as Table 3		

It is therefore impossible to escape the conclusion that the gap between rich and poor nations is narrowing in terms of the HD index, and that even on a simple *per capita* basis, the poorer are becoming richer. The majority of humanity has finally reached the beginning of the second stage of economic growth, where productivity outstrips population growth.

This observation is not incompatible with growing numbers of very poor people, as we have already pointed out. The UN estimates that the number of people surviving on less than 1$ a day actually declined slightly from 1.3 billion in 1993 to 1.1 billion in 2000[12]. This is obviously still far too many, and far more than in, say, 1950 and we cannot but be concerned about the problem. However, as already explained, this is the normal pattern in the first stage of the economic growth process.

3 Economic growth: a dynamic process

We have already described how growth has to start somewhere, with only one or possibly a handful of pioneers, and then spreads out.

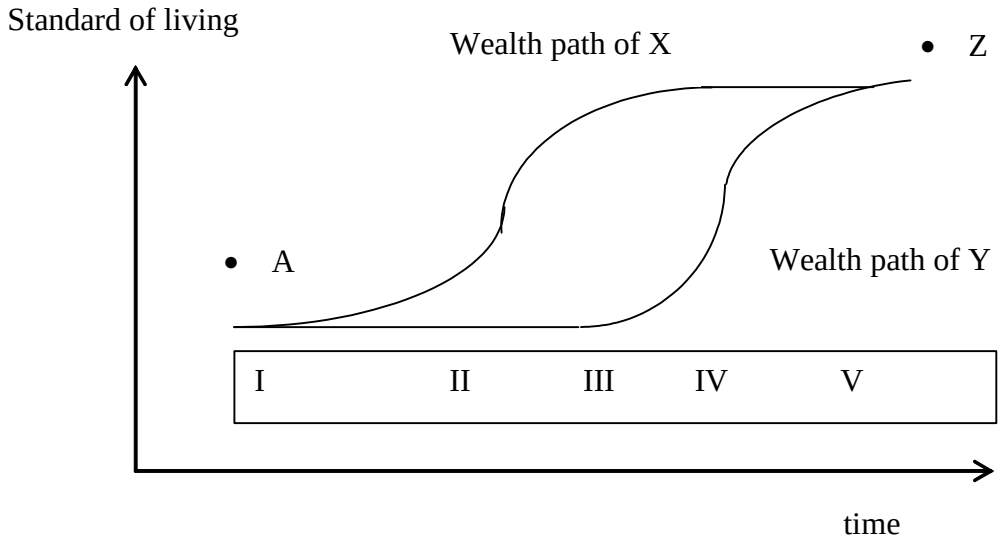
Referring to Graph 1, let us consider the growth paths of individuals X and Y (or country X and country Y if one prefers to think in collective terms). To begin with,

[12] UNDP, « The State of Human Development » in *Human Development Indicators*, *Human Development Report 2004*, p. 129.

at stage I, point A, both are equal in poverty. Nothing has happened yet to change the traditional structures of government, people are not yet aware of their property rights in a broad, Lockian sense – i.e. their basic human right to property and equal treatment under the rule of Law. The beginning of the growth process does not require that everyone should become aware of these basic human rights simultaneously, just that a few should take the risk and start to act. They may or may not duly move ahead, depending on how existing political and religious elites view the matter. Let us suppose that we are in Enlightenment England of the latter 17th century. Individual X creates great riches for himself and his family. The income gap between this family and others grows (stage II), and after a while even looks permanent and intractable (stage III). But at stage IV, Y starts to imitate X, and the gap between them begins to close. By stage V, X and Y enjoy similar standards of living once more, but at a much higher level of wealth than at stage I. They will be copied by more and more people (whose wealth paths are not shown). Of course point Z is not an equilibrium, just a starting point for another round of pioneering, wealth creating discovery. Unequal wealth distribution is an inevitable part of the process of discovery and is necessary for economic growth.

Graph 1

The dynamic process of economic growth



Until the whole world is drawn into the growth process, which will happen in due course, at any one time one can always point to dramatic, growing and seemingly intractable income disparities such as illustrated at stage III. This is because some societies are forging ahead, while others have yet to start. Referring to Table 2, one can see that rich countries have continued to grow in real per capita terms almost as fast as the poorest. This is remarkable, because they were already considered rich and developed in 1975, and to grow fast from a high level is no mean achievement. The inevitable corollary is that the relative income gap is wide and growing. However, (a) there is no reason why rich countries should stop using their intelligence to raise productivity and (b) the poorest are benefiting from the process, as already described. Absolute standards of living are rising in most countries.

However, for those who worry more about income distribution than poverty reduction, it should come as some comfort to note that income distribution "improves" slightly (i.e. becomes more equal) as incomes rise. This should not surprise us, since a

modern competitive society, based on free markets and the rule of law, has in fact thrown off the old traditional institutions based on privilege, where the distribution of income was permanently and highly skewed.

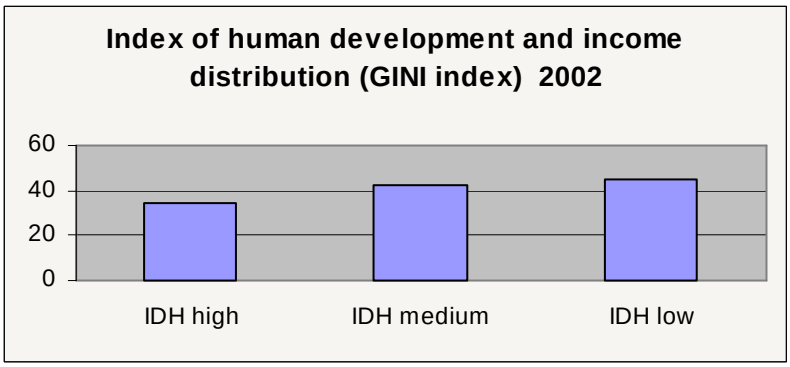
To illustrate the point, Table 5 shows the proportion of national income earned by the middle class (defined as being the 60% of the population between the two extremes of the 20% poorest, and the 20% richest) in four broad categories of countries, grouped according to income levels. There is a clear and simple relationship between higher incomes and a bigger middle class, just as one would expect. Table 5 is deceptively simple, but it represents weighted averages for over 150 countries.

Table 5

Economic growth favours the middle class, 2002		
	Per capita income (Luxembourg = 100)	% national income earned by the middle class*
High income countries	95	53
Advanced countries	82	49
Medium income countries	61	45
Low income countries	40	43
* defined as the 60% of population between 20% poorest and 20% richest		
Source: Own calculations derived from UNDP, World Development Indicators, 2004, Tables 1 & 3		

Further evidence can be derived from relating Gini coefficients of income distribution to levels of economic development. Again, there is a clear relationship in the expected direction (see Graph 2): as we move to the right, towards lower levels of IHD, the GINI coefficient rises, showing a slight "worsening" of the income distribution.

Graph 2



Source: UNDP, World Development Indicators, 2004, Tables 2 and 4.

However, the main point is that even highly developed countries still demonstrate wide income differentials, despite devoting a large and growing share of national income to the cause of greater equality. This is indeed a paradox. I believe that it can be explained by suggesting that the market undoes every evening what was carefully stitched up during the day by the social engineers. Penelope is waiting for her wandering Ulysses. It is basically a waste of time to fight the market by redistributing incomes. It is both costly (in terms of wasted effort and lost income) and ineffective (inequalities of every sort, often more political than market-based, continue to flourish). Far better leave incomes where they are earned, and ride the wave of economic growth.

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