ISSN 1801-0938

New Perspectives on Political Economy
Volume 2, Number 2, 2006, pp. 116 – 135

Economic Growth and Unequal Wealth Distribution: A Dynamic Approach

Victoria Curzon Price*

JEL Classification: B52, B53, D3, D63

Abstract: Th s art cle surveys var ous equ ty-based arguments from Marx to Rawls, n favour of ncome red str but on by means of publ c pol cy. Pol t cal explanat ons, the role of luck versus mer t and the problem of the leg t macy of w de ncome d fferent als, are also d scussed. The art cle argues that ncome and wealth nequal ty, due n great part to luck, s an nseparable part of econom c growth, and even necessary for pol t cal freedom. A survey of data publ shed by the Un ted Nat ons shows that most people today en oy h gher per cap ta ncomes than n 1975, dur ng wh ch t me the world's populat on almost doubled. The art cle cla ms on the bas s of th s data that the world has entered a new phase n econom c development, dur ng wh ch product v ty growth surpasses populat on growth on a broad scale. People are becom ng r cher, but ncome d spar t es pers st because they are an ntr ns c part of the growth process.

* V ctor a CURZON PRICE s professor of econom cs at the Un vers ty of Geneva and at the Inst tute of European Stud es of the same un vers ty. Her research nterests nclude nternat onal trade, European ntegrat on ssues, and harmon zat on versus compet t on of laws and nst tut ons n a European and global context. Insp rat on for the present contr but on has come from her ncreas ng nterest n the nterconnect ons between nst tut ons and wealth creat on seen from an evolut onary or "Austr an" approach.

The unequal d str but on of wealth and ncome s a constant source of rr tat on n any soc ety. In trad t onal soc et es, nequal t es n mater al r ches are s mply part of l fe and may go largely unquest oned for generat ons. One s born nto a part cular soc al class and can expect l ttle change n the course of a l fet me. Wealth and status are not a matter of personal effort or ach evement, but are determ ned by the lottery of b rth and blood-l nes. Th s may have served as a form of enforced leg t mat on n the past, but s not acceptable n modern soc et es.

However, modern soc et es also generate nequal t es of wealth and ncome. How leg t mate are they n soc et es where all are n pr nc ple equal before the law and where pr v lege s supposed to be a th ng of the past? On what grounds should we str ve for a "better" (.e. more equal) d str but on of ncome? What m ght be the cost of ach ev ng such an ob ect ve? Are we mov ng towards a less pr v leged, more equal soc ety, based largely on mer t and personal effort where such d fferences n wealth as m ght subs st could be cons dered ent rely ust?

Poss ble answers to some, I fear not all, these quest ons w ll be d scussed n what follows. A first sect on w ll be devoted to some of the more mportant theor es of nequal ty and the mer ts – or not – of ncome re-d str but on. A second sect on w ll look at some data on the l nk between econom c growth and ncome nequal ty. A th rd sect on w ll attempt a dynam c nterpretat on of econom c h story w th regard to the d str but on of ncome and a fourth and final sect on w ll offer some tentat ve conclus ons.

1 Theories of inequality

1.1 The Marxist interpretation of inequality

Th s v ew s d scussed not because t s past h story, but because t s based on an untestable hypothes s and s therefore not a matter for sc ent fic d scourse, but rather bel ef pure and s mple. And many people st ll bel eve n t. Accord ng to the Marx st v ew, all soc al relat onsh ps are based on power. The employer explo ts the worker, the landlord explo ts the tenant, the bus ness firm explo ts the customer, the doctor explo ts h s pat ent, etc. Th s s a very persuas ve v ew of the world because t expla ns and exonerates all personal fa lures. It den es all progress s nce Roman t mes. The Enl ghtenment never happened. All s “false consc ousness” [1]. Power and pr v lege are all. In fact we have never left trad t onal soc ety and we need to break ts bonds by v olent revolut on before emerg ng from the chrysal s, so to speak, as fully-fledged “modern man”. If you bel eve th s, dear reader, read no more. You are pr soner of your bel efs and can go no further n your understand ng of how the world works.

1.2 The Enlightenment view

To those who bel eve that the Enl ghtenment d d produce a change, allow ng for a more open, more compet t ve and more mer trocrat c soc ety, sheer power and pr v lege of b rth s no longer soc ety’s ma n organ z ng pr nc ple. The moment there s compet t on “explo tat on” n the Marx st sense cannot ex st. The employer has to compete w th other employers n the market place for talent. A person’s wage s a market pr ce, determ ned by supply and demand, not ust a matter for arb trary dec s on by a powerful boss. The land-lord has to compete w th other suppl ers of accommodat on, nclud ng tents and caravans. The firm s n compet t on w th other compan es and cannot charge s mply what t pleases for any old defect ve product, and expect to surv ve. There are plenty of alternat ves. Compet t on s all that s needed.

1.3 But what about luck?

If ncome nequal t es were truly a quest on of mer t n a compet t ve world, then they m ght perhaps be leg t mate. But who can deny the role of luck? If I am lucky enough to be born n Western Europe of reasonably prosperous parents, I w ll start out n l fe ahead of the pack, through l ttle mer t of my own. If well-mean ng soc al eng neers (of wh ch there are plenty) dec de that we should create a more ust soc ety by correct ng part ally for th s factor by mpos ng heavy death dut es on the estates of wealthy parents, what s to be done about the sheer luck of ntell gence, genes or happy c rcumstance?

---

[1] See .a. M chel FOUCAULT, *Le Pouvoir psychiatrique: Cours au Collège de France 1973-74,* Gall mard, Par s, 2003. Foucault s a lead ng contemporary proponent of the modern Marx st v ew, and bel eves that we are all man pulated by h dden power structures. Roger SCRUTON, a contemporary ph losopher of a d fferent persuas on, surveys modern Marx sts n *Thinkers of the New Left*, Longman Group Ltd., Harlow, 1985.

In fact, we cannot correct for luck, and we shall see n a moment that t s an essent al part of what makes modern soc ety relat vely free and prosperous. The reason why we cannot correct for luck s that counteract ve measures land us n dangerous terr tory. They nev tably v olate people's sense of property r ghts. The pr nc ple of "finders keepers" s a deeply ngra ned part of the human psyche. What I find (by luck, perseverance or ntell gence) s m ne by r ght, and belongs to no one else. The unlucky person who finds noth ng *ab initio* must persuade me to part w th what I have ustly acqu red by offer ng someth ng n exchange – work, goods or money. The transact on must be voluntary, or the transfer s not leg t mate.

To correct for luck through soc al pol cy mpl es a v olat on of these pr nc ples of ust possess on[2]. It nvolves us ng force to take from someone who en oys leg t mate possess on, and to g ve to someone who has offered noth ng n exchange and, as we all know, two wrongs do not make a r ght...

In pract ce, all modern soc et es try to resolve the problem of luck *versus* mer t by tax ng h ghly successful people except onally severely. But anyone can see that th s s un ust, for t does not resolve the quest on of what part of ncome, n a part cular case, s due to mer t and what to luck, even suppos ng that th s could actually be ascerta ned. Progress ve taxat on s therefore necessar ly un ust, and one cannot even say that t s on the whole more ust than, for example, a flat tax, for one cannot s mply make rash general zat ons about the source of above-average ncomes.

1.4 Maximin: The Rawlsian condition

Accord ng to John Rawls[3]unequal ncome d str but on s leg t mate f (a) t nc tes people to greater effort, (b) the poorest ga n the most from the process of econom c growth (the "max m n cond t on" and (c) democracy s not endangered. Of these cumulat ve cond t ons the first and last are eas ly met, but what about (b)? In po nt of fact, on cond t on the process of econom c growth s cons dered n ts ent rety, th s cond t on s also eas ly met, for econom c growth has allowed b ll ons of people to l ve rather than d e an early death, hence the world populat on explos on of the 20th century. If l fe s worth

[2] See Dav d HUME, « Just ce and Property » n *Treatise of Human Nature* (1737).
[3] John RAWLS, *A Theory of Justice*, Harvard Un vers ty Press, Harvard, 1971.

l v ng, and s preferable to death, then we must acknowledge that econom c growth has rad cally mproved to lot of the least fortunate. We shall see below that many poor people today even en oy r s ng standards of l v ng, and that we are new engaged n the second stage of econom c growth, where average *per capita* ncomes r se above subs stence level. Whether th s can cont nue ndefin tely unt l all 6-7 b ll on of us en oy the same (h gh) level of real ncome s a separate quest on wh ch w ll not concern us here, for th s would lead us nto ent rely speculat ve terr tory.

1.5 Diminishing marginal utility

Neo-class cal econom cs suppl es a seem ngly rrefutable argument n favour of tax ng the r ch and g v ng to the poor: the pr nc ple of d m n sh ng marg nal ut l ty as appl ed to ncome. Thus 100 EUR n the hands of a wealthy person s ne ther here nor there to them, wh le the same 100 EUR n the hands of a poor person greatly adds to the r welfare. Therefore, nst tut onal zed transfers from r ch to poor mprove soc al welfare. The log c s rrefutable n a stat c sense, f we agree – for the sake of argument – that the ut l tar an calculus s acceptable. But even the ut l tar an calculus fa ls f we cons der the secondary and tert ary effects of ncome re-d str but on, n other words, the r dynam c mpl cat ons. Of these there are many. Here are ust a few:

Income re-d str but on s never ust a case of tak ng a mere marg nal 100 EUR from the r ch and g v ng t to the poor, but of tak ng a wholly d sproport onate share of h gh ncomes to feed the ever-grow ng needs of the state-sponsored red str but on system. Th s systemat c cream ng-off of h gher ncomes s ust fied n the name of equ ty, or soc al ust ce, not marg nal ut l ty. Far from not feel ng the loss of the r ncome, the ser ously wealthy spend a great deal on tax adv ce, and largely succeed n avo d ng (often perfectly legally) what they cons der to be pun t ve taxat on on what they bel eve s r ghtly the rs.

The end results of th s are many: a) the very r ch do not pay the h gh marg nal taxes theoret cally a med at them, b) the m ddle classes pay most of the taxes, c) the d s ncent ve effects are huge[4], d) thus reduc ng the econom c nput of large numbers of energet c and g fted people and e) reduc ng the ob opportun t es for the less g fted. In the end, t s the

[4] Accord ng to Mart n FELDSTEIN "Tax Avo dance and the Deadwe ght 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 ncome re-d str but on, the exact reverse of the Rawls an cond t on.

On a purely eth cal plane, soc al eng neers should never forget Confuc us' story of the fish: g ve a poor man a fish, he eats for a day; teach h m to fish, he supports h mself for the rest of h s l fe. State handouts are l ke g v ng a poor man a fish a day. He becomes dependent on (and subserv ent to) the source of fish. Any sens ble adult would prefer to have a ob and en oy the secur ty and pr de of prov d ng for themselves and the r fam l es. By depr v ng the poor of obs, ncome re-d str but on confiscates the r freedom and d gn ty. Some even get fooled nto do ng noth ng w th the r l ves.

1.6 Debt towards society

I have often heard honest soc al sts say that the wealthy owe a debt to soc ety, and that progress ve taxat on s the correct way of pay ng t off. The argument goes as follows. W thout soc ety, I am noth ng. I can ach eve noth ng. So, f I am successful n my bus ness ventures, I "owe" soc ety a share n my success. A mod fied vers on of the argument goes l ke th s: the r ch have more to lose than the poor n the breakdown of law and order, so they should be prepared to pay more for ts preservat on.

In my humble op n on, these are woolly arguments and/or rash general zat ons. They do not g ve us a rule for dec d ng on what soc ety's share m ght be. The successful bus ness has pa d all ts b lls, taxes and wages, has robbed no one, and has obl ged no one to buy ts product at a pr ce wh ch covers all costs and leaves a profit. In what sense does th s nd v dual "owe" anyth ng more to anyone? Profit s exactly that wh ch s the rs. They d scovered t: t d d not ex st before, and they have created t. F nders keepers.[5] We pay taxes so that government keeps law and order, and protects our property. These are publ c goods n the sense that all benefit from them, and all should, n ust ce, pay for them n equal part. We cannot assume that the poor have less of a stake n law and order than the wealthy, ndeed I can th nk of several plaus ble arguments wh ch go the other way. We cannot go around ask ng people by how much they benefit from law and order, and charge accord ng to each nd v dual's marg nal ut l ty, ust as a seller of

[5] See n part cular Israel KIRZNER, *Competition and Entrepreneurship*, Un vers ty of Ch cago Press, Ch cago, 1973.

shoes cannot charge d fferent pr ces for the same shoes accord ng to the ntens ty of the des re of h s customers to possess them. He has to sell to the enthus ast c buyer, as to the marg nal customer, to the r ch and to the poor, at the same pr ce. A poll tax (everybody pays the same absolute amount, l ke for a pa r of shoes) s the only ust way to pay for publ c goods l ke law and order, and furthermore t prov des a s mple and clear rule to be followed.

Note that th s quest on should be kept d st nct from the ssue of ncome re-d str bu- t on as a matter of soc al ust ce, wh ch was dealt w th under po nt (5).

1.7 Enlightened self-interest

There s a neo-Marx st argument n favour of ncome re-d str but on wh ch goes some- th ng l ke th s: the cap tal st class has reached an underly ng consensus that t s safer for them n the long run to agree to progress ve tax systems for the sake of soc al peace. Income d fferent als result ng from raw market forces are s mply not acceptable or leg t- mate n modern soc ety, and the alternat ve to ncome re-d str but on would be revolt, arb trary expropr at on and soc al unrest, wh ch are far worse than heavy taxes.

Th s type of argument may ndeed expla n the post World War II consensus between Left and R ght to bu ld the Welfare State across the whole of Western Europe. However, t s not a ph losoph cal ust ficat on of ncome re-d str but on. It s purely opportun st c and depends on the c rcumstances. If c rcumstances change, the underly ng consensus w ll change too. In fact, f t becomes apparent that ncome re-d str but on causes h gh unemployment and low ncomes for the poor, and ncreases the probab l ty of soc al str fe, ntell gent cap tal sts m ght th nk aga n. . .

1.8 Market failure?

W thout go ng as far as Marx sm, many people agree w th one of the bas c tenets of neo- class cal econom cs: the market s fine as far as t goes, but t needs constant ad ustment, regulat on and superv s on because t s nherently mperfect. In part cular, t cannot be rel ed upon to ensure everyone a ob and a decent standard of l v ng. Accord ng to th s v ew, government must step n to supply obs, hous ng, health, educat on, support n old age, etc. The market fa lure hypothes s stands n contrast to the effic ent market hypothes s, wh ch states that markets are effic ent enough for most purposes and that t s government ntervent on wh ch s prone to fa lure.

It ought to be a matter of s mple emp r cal ver ficat on as to wh ch hypothes s s confirmed by the facts. However, the nterpretat on of the facts s n d spute. For the moment, the market fa lure hypothes s s dom nant and expla ns the current craze for h gh taxat on and ever-grow ng government regulat on. The results, however, are d sappo nt ng: h gh unemployment, low growth, pr sons operat ng at well over capac ty. For the market fa lure people, th s s ev dence that even more government act on s needed; for the effic ent market people, that less s requ red. The debate cont nues.

1.9 The moral imperative?

Even f we agree that nequal t es n mater al cond t on are a natural part of l fe, are we not morally obl ged to come to the help of our fellow human be ngs n d stress? Most people would mmed ately reply n the affirmat ve, although some m ght l m t the extent of the r generos ty to fellow c t zens, or the r own mmed ate ne ghbourhood, rather than accept ng respons b l ty for the whole of human ty.

But the real quest on s who should be respons ble. If the state s entrusted w th the d str but on of alms to the poor, the act on loses all moral value, s nce the agents of the state do not g ve away the r money, but that wh ch has been taken, by force, from others. It s not a voluntary process on the part of the donors (an nadequate term for wh ch I cannot find an alternat ve). The rec p ents, for the r part, feel no grat tude. The normal pattern of rec procal soc al obl gat on breaks down and s replaced by resentment and false cla ms.

The moral mperat ve to succour those less fortunate surely ex sts, but t cannot become a task to be undertaken by the state. It must rema n voluntary and preferably nd v dual t f s to reta n ts moral value. One m ght be able to ust fy succour to the poor at the lowest poss ble local government level, on terms agreed upon by the commun ty.

1.10 Justice and property rights

A defence of nequal t es based on property r ghts takes the debate onto an ent rely d fferent level. Thus for Locke[6] the r ght to mater al property s only one aspect (but an nherent and nseparable aspect) of nd v dual property r ghts wh ch encompass the r ght of possess on over one's own body, one's r ght to freedom of thought and consc ence, and the r ght to the fru ts of one's own efforts. Interference by others w th any one of these freedoms s a v olat on of property r ghts n the broadest sense and s felt to be deeply un ust. Conversely, I have no r ght to nterfere n other people's property r ghts. Accord ng to Locke, th s rule makes for soc al harmony.

Dav d Hume takes the argument one step further and w th regard to mater al possess ons cla ms that ust ce n possess on s ensured f (a) possess on s stable and recogn zed, (b) possess ons are transferred from one to another by mutual consent and (c) contracts freely entered nto are executed n good fa th by the part es. Accord ng to these rules, I can only acqu re someone else's property by ga n ng the r consent, usually by offer ng someth ng n return. Voluntary exchange s the usual way of acqu r ng th ngs. If these rules are followed, the result ng d str but on of "th ngs" s leg t mate.

Further elaborat ons of the rules of ust conduct n exchange are developed by Hayek[7] and de Jasay[8] n a negat ve fash on: catalaxy results n orderly soc al relat onsh ps as long as exchange s free from pr v lege, fraud and v olence.

For these th nkers, the role of the State can safely be l m ted to the protect on of property r ghts n the broadest sense. If the rules are ust, and enforced, the results are ust. An on-looker to a transact on has no r ght to any part n the result ng creat on of wealth.Can someone cla m compensat on for the loss of an opportun ty to exchange? Suppose a compet tor dr ves me out of bus ness, or reduces my profits. Can I ustly cla m compensat on for loss of ncome? The answer s no. One of the rules of the game s that there should be no pr v leges. Each player takes h s or her chance n an open and compet t ve env ronment. In the end t s compet t on wh ch ensures leg t macy.

---

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,* Un vers ty of Ch cago Press, Ch cago and London, 1976.

8 Anthony de JASAY, *The State*, L berty Fund, Ind anapol s, 1998 (first ed t on Blackwell Ltd. 1985).

Does forced compensat on by the state become leg t mate f t s dec ded upon by a pre-agreed, pol t cally leg t mate democrat c process? To th s quest on we now turn.

1.11 The politics of income re-distribution

Hav ng br efly summar zed var ous strands of th nk ng w th regard to the d str but on of mater al possess ons, t seems to me d fficult to come down firmly n favour of compulsory re-d str but on by the state from a ph losoph cal po nt of v ew. It s lack ng n moral content, t v olates nd v dual property r ghts n the broadest sense, t s neffic ent and degrad ng, and possesses no safe l m tat on of state act on. In short, there s no acceptable theory of re-d str but on compat ble w th freedom, d gn ty and ust ce.

On the other hand, there s a very conv nc ng explanat on of re-d str but on based on the pol t cs of ma or tar an representat ve democracy. It s always n the short-term nterest of the 51% ma or ty to tax the rema n ng 49% m nor ty. There s therefore a permanent bu lt- n const tuency n favour of re-d str but on n any democracy. Add to th s government fa l ngs and pol t cal real t es, and we can see why organ zed nterest groups soon become the pr nc pal benefic ar es of state sponsored re-d str but on. Pr v - leges, wh ch were supposed to d sappear n the modern age, return. So does keep ng to the democrat c rules make re-d str but on leg t mate? The answer s surely negat ve. The tyranny of the ma or ty, or the tyranny of spec al nterests, cannot confer leg t macy on a dec s on concern ng property, no matter what dec s on rules are followed. Leg t macy can only be guaranteed by follow ng the pr nc ples descr bed above. Pol t cs and property do not go well together.

1.12 Unequal income distribution and freedom

We now come to the most mportant element n our d scuss on. At any one t me, a modern economy s n the process of adapt ng to change. Some sectors are expand ng, others decl n ng. All members of soc ety part c pate n th s process, some on the w nn ng, and some on the los ng s de. The game never ends, so opportun t es are constantly renewed to nsp re the latter to do better next t me. Th s renewable game of compet t ve exchange s so much more reward ng than the old game of trad t on, pr v lege and oppress on that

2 Empirical evidence

Although unequal ncome d str but on s essent al to the process of econom c growth, a modern soc ety based more on mer t than on pr v lege turns out – unsurpr s ngly – to be less unequal than trad t onal, autocrat c or total tar an soc et es. Soc et es, as they move from a trad t onal to a modern form of government, beg n to en oy econom c growth. But the process has to start somewhere. In the very first stage of trans t on from trad - t onal to modern, only one economy starts to move. H stor cally, th s was England of the late Restorat on per od. A gap n prosper ty opens up between the first mover and all others, and nequal ty between nd v duals and nat ons grows. The process s the same between as w th n soc et es. To beg n w th, only a few p oneers move ahead, and ncome d spar t es grow. Prosper ty nevertheless spreads outwards, employment grows and opportun t es open up, gradually touch ng ever larger numbers of people. At th s early stage n the process, growth takes the form of a decl ne n nfant mortal ty and a larger populat on. There are actually more poor people than ever before, and the gap between r ch and poor s large and grow ng. The s tuat on looks hopeless f one takes a stat c v ew. But f we look back, we see many bab es surv v ng nfancy who otherw se would have d ed, and f we look forward, there comes a t me when product v ty mprovements beg n to show up as actual growth n average *per capita* ncomes, nstead of ust population growth. Econom c h stor ans place th s moment around 1815 n Great Br ta n, but t came later to the rest of Western Europe and North Amer ca,[11] and for the rest of the world we can say that t only began to occur on a large scale n the 1980s.

In the data wh ch s presented below, we shall be mostly us ng the Un ted Nat ons compos te relat ve Index of Human Development (IHD), s nce th s s more comprehens ve than mere GDP *per capita*. It a ms to capture soc al nd cators l ke l fe expectancy and l teracy as well as standard wealth creat on *per capita*. The h gher the ndex, the more prosperous the country s, w th 1.0 be ng the max mum. At the t me of wr t ng, th s place s occup ed by Norway, w th an ndex rat ng of over 0.9.
Table 1 shows the demograph cs of growth from 1975-2002. The world's populat on almost doubled, from 4 to 7 b ll on, confirm ng that a great deal of product v ty growth

[11] T.S. ASHTON, « The Standard of L fe of the Workers n England 1790-1830 » n F.A.HAYEK, *Capitalism and the Historians*, Phoen x Books, Un vers ty of Ch cago Press, 1954, pp. 123-155

went nto mproved l fe expectancy, as s to be expected n the first stage of econom c growth. However, real GDP *per capita* also grew n the develop ng world (see Table 2), not very fast as yet, but enough to suggest that many countr es had embarked on the second stage of the growth process, .e. where product v ty growth starts to outstr p populat on growth. It s s gn ficant that the h ghest per cap ta ncome growth rates were reg stered by the poorest countr es (see Rawls' max m n cond t on above). It should also be noted that the develop ng countr es most advanced on th s second stage n an absolute sense, those wh ch the UN descr bes as be ng "med um ncome" countr es, conta n the bulk of the world's populat on. Th s suggests that we are not deal ng w th a few solated examples, but that growth n mater al welfare s a w despread, general phenomenon.

Table 1

Demograph cs of econom c growth, 1975-2002				
	Populat ons concerned (m ll ons & %)			
	1975		2002	
	(m ll ons)	(%)	(m ll ons)	(%)
"H gh" IHD countr es	972	24	1,282	18
"Med um" IHD countr es	2,678	67	4,759	67
"Low" IHD countr es	354	9	1,022	14
Total n sample	4,004	100	7,063	100
World populat on	4,068		7,197	
Source: UNDP, Human Development Indicators 2004, T.5 "Demographic Trends"				

Table 2

Average real GDP per cap ta annual growth rates, 1975-2002	
	%
H gh ncome countr es	2.1
Med um ncome countr es	1.4
Low ncome countr es	2.2
Source: UNDP, Human Development Indicators 2004, T.13 "Economic Performance"	

It s true that these results are heav ly nfluenced by the extraord nary econom c development of Ind a and Ch na, wh ch overwhelms the exper ence of many smaller countr es wh ch are not develop ng at all. However, f growth s a dynam c process wh ch spreads partly through trade and partly through m tat on, the fact that these two g ants appear to have ach eved the second stage of econom c development w ll soon have a measurable mpact on the r ne ghbours and trad ng partners. Anecdotes of Ch na nvest ng n raw mater al extract on n Afr ca, for example, are an example of how growth can spread outwards, n th s case part cularly qu ckly s nce Ch na s such a large new player n the game.

We should note from Table 2 that the h gh ncome countr es also exper enced rap d per cap ta ncome growth. Th s means that the per cap ta ncome gap between the r ch and the poor d d not narrow dur ng the per od under exam nat on, but that most grew r cher all the same.

Table 3 shows how the IHD has evolved s nce 1975 for “h gh”, “med um” and “low” countr es. It shows that med um level IHD countr es en oyed the largest ncrease, followed by the poorest countr es. R ch countr es have hardly progressed at all, but that s to be expected, g ven the compos te nature of the ndex. In these terms, the per od 1975-2002 has been one of rap d catch-up growth for the develop ng world as a whole.

Table 3

Index of Human Development, 1975-2002			
	IHD 1975	IHD 2002	Growth of IHD 1975 = 100
“H gh” IHD countr es	0.830	0.850	102
“Med um” IHD countr es	0.504	0.682	135
“Low” IHD countr es	0.352	0.445	126
Source: UNDP, Human Development Indicators, T.2 & T.5, own calculations			

Th s fact s confirmed by Table 4, wh ch shows a substant al narrow ng of the gap between the “h gh” IDH and other countr es dur ng the per od cons dered. Thus n 1975 the IHD ndex for med um level countr es stood at 61% of the ndex for r ch countr es, wh le by 2002 the r status relat ve to r ch countr es had r sen to 80%. The relat ve status of “low” IDH countr es, n the meant me, had r sen from 42% to 52%.

Table 4

The gap narrows, 1975-2002		
	1975	2002
“H gh” IHD countr es	100	100
“Med um” IHD countr es	61	80
“Low” IHD countr es	42	52
Source: same as Table 3		

It s therefore mposs ble to escape the conclus on that the gap between r ch and poor nat ons s narrow ng n terms of the HD ndex, and that even on a s mple *per capita* bas s, the poorer are becom ng r cher. The ma or ty of human ty has finally reached the beg nn ng of the second stage of econom c growth, where product v ty outstr ps populat on growth.

Th s observat on s not ncompat ble w th grow ng numbers of very poor people, as we have already po nted out. The UN est mates that the number of people surv v ng on less than 1$ a day actually decl ned sl ghtly from 1.3 b ll on n 1993 to 1.1 b ll on n 2000[12]. Th s s obv ously st ll far too many, and far more than n, say, 1950 and we cannot but be concerned about the problem. However, as already expla ned, th s s the normal pattern n the first stage of the econom c growth process.

3 Economic growth: a dynamic process

We have already descr bed how growth has to start somewhere, w th only one or poss bly a handful of p oneers, and then spreads out.

Referr ng to Graph 1, let us cons der the growth paths of nd v duals X and Y (or country X and country Y f one prefers to th nk n collect ve terms). To beg n w th,

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

at stage I, po nt A, both are equal n poverty. Noth ng has happened yet to change the trad t onal structures of government, people are not yet aware of the r property r ghts n a broad, Lock an sense – .e. the r bas c human r ght to property and equal treatment under the rule of Law. The beg nn ng of the growth process does not requ re that everyone should become aware of these bas c human r ghts s multaneously, ust that a few should take the r sk and start to act. They may or may not duly move ahead, depend ng on how ex st ng pol t cal and rel g ous el tes v ew the matter. Let us suppose that we are n Enl ghtenment England of the latter 17th century. Ind v dual X creates great r ches for h mself and h s fam ly. The ncome gap between th s fam ly and others grows (stage II), and after a wh le even looks permanent and ntractable (stage III). But at stage IV, Y starts to m tate X, and the gap between them beg ns to close. By stage V, X and Y en oy s m lar standards of l v ng once more, but at a much h gher level of wealth than at stage I. They w ll be cop ed by more and more people (whose wealth paths are not shown). Of course po nt Z s not an equ l br um, ust a start ng po nt for another round of p oneer ng, wealth creat ng d scovery. Unequal wealth d str but on s an nev table part of the process of d scovery and s necessary for econom c growth.

modern compet t ve soc ety, based on free markets and the rule of law, has n fact thrown off the old trad t onal nst tut ons based on pr v lege, where the d str but on of ncome was permanently and h ghly skewed.

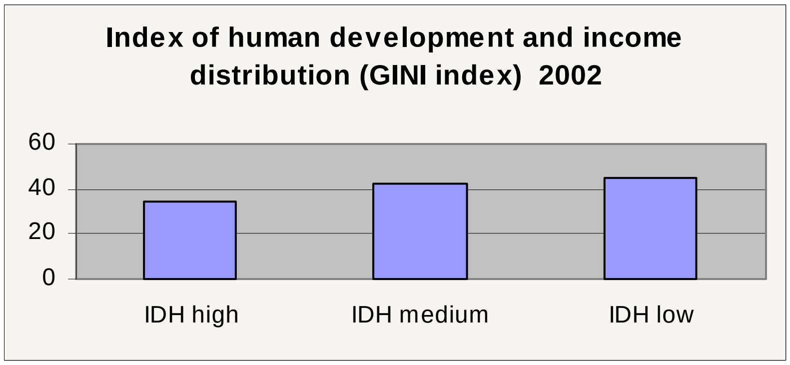
To llustrate the po nt, Table 5 shows the proport on of nat onal ncome earned by the m ddle class (defined as be ng the 60% of the populat on between the two extremes of the 20% poorest, and the 20% r chest) n four broad categor es of countr es, grouped accord ng to ncome levels. There s a clear and s mple relat onsh p between h gher n-comes and a b gger m ddle class, ust as one would expect. Table 5 s decept vely s mple, but t represents we ghted averages for over 150 countr es.

Table 5

Econom c growth favours the m ddle class, 2002		
	Per cap ta ncome (Luxembourg = 100)	% nat onal ncome earned by the m ddle class*
H gh ncome countr es	95	53
Advanced countr es	82	49
Med um ncome countr es	61	45
Low ncome countr es	40	43
* defined as the 60% of populat on between 20% poorest and 20% r chest		
Source: Own calculations derived from UNDP, World Development Indicators, 2004, Tables 1 & 3		

Further ev dence can be der ved from relat ng G n coeffic ents of ncome d str bu-t on to levels of econom c development. Aga n, there s a clear relat onsh p n the ex-pected d rect on (see Graph 2): as we move to the r ght, towards lower levels of IHD, the GINI coeffic ent r ses, show ng a sl ght "worsen ng" of the ncome d str but on.

Graph 2



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

However, the ma n po nt s that even h ghly developed countr es st ll demonstrate w de ncome d fferent als, desp te devot ng a large and grow ng share of nat onal ncome to the cause of greater equal ty. Th s s ndeed a paradox. I bel eve that t can be expla ned by suggest ng that the market undoes every even ng what was carefully st tched up dur ng the day by the soc al eng neers. Penelope s wa t ng for her wander ng Ulysses. It s bas cally a waste of t me to fight the market by red str but ng ncomes. It s both costly (n terms of wasted effort and lost ncome) and neffect ve (nequal t es of every sort, often more pol t cal than market-based, cont nue to flour sh). Far better leave ncomes where they are earned, and r de the wave of econom c growth.

Bibliography

[1] T.S. ASHTON, « The Standard of L fe of the Workers n England 1790-1830 » n F.A.HAYEK, *Capitalism and the Historians*, Phoen x Books, Un vers ty of Ch cago Press, 1954, pp. 123-155.

[2] de JASAY, Anthony, *The State*, L berty Fund, Ind anapol s, 1998 (first ed t on Blackwell Ltd. 1985).

[3] FELDSTEIN, Mart n, "Tax Avo dance and the Deadwe ght Loss of the Income Tax", *The Review of Economics and Statistics*, November, 1999

[4] FOUCAULT, M chel, *Le Pouvoir psychiatrique: Cours au Collège de France 1973-74,* Gall mard, Par s, 2003.

[5] HAYEK, F. A., « The Use of Knowledge n Soc ety » *American Economic Review*, Vol. XXXV 1945, pp. 519-30, repr nted n *Individualism and Economic Order*, Un - vers ty of Ch cago Press, Ch cago & London, 1948.

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

[7] HAYEK, F.A., *Law, Legislation and Liberty*, Vol. 2, *The Mirage of Social Justice,* Un vers ty of Ch cago Press, Ch cago and London, 1976.

[8] HUME, Dav d, « Just ce and Property » n *Treatise of Human Nature* (1737).

[9] KIRZNER, Israel *Competition and Entrepreneurship,* Un vers ty of Ch cago Press, Ch cago, 1973.

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

[11] RAWLS, John, *A Theory of Justice,* Harvard Un vers ty Press, Harvard, 1971.

[12] SCRUTON, Roger, *Thinkers of the New Left*, Longman Group Ltd., Harlow, 1985.

[13] UNDP, *Human Development Indicators*, *Human Development Report 2004, New York and Geneva, 2005.*