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# On income distribution and growth

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**Abstract**

The notion that substantial inequality is a stimulus to growth is extremely questionable. It is noted that a highly impoverished sector of the population reduces the productivity of the labor force. Moreover, the evidence that independent inventors and innovative entrepreneurs as a group receive compensation below those of equally educated employees indicates that disproportionate earnings are a questionable incentive.
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## 1. Introduction

It has long been recognized that the rate of economic growth in a society and the degree of equality in the distribution of its income and wealth are not independent. Indeed, it seems plausible that the two are mutually interdependent: growth rate affects distribution and distribution affects growth. The records do suggest at least some degree of interdependence in their striking behavior patterns, such as great inequality in the stagnant economies. In contrast, in the economies that have grown rapidly to a state of wealth and prosperity, the income and wealth disparities are often moderated substantially.

But this paper will not focus on analysis of empirical evidence, about which much has been written (although not with unambiguous conclusions, as Campano & Salvatore, 2006, report so clearly in their valuable volume). And, unlike much of the literature, I will deal largely with the

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influence of inequality, and of widespread poverty accompanied by extreme wealth of a fortunate few, upon rapidity of economic growth.

## 2. Poverty and growth

There are two obvious sources of the influence of inequality on growth: (1) low productivity of an impoverished labor force (poverty as a physical and mental handicap), and (2) large financial rewards as incentive for vigorous productive effort. Clearly, these influences work in opposite directions. The first asserts that inequality can be a powerful impediment to growth, while the second claims that the prospect of success in attaining the upper strata in a highly unequal community is a vital and perhaps indispensable stimulus to rapid growth because it supposedly is the fuel that fires the exertions of the entrepreneurs.

Regarding the first of these influences, there can be little question—there seems to be no reason to doubt that a population will not provide a vigorous labor force if it is beset by malnutrition and a variety of debilitating illnesses for which the funds required for medication and medical attention are lacking. And if there are no resources for even rudimentary education, the use of plant and equipment of any sophistication will obviously be precluded. Moreover, in such societies, even moderately advanced capital stock does not long endure because means (or incentives) for preservation and repair are all but absent or unknown. An example drawn from my own experience is at least suggestive. Some decades ago, when I visited Port-au-Prince in Haiti, I was told that within the two preceding years a Swiss telecommunications firm had been engaged to install an entirely new network, using the latest and most sophisticated technology. This was done and the immediate results were reportedly entirely satisfactory. No one, however, had been engaged to keep the new system in repair, or perhaps no one there was capable of doing so. By the time of my family's visit to the capital city, the system had broken down completely, indeed, to such a degree that it was impossible for our hotel to communicate by telephone with any of the neighboring hotels.

This does not mean that generous contributions for the alleviation of extreme poverty can be relied upon to produce a takeoff in the recipient economy. There are all too many apparently contrary examples in which such grants, although arguably inadequate, came and went with no noticeable contribution to enduring prosperity. Clearly, more is needed and, as Easterly (2002) points out so cogently, such a program takes no account of the probability that incentives matter. Patently, it is here that the opportunities for wealth accumulation would appear to play an indispensable role. If any economy offers an avenue to abundant wealth to a John D. Rockefeller or a Bill Gates, it is plausible that entrepreneurial individuals will be found waiting in the wings, ready to undertake the exertions that bring prosperity to themselves and to their societies.

## 3. Inequality and growth

I will argue now that matters are here not nearly so simple. Two things should give us pause here. I will cite evidence that casts doubt on the indispensability of such unimpeded avenues to wealth and I will show that the availability of opportunities for such accumulation, if not appropriately circumscribed, can impede prosperity and growth rather than enhancing them. First, there is strong evidence that the inventors and innovators, as a group, rather than acquiring vastly superior financial rewards, are substantially *underpaid* relative to others with comparable education and training. In other words, in the jargon of our discipline, their expected economic profits are negative. Freeman (1978) and Benz and Frey (2004), for example, show that the

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