# The HAVES and the HAVE-NOTS

Branko Milanovic

A BRIEF AND IDIOSYNCRATIC HISTORY OF GLOBAL INEQUALITY

Branko Milanovic

# The HAVES and the HAVE-NOTS

A BRIEF AND IDIOSYNCRATIC HISTORY OF GLOBAL INEQUALITY

# Table of Contents

# Praise for *The Haves and the Have-Nots*

"Where do *you* rank in the all-time world distribution of income? How about Jane Austen's Mr. Darcy? Or Anna Karenina? Was Octavian Augustus richer than Bill Gates? Why might China fall apart, like the USSR and Yugoslavia? Why should we care about differences in income and wealth? In this book of many delights, Branko Milanovic, who has spent twenty-five years studying global inequality, provides us with a veritable *Arabian Nights* of stories about inequality, drawing from history, literature, and everywhere in the world. A pleasure to read, and an eye-opener for haves and for have-nots alike."

*—ANGUS DEATON,*
***Professor of Economics and International Affairs, Princeton University, 2009 President of the American Economic Association, author of The Analysis of Household Surveys: A Microeconometric Approach to Development Policy***

"Learn about the serious subject of economic inequality while you have plenty of fun traveling around the globe and far back in time! Through fascinating stories and wonderful illustrations, Branko Milanovic explains income and wealth inequality—their concepts, measurement, evolution, and role in human life—without compromising precision or balance. This is a delightful book, as commendable for vacations as for the classroom."

*—THOMAS POGGE,*
***Professor of Philosophy and International Affairs, Yale University, author of World Poverty and Human Rights: Cosmopolitan Responsibilities and Reforms***

# THE HAVES
## *and the*
# HAVE-NOTS

## A Brief and Idiosyncratic History of Global Inequality

BRANKO MILANOVIC

BASIC BOOKS
A Member of the Perseus Books Group
New York

*For N. and G.*

"To determine the laws which regulate this distribution [into wages, profits and rent], is the principal problem in Political Economy."

***David Ricardo, Principles of Political Economy (1817)***

"Of the tendencies that are harmful to sound economics, the most seductive, and ... the most poisonous, is to focus on questions of distribution."

***Robert E. Lucas, "The Industrial Revolution: Past and Future" (2004)***

# Preface

This book is about income and wealth inequality in history and today. Inequality appeared as soon a human society was born, because distinctions of power and wealth accompany all human societies. Inequality is by definition social, since it is a relational phenomenon (I can be unequal only if there somebody else). Inequality can thus exist only when there is a society. A Robinson Crusoe canno have a concept of equality, but Robinson Crusoe and his Man Friday do. Moreover, inequality make even more sense when society is not a mechanical accumulation of individuals but a group of peop who share certain characteristics such as common government, language, religion, or historic memories.

The objective of the stories around which this book is organized is to show, in an unusual an entertaining way, how inequality of income and wealth is present in many facets of our daily lives, the stories we read or the discussions we have around our kitchen tables or in our schools or office and how inequality appears when we look at certain well-known phenomena from a different angl The objective is to unveil the importance that differences in income and wealth, affluence an poverty, play in our ordinary lives as well as the importance that they have had historically.

The book is organized around three types of inequalities. In the first part, I deal with inequali among individuals within a single community—typically, a nation. This is the type of inequality th most of us will easily recognize because it is the type of inequality that we are likely to think of fir when we hear the word *inequality*. In the second part, I deal with inequality in income amon countries or nations—which is also intuitively close to most of us because it is the sort of thing w notice when we travel, or when we watch the international news. In some countries most peop appear poor to us, while in others most people seem very affluent. These “between-country inequalities find their expression also in migration when workers from poor countries move to the ric world in order to earn more and enjoy a higher standard of living. In the third part, I move to the top whose relevance and importance are of much more recent vintage: global inequality, or inequali among all citizens of the world. This inequality is the sum of the previous two inequalities: that individuals within nations and that among nations. But it is a new topic because only wi globalization have we become used to contrasting and comparing our own fortunes with the fortun of individual people around the globe. Yet it is probably a type of inequality whose importance wil as the process of globalization unfolds, increase the most.

I’ve illustrated each type of inequality with short stories (vignettes), some of which take us all th way back to Roman times, while others could be almost taken from the daily newspapers—Barac Obama’s family, the global middle class, or Maghrebi migrants to Europe. Each of the vignettes ca be read separately, and they do not need to be read in order. In some cases, however, the vignettes ar linked by their topic, and reading them in succession might be more appealing. Yet they are all stand alone pieces.

Each part is introduced by an essay on what economists have to say about that particular type inequality. The essays, while written to be accessible to all interested readers, are probably a little b more demanding in terms of attention than the vignettes. They are supposed to provide the reader wi a better technical grasp of the issues that are discussed in the vignettes. For those readers who may b perhaps keen to pursue the issues in the book further, the essays offer an introduction to the literatur

At the end of the book, in “Further Readings,” I also include a list of selected publications, arrange by ~~essay and vignette, that readers may consult if they would like to know more. The books ar~~ articles listed are my own choices of what I consider the most interesting and relevant publications f a given topic.

On a personal note, this book was not only a pleasure to write but also a very easy undertakin After working for more than a quarter of a century on the issue of inequality, I have amassed a hug amount of data, information, and interesting stories, and have it literally at my fingertips. I thoug that they would be fun to share with the readers. When I sat down to write the book, I did not have think much about what to include or how to shape it. It was just a question of writing down all th things on which I had thought quite a lot already, and for quite some time, and for which I had ready made data. Perhaps most important from a personal perspective, this book has given me th opportunity to combine my two passions: a passion for numbers and distributions and a passion f history.

I had three objectives, and, of course, like every author, I do not know if I was able to achieve an of them. First, I would like for the reader to pass some pleasant time reading the stories and hope th he or she will be able to combine the pleasure of easy reading with the learning of new facts or of fresh way of looking at things. Second, I thought it important to bring to the attention of the public th issues of inequality in wealth and income that, for many reasons (some “objective” and some perhap dictated by the interests of the rich), have tended to be swept under the carpet so that they do n “disturb” the public too much. Third, bringing the issues of wealth and poverty to the center of social debate, particularly at a time of crisis, should stimulate some old-fashioned social activism. other words, people have the right to start asking questions about the justification of certain incom and the huge gaps that exist between the rich and poor in most countries, including the United State and between the rich and poor countries in the world. These are the issues that some domina segments of public opinion makers have tended to discard, all too easily, I believe, by arguing that a or almost all inequalities are market determined and as such should not be the object of discussio But neither are many of them market determined, but rather determined by relative political power ( the examples—all too numerous—of the global financial crisis show), nor can the questioning b taken out of the social arena by evoking “the market.” The market economy is a social construc created, or rather discovered, to serve people, and thus raising questions about the way it functions fully legitimate in every democratic society.

I have to end the Preface with a technical note. The reader will discover as he or she goes throug the book that it contains the results of a lot of calculations. All the calculations whose sources are n explicitly given in the footnotes are my own unpublished calculations, based on various data source mostly those from the World Bank and World Income Distribution (WYD) databases, which contain lot of macro data and several hundred household surveys from most countries in the world. I thoug that it would be unduly tedious to list such sources for each and every number that I have produced. the reader is particularly interested in a given fact or calculation, I would be delighted to supply th exact source (since the sources are all on my laptop anyway!). He or she can write to my e-ma address (bmilanovic@worldbank.org or branko_mi@yahoo.com). For all other data, which were take from other authors and their publications, the sources are clearly indicated in the text.

It is a pleasure to acknowledge the assistance and support that I have received from man individuals. Because this book is in some ways the result of more than twenty years of work on th topic, the list of people whom I should acknowledge would have to be huge and include practical everybody whom I have met and from whom I have learned something. I, obviously, cannot do tha

So I have to limit it only to the people who were very directly involved in the production of th volume. ~~They are acknowledged at the beginning of each vignette or essay on which I have~~ soug their advice, comments, and suggestions. In addition to them, I am grateful to Tim Sullivan an Melissa Veronesi, my editors, who have shaped the organization of the book; Annette Wenda, who ha carefully gone through every sentence; Michele Alacevich and Valentina Kalk, on whose substantiv and aesthetic advice I have much depended; Gouthami Padam, who has worked with me for more tha seven years; Shaohua Chen, whose assistance on Chinese household surveys was invaluable; Le Wenar, to whose advice regarding issues of political philosophy and in particular the interpretation o John Rawls's works I have frequently turned and who has given me excellent comments on sever parts of the manuscript; and Slaheddine Khenissi, for his vast knowledge of the Arab and Musli worlds. Of course, the responsibility for the opinions expressed in this book is solely my own.

# CHAPTER 1

# ESSAY I

## Unequal People

### *Inequality Among Individuals Within a Nation*

Until about the turn of the twentieth century, income inequality among individuals was subsume under the topic of the functional distribution of national income—that is, how total income was spl between large social classes (workers and capitalists).[1] It was considered by many to be the key top in political economy. Society, under early capitalism of the nineteenth century, seemed normally t divide into several quite distinct social classes: workers, who were selling labor and earning wage and were relatively poor; capitalists, who owned capital and were earning profits, and were relative rich; and landlords, who owned land and received rents, and were also rich. The distribution of incon among these three classes was considered of crucial importance for determining the future of society. English economist David Ricardo, one of the founders of the discipline of political econom believed that the share of landlords would increase as greater population required more food, whic would bring ever less fertile land into cultivation and raise rents. Prices of “wage goods” (food) ar landlord’s rents would skyrocket. He saw the eventual outcome as a stationary state where low profit squeezed between the rising prices of food and rents, would provide little incentive to save ar invest.[2] Karl Marx saw greater mechanization, expressed in an increasing value of capital per worke leading to lower returns to capital and over the long run to a tendency of the profit rate to diminis eventually tending toward zero and choking off investment.

This way of looking at income distribution through the prism of social classes did not change muc with the key turning point in the history of economics, the replacement of classical “politic economy” by the “marginalist revolution” that started around 1870 and focused on individu optimization rather than on broad economic evolution of social classes, nor did it change later with th synthesis of the two strands (classical and marginalist) under the title of “neoclassical Marshallia economics” (from the Cambridge economist Alfred Marshall) and its establishment in the mainstrea position. It was only in the early 1900s that the distribution of income among individuals (not amon classes) attracted the attention of Vilfredo Pareto, a Franco-Italian economist who taught at th University of Lausanne in Switzerland. (His contribution is highlighted in Vignette 1.10.)

It was around the same time that the data on personal income distribution became available for th first time. This went hand in hand with economic development (countries becoming richer) and broader fiscal role of the state. The early statistical information about income distribution emerge because of nation-states’ need to collect direct taxes in a “fairer” way—that is, according to income- and to increase total tax intake, to spend it for public education, workers’ invalidity, and, above al war. The ideological change that saw all individuals as equal before the law, and thus the rich due t contribute more in accordance with their greater wealth and income, was important, too. Taxes had t be more tightly linked to income, and this required better information on incomes and the distribution among households. It is thus not surprising that the data used by Pareto to study incon ~~distribution among persons all came from the European late-nineteenth-century fiscal sources.~~ At th point, our topic had been born.

Economists and social scientists are concerned with inequality in three ways. The first type question they ask is: What determines inequality among individuals within a single nation? Are the certain regularities that make inequality behave in a particular way as societies develop? Do inequality increase as the economy expands—that is, is it pro- or anticyclical? In these types questions, inequality is something that ought to be explained. It is a dependent variable. In the secon type of question, inequality enters as a variable that explains other economic phenomena. Is high low inequality good for economic growth, for better governance, for attracting foreign investment for spreading education among the population, and so on? In these instances, we look at inequality in purely instrumental sense: We are interested in whether it furthers or hampers some particula desirable economic outcome. The third way inequality enters within the social scientists' purview when they address ethical issues linked with it. In these cases, they are concerned with the justice social arrangements that exhibit different amounts of inequality. Is increasing inequality acceptab only if it raises the absolute incomes of the poor? Should inequality due to one's better fami circumstances be treated differently than inequality due to superior work and effort?

**How does inequality change with the income level of a society?** Pareto, basing his work on a limite sample of the late-nineteenth-century tax data from European countries and cities, believed in an "iro law of inter-personal inequality," such that differences in social arrangements (whether a society feudalist, capitalist, or socialist) leave distribution more or less unchanged. The elites could b different; they may control society differently, but the distribution of income—and therefore the lev of inequality—will not be much affected. Today, this is popularly called the "80/20 law," expressin the finding that in some phenomena, we observe a regularity such that 20 percent of people a responsible for 80 percent of outcomes and the reverse (the other 80 percent of people generate on 20 percent of outcomes). It has been argued that the 80/20 law is found in quality control (80 perce of problems are due to 20 percent of products) and marketing and business applications, and we sha see something similar to hold even for global income distribution (see Essay III). As for incom distribution within nations, Pareto failed to define a theory of change in it, although "failure" is not wholly appropriate term simply because Pareto thought, and believed to have empirically proved, th income distribution must be more or less fixed and thus that there were no laws of its "change" wi development. There was, Pareto argued, only a "law of its fixity."

It wasn't until 1955 that Simon Kuznets, a Russian-American economist and statistician, propose the first real theory of what propels change in income distribution. (He is profiled, together wi Pareto, in Vignette 1.10.) He argued—having had access to not many more data points than Pare (although the data were of a different kind, household, not fiscal, surveys)—that inequality amon people is *not* the same regardless of the type of society but varies predictably as society develop Inequality in very poor societies must be low because the income of the vast majority of th population is just around subsistence, and there is little economic distinction among people. Then, an economy develops and people move from agriculture into industry, Kuznets posited, a gap emerg in average earnings between industrial workers (richer) and farmers (poorer). The industrial sect also sees more differentiation in incomes between individual workers than is the case among farme simply because tasks required by modern industry are more diversified. Therefore, income inequali increases both because of the growing gap in average earnings between industry and agriculture an because of rising inequality among industrial workers. Finally, in even more advanced societies, th state begins to play a redistributive role (see Vignette 1.7), education becomes more widespread, an inequality goes down (see Vignettes 1.1 and 1.2). Thus was formulated the famous “Kuznet hypothesis” of an inverted U curve charted by income inequality in the course of econom development: Inequality must first increase before it goes down.

The idea, however, was not entirely novel. It was expressed some 120 years earlier by French soci scientist and politician Alexis de Tocqueville and is worth quoting in full:

> If one looks closely at what has happened to the world since the beginning of society, it is eas to see that equality is prevalent only at the historical poles of civilization. Savages are equ because they are equally weak and ignorant. Very civilized men can all become equal becau they all have at their disposal similar means of attaining comfort and happiness. Between the two extremes is found inequality of condition, wealth, knowledge—the power of the few, th poverty, ignorance, and weakness of all the rest. (*Memoir on Pauperism* [1835]).

But, of course, Tocqueville, not being an economist like Kuznets, did not say anything beyond thi in particular about the mechanism whereby this inverted U shape would be brought into existence.

Kuznets’ hypothesis has been empirically tested and retested by economists ever since it was fir published in 1955. The ever-greater availability of national household surveys of income an consumption, the key source of information on income distribution, has greatly advanced th empirical exploration of Kuznets’ hypothesis. In principle, the hypothesis should work best when w study the evolution of inequality in a single country, as the country undergoes radical transformatio from agricultural to industrial and eventually to service-oriented economy. But in that context, i performance has been mixed: Some countries (and over some time periods) exhibited an inverted pattern, while others did not.

The dissatisfaction with the performance and predictive capacity of Kuznets’ hypothesis led to th addition of new elements that could better explain the behavior of income inequality. The revisio are known as the “augmented” Kuznets’ hypothesis. Factors such as the “financial depth” of a economy, extent of government spending or state-sector employment, openness of the economy, an so forth now appear alongside income level as possible additional variables that explain the moveme of inequality. Many economists argued that these additional elements could improve ou understanding of the movement of inequality. For instance, the rationale was that a more efficient an broader financial sector would allow poor individuals to borrow to finance their own educations, an this would reduce inequality as the doors of educational advancement are thrown open to all and n reserved only for the rich. Government spending (as a share of gross domestic product, or GDP) government employment (as a share of the total labor force) are supposed to have a dampening effe on inequality, first because it helps the poor, and second because it limits wage inequality. Great openness to trade should, in poor countries, reduce inequality as it increases the demand for low-ski intensive products (say, textiles) in which these countries specialize; this would tend to raise th wages of unskilled workers compared to the wages of skilled workers or the profits of capitalists. rich countries, openness to trade should produce the opposite effects since rich countries tend export high-tech products. Their production requires highly skilled workers (say, computer scientis or engineers), so the earnings of college graduates increase relative to those with only a primary secondary education. Thus, inequality goes up. Economists would test a typical Kuznets’ hypothes today by including all of these factors, and possibly quite a few others, in addition to income, often an ad hoc fashion (e.g., adding age composition of the population or distribution of landownership The results are better than when we use income level alone, but hardly spectacular.

More recently, French economist Thomas Piketty has produced a series of empirical studie conducted jointly with a number of other economists (Emmanuel Saez, Anthony Atkinson, Abhij Banerjee) and covering about a dozen countries, which have undermined both the Kuznets' and th augmented Kuznets' hypotheses. Piketty shows that after a long downward swing, inequality Western nations has decisively increased in the past quarter of a century. Although these facts wer well known before, Piketty has provided a "political" explanation, explaining them by government decisions to increase or decrease direct taxation of current income and inherited wealth as well as b the effects of wars (i.e., destruction of physical capital and reduced income of capitalists). This arguably a political theory of income distribution where social attitudes (of what is just or unjust) ar economic interests, reflected through voting and stances of political parties, as well as the war nee of economies, determine the path that inequality charts over time.

Piketty's studies, in order to explain what moves inequality over a long time period (the enti twentieth century), resorted to an old and rather discarded source of data: fiscal statistics. The reaso fiscal statistics, first used by Pareto, have been replaced by household surveys is that fiscal data cov only a portion—the higher end—of income distribution since in most countries direct taxes are n paid by the poor. Household surveys, on the contrary, include everyone. The problem with the use o fiscal data is that conclusions drawn from them are valid only if the following two assumptions hol (1) Taxable incomes are reasonable approximations of actual incomes of households (and the highe taxpayers are also the richest people), and (2) the evolution of overall inequality can be we approximated by the change in the share of the top income groups (say, the top 1 percent of taxpaye whom we believe to be also the richest 1 percent of households). Neither assumption is ful defensible. Taxable income used by Piketty and coauthors is called *market* (or *pre-fisc*) income, whic excludes both taxes paid and government transfers.[3] However, we are normally interested in wh happens to inequality of *disposable* income, that is, income that belongs to households and individua *after* they have paid taxes and received government transfers. Thus, if either taxes or transfers chang market and disposable income inequality can move in different directions. The problem with th second assumption is that inequality statistics should, in principle, include incomes of all people, n focus only on the rich. It could, for example, happen that the income share of the top increases whi the income share of the poor goes up as well and both do so at the expense of the middle-class shar We may then not be able to say that the overall inequality went up, as we would tend to conclud solely from the rising income share of the top. Since Piketty-type studies depend on this particul assumption (which we know does not hold in all places and times), the interpretation of the resul becomes problematic. Of course, if we had income or consumption surveys of the population for th periods sufficiently far in the past, the problem would be solved. We would not need to resort to th much less precise and fragmentary fiscal data. Unfortunately (as we shall see below), such surveys a available in rich countries generally only for the period after World War II and for many developin countries only for the past twenty or thirty years.

This is the situation of inequality studies today. It would be unfair or even impossible to summariz which of these different points of view has won the debate. Probably none. But it does lead to th question beyond simply measuring inequality or understanding how it evolves, and gets to the heart whether inequality is necessary for an economy to grow and, if so, how high it should be.

**How does inequality affect economic efficiency?** We care about inequality, or perhaps we car mostly about inequality, because we believe that it affects some important economic phenomena— notably, economic growth: Do more unequal countries grow faster or slower? Historically, th pendulum has swung from a rather unambiguous answer that inequality is good for growth to a muc more nuanced view that favors the opposite conclusion.

Why has this been the case? To understand it, look at inequality, as far as economic efficiency concerned, as cholesterol: There is "good" and "bad" inequality, just as there is good and ba cholesterol. [4] "Good" inequality is needed to create incentives for people to study, work hard, or sta risky entrepreneurial projects. None of that can be done without providing some inequality in retur (for the effects of "unreasonable" leveling of incomes, see Vignette 1.5 on inequality und socialism). But "bad" inequality starts at a point—one not easy to define—where, rather tha providing the motivation to excel, inequality provides the means to preserve acquired positions. Th happens when inequality in wealth or income is used to forestall an economically positive politic change for the society (e.g., agrarian reform or abolition of slavery), or to allow only the rich to g education, or to ensure that the rich keep the best jobs. All of this undercuts economic efficiency. one's ability to get a good education strongly depends on one's parents' wealth, this is equivalent t depriving society of the skills and knowledge of a large segment of its members (the poor Discrimination according to inherited income is not, in that sense, different from any oth discrimination, such as gender or race. In all cases, society decides that the skills of a certain group people will not be used. Economically, such societies are unlikely to be successful. Depending o which kind of inequality—"positive," needed for incentives, or "negative," ensuring monopoly of th rich—is dominant in a given country and time, inequality may be regarded as either beneficial harmful.

The benevolent view of economic inequality—that it provides incentives for individuals to excel- dominated when economists believed that only the very rich save and that without them, there wou be no investments and no wealth creation. Workers (or the poor) were thought apt to spend everythin they earned. If everybody then had the same (relatively) low income, there would be no saving, n investment, and no economic growth. The rich per se were not important, but it was important to hav them around so that they would save, augment capital, and provide the wherewithal for feeding th engine of economic growth. The rich were supposed to be receptacles for the individualization savings. They would spend and enjoy themselves no more than the others. All the excess would b simply saved and invested. Asceticism, as Max Weber wrote, was the key ingredient of such a "spir of capitalism": "The *summum bonum* of this ethic, the earning of more and more money, combine with the strict avoidance of all spontaneous enjoyment of life, is above all completely devoid of any hedonistic admixture. It is thought of so purely as an end in itself, that from the point of view happiness of, or utility to, the single individual, it appears entirely ... irrational."[5]

It is in the passage written in 1920 by John Maynard Keynes, famous English economist an founder of modern macroeconomics, that this slightly rose-tinted view of the justification inequality of incomes under the condition that high incomes be used for investment finds perhaps i best expression:

> Society [of pre-1914 Europe] was so framed as to throw a great part of the increased incom into the control of the class least likely to consume it. The new rich of the nineteenth centu were not brought up to large expenditures, and preferred the power which investment gav them to the pleasures of immediate consumption. In fact, it was precisely the *inequality* of th

> distribution of wealth which made possible those vast accumulations of fixed wealth and capital improvements which distinguished that age from all others. Herein lay, in fact, th main justification of the Capitalist System. If the rich had spent their new wealth on their ov enjoyments, the world would long ago have found such a régime intolerable. But like bees the saved and accumulated, not less to the advantage of the whole community because the themselves held narrower ends in prospect.[6]

This was the view of capitalists as “saving machines” and entrepreneurs.

But the world was also full of another type of capitalist rentiers who would do very little but s back, relax, and let money “do the work” for them. For a literary description of rentiers we can go Stefan Zweig’s beautiful book about the “world of yesterday,” pre-World War I Europe, a world whe the most cherished compliment (as Zweig writes) was “solid,” the highest value bourgeo respectability, and reasonableness and progress seemed destined to go on forever. For the rich, th living was easy:

> Thanks to the constant accumulation of profits, in an era of increasing prosperity in which th State never thought of nibbling off more than a few percent of income of even the richest, ar in which ... State and industrial bonds bore high rates of interest, to grow richer was nothir more than a passive activity for the wealthy.[7]

From this perspective, the rich looked less indispensable as “receptacles” for savings and possible investors; they appeared much more like parasites living well while clipping coupons ar doing little else. Yet the view of inequality as harmful, which began to dominate in the past couple o decades, did not develop from that ethical perspective. Curiously, it shares the same starting poi with the view of inequality as a benevolent force—namely, that there should be people who a willing to invest—yet it reaches very different conclusions. Here’s how the argument flows[8]: Peop (rich, middle class, and poor) vote for how high they want their taxes to be, taking into account th the advantages from government spending (funded from taxes) accrue mostly to the poor. Ver unequal societies will tend to vote for high taxation simply because there are a lot of people wh benefit from government transfers, pay nothing or little in taxes, and would always outvote the fe rich (see Vignette 1.7). Now, such high taxation reduces the incentives to invest and to work hard, ar this lowers the rate of economic growth. The mechanism is similar to the nineteenth-century fear th people without property, if given half a chance to vote, would expropriate the wealthy. Here the sam thing happens except that the expropriation is a bit gentler: It operates not through outrig nationalization but through taxation.[9]

In both cases—the benign and the malevolent views of economic inequality—the important thing to have people who are willing to invest. But in the first case, rich investors require high inequality. I the second case, the introduction of political democracy is the monkey wrench that makes hig inequality politically unsustainable. Even if the rich could somehow promise the poor that they wou not consume but invest surplus income, and that the rich are thus indispensable for economic growt there is no way that this promise could be enforced. It will not be credible, either. Consequently, th capitalist system must generate on its own a pre-tax income distribution that is sustainable and wi not encourage people to choose extortionary tax rates. For this to happen, assets among people need be distributed relatively evenly. We cannot, over the short or medium term, affect the distribution o financial assets much, but we can affect the distribution of education (what economists call “huma capital”)—hence the emphasis on better access to education for everybody. This is not only becaus education may be thought desirable in itself, not even because higher education may be direct ~~helpful for economic growth, but also because wider distribution of that asset would equali~~ distribution of pre-tax income and make even those relatively poor think twice before deciding to vo for high taxes.

Does a change in economic development also produce a change in our view of the usefulness inequality? Quite likely.[10] In the early stages of development, physical capital is scarce. It is the important to have rich people who are ready not to consume their entire income but to invest it so th more machines and roads can be built. As the economy develops, physical capital becomes less scarc and relative to it, human capital (education) becomes more valuable. It is then crucial to sprea education. But if the spread of education is constrained because talented children of the poor cann pay for education, the growth rate will sputter. Thus, even without the introduction of universal votin rights and democracy, we reach a similar conclusion: For growth to be fast, at higher stages economic development, education must be widespread, and widespread education is tantamount less inequality.

The empirical evidence of the effect of inequality on economic growth is mixed. Perhaps this inevitable because in some places and times, inequality may hamper economic growth (through i monopoly element) and in others help it (through its incentive element). Suffice it to say that our vie regarding the positive versus negative effects of inequality on economic efficiency will always deper on how much weight we put on one or the other element in the essential dilemma: social monopo versus incentives. In those cases where we believe that the monopoly of power and wealth exercis by the rich threatens social stability, and with it economic development and even the viability of state, we would, as Plato did 2,400 years ago, see income or wealth inequality as a social evil to b combated. Asked whether his laying down of austerity as a desirable feature of his ideal state wou not expose it to the danger of conquest from richer neighbors, Socrates (in Plato's words) replies:

> "But what should we call the others [communities that are not an ideal state]?," he asked.[11]
>
> "We ought to find a grander name for them," [Socrates] replied. "Each of them is, as th proverb says, not so much a single state as a collection of states. For it always contains at lea two states, the rich and the poor, at enmity with each other.... Treat them as plurality, offer t hand over the property ... of one section [of population] to another, and you will have allies plenty and very few enemies."[12]

But in those cases where we think that the leveling of incomes—the absence both of the carrot success and of the stick of failure—has gone so far that people will not try harder unless allowed keep the fruits of their labor or investment more fully, we should, as odd as it may seem, opt out an call forth greater inequality.

**Inequality and economic justice.** Income inequality is also an important topic because it straddl two areas that are often at the center of people's interests but not always or easily reconcile economic efficiency and economic justice. Economic efficiency deals with the maximization of tot output or rate of economic progress of a society. Economic justice deals with the acceptance an sustainability of a given social arrangement. Economic inequality plays an obvious role there, to Inequality based on one's inheritance, race, or gender may be regarded as unjust even when n detrimental to economic development, that is, above its purely instrumental value. If most people, an influential minority, regard a given social order as unjust, sustainability of that type of arrangeme will be questioned.

~~Economists tend to use, when assessing the desirability of different social arrangements, the~~ “soci welfare function,” a construct that in principle includes the welfare (utility) of all members of community. The objective is to compare the welfare of all members in one social arrangement wi the welfare of all members in another and find the better one. This is called “welfarism.” A crude wa to do it is simply to add individual utilities, so that in a society composed of Alan, Bob, and Charli the total utility (or welfare) of the society would be equal to the utility of Alan plus the utility of Bo plus the utility of Charlie. The individual utility functions of Alan, Bob, and Charlie are such that eac of them gets positive although decreasing utilities from every additional dollar of income. This is reasonable and empirically confirmed assumption: Think of the fact that the first ice cream on a h day will give you more pleasure than the second, and surely even more pleasure than the third. T idea goes under the general title of diminishing marginal utility of income. Now, assume in additio that Alan, Bob, and Charlie have the same utility functions. Then the optimal distribution of incom would be one of full equality. If we had given a bit more income to Alan than to Bob and Charlie, w can readily see (since they have diminishing and the same marginal utility functions) that the ext income must give less pleasure to the rich Alan than it would give to the poorer Bob and Charli Thus, total utility would increase if we were to keep transferring Alan’s extra income up to the poi where each person would get the same amount.

This was the idea behind one of the key economic contributions to the welfarist approach, Englis economist Anthony Atkinson’s highly influential 1970 article on the measurement of inequality th would also let us rank the desirability of different social arrangements.[13] Atkinson developed measure whereby a society’s inequality is calculated as that relative amount of total income that “wasted” from the welfare perspective because the same total welfare could be realized by a small overall income equally distributed among individuals. This is somewhat ungainfully called “equal distributed equivalent income.” Even if the total pie were smaller but the slices were all of equal siz total pleasure from a smallish pie would be the same as total pleasure from a larger, but unequal sliced pie. Say that Cuba and the Dominican Republic generate the same total amount of welfa among their inhabitants, but the overall Dominican income is higher. Thus, the “excess” part of th Dominican income is really wasted from the utility point of view: Dominicans can just “nix” th extra income, work less hard, and redistribute their smaller income much more equally, as the Cuba do. Ultimately, there would be no loss in welfare. How much income is “wasted” is therefore measure of inequality.

It is easy to see that if some way of adding up the utilities of different individuals existed, it wou be rather easy to say which overall state of affairs (Cuban or Dominican) is preferable. The proble though, is that there is no generally acceptable way to meaningfully combine individual utilities. W may agree that, in general, all individuals will experience diminishing marginal utility as the consumption of whatever good or service increases. But we cannot compare the *levels* of the utilities: A person may be permanently on a higher level of utility than another. In other words, whi the shape of utility functions may be similar (decreasing in income), their levels may vary amo individuals. To go back to our example, even if Bob told us that he lives in a state of permanent blis we cannot be sure that he is really happier than the curmudgeonly Charlie. They may just be usi different utility metrics.

Moreover, even if we knew everyone’s exact utility and could then theoretically maximize welfar there would still be an ethical problem because the distribution that would generate the highest sum welfare would be such that income is allocated mostly to the individuals who have high utili functions, those that are best in converting given income into utility. This is the idea with whic ~~English economist Francis Edgeworth in the late-nineteenth-century used to defend inequali~~ty: H argued that the richer people with more “refined” tastes deserve higher incomes because they deriv more pleasure from (say) better food or wine. Should a society really be so arranged that it transfe most income to those who can best enjoy it? Should optimal income distribution be such that a fe Epicureans who cannot imagine living without champagne and caviar be funded by people who live o bread alone?

This became the basis of Amartya Sen’s influential critique, known as the “capability approach”: a handicapped person cannot get as much utility from playing a soccer game as a nonhandicappe person, should we give more and more opportunities to the nonhandicapped and fewer and fewer to th handicapped people simply because the latter do not “produce” (for themselves, and thus for societ as much utility? To one’s common sense, this is an abhorrent conclusion. Sen argued that we shoul try instead to equalize the “capabilities” of each to enjoy themselves.[14]

In a nutshell, when it comes to using welfare judgments to rank different social arrangements, w face three options. First, we can treat everybody’s utility function as being the same (which we kno not to be the case in real life), which leads to the maximization of total welfare at the point whe income is divided exactly equally. This is the idea behind Atkinson’s “equally distributed equivale income.” Second, we can try to “seek out” individuals who are more “efficient” generators of utili and give them higher incomes. Or, third, we can do the reverse—give higher incomes precisely t those who, as in Sen’s capability approach, are more challenged in enjoying pleasure from a give bundle of goods and services. This could easily reduce the total welfare measured by some simp summation of individual utilities, and we would no longer need to ground our judgments i welfarism.[15]

A more sophisticated welfarist approach consists of constructing a social welfare function whe the utility of each member is included but there is no summation of utilities, just the depiction o welfare states attained by each individual. In that case we can rank as preferable only the “states of th world” where at least one person is better off and nobody is worse off. Such states of the world satis the so-called Pareto criterion: If we move to them, we can be sure that no one would complain. But th problem with such a requirement is that it is not merely ultraconservative. It is much more than tha It can almost never be found in the real world. Try to think of anything that would satisfy the Paret criterion: Wouldn’t better health care be good for most people? Yes, but some would have to pay mo for insurance, and they would object. Would not a miraculous decision to stop consuming addictiv drugs be good for so many people? Yes, but drug producers and traders (they are as much people a anyone else) would lose, and they would object. Wouldn’t you like to pay lower taxes? Yes, bu somebody’s Social Security check would not be delivered, and he would veto it. And we can go o However hard we try, we may never find a policy that would satisfy the Pareto criterion. It is in effe a prescription for immobility, stagnation, doing nothing, and—most important—keeping power an privilege where they currently are.

Thus, no less than its cruder form, a more sophisticated “welfarism” too is flawed. Both are hobble by the inability to make interpersonal comparisons of utility, and the end result is that they are o extremely limited use for ranking alternative social arrangements.[16] In effect, it is difficult to groun a theory of justice of social arrangements in utilitarianism or welfarism. The great dream of Jerem Bentham and John Stuart Mill, the fathers of utilitarianism, that an “objective” way of comparin different societies had been discovered, is probably dead.

On the ruins of this dream was built the most famous recent attempt to provide some guidance o ~~how to reconcile economic inequality and justice: that of John Rawls, an American politic~~ philosopher. Rawls, in enunciating his celebrated "difference principle" in *A Theory of Justic* published in 1971, argued that the justification for any departure from equality can be found only if is needed to raise the absolute income of the poorest. In other words, the baseline position is that complete economic equality among citizens. Any departure from it needs justification. Rawls *Theory of Justice* radically departed from utilitarianism. He stated it rather unambiguously:

> A rational man would not accept a basic structure merely because it maximized the algebra sum of advantages irrespective of its permanent effects on his own basic rights and interest Thus it seems that the principle of utility is incompatible with the conception of soci cooperation among equals for mutual advantage. It appears to be inconsistent with the idea reciprocity implicit in the notion of a well-ordered society.[17]

Rawls linked inequality and injustice in one brilliant sentence: "Injustice, then, is simp inequalities that are not to the benefit of all" and "in particular to the poor" (as he would add a coup of paragraphs later).[18] Although inequality and injustice thus became inextricably entwined and Raw held that the application of his "difference principle" would lead to a relatively narrow distribution income because many arrangements that privilege the rich are not to the *absolute* advantage of th poor, in principle, the difference principle is compatible with a very wide range of inequali outcomes. It may impose rather strict equality if no increase in the income of the rich is needed advance the incomes of the poor. But it may also allow for a very wide and rising inequality, when additional gains are disproportionately received by the rich, so long as there is some, albeit ve modest, increase in the income of the poor.[19]

**Measurement of inequality.** Economists' infatuation with utilitarianism has affected, although rath indirectly, another area that has to do with economic inequality: its measurement. The measureme of economic inequality started as a simple axiomatic-based task of devising a reasonable rod by whic the inequality of an entire distribution could be summarized in one number. The key axioms are easi understandable. For example, if there is a transfer of income from a richer to a poorer individual an nothing else changes,[20] the measure of inequality should go down; if two people swap positions, th measure should not change (this is known as the anonymity principle); if all incomes are multiplie by a constant, the measure should not change; and so forth.[21] As such, measurement was purely technical issue, no different from the measurement of temperature. However, the dominant welfari approach preferred to see these measures as expressing some deeper social welfare-based idea. Th difficulties of welfarism are apparent if we, for example, consider the just defined, and ve reasonable, anonymity principle. To couch that simple technical requirement in welfarism one mu accept the utterly unrealistic notion that all individuals share the same utility function. If they do no then, from the point of view of utility generation, any two individuals cannot be the same: One, a hig utility-generation machine, cannot be easily substituted by a more lethargic "utility-challenge person.

The tension between an axiom-based measurement of inequality and its welfarist interpretation w apparent from the beginning. Italian economist and statistician Corrado Gini, who developed (as w shall see) the most popular measure of inequality, expressed this dilemma as early as 1921:

> The methods of Italian [anti-welfarist] writers ... are not ... comparable to Dalton's [an Englis