ECONOMIC GROWTH AND EQUITY:
COMPLEMENTS OR OPPOSITES?

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There is no automatic mechanism in a market economy to guarantee reduced inequality of income with growth. Some theories lead us to expect just the opposite. At best, there are self-limiting cyclical effects, associated with changes in unemployment. U.S. economic growth has actually been quite slow since the 1950s. Besides, there are structural barriers to reduced inequality that operate with or without growth. Historical evidence for different countries presents a mixed picture. For the U.S. economy, postwar growth has been associated with an upturn in measured inequality. Government intervention has been mildly equalizing, through transfers and expenditures but not through taxes.

TRICKLE DOWN OR NOT AT ALL: IS THAT THE QUESTION?

According to the “trickle down” idea currently in vogue, economic growth and improved equity in income distribution are somehow interlinked. Growth itself generates opportunities for lifting up the bottom end of the income distribution, it is said. Moreover, according to this view, there are possibilities for the adoption of redistributive policies in the context of a growing economy that would not exist or would be harder to implement in a stagnant economy.

What are we to make of this idea? I suppose its appeal lies in two notions. One is the commonsense notion that it is easier to change the way the pie is divided if the size of the pie itself is increasing. In this guise, its appeal comes from the suggestion that there is, after all, a relatively painless way of getting redistribution when the possibility exists of an overall improvement for everyone. Otherwise, it may be necessary to take from some and give to others, and that would be both intolerable and reprehensible!
Second, economists themselves are led into the trap of this way of thinking by the neoclassical theorems on Pareto Optimality. Based on the criteria of these theorems, a superior state of the economy is one that makes at least someone better off with no one worse off, or allows the gainers to compensate the losers and still come out ahead. It is but a small step from this to the presumption that growth of income is a pre-condition for redistribution of income. One ends up, then, with the essentially conservative position that, in the absence of growth, the existing state of affairs is the best of all possible worlds.

Whatever its guise, this idea may be a very comforting one for those who are already well off. But to the poor, underprivileged, and powerless it must seem rather perverse and cynical. This consideration alone should inform us, as the theorists of economic welfare should already know, that the real issue concerns the very nature of the social welfare function itself by which a superior allocation is to be judged. In particular, whose votes (preferences) are to count, and with what weights? That is the question—and essentially a political one at that.

SOME ANALYTICAL ISSUES

The trouble with the trickle down idea, as appealing as it may appear, is that it is both analytically invalid and historically incorrect. The reasons are many and complex, and I shall skip the technicalities here.

Considering first the analytical issues, it may be said that, in general, in the context of capitalist economies working under the customary rules of the game, there is no automatic mechanism to guarantee that there will be redistribution of income with growth—even in the frictionless competitive world of the textbooks. In that world, everything depends on initial endowments, technology, and the composition of demand. Those who happen to have the "right" set of endowments are duly rewarded by changes in technology and demand. Those who do not will find their position eroded. These effects are compounded by pervasive externalities and well-known market failures of various sorts. Thus, left to its own, the rule of the market is: "Them that's got shall get, them that's not shall lose." There is no a priori reason to suppose that the market will redistribute income to the poor just because the economy grows.

Some theories would lead us to expect just the opposite—that is, that a higher growth rate is necessarily associated with increased inequality. This situation comes about because of two possible effects, depending on