Review

Economic Growth and Inequality: The Economists' Dilemma by Laurent Dobuzinskis

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Laurent Dobuzinskis' *Economic Growth and Inequality* discusses the varied interfaces between inequality and economic growth. It is designed to complement his *Moral Discourse in the History of Economic Thought* (Dobuzinskis 2022), which traces economists' explicit and implicit normative foundations going back to Adam Smith's (1759) *Theory of Moral Sentiments*. However dispassionate our aspirations as social scientists, positive economics often conceals systematic moral and ideological tendencies, if only in the choice of subjects for examination. Surely any part of a more encompassing and valid positive economics calls for making these biases more explicit, the better to understand and criticize them. As Dobuzinskis notes, when it comes to growth and inequality, there are so many perspectives on these two interrelated topics—perspectives as diverse as they are passionately held—that researchers and policy analysts need help disentangling them both to evaluate policy proposals and assess the philosophical perspectives they derive from.

Dobuzinskis highlights the perennial research questions of whether equality and growth are correlated at all, is the correlation positive or negative, when and where, under which historical conditions and institutional arrangements, etc. These are all important empirical questions which need to be answered definitively prior to attempting to design policy to promote growth and address inequality. Then there are deeper and perhaps even more important questions of underlying causality. Is growth caused by equality or inequality, to what extent, and under what circumstances? Does growth cause greater inequality? What are the causal mechanisms, and what other factors come into play? Nevertheless, policy is formulated in real time without waiting on research conclusions, and we have an impressive historical record which has yielded results good, bad, and indifferent. We need to evaluate and implement policy now, without waiting for definitive answers in terms of theory. Furthermore, for many, moral-ideological considerations completely override empirical reality. Politicians find it easier to sell voters on an idealized world that should be rather than the mundane, less attractive world that might actually be attainable.

Some economists and political thinkers prioritize equality, others growth; some believe or assume the causality invariably runs from growth to inequality, or from equality to growth, etc. There are also different kinds of equality, from equality of opportunity, equality of initial resources, to equality of outcomes. As Dobuzinskis notes, some forms of equality or redistribution may be more expensive in terms of the potential growth they cost us. Virtually everyone has their own understanding of and preferences about potential tradeoffs between growth and equality, from the two extremes of preferring total equality of wealth, income, and/or status even at the cost of zero economic growth, to emphasizing maximum growth regardless of how much that might contribute to inequality, and everything in between.

The apparent ideal would be redistribution that simultaneously promotes more favorable growth. Purportedly growth-promoting redistributive policies might include guaranteed health-care—since a healthier work force would be more productive, education—providing similar benefits, etc. Whether these public goods would in fact enhance growth and under what circumstances is an empirical question, but Dobuzinskis reviews arguments for and against both views, and evaluates their empirical record. One overriding question that trumps the empirical record for many is whether any inequality at all is permissible, and if so, how much? The innovation and entrepreneurial planning that drives economic growth may inevitably lead to higher income for innovators, and some argue this disparity can be justified by entrepreneurs' contribution to improving efficiency, productivity, want satisfaction, etc., all of which benefit others. Some would argue that these positive externalities can justify some level of inequality. Others condemn growth for its environmental impact and the fear that it may enrich Marxian class enemies.

CHAPTER 1. INTRODUCTION

Dobuzinskis announces at the outset that he will evaluate policy proposals according to the criterion of their not impairing prosperity, implying a pragmatic ideal that favors redistribution that promotes, or at least does not impair, economic progress. Redistribution from the unproductive could be more beneficial than from productive, risk-taking entrepreneurs who likely generate positive externalities. Similarly, redistribution should favor those among the poor who are either productive or potentially productive, though society still needs to protect and support those who are less productive through no fault of their own. Ensuring redistribution focuses on the first groups while not penalizing the second should be a task for tax policy, though curiously that is not something Dobuzinskis emphasizes until the conclusion. The introduction discusses why income inequality has been comparatively neglected up to the 2007-2009 Great Recession, and why it has received renewed attention since then. Pareto's contributions to welfare economics are discussed, along with Stiglitz's conjecture that inequality impairs economic growth. Dobuzinsikis acknowledges Robbins' (1935, 1938) critique of interpersonal utility comparisons, but then follows the lead of modern welfare economics by disregarding it without too much concern. Interpersonal comparisons may be logically impossible, but welfare policy is not always subject to strictly logical tests.

CHAPTER 2. EQUALITY OF WELFARE: THEORETICAL FOUNDATIONS

This chapter outlines a brief but highly informative history of welfare economics, highlighting the contributions of Pigou, whose general view was that economic growth was always beneficial provided it did not make the worst-off in society objectively even worse off. Welfare economics aims to facilitate collective decision making and inform public policy. Anticipating Rawls, Pigou's view was that redistribution aimed at improving the poor's health, education, nutrition, sanitation, etc., was generally beneficial because it also tended to improve worker productivity and thus expand national income. These redistributive public goods, it is argued, provided positive externalities that benefit the wealthy indirectly. Positivist perspectives of Robbins and Arrow that interpersonal utility comparisons were never capable of being operationalized are contrasted with more subjective normative arguments of Davidson (1986), Drakopoulos (1989), and Sen (1995) that these comparisons can be informative in limited contexts, consistently applied, and necessary to implement public policy.

Perhaps the most important distinction in welfare economics is between positive and negative tradeoffs between efficiency and equity. If greater equity can only be purchased at the expense of efficiency and growth, there will be some optimal tradeoff, though each voter's choice of what tradeoff is optimal will be subjective. If greater equality leads to higher growth, and higher economic growth promotes greater equality in turn, there is no tradeoff and the economy ceases to be a zero-sum game. This perhaps elusive ideal is what Dobuzinskis advocates.

CHAPTER 3. EQUALITY OF WELFARE: EMPIRICAL PERSPECTIVES

Dobuzinskis reviews practical measures of income inequality, including the Lorenz curve and the Gini coefficient. The lower the Gini coefficient, the more equally income is distributed. For the U.S. the Gini coefficient is about 40, relatively high among industrialized countries. Newly industrializing and less-developed countries typically have higher Gini coefficients, indicating greater income inequality (Table 1).

Table 1.
Gini coefficients, after taxes & transfers, selected countries

Brazil	0.470
Canada	0.301
Chile	0.460
China	0.514
France	0.301
Germany	0.289
Iceland	0.250
India	0.495
Italy	0.330
Japan	0.334
Mexico	0.418
Russia	0.317
South Africa	0.620
South Korea	0.345
Turkey	0.397
U.S.	0.390
UK	0.366

Source: https://stats.oecd.org/Index.aspx?DataSetCode=IDD (OECD)

A practical demonstration of two different Lorenz curves with equal Gini coefficients but representing dramatically different income distributions is especially informative in illustrating the limits of applied welfare economics (p. 50, fig. 3.3). A discussion of Piketty's analysis of wealth distribution follows. Piketty estimates time series of the capital/income ratio β, hypothesizing that this β ratio converges to the long-run ratio of saving/real output growth. One problem with Piketty's analysis is that he values the return on capital at current market prices but uses inflation-adjusted measures for economic growth, systematically biasing upward his return to capital time series. A further complication comes from the fact that executive compensation is often given in the form of stock options and other forms of incentive pay, blurring the distinction between wages for labor and capital gains.

Piketty views inequality as such a pernicious problem that he is willing to sacrifice growth to eradicate it. However, what if growth lessens inequality, or if certain kinds of growth do? What if inequality lessens growth and removing it would increase growth? The greater the income inequality in a society, the less able the poor are to invest in education and human capital that enhance productivity and output growth, as well as contribute to social mobility. Piketty's proposal is a wealth tax to reverse historical capital accumulation and prevent it from reemerging. The revenue might be used to fund public investment, education programs, R&D, infrastructure, social programs, etc., though this spending would not be subject to a profit test.

Piketty points to high marginal income tax rates in the U.S. between 1932-1980 as having lowered income inequality but also somehow fueling economic expansion and social programs. As Dobuzinskis notes, in this period corporate executives were able to avoid most of this redistributive tax, with the brunt being borne by artists, entertainers, and professional athletes. Piketty argues that a high tax on capital would incentivize the rich to be more productive. Any tax on capital needs to be universal to avoid capital flight to tax havens. Piketty's critics attack his data, analysis, and policy recommendations. In fact, the empirical case for Piketty's claim that income inequality is rising is far more questionable than Dobuzinskis realized (Magness 2019; Auten and Splinter 2020; Geloso et al. 2022), though he does not uncritically accept Piketty's data (p. 64).

Executive compensation has contributed to U.S. income inequality since at least 1970. However, once adjusted for taxes and government transfers, U.S. income shares have been relatively stable from 1960-2015 (Figure 1). The progressive income tax and some government transfers lower disposable income for the highest-earning and raise it for the lowest-earning. If no adjustment is made for taxes and transfers, the income share for the highest 1% of the population appears to be rising from roughly 1985-2015, but when taxes and transfers are correctly accounted for, the highest 1%'s income share appears not to have increased very much, if at all. Income shares have been relatively stable for most industrialized economies since approximately 1900. The U.S. depends more on a progressive income tax and less on regressive sales taxes. Since the progressive income tax has the most pronounced redistributive effect, the need to adjust income distribution data for taxes and transfers is especially great for the U.S., where failure to make this adjustment introduces the greatest bias.

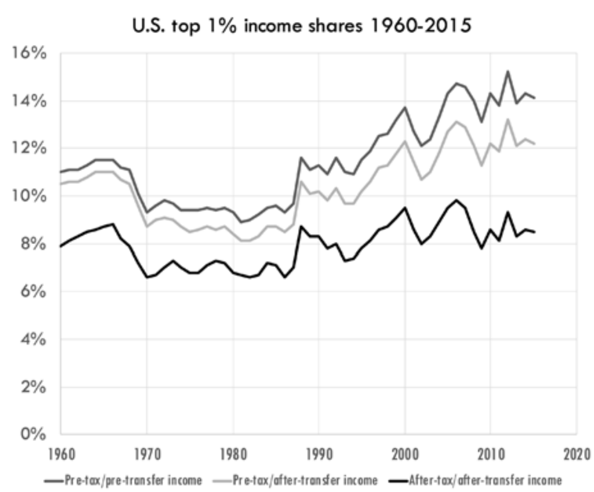

Figure 1. U.S. Top-1% Income Shares 1960-2015
Adjusted for Taxes and Transfer Payments

Source: U.S. Treasury data in the public domain.
http://www.davidsplinter.com/AutenSplinter-TopIncomes-Oxford.pdf

One source of Piketty's overstating wealth accumulation and inequality is that he constructed his capital series based on gross investment without adjusting for depreciation. Piketty's conclusion that inequality is inevitable because the return on capital strictly exceeds national economic growth rates is not well founded. It may be true for some investments but certainly is not globally true, or even true on average. Piketty assumes that the elasticity of substitution between labor and capital is one or greater, meaning any increases in wages contribute to capital appreciation. Recent surveys of gross elasticity suggest it is closer to ½ (Chirinko 2008). Since gross investment is strictly greater than net investment, the net elasticity must be lower than gross.

In the U.S., the 2010 share of non-housing capital was less than in 1950 (p. 65). Housing appreciation has chiefly benefitted the middle class but has also been aggravated by land use regulation which discourages further development and construction, benefitting home owners but making first homes less affordable. Income inequality comes chiefly from labor market conditions, having little to do with Piketty's claim that the return on capital is systematically higher than overall economic growth, measured by his spurious (r – g) difference (Rognlie 2015), regardless of whether Piketty measured these quantities correctly. Subjective welfare depends more on one's relative income and perceived status compared with others, so the focus on redistribution may be misplaced.

Labor markets are segmented because the division of labor results in such an extreme level of specialization in an advanced economy that most workers are not easily substitutable—we cannot substitute neurosurgeons for anesthesiologists, railroad engineers for airline pilots, coding specialists in one language for those in another, plumbers for electricians, etc. The more dependent income is on the specialized technical knowledge or other individual characteristics, the less workers compete with each other, though this particularly applies to the highest compensated executives.

U.S. executive compensation has risen faster than executive productivity, rising almost three times as much as corporate earnings from 1980 to 2004—8.5% annual CEO compensation growth compared with annual corporate earnings growth of only 2.9% (Bebchuk and Grinstein 2005). On the eve of the 2007-2009 Great Recession, S&P 500 CEOs received average annual compensation of $10.5 million, 344 times the pay of the average American workers; however, this ratio had fallen from 2000, when their pay averaged 525 times that of average workers (Bogle 2008).

However, U.S. CEO pay is highly correlated with stock market performance, and American executives provide consistently higher shareholder returns, largely justifying their compensation. CEO performance added $21-25 billion in market capitalization to the largest one thousand U.S. corporations in 2004 but they captured only about $4 billion in higher compensation—accounting for only about 15-20% of shareholder value added (Terviö 2008). This may simply result from the U.S.'s more efficient, transparent, and accessible stock market, but also suggests that for all the concern over executive compensation and income inequality, U.S. CEOs overall are fairly competent, add significant value to their organizations (at least in the short run), and are something of a bargain, because they are either unable to capture significant unearned monopoly rents—or perhaps the best CEOs are public spirited and elect not to do so.

CHAPTER 4. EQUALITY OF OPPORTUNITY I: CLASSICAL LIBERAL PERSPECTIVES

The focus of chapter 4 shifts from outcomes to agency. Workers might acquire or develop numerous skills and capabilities that can enhance their income. Though this might still fall short of a distributional ideal, it is clearly beneficial for society to minimize discriminatory barriers that exclude some from opportunities to optimize their own capabilities, talents, income, and fulfillment—if only from an efficiency perspective, enhancing growth along with equity. The justification for negative rights against discriminatory interference with individual choice, agency, and self-determination is traced from antiquity through Enlightenment thinkers like Locke. Although what Diedre McCloskey calls "bourgeois culture" improved both social welfare and income equality, many progressive leftists still view it as anathema. McCloskey (2006, 2010, 2016) argues for an explicitly normative perspective but emphasizes equality of opportunity rather than outcomes.

One argument for redistribution is that it is needed to alleviate wealth concentration, which enables and incentivizes the wealthy to lobby for their preferred policies and support their preferred candidates. Allowing the wealthy disproportionate influence impairs democracy as well as equity. Tullock (1980) and Wagner (2016) among others critique rent seeking and crony capitalism which work against equality of opportunity as well as equality of outcomes or income. Piketty's proposal for wealth taxes would incentivize tax loopholes, tax avoidance, and rent seeking. Piketty fails to observe that inequality of consumption expenditures has fallen (p. 98), although the remaining inequality of total income implies amplified inequalities of saving and capital accumulation—an observation that incidentally supports Piketty's proposal for a confiscatory tax on wealth. Fighting inequality would likely disincentivize entrepreneurs and innovators. How can entrepreneurs be incentivized to take risks without at least the possibility of rewards? Some researchers find that redistribution does not impair productivity (Ostry et al. 2019). Not all property rights improve economic efficiency, for example, intellectual property rights.

CHAPTER 5. EQUALITY OF OPPORTUNITY II: EGALITARIAN PERSPECTIVES

Chapter 5 brings in Rawls' (1971) *Theory of Justice*. Rawls' views evolved to emphasize an equal distribution of primary goods, including opportunity and agency, abandoning his original focus on equality of outcomes, but he is still frequently cited to justify redistributive schemes. Rawls insists that individuals should be free to choose their professions (2001), but elsewhere supports redistribution to benefit the lowest paid. How public policy approaches income inequality depends largely on whether it is viewed as a value-neutral empirical observation or a pernicious outcome of social injustice. The first does not call for a public policy response, but the second does.

Furthermore, the appropriate response should not be aimed at alleviating income inequality per se but must also consider whether the causes are unjust, as only these call for correction through policy, regulation, or legislation—otherwise we are treating the symptom rather than the disease. Income inequality arises naturally because talent, entrepreneurial awareness, aesthetic sensibilities, technical knowledge, physical strength, work ethic, etc., vary naturally from one person to the next. Individuals who possess or acquire abilities enabling them to produce greater value for others should be rewarded for it through free exchange. Apart from the moral dimension of respecting individuals' property in their own persons, accepting some inequality helps incentivize the most productive to benefit others through market exchange.

Many arguments against income inequality fail to consider whether it has arisen through rewarding growth-enhancing productive activities which benefit the whole of society, or from unproductive rent-seeking which diminishes worker productivity and economic growth. Rent-seeking is the pursuit of income based on legal-institutional inefficiencies. One form of rent-seeking occurs when an industry lobbies the government for subsidies, favorable tax treatment, restrictive licensing, or regulation which reduces competition. These measures provide the lobbying organizations additional income without their having to produce any value for society. Rent-seeking shields less productive organizations from competition—x-inefficiency—and enables them to extract higher prices from the public. Rent-seeking organizations also use bribery and political contributions to encourage elected officials to maintain a legal-institutional environment that shields them and their product from competition. Rent-seeking may raise incomes within the organization, but this can only be at the expense of others in society—wiping out the positive externalities of entrepreneurial competition and substituting the negative externalities of regulatory capture.

The possibility of capturing significant additional income through such non-productive activities calls for reform of the perverse legal-institutional environment so that rent-seeking is not rewarded. Invariably, however, the proposed solution to any form of income inequality has been an indiscriminate and highly punitive progressive tax on all income and wealth, regardless of source. Unfortunately, such a broad and indiscriminate tax further diverts resources and talent toward unproductive rent-seeking. Note further that the evidence of income inequality employed to justify such measures generally relies on flawed measures which ignore the impact of taxes and transfer payments. This purported solution of punitive tax policy is always worse than the problem it was designed to solve, imposing greater welfare burdens on the least advantaged.

CHAPTER 6. GROWTH AND (IN)EQUALITY II: WHAT TO DO ABOUT INEQUALITY?

At this point the book's organization becomes somewhat confusing. Chapter 6 is titled Growth and (In)equality II, but there is no chapter or section titled Growth and (In)equality I. The title implies that we are reading the second part of something, but what remains unclear. This section serves as the summary and conclusion.

Education reduces wealth inequality up to a certain point, but after a certain amount of education, further education seems to aggravate inequality. This seems to be because the highest levels of education are primarily acquired only by the already wealthy. There is no discussion of the vast range of returns to higher education by field of study. Graduates with bachelors degrees in accounting, biomedical engineering, nursing, etc., command high salaries and have little difficulty servicing student loans, in contrast with bachelors in journalism, education, psychology, social work, etc.—to some extent these programs are expensive consumption goods, but poor students with these degrees will be saddled with debt they can never repay, and are thereby locked into poverty. It is difficult to argue that these programs contribute to upward social mobility. Another part of the education puzzle is the deemphasis on vocational skills. Society will always need plumbers, electricians, welders, automotive technicians, etc. Education policy is in many ways peripheral to the central topics of the book, but more discussion in this area would add nuance, scope, and relevance to Dobuzinskis' discussion.

This chapter also provides a discussion of tax reform (pp. 172-175). Minimum wage legislation is cited as a viable mechanism raising the incomes of the lowest-paid workers, but workers whose jobs are eliminated and their subsequent unemployment are disregarded. Codetermination, adopted widely in Europe, where worker councils contribute to local management and workers are represented on corporate boards along with shareholders is also discussed. Comparative analysis of corporate governance in different countries is as important as discussions of comparative tax and regulatory policy.

Dobuzinskis' analysis consistently unravels the philosophical and ideological background underlying different positions on growth and inequality. He develops and applies the analytical tools needed to evaluate policy proposals and assess their underlying philosophical bases. The main value of Dobuzinskis' book is its presentation of perennial research questions: are growth and inequality correlated, is the correlation—if any—positive or negative, how does causality run, how consistently, and how can we design effective policy? His discussion of the theoretical background in welfare economics and diverse philosophical perspectives is equally valuable. These questions will remain vitally important whether approached from a positive-empirical perspective or solely based on value preferences.

Dobuzinskis emphasizes potential tradeoffs between growth and equality. He argues for growth-promoting welfare policies that at least potentially could increase national output, in this regard harkening back to Pigou. He reviews pro and con arguments thoroughly and dispassionately, explaining the full range of moral judgements that any policy measure will attract. Dobuzinskis' *Economic Growth and Inequality* presents especially helpful and welcome background, discussion and analysis on topics of continuing importance and relevance, and will prove extremely valuable to researchers and policy analysts.

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