BY ROBERT J. BARR0

DOES AN INCOME GAP PUT A HEX ON GROWTH?

NO LINK: Data from both industrial powers and developing nations show little evidence that income inequality hurts performance

When it comes to promoting economic growth, there are those who favor "hard" policies and those who believe "soft? ones work. The hard group argues for a monetary policy aimed at maintaining price stability. Also central is fiscal restraint-low levels of public expenditure, efficient tax collections, low marginal tax rates, and effective public-debt management. Featured, too, are policies that promote growth through open trade, market-oriented regulations, and laws that preserve property rights and law and order.

The soft-policies group favors the promotion of democracy (political rights and civil liberties), education aimed particularly at women, environmental protection, elimination of income inequality, and promotion of an array of civic organizations, ranging from Boy Scouts to choral societies. For most people, these soft-policy issues represent goals that are desirable in themselves. The contentious issue is whether these policies actually promote economic growth. The recent Nobel prize in economics awarded to my Harvard colleague Amartya Sen for his work in famine was viewed by some as an endorsement of the softer road to economic development.

DUELING THEORIES. One way to test whether the soft touch works is to look at the economic consequences of income inequality. There is substantial research on the subject, including some of my own. Inequality tends to be highest in sub-Saharan Africa, notably South Africa, and in Latin America, including Brazil, Guatemala. Chile, Honduras, Peru, and Colombia. The lowest inequality is in Europe, South Asia, and such parts of East Asia as South Korea, China and Japan. Interestingly, countries with Anglo-Saxon origins-Britain, the U. S., Australia, and New Zealand-once had low levels of inequality similar to Europe, but the income gap has widened over the past 10 to 20 years.

There are many economic theories about how income inequality should affect growth, but they are all over the map. For example, it is supposed to be bad for growth if poor people lack the resources to invest in productive educational opportunities. It should also be bad for growth if the disaffected poor tend to riot or steal. But. on the other hand. inequality may enhance economic growth if concentrated resources are necessary for some investments and if the rich save a higher fracion of their incomes.

The truth is that empirical evidence since 1960 reveals little relationship between the degree of income inequality and economic growth. Some countries with low inequality grew rapidly, such as Japan up to the early 1970s and South Korea and Taiwan over the past 30 years. Others grew slowly, including South Asia since 1960 and most of Europe in recent years. Some places with high inequality grew slowly since 1960, including much of sub-Saharan Africa and Latin America. But some grew quickly, such as Botswana (the star of African growth since 1960), Brazil in the 1960s, and Chile in the past, 10 years.

QUESTIONS FOR EDUCATORS. There is even a little evidence that inequality is harmful for growth in poor countries but conducive to growth in rich countries. That might make a case for income-redistribution policies to promote growth in some poor places. But the same reasoning would argue against policies that counteract the rise in inequality that has occurred in the U.S. since the 1970s.

To add to the complexity, inequality itself appears to evolve as economies grow. In the poorest countries. rising incomes tend initially to widen inequality, probably because only a minority of the population benefits from entrance into modern sectors of production. However, once average income exceeds roughly $2,000 per person, economic progress tends to reduce inequality. The implied inverted-U curve that relates inequality to average income (named for the Nobel-prize-winning economist Simon Kuznets) has also been found to apply to environmental pollution. That is, rising incomes first increase but later decrease the amount of pollution.

Another finding is that primary education lowers inequality, whereas higher education raises it. Thus, a concern for inequality suggests a focus on widespread provision of elementary schooling in developing countries. However, this policy is unlikely to be growth-promoting because the rate of economic growth responds more to education at the secondary and higher levels.

The bottom line: The promotion of economic growth does not provide a great basis for reducing income inequality. The main thing that can be said is that the overall evidence does not reveal any conflict between higher growth and lower inequality.

Robert J. Barro IS a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).

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