

POLITICAL ECONOMY, ECONOMIC POLICIES AND HUMAN INEQUALITIES: BASIS FOR THE AGENDA *

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PROLOGUE: THE KINGDOM, UTOPIAS AND PRESENT REALITY

“Charity never concludes; instead, prophecies shall terminate, and languages shall cease, and science shall end” (1 Cor, 13:8).

Before crossing the threshold of any scientific discipline allow me to enunciate my own values about the issue of inequality, not only for reasons of intellectual honesty, but also to delimit the sense and scope of the contribution of economics to the study of human inequalities. The evident contrasts and tensions between the essential equality of human beings and every kind of inequalities that reality shows, can be considered from a theological point of view, as well as from political utopias and from scientific analysis.

The Mystery and the Kingdom. What is the reason why a given person, with a name and surname, has had or has such opportunities for their earthly life? The very question evokes a mystery that, for those of us who believe in the transcendental destiny of human beings, will only find a full answer in the Kingdom. This transcendental nature of the problem of inequality is not an invitation to resignation but a warning about the magnitude of the task and an appeal to the best in each one of us to contribute to the construction of a more equitable and solidary world, putting into practice the “preferential option for the poor”.

* This paper presents a synthesis of some of the main recent contributions of economics to the study of human inequalities. The most relevant contributions for the design of policies and programs to reduce inequality were chosen. Only survey and reference works were quoted in the bibliography.

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Utopias. The word “inequality” refers at the same time to a utopia, that of equality, and to its obvious irreality. Secular utopias, properly understood, help to outline a horizon; its gradual achievement is one of the principal missions of the art of politics. Modernity has been generous in conceiving utopias. The two most important ones are liberalism and socialism, with their multiple variations. The postmodern scenario of crisis in all grand “societal projects” is fully revealed in the case of socialism. The equalitarian utopia, however, has not died nor will it die. The escalation of liberalism, on its own, already confronts new and greater challenges, the answers to which it will not be able to give by itself.

Both utopias result biased at the time of inspiring “explanations” about the inequalities among human beings, biases to whose elucidation the social doctrine of the Church has contributed a great deal. The different forms of socialism tend to explain all inequalities with reference to the effects of social organization. On the other hand liberalism, and most especially economic liberalism, tends to leave aside the social causes of inequality.

Reality and the Contribution of Science. The analysis of reality performed by the social sciences plays an extremely useful role. They help us to distinguish the inequalities that decidedly belong to the realm of mystery from those that can be conceivably solved; they allow us to identify the determinant factors of inequalities and, in this way, they can grant more consistency to policies and programs that strive for a greater equity. As regards these policies, the contribution of economics is crucial when evaluating their costs and benefits in the short and the long run.

ON THE DETERMINANTS OF ECONOMIC INEQUALITIES²

“The divergence of theories remains as wide as the political ideologies and social philosophies. Yet certain areas of potential convergence can be clearly identified” (Sahota, 1978).

1. *The Long Run: Nations, Economic Growth and Inequalities.* Let us imagine an arrangement of all homes or people of the world according to their 1994 income level, that is to say, the personal distribution of world

² The main current schools of economics have focused their studies on the distribution of income, whether familial or personal and, to a lesser extent, on wealth distribution. Normally, the household income is the object studied while its internal distribution is considered extra-economic. As to the factors determining distribution of income, this brief outline has included not only the individual or familial, most frequently analyzed nowadays, but also the structural and systemic factors.

income. The reading of this chart would show us that the main single determinant of the households' position in this arrangement is the product per capita of their country. The inhabitants of intermediate development countries will appear more heterogeneous than those from wealthy countries and from poor ones. If we were then to compare this distribution of world income in 1994 with that of twenty or thirty years ago, we would discover that the majority of the changes in the level of households' incomes, as well as their intensity, have a direct relationship with the economic growth of their countries.

This simple exercise allows us to understand some of the main conclusions of economics about the relationships between economic growth and the distribution of income. The positive effect of growth on the absolute standard of living is beyond any doubt. Given the fact that growth rates do not depend on the initial level of wealth, the possibility of growth is open to the majority of nations;³ this is clearly shown by the recent experience of East Asia and of some Latin American countries.

In the initial stages of economic growth the income distribution tends to become more unequal⁴ even when the general standard of living is improving. At the national level, this initial impact of inequality may be attenuated with the aid of adequate economic and social policies (UNDP, 1994). On the other hand, economic growth is the only road by which substantially to eradicate absolute poverty and, in the medium run, it is also a sufficient condition to obtain a better distribution of income.⁵ Finally, if we could differentiate rural household from urban ones we would realize that, within each country, poverty is more intense, although not always of greater numerical magnitude, in the rural areas.

2. *The Very Long Run: Economic Inequalities and Modern Institutions Confronted with Other Forms of Domination.* The previous exercise would thus show us that the level of income of each household, in absolute as well as relative terms and whether analysed through static snapshots or

³ The experience of certain African countries in the last twenty years shows that there are cases in which scantiness of resources and the inadequate institutional architecture may make development impossible. The "democratization of economic growth", on the other hand, is a relatively recent but also increasing phenomenon.

⁴ This is the classical hypothesis of Simon Kuznets (1955) on the initial inegalitarian impact of economic growth. This is not surprising since it starts only in some regions or sectors, rather than universally.

⁵ As is shown by the experience of developed countries, economic development has always been accompanied by the development of political and State institutions that, together, resulted in a more equal income distribution.

dynamically, greatly depends on its national particularity. The explanation, of course, is not based on geographical or "racial" factors, but above all on institutions and their history. The modern society organized around political democracy, property rights and markets is, undoubtedly, the fittest known so far for generating economic growth.

Economic inequalities, however intense they may be, have replaced the "non economic" inequalities, still recognizable today, and universal in the past, of human beings divided into "classes" which were considered to be "naturally" different. These ancient types of inequalities were the consequence of forms of domination based purely on brute force or usurpation by a dominant group as in slavery, feudalism, racism or sexism. Institutionalized change in human rights do not appear in the economists' measurements of income or wealth distribution. Thus, according to some authors, the present distribution of the world income among nations might be regarded as even more unequal than that of the eighteenth century — but human rights were at that time just a dream for the majority of people.⁶

3. *Modern Economic Systems, Disorders and Inequalities.* Comparing the distribution of the world income in 1994 with that of 1989 we find that households which have supported the greater impairment in their income level or in their share of global income are those which belong to countries that underwent serious disruption such as war or hyperinflation.⁷

Both peace as opposed to war and the construction and stability of a modern system as opposed to disorder, are necessary conditions in order to make it possible even to consider diminishing economic inequalities. In fact, economic analysis of the factors leading to greater equality normally assumes the existence of economic growth opportunities and a reasonable price stability.⁸

4. *International Economic Relations and Inequalities among Nations.* Economic history has not yet reached sufficient consensus as regards the role played in the past by international economic relations as determinants

⁶ See, for instance, the important study by Fogel (1992). The fact is that slavery was notably widespread and there existed different types of "lords" who had the "natural right" to devote their lives to idleness.

⁷ A different and especially dramatic case of decadence has been observed recently on the occasion of famines in several African countries due to weather conditions but also to social factors.

⁸ This is indirectly shown by the scarcity of empirical studies on the devastating effects of inflation on the distribution of income, in spite of the existing theoretical consensus among economists about the maximum regressiveness represented by the inflationary tax.

of the huge income inequalities among countries. None of the extreme hypotheses are considered satisfactory; neither those that deny any vestige of “exploitation” in such relations nor, even less, those that maintain that international trade and foreign investment were, or still are, mere exploitation.

Recent experience, however, has changed the axis of the old controversy. On the one hand, in the last thirty years, and perhaps for the first time in modern economic history, many and very important “gaps” between poor and rich countries have been reduced.⁹ In the last two decades, on the other hand, some of the middle or lower income countries have had the fastest rates of economic growth. Finally, this growth has been associated with the expansion of world trade and capital flows directed to the so called emerging countries and, in fact, the old “center-periphery” scheme is being replaced by “globalization” and new regional associations.

Beyond what happened in the past, protectionism in general — and agricultural protectionism in particular — appears today as one of the main obstacles to the development of the lower income countries, as well as to the improvement of the standard of living of their poorest sector, the peasants.¹⁰ The equalizing role of free trade is even more crucial in a world characterized by strong restrictions on the free movement of people across national boundaries.¹¹ The developing countries have become aware of this new situation and it is for that reason that today they compete among themselves to attract foreign investment and they have taken upon them the flag of free trade.

5. Inheritance, Environment and the Decisive Importance of the First Years of Life. Another old controversy is that referred to the relative importance of nature versus nurture in determining people’s income. There

⁹ From 1960 to 1990 the gaps between developed and developing countries referred to life expectancy at birth, adults’ literacy, calories consumed, access to drinkable water and mortality of children under five and had shown an average 27% decline. During the same period the gaps in the product per capita, the number of years of school attendance and total enrollment slightly increased (UNDP, 1994). According to other authors, however, the educational gaps have also been reduced (Tilak, 1989). The results were worse for the subgroup of countries with very low incomes.

¹⁰ In the case of those poor countries highly dependent on imports for their food supply, it is clear for economics that the (world) optimum method to help them is through subsidized grants which distort international prices as little as possible.

¹¹ According to standard economic theory, the income level of different countries will tend to be equal in the long run either given perfect international mobility of capital and labor or free trade.

exists a broad consensus today about the greater, however unquantifiable, importance of the social environment even in intelligence formation. But the greatest virtue of this scientific controversy has been to reveal the decisive role of nutrition and stimulation received from the time of conception to, approximately, five years of age in the configuration of the people's "human capital". This is a clear example of the contribution of the social sciences to the design of egalitarian policies.

6. *The Concurrence of Individual and Social Factors.* A third controversy with strong philosophical roots is that referred to the importance of individual versus social factors in the determination of the income of each person or household. Economic analysis has contributed to clarifying this controversy through the elaboration of complex models in which the household's income depends, on the one hand, on the supply or the endowment of resources of each person, whether social in origin (parents' position, capital inheritance) or individual in origin (skills and, in a certain degree, education). At the same time, incomes appear to be determined by demand factors, that is to say, the employment opportunities of personal resources that arise from institutional conditions, economic growth, prices or the level of economic activity. The conclusions, though not yet definitive nor commanding complete consensus, allow us however, to reject both the extreme hypotheses that put aside either factor as irrelevant.¹²

7. *Education and Human Capital.* In this respect, one of the main contributions of economics in the last decades has been the research program concerned with "human capital". Some of its conclusions are the following: a) education, on its broadest definition, is the single most important determinant of the people's income; b) the increase in the average level of education tends to reduce income inequalities, mainly through changes in the occupational structure; c) economic growth simultaneously enables the expansion of education; d) the "accumulation of human capital" explains economic growth itself to a considerable extent.¹³

Most of the studies in mind made reference only to formal education, but there exists a broad consensus that family and also informal education play a decisive role too. Even when education is not the unique determining factor of income level, it has the obvious attraction of being the single most

¹² Thus personalist conceptions of human beings, such as that advocated by the Social Doctrine of the Church, find greater scientific support than the individualist or socialist ones.

¹³ This is one of the main postulates of the new neoclassical models of endogenous growth, inspired to a considerable extent in a pioneering work of Kenneth Arrow (1962).

accepted and also technically most proficient instrument for combating inequality. Economics teaches that the intervention of the State in the provision of educational services is justified because its social benefits are greater than its private ones.

8. *Labor Markets and Employment Opportunities*. Even people from the same country and with the same "human capital" can have, however, substantial income differences. Opportunities are not the same for everybody, among other reasons, because labor markets are segmented, providing better access for those who in one way or another are already incorporated into them, the constituting of a series of "vicious circles". Income differences according to sex are in some cases a typical example of such segmentation. Education itself is also used sometimes more as a discriminatory "credential" than as an inherent indicator of personal skills.

Moreover, there are signs that some national economies may be going through a long term wave of structural unemployment on whose causes, however, there exists no consensus. Many economists agree that the excessive regulation of the labor market (minimum wages, amount and duration of unemployment subsidies, labor costs in general) is one of the causes; they add that these regulations are biased against the very poor. Not a few economists believe that what is most important is not regulation, but modern technology which essentially reduces work. And they add that the problem has its origin in the globalization of the economy and in the impossibility of competing with some of the developing countries, mostly the Asian ones.¹⁴

Linked to these new trends in employment and unemployment is the apparent increase in family income inequalities, observed during the eighties in some industrialized countries. A similar phenomenon, although for different reasons, was observed in those developing countries most affected by the debt crisis. These new trends, if confirmed, would imply a breakdown of the previous, long lasting progress towards more equity. At all events, it is an issue that deserves very careful study and monitoring regarding its causes as well as its eventual remedies.

¹⁴ If this were the case there would be a clear conflict between the unemployed in the countries affected and the workers, probably the poorer, of less developed countries. Anyway, most economists would agree that protectionism would be a bad solution to this conflict, even when it is justified in terms of "social dumping".

ECONOMIC POLICIES AND HUMAN INEQUALITIES

“Is it possible to design a distribution in which no household is either very poor or very rich, yet which still allows for differentials that promote intense effort and encourage the kind of occupational structure that we would like to see?” (Fogel, 1992).

9. *Macroeconomic Policies.* In any case it seems certain that in some countries there has been an increase in the “natural” unemployment rate (the lowest rate compatible with price stability) and that the degrees of freedom of macroeconomic policy have been significantly reduced.¹⁵ Nowadays it is more difficult than in the past to reach full employment with price stability, and also to eliminate inflation without some extra cost as regards unemployment. Notwithstanding this, most economists, with some disensus, agree that the goal of maintaining price stability must be privileged whilst combating unemployment with instruments such as labor market reform or structural reform of the State.¹⁶

10. *State Intervention, the Public Budget and the Distribution of Income.* To ask what would have been the income distribution in the long run and in the absence of state action lacks counterfactuals and is impossible to answer.¹⁷ Market capitalism and the growth of state participation in the economy have been two very interlinked and typical traits of the development of modern societies in the twentieth century. On the other hand, empirical analysis of the net effect of the public budget (taxes and public expenditures) on people’s income is relatively recent. However, it has been firmly established that throughout the twentieth century, some tax and expenditure combinations have had a clearly equalizing impact on the income distribution. In these cases the poor are generally net receivers of subsidies which amount to a significant proportion of their income, the

¹⁵ The reduction of the degrees of freedom of economic policies has also been caused by the growing globalization of capital markets.

¹⁶ The old consensus about the “Phillips curve” — i.e. the need to accept some more inflation in order to get a lower unemployment rate — is gone. Some economists consider today that this possibility is nonexistent; some others believe that the trade-off is now reversed — more price stability is needed to get lower unemployment; and a third, smaller group, believe that the old curve is still at work, within even narrower margins.

¹⁷ Most of us believe perhaps that the distribution would have been more regressive. But the fact is that societies decided not to wait for this answer. Instead they gave much leeway to state intervention.

richest are net payers while the medium income groups frequently experience a neutral outcome.¹⁸

This historically egalitarian role of the State, however, cannot be generalized to all forms of its intervention in the economy. There are known exceptions, such as defense expenditures. Moreover, the regressive impact of state intervention has also been shown in the collection of the inflationary tax, in the deficit of public companies which are not socially justified, in social expenditures which benefit the medium and higher income groups but which are paid for by everybody and, most especially, in the concession by the state of monopolistic rents to privileged sectors at the expense of social welfare in general. On the other hand, state intervention financed by an excessive level of public borrowing has frequently mortgaged the growth process and the welfare of future generations.¹⁹

11. *The Fiscal Crisis and the Structural Reform of the State.* The crisis of nation States is nowadays evident in many respects, including public finance. In most countries, governments demand more resources that cannot be obtained without affecting growth or price stability. The tax burden is frequently excessive²⁰ and the high level of public borrowing reduces the possibility of increasing employment through fiscal policies. This is the reason why "structural reforms" are considered of great priority.²¹ Together with the liberalization of trade they aim at devolving onto private initiative all state business operations that provide private goods, thus encouraging investment and leaving more resources to the State for the provision of public goods and, what is most important, to making them accessible to everybody.

These reforms, whose progressive impact on the distribution of income in the long run is beyond doubt, are however of great complexity and may entail high transition costs.²² This seems evident in those ex-socialist economies which carried out their "transition to capitalism" without fulfilling the necessary conditions. Holistic reform entailing the co-existence of an effective mechanism for price stabilization, the application of efficient

¹⁸ This conclusion has some limitations because it has not been established in a general equilibrium framework. The neutrality of the net subsidy in the case of middle overall income groups, on the other hand, poses the question about the meaning of this state intervention.

¹⁹ This seems to be the case in some developed countries, not only highly indebted in the present but also on an intertemporal basis.

²⁰ "Excessive" when compared to the level of taxation in competing countries.

²¹ The consensus is more evident among public officials and the multilateral agencies since academic analysis of the structural reform programs has not been so intense.

²² Costs that, anyway, may be lower than those of not carrying out the reforms.

social protection policies and the creation of the conditions for improved international aid are required to temper or eventually avoid the social costs.²³

12. *The Efficiency of Economic and Social Policies and the Crisis of the Welfare State.* It is clear that the structural reforms and the economic policies leading to investment, growth and price stability are the necessary conditions for improving the absolute income of the poorest and also, in the long run, their participation in the global economy. But this is not enough. More specific social and economic policies play an important role in improving equity, and greater goal precision — better targeting — would help to upgrade their efficiency.

Firstly, it would seem not only fairer but also more efficient to give priority to the poorest sectors of society in order to improve distributive equity. This implies an economic and social policy focused on the eradication of structural unemployment and extreme poverty and on the increase of the level of education. In the end, this kind of policy will obtain better results than others which may try to improve distributive equity by means of further rises in progressive taxations or a radical increase in public expenditure, because the risks these entail in terms of growth or price stability.

In the second place, it would seem evident that priority should also be given to the universalization of the people's (and specially children's) access to certain basic goods and services, differing according to the level of each country, such as elementary or high school education, drinkable water and efficient sewage, nutrition and basic health assistance.

It is clear, however, that giving greater priority to the satisfaction of the basic needs of the poor could reduce budgetary resources until now allotted to higher income groups. This reduction could be considerably attenuated if more room for social expenditure were created through the reform of the State. In any case, the crisis of the Welfare State and of its pretence to guarantee everybody's life against risk "from the cradle to the grave" is impossible to deny. Consequently, the issue of the efficiency of public social expenditure becomes one of the most pressing in order to improve equity. To this effect, the design of less bureaucratic welfare systems, based more on individual responsibility and people's participation, will help considerably. This is the case with private pension funds, instead of pay-as-

²³ Unfortunately, technical or political mistakes also matter and should not be confused with the reforms themselves.

you-go social security systems, and of health insurance, housing or education systems with greater freedom of choice.

13. *Reforms in International Economic Relations.* The impact of the efforts carried out to attain growth and more equity in each country would be even greater if they coincided with changes in international economic relations implying, in the first place, free access of producer countries to the markets of developed countries. In the second place, it would be desirable to make more effective progress towards disarmament and the use of the "peace dividend"²⁴ for social programs²⁵ in the context of an increment in the official assistance for development.²⁶ It must be emphasized that the poorest countries have not yet been reached by the current trend toward the "democratization of economic growth". Hence they will need special international aid, perhaps for a long period. This effort should be made conjointly with the much needed improvement in the efficiency of multilateral organizations.

14. *Inequalities and the Will and Quality of Governments.* The efficacy of the economy, nevertheless, will depend to a great extent on the social and political values which surround its development. Thus, for example, we can point out four values characteristic of the "quality" of government which appear very relevant in making the endeavor to attain more equitable societies effective. Honesty, austerity, accountability and the search for common welfare above personal interests help to produce more funds for social programs and a more efficient use of them. In addition they also convey to society the message that the government, even given the limits imposed by the market and the budget, has the real will to attain equity and is doing as much as it can. These qualities of government are even more necessary in the context of structural reforms that intrinsically demand special efforts from many sectors of society.

On the contrary, corruption, ostentation, irresponsibility and particularism, which are unfortunately very frequent nowadays, represent a

²⁴ The United Nations Development Program estimated that between 1987 and 1994 the peace dividend reached 935 billion dollars, but that it was not mainly used to finance better social programs. An annual 3% decrease in military expenditure may free another 460 billion dollars between 1995 and the year 2000 (UNDP, 1994).

²⁵ The UNDP proposal for the World Social Development Summit (Copenhagen, April 1995) establishes attainable goals as regards education, health, nutrition and drinkable water which would cost 35 billion dollars annually in the period 1995-2005.

²⁶ The Official Assistance for Development (OAD) of the OECD countries has remained in about 0.33% of the GNP (Gross National Product), far below the established goal of 1%.

really significant hindrance for pro-equity policies, not only as regards funding, but also in terms of social and political credibility.

15. *Postmodern Culture and the Endeavor to Attain Equity.* The search for a greater equity, however, is not only the responsibility of governments, but of society as a whole and most especially of social leaders. It is worth mentioning, in this connection, that values such as those which enhance the quality of governments are not the prevalent ones in the “post-modern culture” typical of our times. Its excessive emphasis on individualistic consumption and resistance to long term projects, savings, collective action and effort do not create the best environment for good government and for the operation of market economies with a more solidary framework.²⁷ As economists, finally, we also must recognize that if societies are not able unaided to combine the management of the budget and the markets with values of solidarity, then not only equity but also the economic development itself could be jeopardized. In this regard, an important contribution of the Pontifical Academy of Social Sciences (due to the values it endorses and because of its interdisciplinary nature) could be to offer an integrated view of the different aspects of inequalities and of the requirements for attaining a greater equity.

CONCLUDING REMARKS

Purely economic inequalities, however intense they may be, imply a clear progress when compared to any of the previous forms of domination based on brute force or on the division of human beings into classes which are considered “naturally” different. The combination of political democracy and market capitalism is, on the other hand, the most conducive institutional framework (known to date) to promoting economic development and also to facilitating peace. Without economic development it is impossible to eradicate absolute poverty and, in the long run, it is also impossible to introduce more economic equity.

The first impact of economic development, however, generally implies a more regressive income distribution. This negative impact may last a few years or many decades, yet could be avoided if the proper mixture of social institutions and policies were adopted. Historically, societies decided to

²⁷ This assertion does not seek to deny some positive values of postmodern culture, such as pacifism and concern for environment.

cope with this situation by means of very widespread state intervention in the economy. This helped considerably not only in improving the distribution of income, but also in gradually consolidating democracy.

It seems evident, however, that state intervention went too far and that, in the last two decades, this excess played a negative role regarding growth, stability, fiscal solvency and, perhaps, also the equitable distribution of income. Nowadays, the issue is not whether the market on its own can solve economic and social problems. Almost nobody agrees with that. The issue is what sort of state intervention is more equity-prone. The growing consensus is that a complete reorganization of the state is needed in order to transform it in an efficient mechanism for the production of public goods and for the redistribution of income in such a way as to effectively improve the situation of those that really need it. It is not only an issue of privatizing private goods, but also of making more public the real public goods.

This would also imply a radical reform of the Welfare State itself. On the one hand, it needs to give priority to the most efficient policies for eradicating poverty and promoting more equity. Some of these are the expansion of education, policies aimed at improving the living conditions of children under five and a labor reform to overcome labor market segmentation and structural unemployment. On the other hand, the need to develop less bureaucratic welfare policies, based more on individual responsibility, also seems evident.

The end of this century confront us with new and very special challenges. Future prospects for economic development and social progress look very different throughout the world. In the developing and emerging countries which are making comprehensive economic reforms; prospects look more promising than before. For them, and also for their contribution to world development, free trade is crucial. The developed countries now have better prospects with regard to the end of the world recession, but some of them still need an intense reform of the State that will not be easy. Finally, the majority of the ex-socialist countries and of the poorest nations of the world, mostly the African ones, are in such a situation that it makes it advisable to design special international help packages in order to give them the opportunity to participate in world growth prospects.

Without ignoring the seriousness of the challenges we confront in various regions it is very important to learn that any return to the old, well intentioned but basically erroneous policies of excessive public expenditure, intensive state regulation and widespread protectionism would imply a serious historical mistake. The new challenges, beyond any doubt, require new solutions.

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