

Inequality and the Process of Development

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 - ⇒ enhances the development process

The Neoclassical Paradigm

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The Modern Perspective: Origins

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Underlined the adverse effect of Inequality on the growth process

The Credit Market Imperfections Approach: Assumptions

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 - Differences in the interest rates for borrowers and lenders
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- Fixed investment cost in education or in other individual-specific projects
or
- Saving and bequest rates are increasing function of wealth (Moav, (2002) Galor and Moav (2004))

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- The human capital channel is consistent with evidence (Perotti (1996))

The Political Economy Approach

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Echoes the hypothesis of the CMI Approach

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 - Efficient redistribution policies are not implemented

Benabou, (2000), Galor-Moav-Vollrath (2009)

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⇒ slows the growth process

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Galor and Moav (2004):

- Captures the changing role of inequality in the growth process
- Unifies the Classical and the Modern Paradigms
- Provides an intertemporal reconciliation between conflicting viewpoints about the effect of inequality on economic growth
- Underlines the role of inequality in triggering socio-political transition (Galor-Moav-Vollrath (2009), Galor-Moav (2006))

A Unified Theory of Inequality and Development

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- Early stages of industrialization: physical capital accumulation is a main engine of growth \implies
 - Inequality enhanced development by channeling resources towards individuals whose marginal propensity to save is higher
- Later stages of development: the return to human capital increases due to capital-skill complementarity and human capital became the prime engine of growth \implies
 - Inequality, due to credit constraints, is harmful for growth

Central Argument

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 - Physiological constraints subjects its accumulation *at the individual level* to diminishing returns
 - The accumulation of human capital would be larger if it would be widely distributed among individuals in society
- Physical capital is not embodied in humans \implies
 - Physical capital accumulation may benefit from the concentration of wealth among individuals whose marginal propensity to save is larger

Inequality and Physical and Human Capital Accumulation

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- **Inequality** is conducive for **physical capital** accumulation, as long as the marginal propensity to save rises with income

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- **Inequality** is conducive for **physical capital** accumulation, as long as the marginal propensity to save rises with income
- **Inequality** is harmful for **human capital** accumulation, as long as credit constraints are binding

Inequality and Growth in Different Stages of Development

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- **Inequality** stimulates economic growth in stages of development in which **physical capital** accumulation is the prime engine of growth
- **Inequality** is harmful for economic growth in stages of development in which **human capital** accumulation is the prime engine of economic growth and credit constraints are still binding