ON THE RICH GETTING RICHER AND THE POOR GETTING POORER

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I. INTRODUCTION

The politics of equalization has come to the fore in the recent years. The politics of equalization—through taxation, redistribution, and regulation—reflects basically four kinds of beliefs: (1) the belief that the observed degree of inequality in income and wealth distribution is not acceptable, (2) the belief that much of the income and wealth of the rich is undeserving, (3) the belief that one's gain is necessarily at the expense of another, and (4) the belief that there is a tendency for "the rich to get richer and the poor to get poorer", (RGR, hereafter.) Of these four, (1) and (2), being in the realm of preference and justice, fall largely out of economics. The fallacy of (3) has been fully exposed by economics. However, even as (4) has gained popularity with potentially grievous consequences and it pertains to the subject matter of economics more than any other elements of the politics of equalization, viz., the process of income and wealth generation and distribution, it has been little examined. Therefore, this paper aims to evaluate its validity.

Recently, frequent references have been made to the idea of RGR. Presumably, the deeply held belief has been rekindled by the income statistics of the 1980s and the early 1990s. That a large and growing proportion of the population has come to believe that the system is rigged against them is significant in itself. Many who believe that the notion of RGR is valid beyond doubt, may feel compelled to advocate measures to counter the systemic tendency for greater polarization, (knowing full well that even the most draconian, and repulsive, measures have not in the past succeeded in equalizing income or wealth.) The consequence of such measures, however, will have significant impacts on our lives—lessening individual liberty, a less dynamic economy, and reduced social mobility across social strata. Therefore, the growing perception that RGR deserves a close study as for its verity.

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Yet, this widely held belief is seldom examined, perhaps because so many people are convinced of the fact that few have bothered to examine its validity. To many, it sounds too obvious to bother to think over. For example, Paul Krugman (1996, p. 47) is so convinced of the idea that he suspects anyone who proposes to critically evaluate the validity of the common inference of RGR from the statistics as "hired guns of the right." But in reality, the process of income and wealth generation is far from well understood. Krugman himself admits the process is not well understood.

The aim of the paper is to fill this lacuna by analyzing the processes of wealth and income creation and distribution, with the aim of evaluating the validity of the idea of RGR. As I consider entrepreneurship as the most important factor in the process of creating and destroying wealth, and therefore of, economic mobility, the paper is a contribution to a theory of entrepreneurship, as well.

The outline of the paper is as follows: In the next section, I will briefly review the arguments supporting the idea of RGR. It will be followed by a section in which I will argue that there is much contrary evidence, and, most importantly, the implications of the idea of RGR are not at all borne out by evidence. I end the section by concluding that the notion of RGR is based on a deficient understanding of the economic processes by which income and wealth are generated, viz., entrepreneurship. The following section spells out in detail how the entrepreneur creates and destroys wealth. The main thesis of the section is that as entrepreneurship is not based on ownership of assets, but on the discovery of profitable opportunities and that, therefore, the rich do not have an advantage. Furthermore, what advantage the rich may have by greater ownership of assets, can be more than off-set by their tendency to adhere to the proven way of doing business. I end the paper with a consideration on the policy implication of the argument in the preceding sections.

II. ARGUMENTS FOR RGR

The idea of RGR reflects the perceived processes of income and wealth distribution / generation where the rich have inherent advantages over the poor. Surely, one can easily think of many advantages of the rich over the poor. Broadly interpreted, "the rich" may stand for any possession, (e.g., strength, size, beauty, family connections, intelligence, etc.), that is supposed to render an advantage and "the poor", a lack thereof. As such, the popular perception is often interpreted as a valid description of the distributive tendency not only of personal income and wealth, but of the fortunes of firms, regions, nations, etc., as well. Let us briefly consider a few arguments commonly advanced in support of the popular belief.

It must be noted at the outset that, traditionally, economists have not had much to say directly about the *processes* of wealth and income generation. It is because the economic theory is primarily concerned with static equilibrium and the bulk of economic research in the relevant area is devoted to the analysis of the functional division of social output among the factors of production and statistical explanations of the patterns of income distribution. [1] Yet, most of what economists have said does not appear to be inconsistent with the idea of RGR. The reason is that economic theory views income distribution as a by-product of economic activities of transforming given resources into goods through known methods of production or trade. Under this situation, one cannot imagine a case where a man with less resources ever doing better than another man with more resources. The poor may attempt to improve his lot by acquiring skills or education; but the rich can do better, given his better ability to finance! Only luck could bring about a change in one's relative standing on the income ladder. Therefore, the majority of economists do not voice objection, and even appear to agree with the idea of RGR when they admit that there is a trade-off between prosperity and equality.

Recently, however, arguments intended to provide a more direct support for the idea of RGR have appeared. Frank and Cook (1995), for example, argue that in the modern economy there is a pronounced tendency of RGR. Their argument is based on the perceived tendency of presumably small differences in ability (and resources) to be translated into large differences in income (and wealth) in modern economics.[2] They portray the process of income and wealth distribution in modern society as "the winner-take-all-society". They further observe that there is widespread tendency of "those-near-the-top-get-a-disproportionate-share"(3) and those who are only slightly inferior in ability fail miserably. They see the tendency not only in art and entertainment (actors, singers, fashion models, sport players, books, etc.), but also in law, business, technology, investment, academia, and even in lowly entry level white color jobs. In short, they see the real source of rising inequality in the spread of the "winner-take-all-markets."(98)

For Frank and Cook, not only does the "winner-take-all-society" mean growing inequality, but inefficiency as well. They reason that as more and more people compete to acquire the desired attributes, people end up overinvesting in them. The market, in other words, has become inequitable and inefficient. As they see no trade-off between efficiency and equity, they propose certain reforms such as taxing the rich and regulating the market to reduce the *wasteful competition*. The result they anticipate is more equitable distribution and greater efficiency!

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[1] See Sahota (1978) for a survey of literature.

[2] Earlier, Alfred Marshall commented on the phenomena as a by product of the expansion of the market, which reflects improvements in transportation and communication. Since then, others, e.g., Rosen (1982) and Adler (1985), have formalized the idea.

A more traditional argument for RGR is based on two considerations: (1)differential savings rate across different income strata, and (2)the "law of compounding interest". The argument runs as follows: The rich have a higher savings rate than the poor, the poorest saving virtually nothing. Given this, it is inevitable that the wealth of the rich will grow at a higher rate, even if everyone earned the same rate of return on their savings. Accordingly, wealth will increasingly concentrate in the hand of the rich, and the gap between the rich and the poor will grow.[3]

There have been other arguments that can be, (and have been) interpreted as supporting the thesis of RGR. For example, earlier, the sociologist Robert Merton (1968) described the process of cumulative advantage in science as “the Matthew effect”, after the passage in the New Testament: “for unto everyone that hath shall be given, and he shall have abundance: but from him that hath not shall be taken away even that which he hath.” The Matthew effect is meant as a generalization of findings in the sociology of science where “eminent scientists get disproportionately greater credit for their contributions to science while relatively unknown scientists tend to get disproportionately little credit for comparable contributions” both in case of collaboration and independent multiple discoveries.[4] Merton speculated that the Matthew effect will become more pronounced as “little science give way to big science”, which relies on expensive equipment, resulting in the concentration of resources and talents around eminent scientists in elite institutions.

A similar idea was also expressed by Schumpeter (1975), who argued that, in the context of industries, large firms have advantages in technological innovation and there would be an increasing concentration of wealth. His argument is something like this: As an economy develops through increasing specialization, research necessary for modern industrial innovations become a specialization as well. Large firms, especially those that attained the dominant positions in their respective industry and enjoy above average profit, will be able to invest more in research and therefore innovate better. Using their wealth, large firms can nip the bud of what challenges small or medium-sized firms might pose. In the end, wealth will become concentrated in a “small number of bureaucratized corporations.”[5] Schumpeter’s idea of increasing concentration of industries is a variation of the idea of RGR.

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[3] Inhaber and Carroll (1992).

[4] Eminent scientists, for example the Nobel Laureates interviewed by Harriet Zuckerman, who benefit from the process themselves appear to view it as basically unjust. (Merton 1968, pp. 58-9)

[5] Schumpeter (1975, p. 219)

III. EVIDENCE AGAINST RGR

Surely, one can easily think of many advantages of the rich over the poor. That is why many people find the idea of RGR so plausible in the first place. But can it be truly the dominant feature of the process of generating income and wealth in a market economy? I do not think so. I believe that the advantage of the rich is more pronounced in the short run. After all, in the extremely short run, it is definitional—the rich have and the poor don't.

In a longer run, however, the putative advantage of the rich and disadvantages of the poor becomes less clear. I shall argue subsequently, that there are other more important factors than the ownership of currently valued assets in determining income and wealth in the future. In this section, we will examine whether the implications of the popular perception of RGR is borne out by experience. I present some contrary evidences.

The process of income distribution, in the context of our discussion, has three possibilities: (1)The income of the rich grows, on the average, at a higher rate than the income of the poor, or (2)The income of the rich and the poor grow at the same rate, or (3)The income of the poor grows at a higher rate than the income of the rich. When people observe that there is a tendency for the rich to get richer and the poor to get poorer, they clearly cannot mean (3). They probably do not even mean (2). For in this case, the relative position of the rich and the poor is not altered, though the absolute amount gained by the rich is greater than that by the poor. To characterize this as the rich getting richer is to commit a conceptual confusion. For then, one employs the distinction of the rich and poor, which is a relative concept, and at the same time the income gap over time is measured using an absolute scale. Only (1) is unambiguously consistent with the notion of RGR. Probably, this is what people have in mind when they utter RGR.[6]

Now, if it were true that RGR in the sense of (1), we should observe little mobility and increasing polarization of income and wealth distribution over time.[7] While the future is yet to be seen, historical records counsel us to be more cautious in our projections. For we observe the contrary: (a) much mobility

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[6] Even this has two possible versions: (1) $[\Delta W/W]_{rich} > [\Delta W/W]_{poor} > 0$; and (2) $[\Delta W/W]_{rich} > 0 > [\Delta W/W]_{poor}$. In light of the phenomenal increase in the standard of living in the recent centuries, one cannot seriously argue for the latter version.

[7] See Inhaber and Carroll (1992) for a numerical illustration. However, by only calculating for so many years, and not more, they fail to see the unreality of the eventual implication of extreme polarization. Krugman (1996, p. 49) is more prosaic: "…it does not take much imagination to envision what our society will be like if this process [of RGR] continues for another 15 or 20 years…. [It will be a state]... in which a few people live in luxury while the majority grovel in Third World living standards."

and (b) a relatively stable pattern of income and wealth distribution, (especially after allowing for changes in demography, institutions, industrial structure, etc.) Let me explain them in turn.

1. Relative stability of the patterns of income distribution: The implied extreme polarization of wealth distribution is not consistent with the evidence. According to economic historians, the pattern of American male earnings distribution in the last 150 years is "marked by long periods of relative stability and shorter periods of substantial change."[8] The pattern of income distribution in the period between the end of the Civil War and World War I was stable. Inequality declined sharply during and immediately after World War I, but gradually increased to the pre-World War I level by 1929. From the beginning of the Great Depression to 1949, inequality declined sharply but from 1950 it remained stable for nearly 30 years. From a historical perspective we should conclude that the degree of inequality, has, through minor ups and downs, remained rather stable. In fact, the pattern of income distribution does not vary much across ages and across different economic systems.[9]

What about more recent trends in income distribution? Though the increasing inequality in the 1980s has drawn much attention, many economists believe that much has to do with changes in demography, labor market conditions, and industrial structure. Economists who have investigated into this issue of great popular concern have generally concluded that since 1979 there has been growing inequality. But what we are to make of the fact is open to many suggestions. Based on evidence available, Levy and Murnane (1992, pp. 1340-1341) conclude that "the growing inequality" between groups is largely attributable to "the plight of young, less educated workers" which reflect the shifts in the demand and supply of labor. The supply of young and less educated males increased (relative to the more educated), reflecting a low premium on education during the preceding decades. At the same time, the demand for the less educated male labor declined in the 1980s when the strengthening of the dollar accelerated restructuring of industries and increased industrial migration to high tech/ service industries and the relocation of manufacturing to overseas.[10] Ergo, the plight of young and less educated males which shows up as growing inequality. Greenwood (1997) wonders whether the observed growing inequality is

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[8] Levy and Murnane (1992, p. 1340).

[9] International (as well as intertemporal) comparison of income dispersion is difficult because of data incompatibility. But according to Atkinson (1975, p. 27), Lydall (1968) found that that "within the group of industrialized countries the degree of dispersion is broadly the same," despite differences in economic structures. Inhaber and Carroll (1992, p.2) speak of the "natural laws" of income distribution in the sense that all income distribution is lognormal with a Pareto tail.

[10] Another factor is the increased competition in the labor market brought about by women, who had marked gains during the period under consideration.

but a reflection of radical shifts in technology, as in the Industrial Revolution. Whatever the cause, there is no good ground to project the recent trend into the future.

2. Mobility: The implied lack of mobility is also contrary to the evidence. For example, the Treasury Department data based on the US income tax returns show a high degree of mobility. Frenze reports a high degree of income mobility in the US based on the US Department of Treasury's tabulation of income tax returns filed in 1979 and 1988.

Table 1

1979 Quintile	Percent in Quintile in 1979	Percent in each Quintile in 1988 1st	2nd	3rd	4th	5th
1st	100%	14.2	20.7	25.0	25.3	14.7
2nd	100%	10.9	29.0	29.6	19.5	11.1
3rd	100%	5.7	14.0	33.0	32.3	15.0
4th	100%	3.1	9.3	14.8	37.5	35.4
5th	100%	1.1	4.4	9.4	20.3	64.7

Source: Frenze (1996)

The information does not distinguish between the change in the location of income distribution through life-cycle and the change through what may be called genuine mobility. But the degree of mobility is striking. For example, 85.8% of the poorest 20% of those who filed income tax returns in 1979 improved their situation in 1988, 40% finding themselves among the richest 40%. Also noticeable is the fact that the chance of someone in the poorest 20% in 1979 remaining, after nine years, in the same station is just as great as him or her joining the rank of the richest 20%.[11] In an earlier study Duncan (1984) also showed substantial mobility and observed that only about 2.6% of the population appeared to be chronically poor.

Some people might argue that anything short of equality between the probability of the poor becoming rich and the probability of the rich becoming poor, is not mobile enough. Foreigners, however, are often

[11] Cox and Alm (1995, p. 8) cites even more impressive degree of mobility between 1975 and 1991 based on the University of Michigan's Panel Survey of Income Dynamics.

struck by the frequency of people of relatively humble backgrounds in the top echelons in the US—in arts, academia, government, and business.[12]

Another indication of the degree of mobility at the very top of the wealth scale can be seen from the following tables complied from "The Forbes Four Hundred."[13] First, let us consider the ten richest people in 1983 and their subsequent standing in 1989 and 1995.

Table 2

	1983 Rank	1989	1995
G. P. Getty	1	46	39
S. M. Walton	2	17	8*
D. K. Ludwig	3	119	N/A
D. Packard	4	14	11
A. Wang	5	---	N/A
N.B. Hunt	6	N/A	N/A
C. R. Hunt	7	69	202
H.R. Perot	8	8	22
M. Hunt Hill	9	47	57
George Mitchell	10	110	190

Source: Forbes, various years. The symbol * means that the ranking is based the combined inheritances of Walton fortune among 5 heirs. N/A means that the person is not listed among the 400 richest. It could be death or it could a drastic diminution of fortune.

We see that only one of the ten richest in 1983 stayed that way in 1989, and none did so by 1995. The Sam Walton fortune is ranked 8th in 1995 only by combining the inheritances of 5 heirs. The An Wang fortune sank from 5th in 1983 to outside the richest 400 in 1989 even before his death.

Now let us consider the ten richest people in 1995 and see what their standings were in 1989 and 1983. We see that only one of the ten richest people in 1995 was ranked so in 1983. (Again, it is the sum of the 5-way inheritance of Sam Walton's fortune.) Only twelve years before, five out of the ten were not even ranked among the richest 400! Gates, Allen and Ellison truly had a meteoric rise of fortunes.[14]

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[12] Peter Bauer (1981, pp.26-39) observes much mobility in the U.K., which many presume to have a rigid class structure.

[13] We duly acknowledge problems involved in the estimation on the part of *Forbes*, having to do with much guesswork.

[14] Hacker (1997, pp. 89-99) makes a similar point.

Table 3

	1983	1989	1995
W. H. Gates III	N/A	43	1
W. E Buffett	31	2	2
J. W. Kluge	100	1	3
P. G. Allen	N/A	86	4
S. M. Redstone	N/A	3	5
R. M. DeVos and J. Van Andel	102	268	6
S. I. and D. E Newhouse	19	6	7
Waltons	2	17	8
R. O. Perelman	N/A	5	9
L. J. Ellison	N/A	98	10

Obviously, the rich (which can stand for smart, good family background, good looks, athletic ability, good grooming or schooling, or whatever else is valued) do not always stay on top. Many sink and get replaced by the poor (which can stand for not-so-bright, late bloomers, humble background, plain or positively bad look, ordinary, and bad or little grooming or schooling, etc.). In fact, few heirs of great fortunes of the roaring 20s are still counted among the richest. Many cannot even afford to maintain the mansions their grandparents left behind and have resorted to opening them as museums or even inns to finance maintenance costs, (that is, of course, if the mansions have not already been sold off to finance the profligacy of the heirs.)[15]

Of course, there are Rockefellers, DuPonts, and Mellons who have more carefully husbanded their inheritances and remain among the richest.[16] However, their fortunes pale compared to the newly found fortunes of Bill Gates, Warren Buffett, and the like.

A similar kind of observation can be made about the list of Fortune 500 companies. We do not see one firm monopolizing the whole economy, not even an industry. The would-be monopolist is constantly challenged or by-passed. Daily, we see dominant firms are challenged and supplanted by more nimble rivals, many of which are start-up firms, even in industries that are characterized by intense research and development. For example, IBM, after spending multi-billion dollars on R and D year after year, hiring

[15] In an extreme case, an elderly gentleman was evicted from his Manhattan apartment for being in arrears for maintenance fees, the very gentle man who in his youth some fifty years ago, as the sole heir to the A and P fortune, was counted among the very richest.

[16] Frequently, each such fortune is shared, in three or four generations, by hundreds of heirs.

people with some of the best credentials has been challenged by rag-tag armies many of whose leaders include college drop-outs. Many great firms have sunk into obscurity (or even gone bankrupt) while others have risen to dominance from obscurity (and sometimes out of nowhere.). From a study of the assets of the 500 largest American industrial firms from 1961 to 1980, Kirchhoff (1994, p. 46) finds that these firms did not increase their share of assets and, more interestingly, that "at least 16 percent of the firms in the Fortune 500 largest category change every two years. Some of the additions to the 500 were firms that formed and grew into the 500 within ten years."

Also, the popular notion that people with better academic credentials have insurmountable advantage over those with lesser credentials in earning income, underlined by Frank and Cook (1995), is of dubious validity. Contrary to the popular view, graduates of elite universities do not earn the most, nor do they monopolize the top posts. Of the 1,981 present and former CEOs of Fortune 500 and Service 500 companies survey by *Fortune* magazine, 156 graduated from the Ivy League schools. That is a little over 8%.[17] All the graduates of the schools that produced more than three CEOs--which includes not only Harvard and Yale, but also Xavier, University of Oklahoma, University of Detroit and the like-- add up to 495. That is about 26%! From this, I deduce that the great majority of CEOs of Fortune 500 companies graduated from less well known colleges and universities. In all probability, the academic credentials will be even less impressive if we survey smaller firms, many of which grow much faster than the Fortune 500 firms. Hacker (1997, p. 217) concurs: "…anyone who has attended reunion of Ivy League college graduates cannot help but be struck by how many of these alumni end up with middle class incomes and quite commonplace careers. What is instructive is that so many man and woman from quite modest backgrounds ascend to higher echelons, moving ahead of people who started with more auspicious credentials."[18] Yet, the popular perception is that acquiring the right credentials is crucial.[19]

Based on this evidence, one cannot but wonder whether the perception of RGR is sound. It cannot be. There must be some countervailing forces that counter the perceived tendency of RGR, allowing some of the poor, with all their disadvantages in resources, (e.g., poor manpower, difficulty of raising capital, lack of connections, etc.), somehow to supplant the rich, while many rich, with all their putative advantages, fall from their dominance. If so, to emphasize the idea of RGR at the neglect of the countervailing tendencies that contribute to much mobility and to a skewed but stable overall pattern of income and wealth distribution that we readily observe, therefore, is not only to misrepresent the facts,

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[17] Caminiti (1990, p. 120). This is the very same source Frank and Cook (1995) meant to support their thesis!

[18] See Bauer (1981) for a similar observation about the alleged class rigidity in U.K.

[19] People in academic establishment would have vested interest in perpetuating the misconception.

but to display a profound misunderstanding of the way the economy operates. Let us now examine how this may be the case.

IV. ENTREPRENEURSHIP: PROCESS OF INCOME AND WEALTH GENERATION

The folk wisdom of RGR describes a local and short term trend. It would not be valid to generalize beyond the local ranges for which it is meant.[20]

There are some obvious factors that close off the endless accumulation of rich: (1) As the founder of a fortune passes away his fortune is divided among a growing number of offspring. This makes the shares of each offspring smaller and smaller as generations pass[21]; (2) The wealthy are likely to be the target of fortune hunters, whose main weapon is charm[22]; (3) The wealthy, and especially their heirs, tend to be profligate and concerned with many finer pursuits than making money[23]; and (4) Across generations, fortunes are reduced by inheritance taxes (though there are ways of lessening the impact, as evidenced by the similar patterns of income distribution across countries with varying degrees of progressive taxation.)[24]

But none of these is as significant as **entrepreneurship** that can create and destroy wealth. Entrepreneurship is the most important force that puts a limit to the process of cumulative advantage of

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[20] Writing twenty years later on the topic, indeed, Robert Merton (1988, pp. 609-610 and 618) warned against the temptation to generalize "the Matthew effect" observed in science as the law of the processes of distributing income and wealth. For in science itself "the Matthew effect" is a short-term phenomenon.

[21] Primogeniture and assortive mating may, in principle, slow the process somewhat. But primogeniture is hardly practiced nowadays and the prevalence of assortive mating is difficult to discern.

[22] Without meaning to imply that any of the people who marry and divorce their wealthy spouses are fortune hunters, the following gives us an indication: Patricia Kluge received a divorce settlement of $1 billion plus a mansion after a nine-year marriage to John W. Kluge and Amy Irving received a divorce settlement of $100 million after a three-and half year marriage to Steven Spielburg. One can go on and on. See Johnston (1996).

[23] In doing so, one should note, they sometimes perform a valuable social function of financing "outrageous" experiments.

[24] Also, considering the fact that the amount of taxes collected from intergenerational transfer of wealth, the major impact of inheritance taxes is rather channeling resources to uses that are less valued than the ones that would have been undertaken without taxes.

the rich, and underlies much of social mobility. The entrepreneur creates wealth by discovering and exploiting profitable opportunities for placing resources at higher valued uses than hitherto thought possible by others. It can also destroy the wealth of those whose fortune is built on the assumption that tomorrow will be like today and that the competition posed by the entrepreneur is unlikely.

The nature of entrepreneurship, however, is not well understood, even by the majority of economists. After looking into the issue, for example, Baumol (1982, p. 30) concludes that entrepreneurship is not subject to systematic principles. A few find it elusive.[25] Demsetz (1982, p. 275) goes so far as to wonder whether it is meaningful to talk about entrepreneurship at all. It is because modern economics adopts the perspective of the economy as allocating given resources to known ends and distributing goods among resource owners according to the productive contribution of the resources that they own. The basic theory of modern economics, perfect competition, takes elaborate steps to establish that there is no profit in competitive markets.[26] (Obviously, there can be no profit in doing what everyone else know about.)

The existing economic theory, along with the popular perception of the rich getting richer, sees the process of income and wealth generation as a race along a known track, as it were. From this perspective, it is obvious that people with more (currently) valued talents and resources for the purpose at hand will have an advantage over others with less. Other than a string of bad luck, or some personal shortcomings such as sloth and debauchery (as in the fable of tortoise and hare), it is difficult to imagine how the rich might ever be outdone by their poor brethren.

However, it would be a serious mistake to think that this—running a race along a known path—is all there is to the processes of wealth and income generation. This perspective ignores the fact that human beings have to act in the face of uncertainty, that the availability and the use of resources are yet to be explored and determined, and that the prospect of profit induces vigorous exploration and experimentation of all manners. People who hold the idea of RGR as valid apparently forget that the way to riches is not only running faster than others along the proven path (where 'the rich' would have an advantage), but also (and often more importantly) in discovering a short-cut (or even a new destination) that others somehow ignore, perhaps because their heart is so set on running as fast as they can along the proven paths. In the later case, in the case of entrepreneurship, the rich do not have an advantage because the road to riches rests not on resource ownership, but on the discovery of profitable opportunities.

The entrepreneurs, in the process of creating wealth for themselves, may also destroys other people's wealth to the extent that the entrepreneurial action exposes their mistakes. The way the entrepreneur creates and destroys, in short, is as follows: The entrepreneur discovers a profitable opportunity where he

[25] Schultz (1990, p. 31) and Kilby (1971, p. 1).

[26] Kirzner (1973).

can round up resources needed to produce a product at a price lower than the prevailing price of the product. He reaps the price difference as profit. If the price difference is expected to last into the future, the present value of the expected income stream becomes an increase in his wealth. This is how big fortunes are created. The resource owners involved in the creation of the fortune, to a greater or lesser extent, share in the fortune. When the entrepreneur successfully creates a fortune in the process of better satisfying the consumer demand, he may destroy others' fortune along the way to the extent that the entrepreneurial innovation raises the costs of (resource) rivals—others things being equal it would reduce the expected net revenue stream and lower its present value estimate—or lower the price of (product) rivals. The fortunes of the rivals, (including those of many erstwhile rich), are diminished.

In fact, all business enterprises face the threat of competition at all time: Somewhere and somehow, successful rivals who can better serve the consumer will appear in the resource markets or in the product markets and diminish the value of the firms. The current rich face constant threats of being wiped out. It does not matter whether the current rich are the original entrepreneur, or the investor who bought the going concern from the original entrepreneur (with the funds from other entrepreneurial success, or from inheritance, or, much less likely, out of savings.) Firms face constant threats of diminution from other entrepreneur.

If an entrepreneurial fortune is cashed in, the entrepreneur or his/her heirs, would be less subject to the challenge from the next entrepreneurs. But as coupon clippers they are not likely to do better than the average rate of return in the market as a whole. Therefore, one cannot maintain for this class of people that the rich get richer. This class of people, largely exempting themselves from the entrepreneurial challenge, have many reasons to spend down the fortune—the pursuit of finer things in life, the need to maintain the appearances corresponding to their standing in society, and all the attentions from the gorgeous people and the people with ingenious schemes, who would love to show the rich how to use their wealth, (as well as being subject to the inevitable fact of having to divide the fortune among the increasing number of heirs as generation passes, among other things.)

V. DO THE RICH HAVE ADVANTAGE IN ENTREPRENEURSHIP?

If entrepreneurship consists of discovering profitable opportunities, is it possible that the rich are still in a better position to discover them, since they can devote more resources to the search for profitable opportunities? If so, the idea that RGR would be still valid. But is this view correct?

The trouble with this view is that the process of discovering profitable opportunities is seen as something similar to combing the beach with metal detectors. The wider area you cover using more resources, the more likely you will come up with discoveries. In this metaphor, you are presumed to know the general area to be searched. However, considering how small or medium-sized firms can and do often successfully enter industries dominated by firms that spend large resources on R&D, such presumption is doubtful. Just think about challenges IBM, DEC, etc. are facing. And also think about all the inventions in the research labs of IBM, KODAK, XEROX, AT&T, etc., cast aside as unworthy, only to regret that others create fortunes for themselves from the inventions![27] On the problem of forecasting future technology, Nathan Rosenberg (1995, p. 20) observes: "We frequently simply do not know what new findings may turn out to be relevant or to what particular realm of human activity that relevance may eventually apply."

Still, how is it possible that profitable opportunities are left unexploited when they are available for grabbing, so to speak? Aren't there enough people in the world intent on getting rich, doing everything they can to realize their dreams? In the traditional economic theory, it is not possible.[28] To make sense of how profitable opportunities can be left unexploited by some, but exploited by others, I suggest that we examine certain aspects of human decision making under uncertainty to gain some insight.

Human beings have to make decisions in the face of uncertainty, meaning that human action is a very much mediated response to stimuli. This fact reflects the human constitution: Like all animate beings we are driven by the will to live. Through evolution, human beings have acquired a highly developed capacity to make tools, especially mental tools, (e.g., perception, categories, theories, rules, etc.), to make living. In the course of living, each of us develops an elaborate and intricate set of mental tools serviceable in our familiar surroundings.

When we are faced with an unfamiliar situation, we have to decide what the situation we are faced with is and how to best bring about results that we can live with. The processes by which we resolve uncertainty, by which we decide what to do, are open to speculation. But this much can be said with much confidence: (1) The processes must involve the existing set of mental tools; (2) In the processes of resolving uncertainty, the existing tool set is modified to handle the novelty--either by fashioning new tools, or by learning to use existing tools in a new way; (3) the process of modification is conjectural and experimental, and not at all guaranteed to succeed. The process of decision making in the face of uncertainty--in many ways similar to the way scientists study this subject and hypothesize or the way

[27] Audretsch and Acs (1994, p. 174).

[28] Arrow (1974, pp. 7-8).

jurists examine cases and render verdicts--enable us to learn about the situation we are faced with and learn to live with it.[29]

If our action is less successful, we will place little confidence in the appropriateness of the tools we used, (and/or the implicit understanding of the situation), and would be more willing to look for some other approaches, through mental experimentation or through the imitation of the successful. If our actions are successful, however, our confidence in the appropriateness (if not the verity) of the view we take of the kind of situation will increase. If our actions are met with repeated successes, we are increasingly likely to take the view adopted as the only possible one, becoming less inclined to entertain the possibility of doing better by adopting an alternative way of looking at the situation.

In other words, if we have met success in the past with certain ways of doing business and become rich, we are less likely to deviate from them (unless it is something almost guaranteed.) Conversely, we are more likely to explore different possibilities, if we have not had much success with our approach, (unless of course we have not already lost ambition and come to learn to live in a meager station.)

To avoid a misunderstanding, let me add a few words about the greater willingness of the successful to adhere to the accustomed and proven ways of doing business. It is not so much that the successful will do exactly what they did in the past, but that the successful tend to adhere to general perspective and approaches that brought them success in the past. My argument is not so much the successful getting lazy, as their getting confident about proven ways of doing business and therefore becoming less inclined to entertain alternatives. [30]

The complicating factor for the successful is that there is always room for improvement, however marginal, within the adopted approach. The impulse of those who have grown comfortable and proficient with certain approaches is to make improvements within the chosen framework, rather than trying some radically different approach which may not be fully developed, or with which one is not proficient, (so that the prospect of improvement over the old ways is not at all clear.)

The tendency of human beings, especially the successful, to adhere to their proven ways of doing business creates the possibility of neglecting profitable opportunities that could be had, only if one were

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[29] For a more detailed account of what follows, see Choi (1993b). The view espoused here is largely consistent with the central themes of Hayek (1952). Others have expressed similar views, e.g., Loasby (1991) and Earl (1983).

[30] Klein (1998, p. 67) observes: "The biggest danger of using mental simulation is that we can imagine any contradictory evidence away." See Perrow (1984) and Hirt and Sherman (1985) for documented evidences in real life and in lab experimentation. See Schoenberger (1997) for discussion of the tendency of industrial firms to adhere to the established ways.

willing to consider them. For those who are less successful, (provided that they have not yet given up the thought of doing better and adjusted to be content in their meager stations or given to criminal pathes), who are more likely to explore and experiment with different approaches, may discover that some profitable opportunities are there to be grasped, as it were. That is why among the ranks of entrepreneurs, we find a disproportionate representation of people who cannot be said to be privileged—immigrants, minorities, school drop-outs, etc.

Based on these considerations, I argue that the rich do not have an advantage in entrepreneurship. In fact, I am inclined to argue the opposite—as far as entrepreneurship is concerned, the rich may be disadvantaged. This, I believe, is the most important of the countervailing forces that limit the cumulative advantages of the rich.

VI. CONCLUDING REMARKS

I have argued in this paper that the idea of RGR as a characterization of the process of wealth generation is valid locally and in the short run, but in a wider context, and over time, it is limited, (and even negated), by countervailing forces, the most important of which is entrepreneurship. To the extent that entrepreneurship consists of the discovery of opportunities, not of the ownership of resources, the rich has no advantage over the poor in this regard. I further argued that, given the way the human mind works the rich (or the successful) are less likely than the poor to venture off the proven, and beaten track, wherein consists entrepreneurship.

The popular perception of RGR, fanned by popularity-seeking and politically-motivated intellectuals, leads to the belief that the masses are doomed to fail and a system so unfair must be somehow be brought down, or amended. Implications are enormous. Earlier Frank Knight (1935, 60-4) observed that the protest of the propertyless and ill-paid masses spring in good measure from the sense they have of playing in an unfair contest where all the cards are stacked against them. The politics of equalization thus motivated will entail severe restrictions on what individuals can or cannot do, beyond the general rules of conduct, as economic processes must be fitted to conform to some acceptable level of equality. Consequently, if redistributive measures are at all successful, it will mean: (1) a stagnant economy through the restriction of entrepreneurship, and (2) a society with more rigid class distinctions through a diminution of mobility. The end-result will be a poorer society where the rich and the poor stay as they are. It is most tragic that the pessimism about one's life prospect and the ill-feeling toward the market system, (based largely on a mistaken view of the way the market economy works), becomes self-fulfilling.

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SUMMARY

Recently, the politics of equalization has been rekindled by the increasing perception of "the rich getting richer and the poor getting poorer (RGR)." Though the perception involves the subject matter of economics, it has scarcely been examined. The reason for the neglect is that most people find it rather obviously true. This paper examines the validity of the thesis of RGR, logically and empirically, and finds it wanting. For example, an implication of RGR, viz., increasing polarization of income and wealth distribution, is not borne out by observation. Also, there is too much mobility across income strata to be consistent with RGR. RGR is at best a short term observation and it is a mistake to regard it as a long term tendency. The idea of RGR rests on a faulty understanding of the way the market economy works. The fault lies in taking a static view of a dynamic economy and ignoring the dynamo, viz., entrepreneurship. The essence of entrepreneurship is not the ownership of currently valued assets, but the discovery of opportunities. The attempts to redress the perceived tendency of RGR through various redistributive schemes and regulations will merely handicap the entrepreneur and reduce mobility. Ironically, the misperception of RGR, if vented in the politics of equalization, will result in more permanent distinction between the rich and the poor.

ZUSAMMENFASSUNG

In letzter Zeit ist die Gleichheitspolitik wieder ins Rampenlicht geholt, durch die steigende Affassung, die lautet, dass <<Die Reichen werden reicher, und die Armen werden armer (RWR)>>. Obwohl diese Affassung des Thema auf das Fachgebiet Ökonomie Bezug nimmt, hat man sich damit kaum auseinander gesetzt. Der Grund dieser Nachlässigkeit ist, dass die meisten Leute sie aufensichtlich als wahr betrachten. Dieser Aufsatz untersucht die Gültigkeit dieser These vom Standpunkt der Logik und des Pragmatismus aus, und hält dafür, dass sie nicht verlässlich ist. Zum Beispiel, eine Schlussfolgerung von RWR: die steigende Polarisierung von Einkommen und der Vermögensverteilung, wird nicht in der Praxis bestätigt. Es gibt zu viel Transfer unter die verschiedenen Bevölkerungschichten um mit dieser These übereinzustimmen. RWR ist, im besten Falle, eine kurzfristige Beobachtung, und est ist ein Irrtum sie als eine langfristige Tendenz anzusehen. Das Konzept von RWR basiert auf einem fehlerhaften Verständnis bezügliclh der Art und Weise wie die Marktwirtschaft funkzioniert. Der Fehler liegt daran, dass man den Standpunkt einer statischen Wirschaft einnimmt, und, dass man den Dynamo, dass heisst die Rolle des Unternehmers, dabei ignoriert. Die Esenz dieser Rolle ist nicht der Besitz von wertvollen Guthaben, sondern die Entdeckung von Möglichkeiten. Die Versuche dieser aufgefasste Tendenz von RWR durch verschienene Wiederverteilungstragien zu korregieren wird nur den Unternehmer behindern

und die Flexibilität reduzieren. Ironischerweise, wenn RWR falsch aufgefasst wird, wird dies zu einer ziemlich permanente Unterscheidung zwischen den Reichen und den Armen führen.

RÉSUMÉ

Récemment, la politique d'égalistaion a été ravivée à cause de la propagation de la conception que les riches s'enrichissent et les pauvres s'appauvrissent (LRS). Bein que cette vue touche le domaine de l'économie, il reste encore à l'approfondir. Elle a survécu du fait que la plupart des gens estiment qu'elle est plutôt indubitable. L'objet de cet article est d'examiner la thèse LRS d'une manière logique et pragmatique et d'exposer les raisons de la remettre en cause. Par exemple, l'une des implications de cette thèse, l'hypothése que la distribution du revenu et de la richesse est en voie de polarisation, n'est pas confirmèe par l'observation. Par ailleurs, il y a trop de mobilité parmi les tranches de revenus pour que celle-ci corrobore la thèse LRS. Cette thèse est, au mieux, une contestation à court terme. Il serait donc erroné de la considérer comme une tendance de plus en plus marquée. La thése LRS repose sur une fausse interprétation du fonctionnement de l'économie libérale. L'erreur consiste à estimer une économie dynamique comme invariable et de ne pas en considérer le dynamo, c'est-à-dire l'esprit d'entreprise. Le but de cet esprit n'est pas l'acquisition de biens mais la découverte de circonstances favorables. Les tentatives de réparer la tendance de la thèse LRS à l'aide de procédés de redistributin et de réglementation ne front qu'handicaper l'entrepreneur et réduire la flexibilité. Paradoxalement, si la dite interprétation erronée est appliquée comme une politique d'égalisation, cela fera une différence plus ou moins irréparable entre les riches et les pauvres.

JEL Classification: D3

JEL Summary

This paper evaluates the validity of the thesis of "the rich getting richer and the poor getting poorer (RGR)" and finds it wanting. Its implication of increasing polarization of income and wealth distribution is not borne out by observation. There is too much mobility across income strata to be consistent with RGR. The idea of RGR rests on a faulty understanding of the way the market economy works. The fault lies in taking a static view of a dynamic economy and ignoring the dynamo, viz., entrepreneurship. The essence of entrepreneurship is not the ownership of currently valued assets, but the discovery of opportunities.