

*Urszula Zagóra-Jonszta, prof. dr hab.*<sup>1</sup> 

Department of Economics  
University of Economics in Katowice

## **The problem of income inequality in the view of John Kenneth Galbraith and Milton Friedman**

### INTRODUCTION

Income inequalities have accompanied societies from the earliest times. Even in primitive community systems, a greater proportion of the goods belonged to the elders. Later economic systems exacerbated the problem, and it continues to pose a serious challenge today.

This paper aims to define the essence of income inequalities and their consequences in the works of two American economists: a neo-institutionalist – John Kenneth Galbraith, and a monetarist – Milton Friedman. Attention was drawn to the differences in the approaches to this problem of these important trends in 20th-century economic thought. Although both economists did not advocate excessive income inequalities, they presented different views on levelling out the inequalities. These differences resulted from their doctrinal assumptions. Galbraith, according to the doctrine of neo-institutionalism, presents a more pro-social attitude, seeing in the institution of the state an entity capable of mitigating the results of income differences, while Friedman, based on the principles of liberal economics, claims that the market alone can deal with the problem of inequality. A comparison of the contentions of both economists shows how doctrinal assumptions influence proposals for practical solutions. This paper uses comparative analysis and the desk research methods, based mainly on the publications of each economist.

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<sup>1</sup> Correspondence address: University of Economics in Katowice, Department of Economics, 1 Maja st. 50, 40-287 Katowice; e-mail: urszula.zagora-jonszta@ue.katowice.pl; ORCID: 0000-0003-4904-1025.

## SOURCES OF INCOME INEQUALITIES IN GALBRAITH'S VIEW

Institutional economics paid attention to income differences, both within societies and between them. Already Veblen wrote about the leisure class and condemned the lifestyle of the descendants of hard-working pioneers who gathered wealth that allowed their heirs to live off the interest payments. He was not too concerned about those who lived in poverty. Social inequalities were approached with much greater interest and empathy by Galbraith, the main representative of American neo-institutionalism. In his works, the problem of social (income) inequalities is mentioned frequently and, as the author points out, should be an important element of economists' considerations since it had yet to be solved<sup>2</sup>. Meanwhile, neoclassical economics overlooks this issue, trying to minimize it or at least not to recognise it. Galbraith, on the other hand, seeks the sources of inequality and the answer to the question whether it is possible to reduce the differences or move the majority of society to a higher, richer class than at present. He is concerned with income inequalities, both in relation to rich and poor countries.

Already in his first book *The Affluent Society*, published in 1958, he drew attention to the differences between the poor and the rich, considering American society. With a characteristic note of light irony, he writes: "*The poor man has always a precise view of his problem and its remedy; he hasn't enough and he needs more. The rich man can assume or imagine a much greater variety of ills and he will be correspondingly less certain of their remedy. Also, until he learns to live with his wealth, he will have a well-observed tendency to put it to the wrong purposes or otherwise to make himself look foolish*" (Galbraith, 1965, p. 13). This observation also applies to entire nations.

The source of income inequality in the US lies, according to Galbraith, in the division of the economy into two sectors: market and planning<sup>3</sup>. The former consists of small enterprises that find it difficult to employ modern but expensive investments, and which are exposed to high risk during periods of economic contraction. Their employees earn less, and additionally, their wages fall with every downturn, and they are more likely to be made redundant. The latter sector – planning – comprises large corporations that influence the market, prices and production volume, make expensive investments, employ well-paid specialists and feature high job stability. This sector is dominated by corporations that have freed themselves from state

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<sup>2</sup> In nearly all of economic history most people have been poor and comparatively few have been very rich. Accordingly, there has been a compelling need to explain why this is so – and, alas, on frequent occasions, to say why it *should be* so. In modern times, with rising and increasingly general affluence, the terms of this subject have greatly changed. The distribution of income remains, however, the most sensitive business with which the economists deal (Galbraith, 1991, p. 17).

<sup>3</sup> For the bimodal economy from Galbraith's point of view, see P. Umiński (2013b, pp. 210–219; 2013a, pp. 135–147).

authority and have their own financial resources. The first sector is exposed to the effects of competition, the other is not. Corporations pay their managers generous remunerations approved by submissive supervisory boards. "*Legal self-enrichment in millions of dollars is a common feature of modern corporate government. This is not surprising; managers set their own compensation*", writes Galbraith (2005, p. 42). The corporate system is based on the unrestrained power of self-enrichment, sometimes with declining sales value and profits.

The uneven economic development of both sectors has negative consequences. The degradation of the natural environment is a side effect of the intense growth generated by the private sector in particular. The imbalance results from the disproportion between the wealth of the private sector producing goods and the poverty of the public investment sector and social benefits. Galbraith sees the balance in a broader context, as a social balance that is based on the uniform development of production, consumer goods and public services. As a result of producer manipulation, there is a common belief that a better life is associated with an increase in the number of modern goods, while the public sector inhibits this increase (Galbraith, 1973, p. 6). Galbraith describes this as a dependency effect that does not exist in the public sector. Consequently, there is an imbalance consisting of high production and consumption of high-quality consumer goods and a small number of poor quality public goods. At the same time, the desire to possess gave rise to the conviction that an increase in production would eliminate poverty and inequality. Meanwhile, as Galbraith points out, "*Increasing aggregate output leaves a self-perpetuating margin of poverty at the very base of the income pyramid*" (Galbraith, 1973, p. 84).

Already in his first work, to illustrate the gap between private wealth and public poverty, Galbraith uses the concept of "conventional wisdom". He gives an example of a family driving a luxurious, air-conditioned car through a city crammed with rubbish, with neglected buildings and pavements, for a picnic where they will have a meal in the vaporous air. But of course the book goes far beyond such descriptions. *The Affluent Society* contains a logical deconstruction of orthodox versions of the public choice theory. It is based on the observation that stable preferences cannot apply to non-existent goods: consumption depends on production, and not the other way around.

The economy of highly developed countries is characterised by saturation of material goods that exceed their rational use. This increases waste without reducing poverty. Hence the ultimate goal of social activity cannot be an increase in production. However, it can become a means to higher ends, such as eliminating social tensions or improving the quality of life. Only their implementation can lead to social balance.

Galbraith also analyses the issue of income inequality on the international level. He examines a situation which he calls the equilibrium of poverty, characteristic of underdeveloped countries. He does not agree with the reasons

provided for the poverty: poor soil, lack of well-educated management, excessive population growth, lack of natural resources, cultural backwardness, missteps of governing bodies, etc. These factors affect the social situation, but are not the most important. What he considers crucial is adaptation to a low standard of living and its acceptance (Galbraith, 1987, pp. 77–80). The equilibrium of poverty compared to the standards of living in rich countries, however, creates imbalances at the international level, which widen the gap between states.

Looking for an alternative to the society of inequality, he creates a vision of a good society that mitigates income gaps, protects the natural environment, and maintains proper relations with trade partners and good relations in international contacts. In such a society, each individual should feel valued by creating for them conditions for a satisfying job, promotion, and later a decent retirement. Citizens should feel safe, have sufficient resources to live in dignity, and be provided for by state welfare. The condition is also to ensure high economic growth (Galbraith, 1999, pp. 27–33).

Finally, Galbraith raises the issue of a good society's attitude towards poverty in the world. He considers that no country can feel comfortable and satisfied with its prosperity knowing that other countries are in extreme poverty. Moreover, he indicates that this cannot only be the case with former colonial powers (Galbraith, 1999, p. 107). Therefore, he suggests that the duty of the rich should be to increase the assistance to the poor. These are beautiful words although the implementation proves to be very difficult, because it requires the ridding of the egoism so characteristic for rich societies.

For example, the United States currently spends only 0.2% of its GDP on foreign aid annually, while after World War II, on the basis of the Marshall Plan, it spent 2%. Rich countries are reluctant to share with the poor. Galbraith's views make him a naive preacher of unpopular ideas, who believes in the possibility of repairing the world and in reversing dangerous trends in the development of the economy. In a sense, they are a collection of pious wishes that, perhaps, the author himself does not really believe.

#### FRIEDMAN'S ATTITUDE TO INCOME INEQUALITY

According to the assumptions of monetarism, which is located in the neoliberal trend of economics, Friedman, firstly, does not attach so much importance to the problem of income inequality, and secondly he postulates other solutions in order to alleviate excessive income inequalities. He believes that in every society, regardless of the system, there is always dissatisfaction with the distribution of income because public opinion inclines towards greater egalitarianism, while governments "repair" the market-generated disparities without achieving a satisfactory result (Friedman, 1996, p. 20). Friedman distinguishes income inequalities resulting from income

differentials and those that result from the inheritance of talents and assets. The former stir greater emotions. A market economy, in his opinion, is characterised by payment in accordance with the product, which is generally considered to be moral. It effectuates the allocation of resources without coercion, and it takes place impersonally, without resorting to authority (government). Due to inequalities, there are sponsors who finance experiments and the production of new products (Friedman, 1993a, p. 157). At the same time, Friedman ascertains that “*contrary to popular conception, capitalism leads to lesser inequality than alternative systems*” (Friedman, 1993a, p. 158). Progress and development have freed the masses from laborious effort and enabled the use of products and services previously available only to the rich.

He poses the question: Is (substantive) equality more important than freedom? – and answers it in the negative. He believes that a society that puts equality before freedom will neither achieve equality nor freedom. Freedom, on the other hand, liberates energy in society and the pursuit of its own goals, which translates into a greater equality that in a sense forms a kind of by-product of freedom (Friedman, 1996, p. 142). Moreover, although freedom does not prevent a few from reaching privileged positions, it does not allow the institutionalisation of these positions and ensures that those privileged are attacked constantly by other talented and ambitious people who also want to be at the top of the social ladder. Freedom gives everyone a chance for a fuller and richer life.

Countries which wanted to move towards greater egalitarianism in income and made a major redistribution of wealth did not reach the intended goal. The effect of such a policy was the creation of new privileged classes that replaced or supplemented the existing ones. This regards bureaucrats, trade union activists, and new millionaires dodging regulations so that they do not pay taxes. Thus, wealth and income were re-shuffled, but inequalities were not reduced. Friedman cites many examples of the negative effects of extending social welfare by governments in the form of social security, social assistance, housing subsidies, health care, etc. As it consists in spending other people’s money, the total expenditure increases. Moreover, such a policy leads to corruption and interception of some of the money by the administering bureaucrats, so not all the money benefits the needy (Friedman, 1996, pp. 110–114). Therefore, he is a strong opponent of the welfare state, which, by its very nature, threatens freedom because decisions regarding social and economic policy are imposed by the government (Friedman, 1997, p. 137).

He also traces back the sources of inequality to monopoly privileges granted by the government, customs, and legal solutions beneficial to specific groups – in short, to various forms of state intervention.

He believes that income inequality should be discussed in the short and long term. Short-term differences in income are attributable to a market economy characterised by high social mobility, equal opportunities and changes, as a result of which the position of individual families in the income hierarchy varies from

year to year. In turn, in countries with a lack of mobility and a rigid social structure, each family occupies the same position year by year. One kind of inequality results from the dynamics of change, the other from the lack of it.

*“Life is not fair. It is tempting to believe that government can rectify what nature has spawned”*, but he adds that at the same time, *“we benefit from the very unfairness we deplore”* (Friedman, 1996, p. 131). An equitable (even) distribution of income is impossible and harmful. If everyone had a similar income, they would not strive to work intensively. Nobody would like to do heavy physical work. In addition, the concept of justice is very blurred and difficult to define. Friedman rejects a widely held view that the free market exacerbates income inequalities.

In criticising various forms of social policy, he states that benefits should flow from the rich part of society to the poorer part, but in fact the opposite is true: children of poorer parents quickly take up employment and pay taxes that cover benefits. As a result, the middle class benefits the most. The general conclusion, then, is that the government spends too much money, which is also inadequately spent (Friedman, 1993b, p. 11).

Galbraith disputes this approach, resenting the liberals who defend inequality and argue that it is a capital accumulation factor. He argues that it is a misinterpretation that if income was shared among all, it would be spent in its entirety; if only a few (the rich) use it, they spend a part on investments. These, in turn, increase production, which benefits society as a whole (Galbraith, 1973, p. 66). Idleness is a privilege of affluent people and their families, it is morally harmful for the poor and condemned by them, and additionally it costs public and private money, says Galbraith (2005, pp. 34–35).

## WAYS OF COMBATTING INEQUALITIES ACCORDING TO NEO-INSTITUTIONALISM AND MONETARISM

### GALBRAITH’S SUGGESTIONS

Galbraith’s basic postulate is as follows: in order to achieve social balance in highly developed countries, such as the USA, public services should be activated and the proportion of investment should be changed in favour of the public sector. Investments in this sector are investments in people, their knowledge and qualifications, namely, expenditures that are decisive for the further development of society. He does not believe in a fair distribution of income through the market. Only a strong state, through taxes and appropriate investment policy, can develop the public sector. This will be a step towards poverty eradication (Galbraith, 1973, p. 344). What is needed is therefore a change in government policy aimed at reducing income inequalities by:

- extension of state control over weaker parts of the market system, e.g. housing, public transport, railways;
- state aid for market sector enterprises in such a way as to counterbalance the excessive power of the planning sector;
- nationalisation of the largest corporations;
- subordination of concerns to state plans and the possibility of direct government interference in decisions taken by these concerns;
- introduction of a law on minimum income and wages (Semkow, 1988, pp. 235–237).

These postulates assume the extension of the role of the state and constitute a rather naive belief in the possibility of their implementation, although Galbraith is aware of the close, frequently personal relations of the state with the planning sector.

Seeking the best solutions to eliminate excessive inequalities, he gives guidance within the framework of neo-institutional economics, though they closely resemble Keynesian solutions. Assuming that the more unequal the distribution of income is, the more dysfunctional it becomes, he postulates:

- creating an aid system for the poor;
- eliminating fraudulent transactions, dominant in the financial world, stimulating the mechanism of speculation;
- lowering the exorbitantly high income of corporate managers, which requires the activism of shareholders and broadly understood public opinion, the effectiveness of which is not really believed in by its proponent;
- introducing a progressive tax on income that reduces excessive disproportions;
- strengthening the role of labour unions;
- introducing sickness insurance, unemployment benefits and ensuring a socially adequate minimum wage (Galbraith, 1999, pp. 57–60).

In seeking another authority capable of restoring social balance, Galbraith emphasizes the role of intellectuals (calling them the scientific and educational estate), playing an increasingly important role in modern society. Already at the end of the 1950s, he recognised that it was capable of “humanising” American capitalism. The development of society through education allows advancement to a higher class, which is called the New Class. *“The New Class is not exclusive. While virtually no one leaves it, thousands join it every year. (...) The son of the factory worker who becomes an electrical engineer is on the lower edge; his son who does graduate work and becomes a university physicist moves to the higher echelons; but opportunity for education is, in either case, the open sesame. (...) in the last few decades, the New Class has increased enormously in size. (...) This being so, there is every reason to conclude that the further and rapid expansion of this class should be a major, and perhaps next to peaceful survival itself, the major social goal of the society. Since education is the operative factor in expanding the class, investment in education, assessed qualitatively as well*

*as quantitatively, becomes very close to being the basic index of social progress. It enables people to realize a dominant aspiration. It is an internally consistent course of development*" (Galbraith, 1965, pp. 276–277). This thought is present in many of his works. Education is a priority factor for economic development that also performs a political and social role. It allows people to move up the social ladder, guarantees political stability and promotes democracy (Galbraith, 1999, p. 62). Like Veblen, who recognised the emergence of science and technology as the leading forces of historical change in the 20th century (Heilbroner, 1993, p. 218), Galbraith, as a worthy successor to the creator of institutionalism, also put great emphasis on knowledge and the development of science to help reduce income inequalities.

#### FRIEDMAN'S APPROACH

Tax progression was a commonly used method of reducing income inequalities. Friedman, however, doubts its effectiveness in relation to the legal possibility of reducing tax rates. He proposes to expand the tax base and reduce rates to decrease inequality. As a liberal, he finds no justification in diversifying rates solely in order to redistribute income. The best method would be a single income tax rate for individuals (Friedman, 1997, pp. 73–79). In the field of fiscal policy, he also proposes:

- abolition of corporate income tax and assignment of corporate income to shareholders who would have to show it in tax returns;
- abolition of tax rebates on raw materials;
- taxation of interest on state and local securities;
- abolition of the favourable capital gains treatment;
- abolition of numerous tax allowances, reducing the tax base (Friedman, 1993a, p. 163).

To the question of what role fiscal policy plays in overall macroeconomic activities, Friedman briefly answers: none (Snowdon, Vane, 2003, pp. 190–191). He believes that the government cannot force people to act incompatibly with their personal interests in the name of public interest. Taking from some to give others brings the opposite effect to the intended one.

He states that in the area of tax policy, the government has done more harm than good in generating benefits from these solutions. In his opinion, the means of mitigating social inequalities could be the so-called negative income tax. Taxpayers with an income lower than the tax-free allowance plus permitted deductions would receive subsidies from the state budget. This system, unlike other forms of social assistance, such as unemployment benefits, would not weaken the motivation to look for ways to improve the material situation. An additional advantage of a negative tax would be that it does not require the expansion of administration and can be carried out jointly with the applicable

tax system. In addition, it would be strictly focused on the issue of poverty and of a general nature; the only criterion would be income earned (Friedman 1996, pp. 114–117; Friedman, 1993a, p. 183). Such a solution would be cheaper and more transparent, but would require acceptance from this part of society which, being richer, would finance the poorer. This tax would be combined with the liquidation of all welfare programs, including the pension scheme. The gradual abandonment of the social security system would activate society to take up employment, which would raise national income and personal income, and would leave employees free to pay or not to pay pension and disability contributions (Friedman, 1996, pp. 118–119). Many authors believe that such an approach does not mean a lack of empathy (Cole, 2008, p. 239). According to Cole, a negative income tax, “like it or not, is a policy of income redistribution – an effective one, to be sure – that involves taking from some, by force, in order to give to others”, but it really reduces social inequalities (Cole, 2008, p. 247). Friedman does not reject help for the poor completely. This concept stands in contrast to Friedman’s libertarianism, leading Rothbard to believe that he was not a liberal (Rothbard, 2002, p. 52), while Buchanan called him a “compassionate classical liberal” (Buchanan, 2005, p. 8).

As with many considerations, like Galbraith’s, Friedman considers education a method of bridging inequalities. Investments in human capital are a sure way to raise the standard of living, not only of specific people but also of entire societies. They contribute to economic growth, inventions, and technological progress (Friedman, 1996, p. 19).

Assuming that capitalism reduces inequalities in the distribution of income, he claims that the most effective form of aid for the poorest is and will be a free market, because it guarantees progress, releases initiative and creates incentives for innovation. This does not mean that he does not see market failures; there is a million of them, but there is no alternative. “*Market errors cause damage, but much smaller than government errors. A market error is also its opportunity*” – he stated in one of his last interviews (Ptak, 2006, p. 7).

## CONCLUSIONS

The approaches to income inequalities of the main representatives of neo-institutionalism and monetarism differ, which results both from doctrinal assumptions and perhaps also from the character traits of each economist. Galbraith seems more sensitive to the problem of excessive differences in income and seeks help in levelling them in state institutions. He considers income disparities, the source of which is not economically justified, to be a negative phenomenon. Friedman assumes the ineffectiveness of the state’s actions in economic policy and therefore refers to the market. On the other hand, he is not so naive as not to notice market failure. Moreover, he believes that all government actions under

economic and social policy have not yet brought the expected results. Therefore, he refers to the initiative of the individuals themselves, for whom the free market creates appropriate operating conditions. He trusts that individual freedom and the free market will contribute to overcoming excessive income disparities. If the state allowed the market to operate efficiently and did not use coercion in economic and social policy, the problem of excessive income differences would disappear by itself. Who is right? The answer depends on the economic doctrine of a person who answers it.

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### *Summary*

The paper presents the approach to income inequality of two great American economists: a representative of neo-institutionalism – John Kenneth Galbraith, and the creator of monetarism – Milton Friedman. Both of them dealt with this problem extensively.

The paper aims at revealing differences in both seeking the sources of inequalities and ways to combat them. Although both economists were against excessive inequalities, the methods of overcoming them were perceived differently by each of them. Galbraith advocated that the state should be activated. Therefore, he proposed the implementation of various aid programs, claiming that there should not be poor people in rich countries, even if not everyone honestly uses such assistance. Moreover, various forms of poverty alleviation should be introduced in poor countries. On the other hand, Friedman concluded that the best way to mitigate income inequalities is a non-intervention approach of the state and free market should be left to work freely. According to him, only the market can reduce income disparities. He considered all programs implemented to overcome them to be unsuccessful because they cause social indolence as the number of people using these forms of help increases. In addition, the state is not a charitable institution and it should not include such a form of activity that is only appropriate for bodies specially appointed for this purpose (charity).

The paper uses the source analysis method and the comparative method. The main works of both economists were examined in an attempt to highlight the specific nature of their approaches.

*Keywords:* income inequality, John Kenneth Galbraith, Milton Friedman.

## **Problem nierówności dochodowych w ujęciu Johna Kennetha Galbraitha i Milтона Friedmana**

### *Streszczenie*

Artykuł przedstawia podejście do nierówności dochodowych dwóch wielkich amerykańskich ekonomistów: przedstawiciela neoinstytucjonalizmu – Johna Kennetha Galbraitha oraz twórcy monetarizmu – Milтона Friedmana. Obaj sporo miejsca w swoich publikacjach poświęcili temu problemowi.

Celem artykułu jest wykazanie różnic zarówno w poszukiwaniu źródeł nierówności, jak i sposobów ich zwalczania. Wprawdzie obaj ekonomiści byli przeciwni nadmiernym nierównościom, ale każdy z nich inaczej widział sposoby ich przewycięzania. Galbraith uważał, że należy uaktywnić państwo. Proponował więc wdrożenie różnych programów pomocowych twierdząc, że w bogatych krajach nie powinno być ludzi biednych, nawet jeśli nie wszyscy uczciwie z takiej pomocy korzystają. Również w państwach ubogich należy wprowadzać różne formy niwelowania biedy. Natomiast Friedman uznał, że najlepszym sposobem łagodzenia różnic dochodowych jest brak interwencji ze strony państwa i pozostawienie swobody działania wolnemu rynkowi. Według niego tylko rynek potrafi zmniejszyć rozpiętości w dochodach. Wszelkie programy wdrażane w celu ich przewycięzania uważał za nietrafione, ponieważ rozleniwiwały społeczeństwo, bo rosła liczba osób korzystających z tych form pomocy. Ponadto państwo nie jest instytucją charytatywną i w jego gestii nie powinna się mieścić taka forma działania, która przystoi tylko organom specjalnie do tego powołanym (charytatywnym). W artykule zastosowano metodę analizy źródeł oraz metodę porównawczą. Wykorzystano przede wszystkim główne prace obu ekonomistów, starając się uwypuklić specyfikę ich podejścia.

*Słowa kluczowe:* nierówności dochodowe, John Kenneth Galbraith, Milton Friedman.

JEL: B20, B22, B25.