

Why do some societies produce more inequality than others?

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Jan Pen's parade of wealth is probably the most accurate metaphor of economic inequality.¹ Although it shows the striking difference in wealth distribution within the American society, it is not just the American problem. In OECD countries the richest 10% of the population earns approximately 9 times more than the poorest 10%.² Keeping in mind that the top 10% is composed of university teachers as well as people of the calibre of Warren Buffet we can realise just how enormous the inequality is. In Nordic and continental European countries, however, the difference in average income between the top and bottom 10% of population is below OECD average, while in Turkey, Israel and USA there is a 14-fold difference between earnings of the outermost 10% of population.³ It is then evident that the economic inequality varies greatly between developed countries. The question this paper attempts to answer is: why? In order to understand the cause of varying inequalities we must analyse the differences between capitalist systems across OECD countries. However, it is doubtful and unlikely that there would be only one variable responsible for those differences. After all, Fred Block's analysis (his "new paradigm") suggests that states play a much more important part in composing markets than we used to believe.⁴ It is therefore equally important to look into political systems of those countries. Finally, one cannot ignore the importance of historical and cultural background in creating a specific political reality. Hence the historical analysis will be the final issue discussed in this paper.

There is agreement between political economists that we can classify capitalisms into several categories, although the exact types are the question of debate. Esping-Andersen recognizes three capitalist welfare regimes⁵: liberal, social-democratic, and corporatist. The first regime-type of capitalism dominates in the Anglo-Saxon world⁶. It is characterized by very strict and modest social-spending programmes.⁷ The data from OECD shows that these countries, aside of Mexico, Israel and Italy, have the highest levels of income inequality.⁸ It is interesting to compare those highly liberal capitalisms with social-democratic states like Sweden, Norway or Denmark. The OECD statistic show that these countries have the lowest

¹ Jan Pen's wealth parade is a metaphorical representation of wealth distribution in American society. Each person's height is equivalent to its income. And as the parade marches on we see very small people at the beginning, then many people of the average height, and then, at the very end, a few giants of the size of the skyscrapers.

² OECD report: *Divided We Stand: Why Inequality Keeps Rising -An Overview of Growing Income Inequalities in OECD Countries: Main Findings*; p.22

³ Ibid, p.22

⁴ Block, Fred (1994) "The Roles of the State in the Economy" from Smelser and Swedberg (eds.), *The Handbook of Economic Sociology*. Princeton NJ: Princeton University Press, p. 696-705

⁵ Esping-Andersen, Goesta (1990). *Three Worlds of Welfare Capitalism*. Cambridge: Polity Press; p.18-21: "welfare state/regime [...] involves state responsibility for securing some basic modicum of welfare for its citizens.";

⁶ USA, Canada, Australia and United Kingdom

⁷ Op.cit, p.26-27

⁸ OECD report: *Divided We Stand: Why Inequality Keeps Rising -An Overview of Growing Income Inequalities in OECD Countries: Main Findings*; p.24

levels of inequality.⁹ That is because in those states governments decided to promote high redistribution of wealth. By implementing highly progressive taxes social-democrats were able to create a very extensive social-service programme. The division between liberal and social-democratic capitalism represents the issue discussed in length by Alexis de Tocqueville in his book: "Democracy in America". As he pointed out, in democracy there is an inescapable trade-off between freedom and equality. The two welfare-regimes could be understood in relation to Tocquevillian dualism, and hence representing higher degree of freedom in liberal capitalism, and higher degree of equality in social-democratic capitalism- in either case for the price of the other. Esping-Andersen recognizes one more type of welfare-regime- corporatist.¹⁰ Represented by France, Italy, Austria and Germany, this type represents a compromise between the two other systems. Esping-Andersen's model is very useful as it shows a clear distinction between liberal and social-democratic capitalisms. However, it is not particularly useful when assessing inequalities in corporatist capitalisms of continental Europe; the OECD statistics for those countries vary from high levels of inequality in Italy, Greece or Spain to intermediate levels in Belgium, Netherlands, or Germany.¹¹ The model of Hall and Soskice, although simplifying the division of capitalist systems into two broad categories: liberal market economies (LME) and coordinated market economies (CME), might help us understand this problem.¹² In CMEs, like Germany or Sweden, there is a high degree of government regulation of finance and labour market (via labour law) which results in strong position of labour unions, among other things.¹³ In LMEs, on the other hand, there is a trend of decentralisation and deregulation.¹⁴ The OECD data shows that countries with high levels of market regulation (Mediterranean states) and countries with very low government regulation (Anglo-Saxon states) tend to produce high levels of inequality.¹⁵ At the same time countries like Sweden or Netherlands with intermediate regulation produce much lower levels of inequality. By combining Esping-Andersen's and Hall's & Soskice's view we could therefore draw a conclusion that levels of inequality in any society depend on the combination of social redistributive policies and levels of government regulations. But as it was mentioned, governments play a significant part both in both models. Therefore it is evident that those different capitalisms do not emerge independently from political systems.

One glance at the map of electoral systems in the world is enough to realise that there is a certain correlation between varieties of capitalism and political systems.¹⁶ Anglo-Saxon countries mostly adopted majoritarian systems where people elect their

⁹ Ibid, p.24

¹⁰ Esping-Andersen, Goesta (1990). *Three Worlds of Welfare Capitalism*. Cambridge: Polity Press; p.27

¹¹ OECD report: *Divided We Stand: Why Inequality Keeps Rising -An Overview of Growing Income Inequalities in OECD Countries: Main Findings*; p.24

¹² Hall, Peter and David Soskice (2001).(eds.) *Varieties of Capitalism*. Oxford: Oxford University Press, p.8-9

¹³ Ibid, p.21-23

¹⁴ Ibid, p.27-33

¹⁵ Data taken from Dr.J Hopkin's presentation on „Understanding Diversity:The Political Origins of Capitalism”, slide nr.32

¹⁶ <http://www.idea.int/esd/upload/ESD%20map-english.pdf>

representatives from single-member constituencies. This system leads to a situation in which only a few parties (only 2 in the USA) win seats in the parliament. On the other hand, most European countries have adopted different kinds of proportional representation. In this case many parties win seats in the parliament thus resulting in greater representation of the people. The data shows that there is a strong correlation between the degree of proportionality of electoral system and government coordination of the market.¹⁷ It is evident then that majoritarian systems lead to more liberal capitalisms, while proportional systems (PR) promote more coordinated systems. That is because in PR systems, because of greater representation, more political groups succeed in entering the parliament. Also, politicians can gain support by addressing different social groups, i.e. they may promise poor families child support, labour unions greater power etc. Therefore each vote (in terms of minorities and specific groups) gains in importance. In majoritarian systems votes of particular minorities are of lesser, if any, importance. Politicians address the majority and do not have to worry about improving lives of minority voters. Since the winner gains all power, and smaller parties do not matter, people will tend to vote for big parties because otherwise their vote would just be lost. However, although we established a visible relation between electoral system and a specific type of capitalist system we are not yet close enough to understand why different countries have different levels of inequality. Norway, Sweden and Denmark, with the lowest levels of inequality, have the same electoral system as Poland, Spain, Portugal or Greece, which have very high levels of inequality. Also, it does not seem reasonable that majoritarian system should produce liberal rather than social-democratic order. Especially in countries like USA and UK where inequality levels are high it would seem obvious for a society to demand more redistribution. Theoretically majoritarian systems should produce centrist, or even centre-left governments, since amount of people with low incomes that could appreciate more redistribution outnumbers by far the amount of people with high incomes who would not appreciate the idea. It seems therefore that there is a third element, besides political and economic system, that we need to include in our examination.

Analysing historical and cultural background offers a very important insight into why levels of inequality differ between countries. An interesting point is raised by Alesina and Glaeser: racial homogeneity in Europe supports greater redistribution of wealth.¹⁸ In USA all citizens have different roots: Irish, Italian, Polish, Japanese, etc. Therefore certain national or racial minorities may on this ground oppose redistribution as they do not see themselves as one people. Moreover, Esping-Andersen in his description of corporatist welfare regime points out that this specific type of capitalism is highly influenced by Christian religion.¹⁹ In Germany, Italy, or Spain the social policies are designed to support traditional institutions of

¹⁷ Iversen, Torben and David Soskice (2009). 'Distribution and Redistribution: In the Shadow of the Nineteenth-Century', *World Politics* : p.444 figure 2

¹⁸ Alberto Alesina, Glaeser and Bruce Sacerdote. Why Doesn't the US have a European-style welfare state? *Harvard Institute of Economic Research*, Discussion paper N.1933, p. 3

¹⁹ Esping-Andersen, Goesta (1990). *Three Worlds of Welfare Capitalism*. Cambridge: Polity Press; p.27

family, rather than to address individuals like in Sweden. In Israel, which has one of the highest levels of inequality among OECD countries, the religious order has contributed the most to this situation.²⁰ The women, especially in Arab population, do not work because of the high government payments for them to stay home and take care of the children, while 13% of the Israeli society is composed of *haredi*- the ultra-orthodox Jews that focus on studying sacred texts, but have no practical education, leading to nearly 60% unemployment among this group.²¹ Italy, on the other hand, suffers greatly from internal economic division between North and South.²² It is to some extent based on more agriculture-oriented industry in the South, while North has always been much more industrialised. On top of that South has been always a place of very high mafia's influence. It is not necessary to present more data because it is evident that specific national circumstances, like that of Italy, Israel or USA, can have an enormous influence on how the economy, so the people, behave, despite the electoral or capitalist system.

This paper aimed to answer the question why do some societies produce more inequality than others. After a very brief examination we realise that there is more than one reason. In democracies that operate in PR system politicians have greater incentive to propose greater social spending simply because it will win them more votes, which is not necessarily the case in majoritarian systems. We saw how those electoral systems correlate to different capitalist systems of Esping-Andersen. What we did not see, however, is why some countries with PR system would exercise greater control of the market than others, and why would the inequality differ so much between states that apparently shared the same political and economic regime. The answer to those questions is ironically very easy and can be found in Fred Block's paper.²³ In his "new paradigm" the accent is put on the fact that market and government are not independent from the society that constitutes them. It is then specific culture and historical complexities that are responsible for Sweden adopting more egalitarian system than Israel or USA.

²⁰ Economist article: <http://www.economist.com/node/21559393>

²¹ Economist article: <http://www.economist.com/node/17366165>

²² New York Times article: <http://www.nytimes.com/1996/11/15/world/north-south-divide-in-italy-a-problem-for-europe-too.html?pagewanted=all&src=pm>

²³ Block, Fred (1994) "The Roles of the State in the Economy" from Smelser and Swedberg (eds.), *The Handbook of Economic Sociology*. Princeton NJ: Princeton University Press

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