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ESS — Extension of Social Security

**Income Inequalities in Perspective**

Jomo Kwame Sundaram  
Vladimir Popov

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INITIATIVE FOR POLICY DIALOGUE (IPD), COLUMBIA UNIVERSITY

INTERNATIONAL LABOUR OFFICE, GENEVA

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The editor of the series is the Director of the Social Protection Department, ILO. For more information on the series, or to submit a paper, please contact:

Isabel Ortiz, Director Social Protection Department  
International Labour Organization  
4 Route des Morillons  
CH-1211 Geneva 22 • Switzerland  
Tel. +41.22.799.6226 • Fax: +41.22.799.79.62  
email: [ortizi@ilo.org](mailto:ortizi@ilo.org)

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## Abstract

Income and wealth inequalities in most countries – in the West, the former ‘communist’ economies and in the developing world – have been on the rise in the last three decades with some notable exceptions. Inequalities in the 19<sup>th</sup> century (Figure 1) were much higher than before the Industrial Revolution. Following the rise of workers’ movements in the West and the 1917 Bolshevik revolution, the growth of inequalities of the previous century was reversed for over half a century until the 1980s as the threat of the spread of communism inspired welfarist redistributive reforms, giving capitalism a more human face. Such checks and balances have been greatly weakened in recent decades, even though improved economic performance in many developing countries, including sub-Saharan Africa in the last decade, contributed to some convergence of incomes between rich and poor countries.

**JEL Classification:** F02, F63, I30, J31, N00

**Keywords:** Income and wealth inequalities, communism, capitalism, welfare state, share of labour and capital in national income

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## 1. Growing inequalities within countries

The long term trends suggest increasing inequality from the ancient times before reaching an all-time peak in the early 20<sup>th</sup> century (Table 1, Figure 1), and then starting to decline after the First World War and the 1917 Russian revolution.

**Table 1. Gini coefficients around particular CE years in some Western countries (%)**

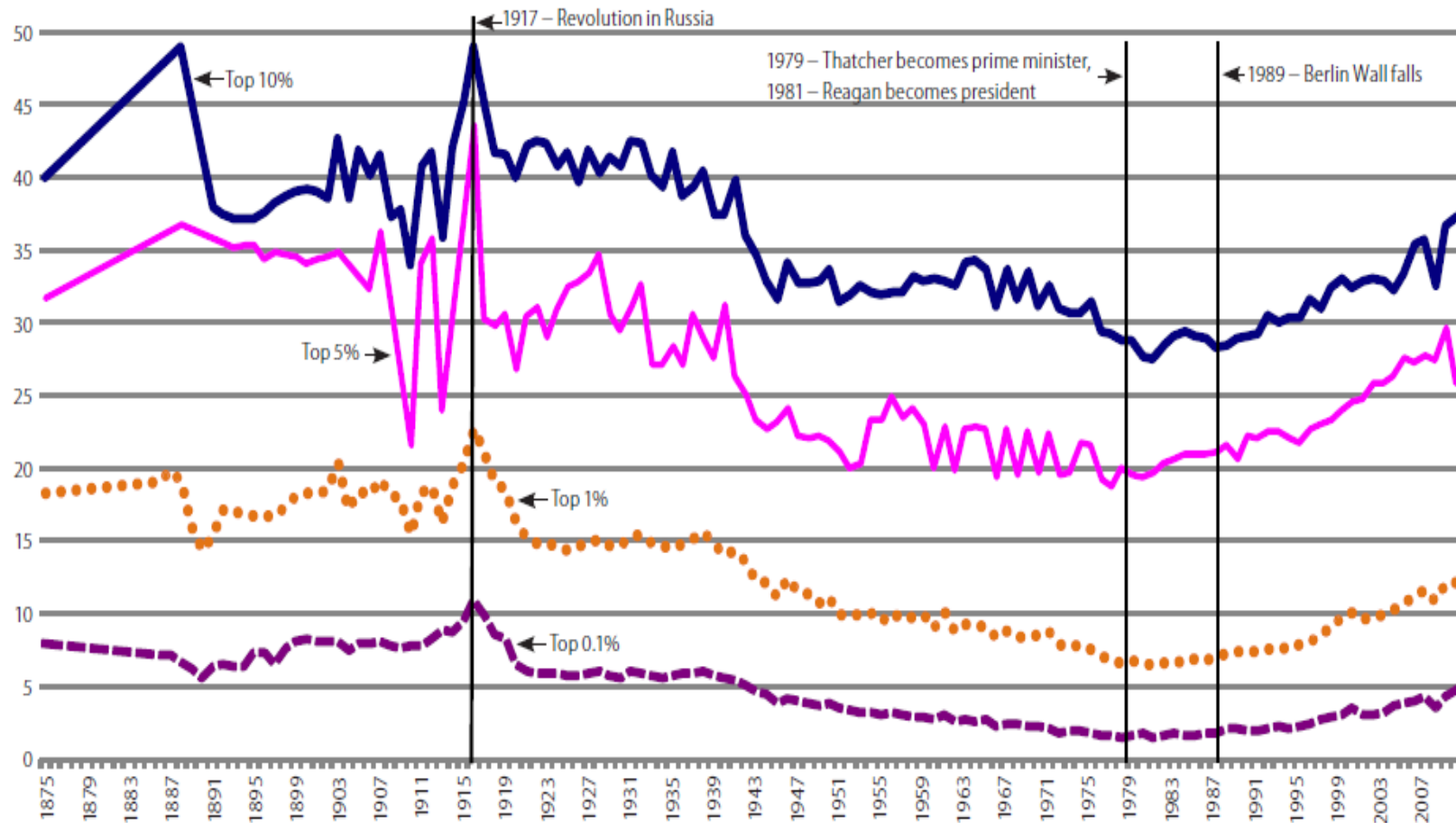
Years	14	1000	1290	1550	1700	1750	1800	2000
Rome	39							
Byzantine		41						
Holland				56		63	57	30.9
England			36.7		55.6	52.2	59.3	37.4
Old Castille/Spain						52.5		34.7
Kingdom of Naples/Italy							28.1	35.9
France							55	33

Source: Milanovic, Branko, Peter H. Lindert, Jeffrey G. Williamson. Measuring Ancient Inequality, World Bank [Policy Research working paper](#) no. WPS 4412. (Published as: Pre-Industrial Inequality. *The Economic Journal*, 121, March 2010: 255–272); data for 2000 are sometimes from the World Development Indicators database.

The destruction of communal and collectivist institutions, first carried out in European countries in the sixteenth to nineteenth centuries (e.g. the enclosure movement in England) and extended by colonialism beyond, has been accompanied by increasing wealth and income inequality in most societies. Available data suggest that in England, Holland and Spain in the eighteenth century, the Gini coefficient of income distribution was around 50 to 60 percent (Table 1) — an extremely high level by today’s standards, and probably, by the standards of the distant past (around 40 percent in Rome in the first CE century and in Byzantium in the eleventh century). In England and Wales, the Gini coefficient increased from about 46 percent in 1688 to around 53 percent in the 1860s (Saito, 2009). In Denmark, a country with very good statistical records of individual incomes, the share of total income of the top 10 percent in 1870-1920 was always over 40 percent (reaching 54 percent in 1917), while the Gini coefficient for this period was always higher than 40 percent, even exceeding 70 percent in 1917 (Atkinson, Sogaard, 2013)! Data for Britain and the US, based on reconstruction of social tables for the pre-modern period, provide a similar picture of increasing inequality before the 1860s and then a decline from the 1930s to the 1980s (Figure 2).

Figure 1. Income shares of top 10, 5, 1, 0.5 and 0.1 per cent, un-weighted average for 22 countries

Chart: Income Shares, Average for 22 Countries

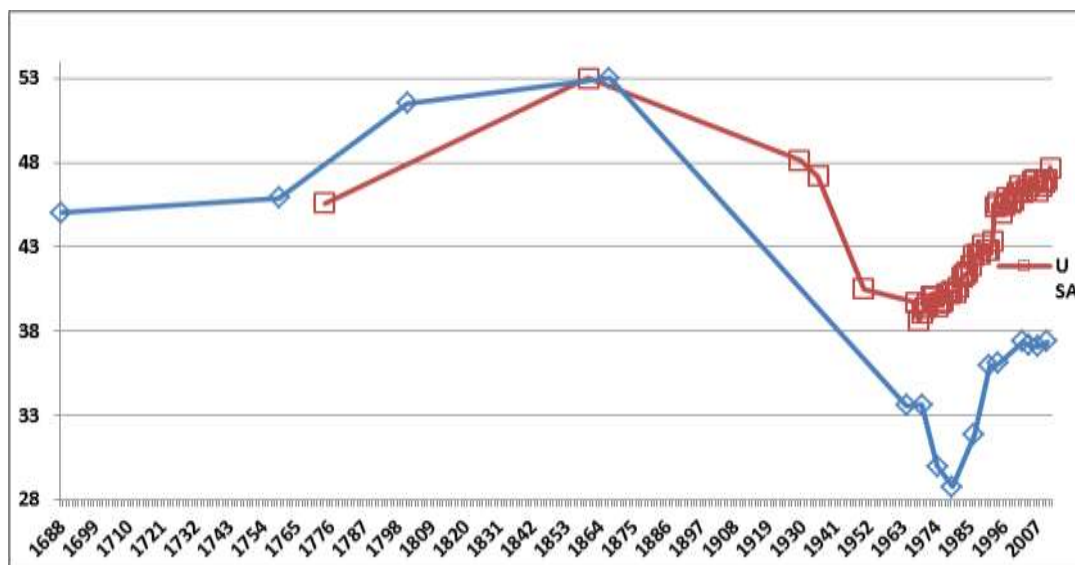


European countries: Denmark, France, Germany, the Netherlands, Switzerland, UK, Ireland, Norway, Sweden, Finland, Portugal, Spain, Italy; North America: United States and Canada; Australia and New Zealand; Latin American country – Argentina; Asian countries – Japan, India, China, Singapore, Indonesia; Sub-Saharan Africa – South Africa, Mauritius, Tanzania.

Overall – about ½ of the population of the world.

Source: Alvaredo, Facundo, Anthony B Atkinson, Thomas Piketty and Emmanuel Saez, "The World Top Incomes Database," <http://g-mond.parisschoolofeconomics.eu/topincomes>, 25 April 2012.

Figure 2. Inequality in the US and UK over the long run, Gini coefficients (%)



Source: The Gini coefficients were computed by Milanovic from social tables before the 20<sup>th</sup> century and from household survey and tax returns afterwards (Milanovic, Branko. *The Haves and Have-Nots. A Brief and Idiosyncratic History of Global Inequality*. Basic Books, New York, 2011; Milanovic, Branko, Peter H. Lindert, Jeffrey G. Williamson. *Measuring Ancient Inequality*, World Bank Policy Research working paper no. WPS 4412. (Published as: Pre-Industrial Inequality. *The Economic Journal*, 121 (March 2010): 255–272; and personal correspondence with Milanovic). N.B. Comparable data for the 1867-1929 period are not available.

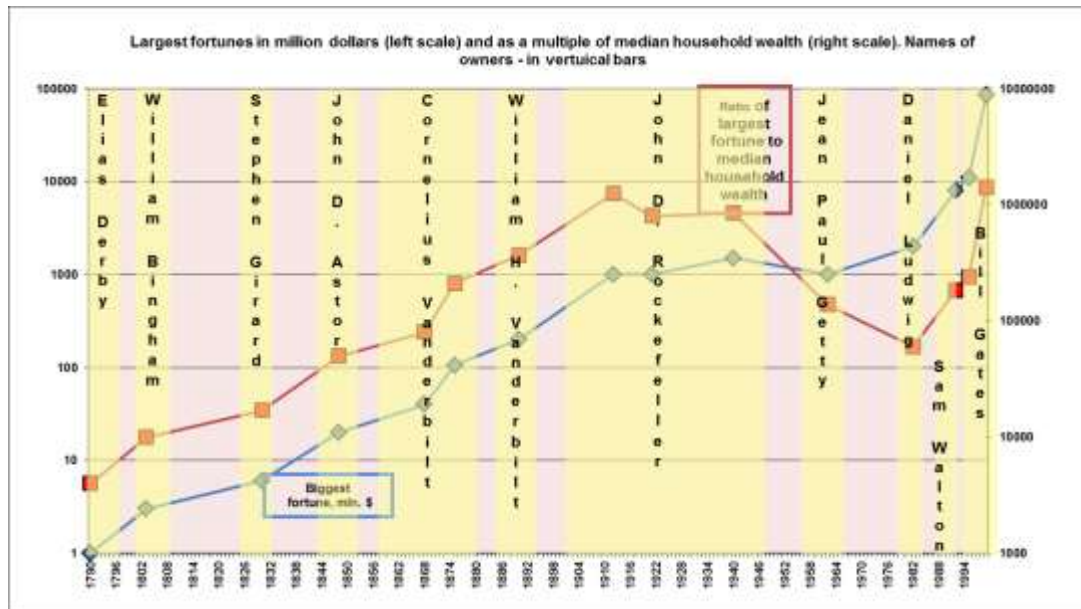
In the United States in the late 18<sup>th</sup> century, income and wealth inequalities were initially probably lower than in Europe due to the absence of large accumulated fortunes in the New World and the availability of abundant “free land”. In the late 18<sup>th</sup> century, the top 10 percent of wealth holders accounted for only 45 percent of total wealth in the US, compared to 64 percent in Scotland and 46-80 percent in Finland, Norway, Sweden and Denmark (Soltow, 1989). But it appears that inequalities increased greatly in the 19<sup>th</sup> century and in the early 20<sup>th</sup> century, reaching a peak between the two world wars. Soltow (1989) finds some decrease in income inequality in 1798-1850/60 period in the US, and little or no increase in wealth inequality over the same period. However, the ratio of the largest fortunes to the median wealth of households (Figure 3; Phillips, 2002) suggests a different story. This ratio increased from 1000 in 1790 (Elias Derby’s wealth was estimated to be worth \$1 million) to 1,250,000 in 1912 (John D. Rockefeller’s fortune of \$1 billion), falling to 60,000 in 1982 (Daniel Ludwig’s fortune of “only” \$2 billion), before increasing again to 1,416,000 in 1999 (Bill Gates’ \$85 billion fortune)!

Comparison of the wealth of the richest tycoons in different countries in different epochs (Figure 4) gives different numbers (for average income, not average household wealth), but points to a similar conclusion – compared to the average income in the US, Bill Gates was relatively richer than Carnegie and Crassus (though not richer than Rockefeller), whereas Russian tycoon Mikhail Khodorkovsky was relatively richer in 2003 (compared to the average income in Russia) than all of them! The world may not have reached the highest level of inequality yet, but may still be moving to the greatest inequality ever observed in human history.

Only during the Eric Hobsbaum’s “short 20<sup>th</sup> century” was the trend towards increased income and wealth inequalities temporarily interrupted, probably because of the greater egalitarianism of the socialist countries with lower levels of

inequalities (with Ginis between 25 and 30 percent on average) and the checks to rising inequalities with the growth of labour and other egalitarian movements (Figure 3) noted by Polanyi among others.

**Figure 3. Largest fortunes in the US in million dollars and as a multiple of the median wealth of households, log scale**

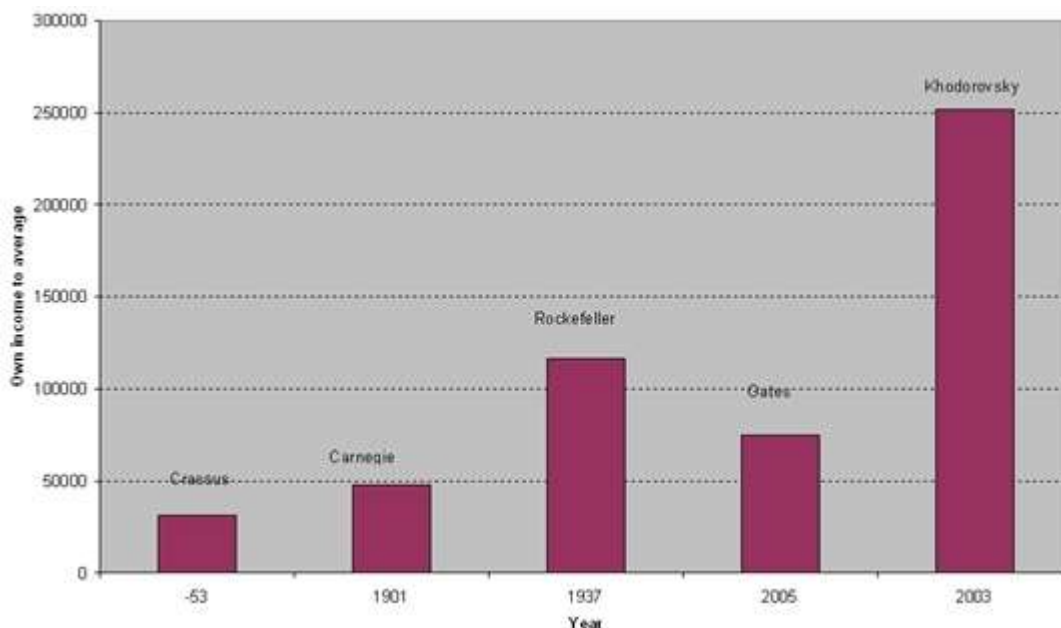


Source: Phillips, Kevin. *Wealth and Democracy: A Political History of the American Rich*. Broadway Books, New York, 2002.

The recent period has seen greater income inequality in most, though not all societies. In recent decades, there has also been a general decline in social provisioning in many societies. This is not only true of many so-called welfare states, but also of postcolonial societies featuring some tax-financed social provisioning. Such social provisioning has declined in China, Russia and many other ‘economies in transition’. As a consequence, the welfare of individuals and families depends much more on what they can afford based on their wealth and incomes. The era of economic liberalization has witnessed not only increasing income inequality at the national level (Figure 1), but also growing concentration of income and wealth at the world level (Figure 5).

The increase of income inequalities within countries since the 1980s has been especially pronounced. The income shares of the richest one, five or ten per cent of the population have been growing for over thirty years. In many countries, inequality has been approaching levels before the Second World War, which led to the emergence of the socialist bloc and the dramatic decline in inequalities in most countries. To give one example, in the United States, the share of the nation’s total income held by the top (richest) ten per cent of the population was 40–45 per cent in the 1920s and 1930s, fell to 30–35 per cent from the 1940s to the 1970s, and started to increase again from the early 1980s, reaching 45 per cent in 2005.

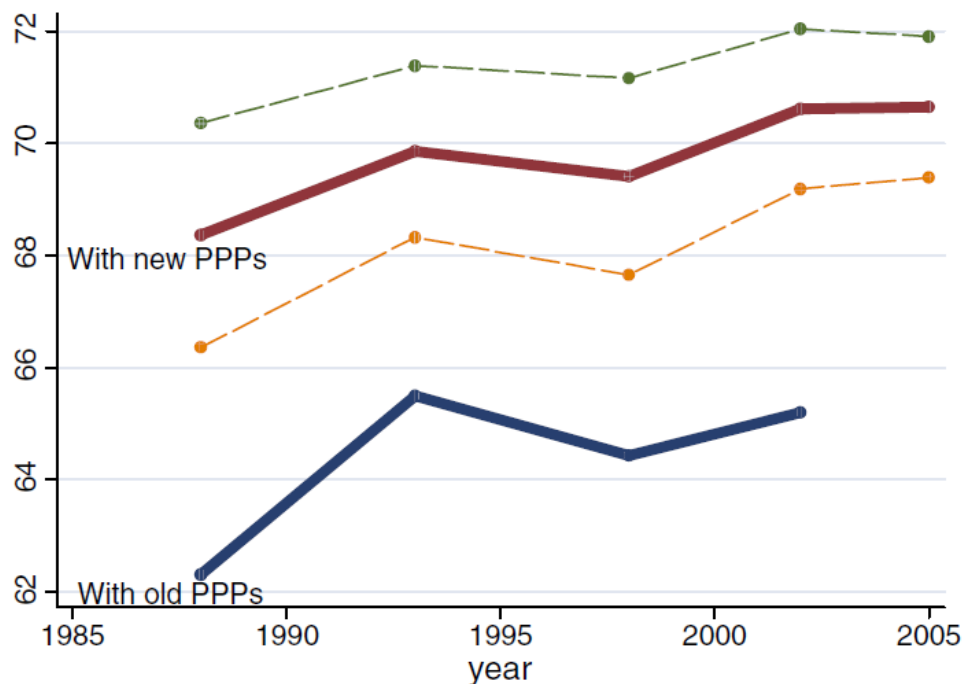
**Figure 4. Incomes of the richest as a multiple of average national income**



Source: Milanovic, B. *The Haves and Have-Nots: A Brief and Idiosyncratic History of Global Inequality*. Basic Books, NY, 2011.

The recent rise in inequality has paralleled an increasing rate of profit. During the post-war Golden Age, typically, when profits were high, capital’s success was shared with other social groups. In the 1950s and 1960s, for instance, wages, salaries and social security benefits grew together with rising profit margins. But since the early 1980s, profit margins have increased hand in hand with rising inequalities.

**Figure 5. Global Gini coefficients for income inequality, 1988–2005, calculated with new and old PPPs**



Source: Milanovic, Branko. Global inequality recalculated and updated: the effect of new PPP estimates on global inequality and 2005 estimates. — *Journal of Economic Inequality*, March 2012, Volume 10, [Issue 1](#), pp 1-18

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It is not clear where the trend in income inequalities will lead. Simon Kuznets (1955) hypothesized that there is an inverted U-shaped relationship between economic growth and inequality, with inequality increasing at the industrialization stage, when the urban-rural income gap rises, and declining later with the rise of the welfare state. But empirical research does not unequivocally support the Kuznets curve hypothesis.

In *Capital in the XXI century*, Thomas Piketty (2014) argues that the recent trend of rising national-level inequality is permanent because the profit rate is higher than the economic growth rate. For him, rising inequality is a long term trend due to the increased wealth (capital) to output ratio (K/Y) under “patrimonial capitalism”, leading to the rising share of capital in national income. He believes this trend will continue into the future and was only temporarily interrupted in the 20th century due to the destruction of capital during the two world wars and for other reasons. In this logic, it is not clear why the sustained increase in capital (versus labour) has not induced a decline in the rate of profit offsetting the effect of the growth of capital (Milanovic, 2014).

An alternative view, consistent with the trends noted above, is that the reversal of growing inequality followed the 1917 Bolshevik revolution in Russia<sup>1</sup>, the emergence of the USSR and other socialist countries, the strengthening of socialist and populist movements, the growth of the welfare state and other changes associated with Karl Polanyi’s *Great Transformation*. Education and health care access not determined by personal and family means and the strength of robust and egalitarian alternatives have constrained and checked economic inequalities, especially as long as socialism was relatively dynamic and seemed to be catching up with the West. As such socialism lost its dynamism from the 1960s and posed less of a threat, income inequalities started to grow again.

## 2. Capital versus labour

If income earning producers are mainly wage earners, income distribution will be influenced by the nature of wage determination and wage contracts. Where unemployment is high and incomes low, workers are usually more willing to accept wages close to subsistence. But where labour is better organized for collective bargaining and working conditions are regulated, wages are more likely to rise with productivity increases. For instance, for several decades, living standards in China did not rise as fast as productivity, but in recent years, living standards have risen faster as employers experienced labour shortages and expected greater skills and productivity from their workers. And with greater social protection and provisioning (public health, education, housing), the ‘social wage’ may increase much more than suggested by the money or real wages workers receive. But in many countries, the “social wage” has not risen faster than profits since the 1980s.

To put the issue in historical perspective, the 2008-2009 crisis does not yet seem to be a turning point in the long run, comparable to the Great Depression of the 1930s (Eichengreen and O’Rourke, 2009). The 2008-2009 crisis was not unique

<sup>1</sup> Turchin (2013) associated the decline in inequality after 1917 with the rise of the workers’ movement in the US and “the lure of Bolshevism”.

in terms of recent collapses of stock indices; between October 1972 and July 1974, and again between January 2000 and July 2002, the S&P index fell by almost half – as happened between October 2007 and March 2009 (Figure 6). The collapse of world output (by 3.4 per cent in 2009) was the largest decline in 60 years – much greater than the 1.4 per cent reduction in 1982, the 0.4 per cent reduction in 1974, and the 0.8 per cent reduction in 1975 (Figure 7). US profit margins and the rate of profit reached their lowest post-war levels in 1974, 1980 and 2002 (Figure 8). The US unemployment rate reached its post-war peak of 9.7 per cent in 1982, just ahead of the 9.6 per cent in 2009 (Figure 9). Meanwhile, real wages in the US are well below their early 1970s' level, while profits remain high<sup>2</sup>.

**Figure 6. US Standard & Poor stock price index since 1950, log scale**

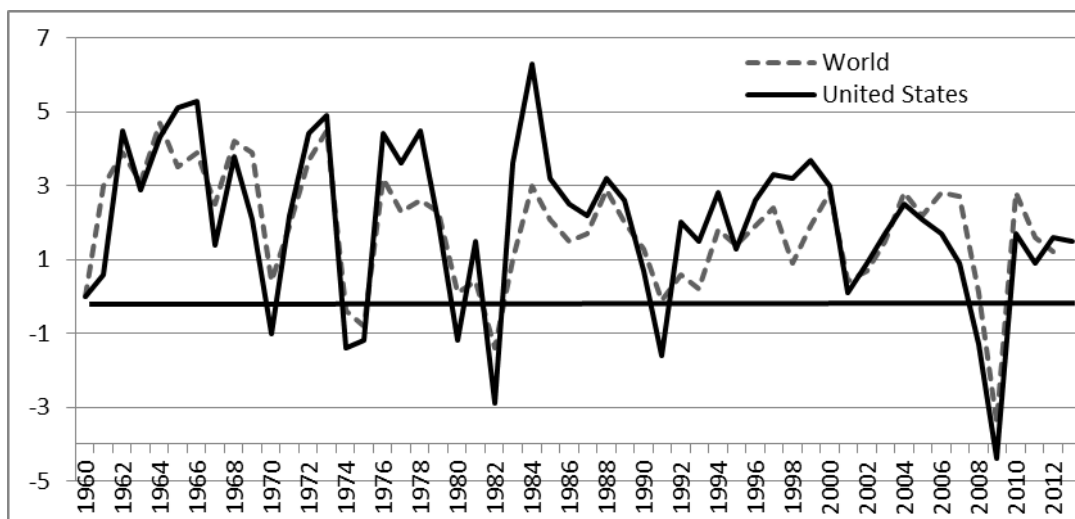


Source: Yahoo finance.

There were high, even double-digit inflation rates and economic slowdowns in major Western countries in the 1970s following the two oil price shocks of 1973-1974 and 1978-1979. This unexpected combination was dubbed a period of 'stagflation' and seemed unresponsive to traditional Keynesian fiscal and monetary policies. The first oil price shock followed the Arab-Israeli War of 1973, while the 1979 Iranian Revolution accompanied the second one. The 1974 Portuguese Red Carnation revolution, the subsequent collapse of the last colonial empire, US military defeat and withdrawal from Indochina in 1975 and other contemporary developments seemed to promise the prospect of major transformations.

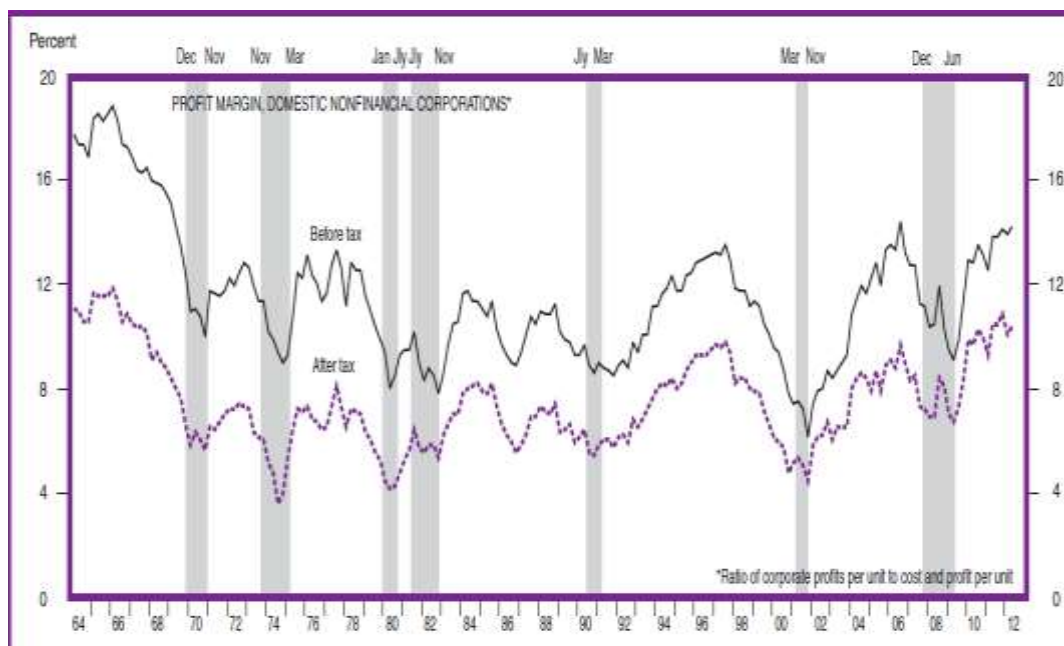
<sup>2</sup> If Kondratieff long waves exist, the lowest point of the long cycle should come in the 2020s or 2030s, not now; the previous troughs were in the 1870s, 1930s, and 1970s-1980s.

**Figure 7. World, US GDP per capita growth rates, 1960-2013 (%)**



Source: World Development Indicators database, World Bank.

**Figure 8. US domestic non-financial corporations' profit margins (share of profits in sales), 1960-2012 (%)**

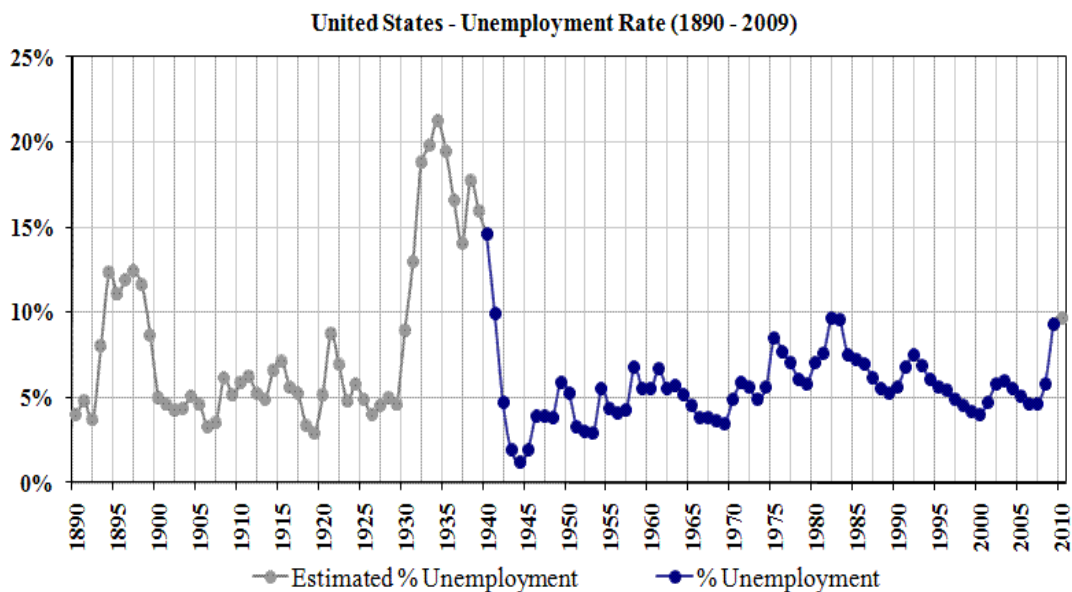


Source: Bureau of Economic Affairs.

Thus, by the 1970s, the hegemony of Western capitalism seemed under threat from within and without. The conservative reaction in the Anglophone West soon followed, led by Thatcher and Reagan in the 1980s, weakening workers' movements. Government spending, including social spending, stopped growing, many social security programs were curtailed, and unemployment rose to highs not seen since the 1930s, as trade unions were defeated in their industrial actions (coal miners in the UK, air traffic controllers in the US), causing union membership to decline. The top income tax rates, higher than 50 percent in the US, UK, Germany and France during 1940-80, dropped to below 50 percent by 2010 (Figure 10). Not surprisingly, income and wealth inequalities have risen in most countries since (Figure 1).

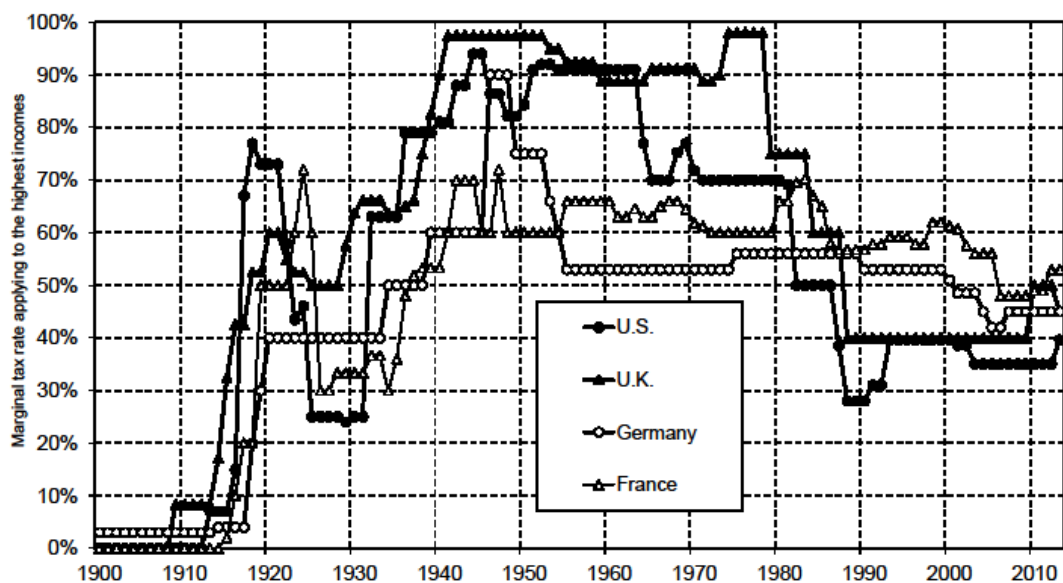


Figure 9. US unemployment rate long term trends (%)



Source: 1890-1930 data from: [Christina Romer](#) (1986). Spurious Volatility in Historical Unemployment Data. *The Journal of Political Economy*, 94 (1): 1-37. 1930-1940 data from: Robert M. Coen (1973). Labor Force and Unemployment in the 1920s and 1930s: A Re-Examination Based on Postwar Experience. *The Review of Economics and Statistics*, 55 (1): 46-55; 1940-2011 data from the US [Bureau of Labor Statistics](http://en.wikipedia.org/wiki/File:US_Unemployment_1890-2009.gif) ([http://en.wikipedia.org/wiki/File:US\\_Unemployment\\_1890-2009.gif](http://en.wikipedia.org/wiki/File:US_Unemployment_1890-2009.gif)).

Figure 10. Top income tax rates in the US, UK, Germany and France, 1900-2010 (%)



Source: Technical appendix to *Capital in the 21st century* by Thomas Piketty, March 2014 (<http://piketty.pse.ens.fr/capital21c>)

The collapse of the Berlin Wall (1989) and the USSR (1991) were among the high points of this resurgence, reflected in the counter revolution against Keynesian and development economics. The income share accruing to capital increased, at the expense of labour, with rentier shares (e.g. accruing to finance or intellectual property rights) growing much more than the real economy. Generally higher unemployment and real wage stagnation, if not contraction, despite productivity increases, ensured rising profit margins and income inequalities. Meanwhile, trade union and worker movements in Western countries have been experiencing decline since the 1980s. In this sense, the Thatcher-Reagan counterrevolution was

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successful on a global scale. Today, capitalism is the only ‘show in town’, and the main choice and debate is among varieties of capitalism, rather than between capitalism and some systemic alternative.

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(<http://www.aeonmagazine.com/living-together/peter-turchin-wealth-poverty/>)