

Wagschal, Uwe

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# Luxembourg Income Study Working Paper Series

Working Paper No. 152

Income Distribution, Inequality and Unemployment

Uwe Wagschal

February 97

*(scanned copy)*



# "Income Distribution, Inequality and Unemployment".

## 1. Introduction

The following study deals with unemployment and employment on the one side and income distribution and related subjects on the other side. Its main focus is on the relations between the two topics and on common underlying factors. There have been massive changes in the earnings' inequality and income distribution in the OECD area during the 80s and the early 90s, as well as huge variations in the development of the unemployment and employment figures. The question, therefore, is obvious: Are there any systematic relations between income inequality and labour market indicators and, moreover, which common factors caused these changes? Which political climate and institutions are favourable to such a change?

The proceeding is the following: Chapter one describes the development of unemployment, employment and inequality, measured by various indicators. In the second chapter I will discuss the relation between the income inequality and the labour market indicators. Predominantly I will deal with the incentive structure for taking on work, before stressing the political science focus, by discussing political and institutional driving forces and barriers for these changes since the beginning of the 80s. Before concluding I shall turn to the question, whether the poor are really the losers of this transformation process.

## 2. Unemployment, employment and inequality in comparison

Over the past 35 years there have been tremendous changes in the labour markets of the OECD countries. Starting comparison in 1960, the range between the country with the best unemployment performance (Switzerland) and the worst unemployment performance (Canada) is 6.90 percentage points. In the mid-90s this gap has widened, so that the maximum range between the extreme cases of Luxembourg and Spain is now three times as large as in 1960 (21.5 percentage points). As shown by figure 1 it was not only different countries but also nation families who underwent different ways to various stages. Japan, which can not be classified into a geographical or linguistic region performs best, while the countries of southern Europe come off worst. Within each region there are, however, big variations, so that

the percentage point difference between Luxembourg and Belgium in the sub-group "Central Europe" lies at 10.4 in 1994.

**Figure 1: Unemployment in OECD Regions**

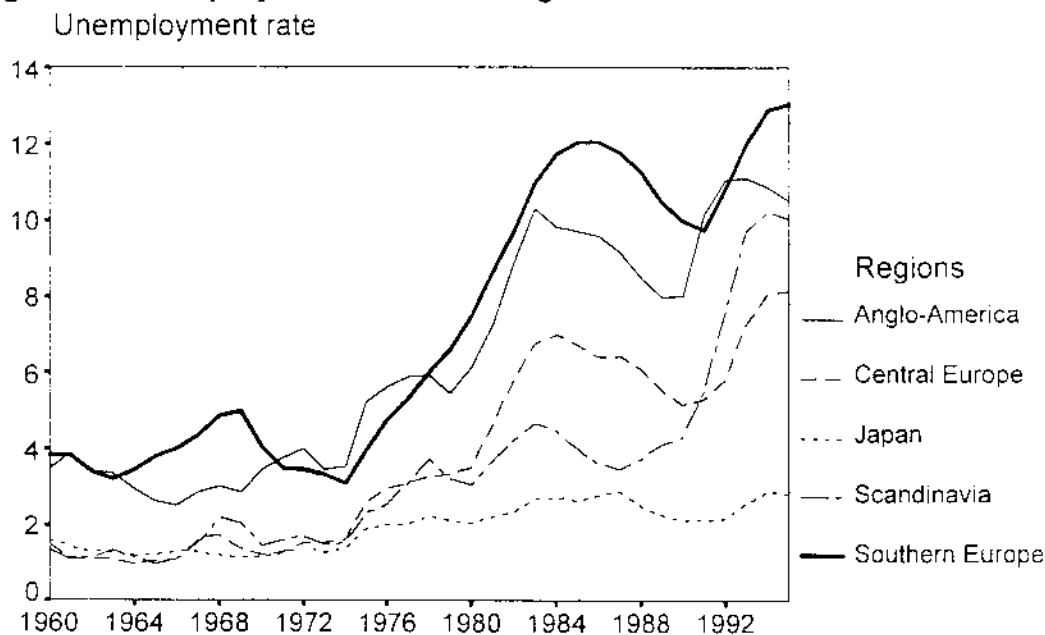


Figure 1 displays four massive increases in the unemployment figures: a first push in the late 60s, a second after the first oil crisis, another after the second oil crisis and finally a fourth push in the late 80s and early 90s. Important is the tremendous rise during the fourth unemployment wave, when the figures for Sweden and Finland in 1994 are five times as large as in 1990.

The American job machine with decreasing unemployment figures and rising employment is often mentioned as the bright example for how to cope with unemployment (Blank 1995, Schettkat 1995). The main reasons for this success are - if one believes the literature - a widened gap in inequality, lower replacement ratios for the unemployed, a low level of employment protection laws, lower marginal effective tax rates for low-income groups and therefore higher incentives for taking on work (Deutsche Bundesbank 1996, Glyn 1995, Björklund 1993). It might be possible to gain from the good experience of one single country. However, it is important to bear in mind whether this relationship is valid for other OECD countries, too, and to analyse the underlying mechanisms at work. Before turning to this problem a few remarks on inequality measurement need to be made.

Measuring inequality is rather complicated (Jenkins 1991, Förster 1993, OECD 1995a). Multiple choices and decisions can influence the result. Before measuring inequality one needs to define the variable of interest: income data, assets or expenditures. In this study only with income data is dealt. Next one has to decide whether

to look at gross or net income. Are taxes, social contributions, benefits and income in kind included? Another point of interest is the time period over which income is recorded. The longer the time period, the less the fluctuation of income. A third problem when measuring inequality is related to the income receiving unit: Is income measured per household, family or individual? This leads to the problem of weighting the household (or family) members in the calculations, that is the use of a correct equivalence scale (Förster 1993: 15f.). Finally, one has to take into account that some individuals might be excluded from the sample, such as very poor or homeless people. Another bias might be caused by the fact that very rich people do not always report their accurate income.

**Table 1: Changes of Inequality, Unemployment and Employment in the 80s and early 90s**

	Change of decile ratio D9 / D1 from 1980 to 1993 <sup>a</sup>	Decile ratio D9 / D1 in 1993 <sup>a</sup>	Change in inequality between early 80s and early 90s (based on Ginis) <sup>a</sup>	Unemployment rate in 1994 <sup>c</sup>	Change of Unemployment rates from 1980 to 1994 <sup>c</sup>	Change of total employment rates from 1980 to 1994 <sup>d</sup>
USA	0.91	4.16	large increase	6.10	-1.07	7.70
UK	0.54	3.33	very large increase	9.20	3.10	-2.80
POR	0.43	4.05	no change	6.90	-1.08	1.50
ITA	0.16	2.80	small decline	11.30	3.64	-3.90
NZ	0.15	3.04	moderate increase	8.10	5.43	4.20
ÖST	0.13	3.58	no change	5.90	4.26	5.70
SWE	0.09	2.13	large increase	8.00	6.35	-9.20
NL	0.08	2.59	small increase	7.60	2.95	9.50
JAP	0.03	3.04	moderate increase	2.90	0.88	3.90
DEN	0.02	2.17	small decline	12.20	5.20	-2.30
CAN	0.01	4.02	no change	10.40	2.94	1.10
F	0.00	3.26	no change	12.30	6.03	-4.80
AUS	-0.05	2.79	moderate increase	9.70	3.70	1.00
NOR	-0.08	1.98	small increase	5.40	3.74	-1.30
FIN	-0.17	2.29	no change	18.40	13.73	-12.80
BEL	-0.25	2.25	small increase	13.10	5.21	-3.00
D	-0.37	2.32	no change	9.60	6.41	-0.80
SWI	.	2.71	.	4.70	4.50	5.30
GR	.	.	.	9.60	6.85	-0.40
ICE	.	.	.	4.70	4.42	6.50
IRL	.	.	no change	14.20	6.90	-3.90
LUX	.	.	.	2.70	2.01	7.80 <sup>f</sup>
SPA	.	.	no change	24.20	12.74	-5.80
Mean	0.10	2.92		9.44	4.73	0.14

Notes: a = Based on the authors' own calculations. Data taken from the OECD Employment Outlook (1996b: 61f.). Data refers not always to 1993; in this case the latest available data was used. Data refers to gross income and full-time workers. b = Classification based on disposable income (various studies). Ranges of change in Gini coefficients used for classifications: 1) small decline = -5 percent or more; 2) no change = -4 to +4 percent; 3) small increase = 5 to 10 percent; 4) moderate increase = 10 to 15 percent; 5) large increase = 16 to 29 percent; 6) very large increase = 30 percent or more. Source: Smeeding and Gottschalk (1996). c = Source: OECD Economic Outlook 59 (1996a). d = Source: OECD Economic Outlook - Historical Statistics 1960 - 1994 (OECD 1996c) and OECD Employment Outlook (OECD 1996b)

Having dealt with these problems and taken the necessary crucial decisions one can calculate summary statistics, such as the Gini coefficient or decile ratios. Column 4 of table 1 displays the development of the Ginis (based on disposable income) in various countries from the early 80s to the early 90s. The classification is founded on several studies of inequality (Smeeding and Gottschalk 1995), whose data base is usually the Luxembourg Income Study (LIS). The largest increases in inequality have taken place in the UK, the USA and Sweden. Only two countries, namely Italy and Denmark, experienced a shift towards greater equality. The level of the Ginis (see figure 4) suggests that the Scandinavian countries are most equal (Finland is on top of the ranking), followed by the Benelux Countries and Germany (OECD 1995a: 45f.). The most unequal income distribution is found in the USA, followed by Switzerland, the UK and Italy (data referring to the early 90s only).

A slightly different picture is given when using the decile ratio of the gross earnings and its changes between 1980 and 1993 (column 2 and 3). The correlation between the changes of the Ginis in the 80s and changes of the decile ratios estimates at only  $r = 0.47$  ( $r_s = 0.29$ ), due to different income concepts. In contrast, both the levels of the various decile ratios ( $D9/D1$ ,  $D9/D5$ ,  $D5/D1$ ) and the Ginis for disposable income (early 90s) are considerably strong correlated (above  $r = 0.6$ ). It is remarkable, that unequal countries became even more unequal during the 80s. This illustrates that the relative gap between the countries has widened and suggests that relatively equal countries are more resistant to changes towards more inequality. One can interpret this as a kind of "aggregate" Tocqueville effect: The higher the level of equality, the more sensitive people are about changes of this condition.

Analysis of table 1 leads to a positive answer to the question raised, namely whether there are any visible relations between unemployment, employment and income distribution. The simple bivariate correlations between the level and change of the decile ratios on the one hand and the change of the unemployment rates on the other are high and significant ( $r = -0.61$  for the level and  $r = -0.63$  for the change). The higher the inequality and the stronger the move towards income inequality, the easier the way through the 80s concerning the labour market. The bivariate correlations with the unemployment and employment levels are lower, though always with the expected sign. Nevertheless, the inequality indicators in multivariate regressions are highly significant, as shown by the following two regressions, which includes two other variables: the starting point in 1980, as a control for the different labour market pressures and idiosyncrasies, and the level of part-time employment. The hypothesis

for the impact of part-time employment is straightforward and one of the most mentioned reasons for good unemployment performance: the higher the share of part-time work, the lower the unemployment and the higher the employment. As both regression coefficients show, this relation holds to be true.

1) Unemployment 1994 =	Constant	Decile Ratio 1993	Part-time Work 1993	Unemployment 1980
	17.99	-3.22	-0.18	0.78
	(4.87)**	(-3.41)**	(-2.08)*	(2.97)**

$R^2 = 0.62$ ,  $n = 18$ , t-statistics in brackets, \*\* = significance at the 1%-level; \* = significance at the 5%-level. (one-tailed test).

2) Employment 1994 =	Constant	Decile Ratio 1993	Part-time Work 1993	Employment 1980
	2.65	4.57	0.49	0.62
	(0.24)	(3.34)**	(4.01)**	(4.47)**

$R^2 = 0.77$ ,  $n = 18$ , t-statistics in brackets, \*\* = significance at the 1%-level; \* = significance at the 5%-level. (one-tailed test).

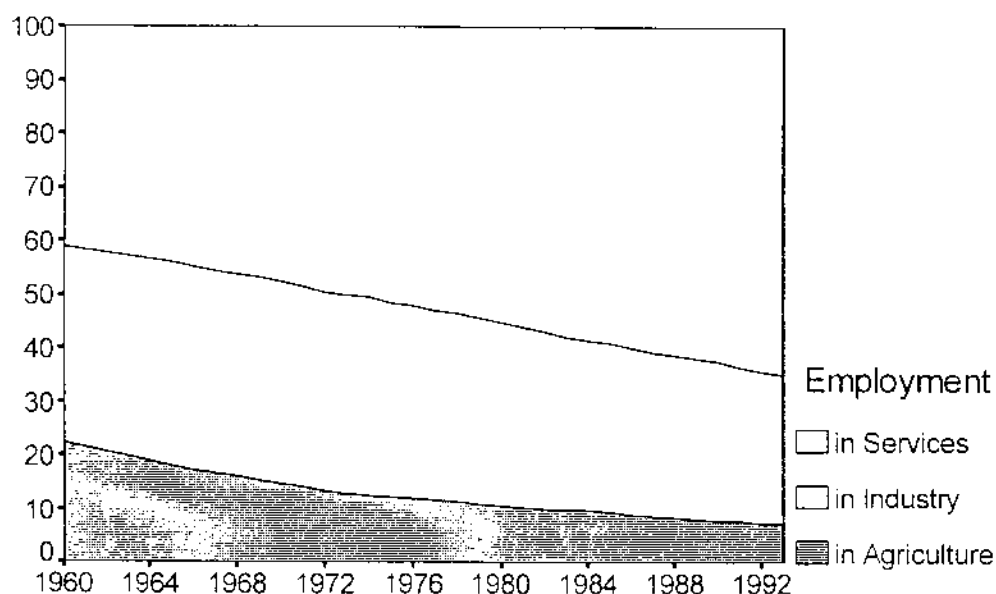
The conclusion to be drawn from the various inequality indicators and the different ways of looking at them is very clear: countries with high income inequality and a strong move towards more income inequality experienced a better labour market performance, resulting in higher employment and lower unemployment figures.

### 3. Why does income inequality lead to lower unemployment?

The typical earning situation of a family in the post-war-era is known as the well-known breadwinner model. The male head of the household went to work and earned the families living. In the post-fordist revolution this employment structure has changed dramatically. Industrial employment as a percentage of the total civilian employment fell to a great extent: the OECD average dropped from 36.5 in 1960 to 28.4 in 1993. Almost every country suffered from large job losses in the industrial sector, except some industrial latecomers like Greece, Portugal, Ireland, Spain and Japan. The largest decrease was experienced by the UK with a difference of 21.5 percentage points in the share of industrial employment on the total civilian employment. The overall OECD trend was not only a decrease in industrial employment but in agricultural employment (see figure 2), too. It was the service sector, who gained from that. These changes did not only affect the overall employment structure but found expression in decreasing male, respectively increasing female employment (Schmidt 1993) as well. All these trends influence the earnings and income distribution. Moreover, comparable time series data for the incomes relating to gender in the different sectors are not available. Still, some general statements for the relation between income distribution and unemployment can be made.

The first well-known opinion is that the level of the real wages does affect employment and unemployment. The lower the wages, the higher the demand for labour. Wages are usually sticky, meaning there is no wage flexibility. Especially during a crisis, the lack of downward elasticity is regarded as one of the major sources of unemployment. The link with the income distribution is not directly. Supposing all incomes of the shrinking sectors to be stable, while the incomes of the well-doing and booming sectors increase, there is greater income inequality, which is regarded as a necessity of more growth and lower unemployment in the future. Furthermore there are other intervening variables which can affect the flexibility of the real wages, such as education, gender and age. And indeed, if one looks at the data, one can observe huge changes over the time (OECD 1994a: 5, Freeman and Katz 1995).

**Figure 2: Changes in the employment structure in the OECD world**



Note: Calculated as averages of 23 OECD countries. Source: OECD-Historical Statistics.

The general hypothesis is that higher income inequality leads to lower unemployment because the relative distance between different income groups represents a work incentive. As stated in chapter 2, this relation holds true for the 80s and early 90s but when looking at the 70s and the year 1980 this connection could not be proven by the data. All the egalitarian Scandinavian countries had low unemployment rates, as well as some Central European countries. In addition, it is not clear - at first glance - why an equal income distribution should prevent workers from taking on work or employers from offering it. A small distance between the upper decile and lower decile has no direct impact on the incentives for workers or motivations for employers. For employers, the labour costs, which are influenced by taxes, social



contributions and the wages are much more relevant. On the other hand, the labour supply is much more influenced by the replacement ratios, the unemployment and social benefits, the take home cash and the real wages. Especially a high marginal effective tax rate can hinder workers to accept jobs. These topics are indirectly related to the income distribution in a society but it is the tax and benefit system, which is closer related to the labour market. However, it was not the overall level of taxation that caused high unemployment. Over the past decades a lot of countries with high levels of taxation have had low unemployment rates. The OECD comes to the same conclusion: "As with the total tax/GDP ratio, however, it is all but impossible to find a simple relationship between taxes on labour and unemployment." (OECD 1995b: 14). High taxation becomes a problem when the unemployed have little incentives to look for a job. It is not such a big problem for high income groups because it is even possible that they will extend their labour supply to maintain their standard of living while facing increasing taxes. Moreover, their possible net replacement ratio is smaller than that of low-income groups. From an economic point of view it is unreasonable for an employee with high human capital and high income to skip work because his skills will soon become devaluated.

There are several ways to illustrate this unemployment trap. The German Bundesbank recently demonstrated in a study that the distance between the wages and the social benefits is too narrow for some groups (Deutsche Bundesbank 1996: 61ff.). In the end, work does not pay for workers with low human capital. Another intervening factor is the family size. The more the dependent family members, the less the incentive to work since the household is better off when relying on social benefits. This is connected to the fact that benefits are higher for families with children. In the OECD world one can compare the replacement rates for different types of households, e.g. single-earner households under several conditions (single, couple no children, couple two children). The level of comparison is a fictive average production worker (APW). In some countries the net replacement ratios, after taxes and other benefits, are higher than the earnings from work. In Scandinavia (1994) the net replacement ratio for a single-earner household with two children and housing benefits and an income of two thirds of the APW varies from 95 percent in Denmark to 121 percent in Sweden (OECD 1996b: 32). The rational behaviour ensuing is obvious: it is not profitable to work.

For a cross-country comparison one should look at certain indicators which can be used for identifying a relationship between the work disincentives and unemploy-

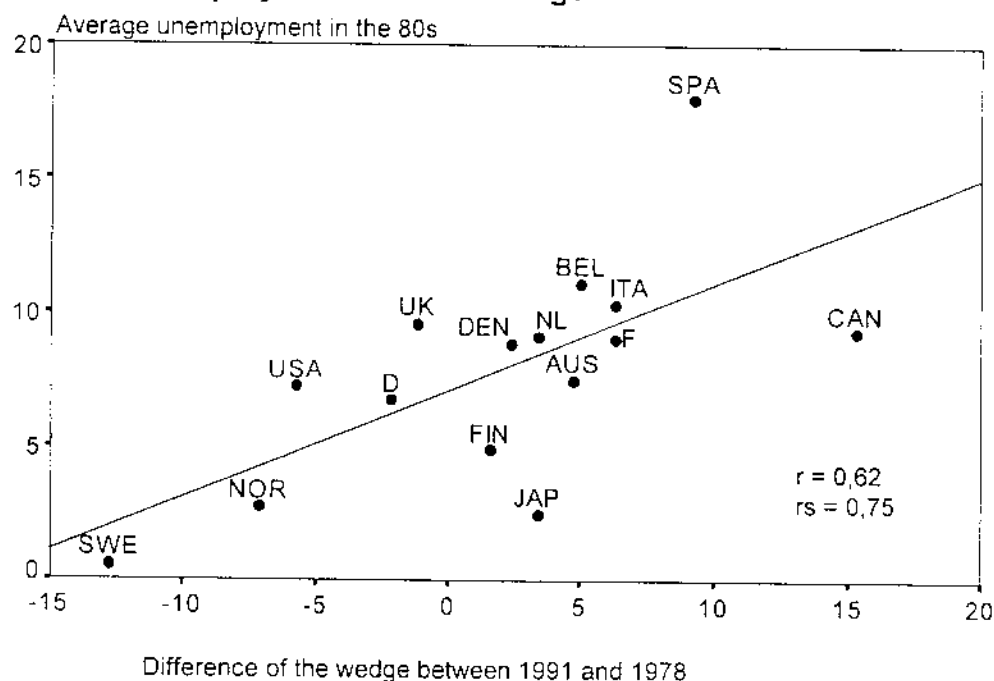
ment: 1. The marginal effective tax rates, which measure the increase in net income of one additional unit income, taking social contributions and taxes into account. 2. The take home pay plus cash transfers, controlled for various family types (OECD: 1994b). 3. The net replacement ratio also controlled for various family types. A replacement ratio measures the ratio of income received when unemployed against that which could be received in employment. 4. The tax wedge which is the "difference between the cost of employing someone and the consumption which can eventually be financed from work" (OECD 1994a: 240). This is an indicator for the tax burden. A large wedge indicates a high tax burden. 5. Unemployment benefits, social expenditures and other aggregated social expenditure figures.

Overall averages for a single country have a problem: they do not take differences between various income groups and family types into account. A decrease in marginal tax rates for high incomes can cancel out increases in marginal tax rates for low incomes. There are also variations in the replacement ratios and take home cash for singles and couples (with and without children). A good example is Germany with different developments for the marginal and average tax rates since 1978. For high incomes the marginal as well as the average rates went down, while the average rate for some high income went up. For low incomes the marginal rates increased, although with constant average rates. Finally, the mid-incomes experienced constant average rates, but decreasing marginal rates (OECD 1995b: 27). It would therefore be much more appropriate to look at unemployment rates for these distinct groups in order to identify the real impact of this disincentive structure.

As the OECD statistics and the Bundesbank study (1996) show, the relation between unemployment and disincentives is predominantly a problem of less skilled and low-wage workers and employees with children. People with these attributes and in certain labour market segments (e.g. in hotel industry, manufacturing, retail trade) face a strong stimulus not to apply for jobs when unemployed. This coincides with the unemployment and employment changes in the 80s controlled for education and blue-collar workers. Except for the USA, the Netherlands and Mexico there have been reductions in the employment for blue-collar workers. Unemployment figures are considerably higher for low skilled blue-collar workers (OECD 1996d: 84f.). This holds to be true for the education level, too, where high educated people are much more unlikely to become unemployed (except for Italy).

The simple bivariate correlations are not as clear as the theoretical reasoning suggests. If one looks at the correlations between unemployment and employment on the one side and the various disincentive respective incentive indicators on the other, they generally have correct signs for our examined period. However, the **level** indicators are usually insignificant. An exception is made by countries with high net replacement ratios for low income groups, which experienced high increases in unemployment ( $r$  about 0.5). The findings of chapter 2 imply that the overall indicators of inequality, such as the various decile ratios ( $D9/D1$ ,  $D5/D1$ ,  $D9/D5$ ), show a higher correlation than the disincentive indicators. Investigation of the **changes** for the various indicators during the 80s gives a more definite picture. Countries moving to a more market orientated system with lower marginal tax rates, increasing take home pay and a lower wedge underwent lower unemployment during the 80s. The relationship between the change of the wedge and the average unemployment rates in the 80s (see figure 3) indicates that the stronger the move to a lower tax burden, the lower the average unemployment rates.

**Figure 3: Unemployment and the Wedge**



Review of the literature about the causes and determinants of unemployment pinpoints various factors, some of whom institutional. Other possible determinants are the employment protection laws, the wage bargaining system, corporatism, the strength of trade unions, minimum wages, part-time work, early retirement programmes and profit sharing. To handle this heterogeneous picture, one needs to estimate multivariate regressions. The following regressions 3 and 4 considers the role

of one of the most other mentioned causes for unemployment since 1980: part-time work. Other indicators in both equations either refer to the income distribution or to the disincentive structure (net replacement ratio and take home pay). Equation 3 also includes the average of the real growth during the 90s since a high growth is the best way to reduce unemployment.

3) Unemployment 1994 =	Constant	Change of Decile Ratios 1980-1993 <sup>a</sup>	Part-time Work 1993	Take home pay 1993 <sup>b</sup>	Real Growth (1990-1994)
	36.80	-4.39	-0.22	0.25	-1.61
	(4.35)**	(-2.31)*	(-2.49)*	(2.61)*	(-2.42)*

$R^2 = 0.71$ ,  $n = 17$ , t-statistics in brackets. \*\* = significance at the 1%-level; \* = significance at the 5%-level (one-tailed test) <sup>a</sup> = Difference between D9/D1 in both years (see table 1) <sup>b</sup> = measured as take home pay plus cash benefits for a single earner couple with two children

4) Unemployment 1994 =	Constant	Decile Ratio (D9/D1) 1993	Part-time Work 1993	Replacement Ratio 1994 <sup>a</sup>	Unemployment 1980
	4.72	-1.21	-0.33	0.16	0.65
	(1.19)	(-1.53)*	(-4.71)**	(4.10)**	(3.09)**

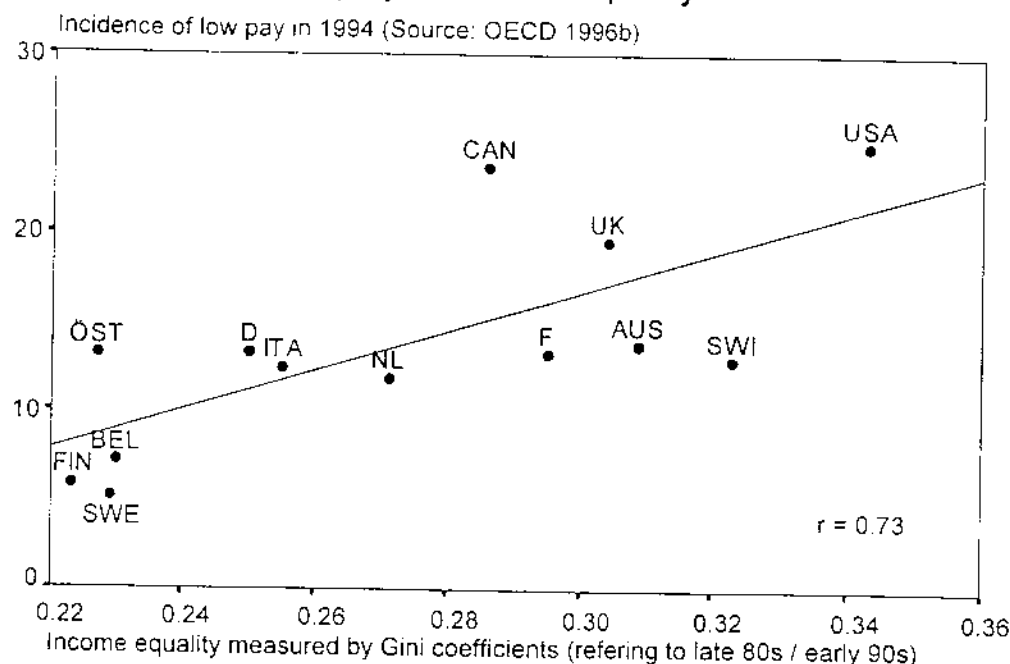
$R^2 = 0.86$ ,  $n = 16$ , t-statistics in brackets. \*\* = significance at the 1%-level; \* = significance at the 5%-level (one-tailed test) <sup>a</sup> = Net replacement ratio of a 2/3 average production worker, single-earner-couple with two children.

The results of equations 3 and 4 (and other related findings) indicate that: greater income inequality, high part-time work, weak disincentives especially for low-paid workers and high growth rates are favourable to low unemployment. Substitution of similar variables for the disincentive structure shows that the strongest impact and highest significance is achieved for low-paid single-earner-couples with children. As noted above, this is exactly the group threatened by higher unemployment and susceptible not to take on a job because the distance between social benefits and wages is too small.

While on the one hand the USA are regarded as an outstanding example for coping with the unemployment crisis, a major critique on the other hand is that only low-paid jobs have been created during the employment rise since the beginning of the 80s (Glyn 1995: 11). Indeed the USA have the largest share of low-paid employees in the OECD area: 25 percent of all full-time workers are in low-paid jobs. The lowest figures are observed in the Scandinavian countries and in other countries with a high degree of corporatism. Low-paid work leads automatically to higher inequality in earnings (see figure 4). There is a high correlation between the decile ratios and the low-paid employment, for the D9/D1 ratio it is  $r = 0.89$  and for the D5/D1 ratio  $r$  is 0.85, which, of course, is not surprising. The correlation with the Gini index is also high ( $r = 0.73$ ). However, there is no significant relationship between low-paid work and the unemployment and total employment figures. A large proportion of low-paid

employees are found in the service sector, mainly in wholesale and retail trade as well as in hotels and restaurants. There are as well considerable differences between women and men in all OECD countries: women are much more likely to work in low-paid jobs (OECD 1996b: 74).

**Figure 4: Low-Paid Employment and Inequality**



Source: Data from the Luxembourg Income Study; Smeeding and Gottschalk (1995: 10)

Notes: The incidence of low pay refers to low employment only. Low pay is defined as less than two-thirds of median earnings for full-time employees.

What do these findings imply? Is low-paid work simply an evil or does it have positive aspects, too? First of all, even a job with a relatively small salary is better than unemployment, considering the costs of human capital, resulting in long-term unemployment and hysteresis phenomena on the labour market. Furthermore, the psychological burdens of unemployment, such as loss of self-esteem, are high. Secondly, such a job can be a stepping-stone for a career, unemployment not. Thirdly, the government does not need to spend as much for social benefits. Finally, low-paid employment can result in bigger earnings, when there is a high earning mobility. An examination of earnings mobility of low-paid workers (full-time) shows that there is great chance of getting out of low-paid jobs (OECD 1996b: 88ff.). In all analysed countries only a minority of those who were situated in the bottom quintile in 1986 had still been there in 1991. The workers either moved out of full-time employment or to higher quintiles. Taking the low-paid workers who were employed in 1986 and in 1991 as a group of comparison, the range of the percentages of low-paid workers who moved up to other quintiles varies from 47.8 in the USA to 60.9 in Finland. This

means that even in the USA there is a big chance to improve one's earning situation. The second largest upward trend can be detected in the UK, where 58.9 percent of the low-paid worker in 1986 went to an upper quintile in 1991. From a Rawlsian point of view this is not bad: It is possible to accept inequality as long as the most underprivileged member of the society benefit from it. Though there is great earnings inequality in the USA and in the UK, there is still an opportunity of getting ahead. And due to relatively low unemployment more people can grasp this opportunity.

#### **4. Explaining the Change**

In this chapter I will focus on several possible explanations, which could have led to the changes in income inequality and unemployment:

1. The impact of general policy changes in the government.
2. The role of trade unions and the wage bargaining structure in a society.
3. The extent of the welfare state.
4. An explanation via the preferences of the voters resulting in different objectives of the parties and then leading to policy changes.
5. An investigation of the partisan theory of politics.
6. The importance of globalisation in the process of change.

The biggest changes in inequality occurred in the USA and the UK. Whilst the USA have been very successful in reducing unemployment, there was only a moderate mastery of this problem in the UK. However, a decrease in unemployment and an increase in employment took place in the UK, just like in Portugal, the country with the third largest increase in the decile ratio D9/D1 between 1980 and 1991. This development is connected with policy changes in the early 80s, symbolised by the Reaganomics and Thatcherism. Both constituted changes towards monetarist and supply-side economics. Though some of these changes occurred earlier, the emphasis of both Reagan and Thatcher led to substantive policy changes, their essences being simple: Tax cuts for the rich are positive for the economy and will therefore lead also to gains for the poor. A theoretical foundation of the Reaganomics was the well-known Laffer curve, which suggested that tax cuts lead to higher tax revenues. Thatcherism included not only tax cuts and tax reforms, but also huge privatisations, attacks on trade unions and the dissolution of monopolies. Both strategies aimed at market-oriented reforms with deregulation, emphasis on price stability and reduction of the government's role. Such substantial reforms were not only re-

stricted to the USA and the UK but took place in Portugal, too. The neo-liberal government Silva reduced the tax rates (OECD 1989: 33) and undertook privatisations (OECD 1991: 41). The major tax reforms were introduced at the end of the 80s and were part of the modernisation process of Portugal's economy. It was moreover a general reform but also with the impetus to lower the tax burden (OECD 1991: 96). This emphasis on more market and tax-cuts for the wealthier people led to more earning inequality, as intended, but moreover to a good performance on the labour market. Table 5 shows that the change in the D9/D5 decile ratio between 1980 and 1993 was largest in Portugal. At least in the case of Portugal another important factor should be mentioned, namely the role of the European Community in the fast catch-up process (Huckemann and van Suntum 1995: 87).

An important argument in favour of a relationship between unemployment and inequality, is the occurrence of different labour market regulations. Labour relations, which influence the possible choices of the employers, can lead to sticky wages and less flexibility (Blank 1995: 5). The labour markets of the UK and the USA are less regulated compared to other countries. Literature on labour market relations (Calmfors and Driffill 1988, Soskice 1990, Iversen 1996) points out that distinct wage bargaining systems are responsible for different labour market outcomes. Calmfors and Driffill (1988) suggest that there is a hump-shaped relationship between the centralisation of wage bargaining and unemployment. Low centralisation as well as high centralisation lead to low unemployment. Soskice (1990) criticised the Calmfors and Driffill approach not to be correct, putting more emphasis on the role of co-ordination. He labelled countries with a high degree of co-ordination "Co-ordinated Market Economies". Furthermore, he stressed the position of the employers and the importance of companies in the bargaining process. Especially the USA and the UK have very low co-ordination on the employer and union level. A cross-country comparison showed lower unemployment for co-ordinated economies (Soskice 1990: 57). Iversen (1996), too, argued that centralised and decentralised wage bargaining systems can also result in low unemployment, regardless of the corresponding monetary policy regime is flexible or non-accommodating. Though co-ordination and centralisation are different concepts, they are highly correlated for the 80s ( $r_s = 0.65$ ). Japan is the most divergent case with a high degree of co-ordination and bargaining on the plant level. These studies about co-ordination and centralisation of bargaining levels relate to the long discussion about the theoretical concept of corporatism. However, the main question must be: what is the link to inequality? Trade unions

mainly bargain for their members. The hypothesis therefore is that high union density leads to more equal distribution since stronger unions can negotiate higher incomes.<sup>1</sup> This reflects an Insider-Outsider problem, where the insiders have work, while the outsiders do not. The unions bargain for higher wages for the insiders, who have a kind of blackmail potential, whilst the powerless outsiders remain unemployed, maybe with undesirable effects for poverty outcomes. The findings support this hypothesis. Strong unions are able to achieve high income equality (e.g.  $r = -0.68$  for the union density in 1990 and the Gini index for disposable incomes,  $n = 18$ ). In addition, they have the power to influence the redistribution process between the market incomes (before taxes and benefits) and the disposable income. This holds also true for strong corporatism ( $r_s$  is above 0.6 for the Gini and various corporatism indicators) and the bargaining level, though corporatism and union strength are only mediumly strong correlated with each other. A centralised bargaining level is favourable to a more equal income distribution because it is easier for the unions to obtain - on average - the same wage increases. On the other hand, bargaining on the plant level has much more flexibility, though it also has weaknesses (Soskice 1990: 48). Nevertheless, more productive and profitable firms are able to pay higher wages, whilst less-profitable ones pay lower wages. The result is a greater variation in income distribution.<sup>2</sup> The level of bargaining varies not only across countries, but also across time (OECD 1994a: 11, Iversen 1996), so that there are some differences between the 70s and the 80s. In the UK, for example, lower level bargaining on the plant level becomes predominant. This process continues, e.g. the centralised bargaining system in Finland was decentralised in 1992 (MISEP 1996).

How does the welfare state affect the major economic aggregates and equality? Here one deals with the old question of a trade-off between equality and efficiency (Okun 1975). Olafsson (1992) has shown for the 70s up to the early 80s that advanced welfare states did not perform worse than less advanced ones. The figures for the 60s and 70s, indicate that then unemployment was low and equality high. Affluence and real growth figures were also at a high level in the socialist world of welfare. It was generally believed that equality was compatible with work incentives and the market and that therefore there was no trade-off between equality and efficiency. Equality was produced via high spendings, especially high social security expendi-

<sup>1</sup> A high degree of unionisation is not necessarily an indicator for market power.

<sup>2</sup> The correlations give strong support for this reasoning. Bargaining levels (for the 80s and 70s both coded 1 = central, 2 = sectoral, 3 = plant) are quite strong correlated with the corresponding measures of inequality, e.g.  $r_s = 0.64$  for the bargaining level (80s) and the decile ratio D9/D1 in 1993.



tures, as mirrored by very high cross-country correlations with the equality measures ( $r$  is about 0.8). The redistributive function of the welfare state worked well and was able to maintain low unemployment and high employment.

**Table 2: Worlds of Welfare, Equality and Efficiency**

Type of welfare state	Gini Index early 90s <sup>a</sup>	Decile Ratio D9 / D1 in 1993 <sup>b</sup>	Unemployment 1994 <sup>c</sup>	Change of employment 1980-1994 <sup>d</sup>	Inflation 1980-1989 <sup>e</sup>	Real Growth 1980-1989 <sup>e</sup>	Total social expenditures 1993 <sup>e</sup>
Socialist	0.24	2.37	9.95	-1.98	7.53	2.41	32.78
Liberal	0.31	3.34	7.17	2.70	5.61	2.94	19.60
Conservative	0.26	2.84	11.07	-1.78	6.60	2.29	25.57

Notes: Table 2 displays averages for each category. Classifications of welfare state regime according to Esping-Andersen (1990: 75). a = Source: Smeeding and Gottschalk (1995); b = Source: see table 1; c = Source = OECD - Economic Outlook (1996); d = Source: OECD Historical Statistics (1996c); e = Source: Total Social Expenditure in % of GDP (OECD 1996e).

Is this still true for the 80s and early 90s? Table 2 gives some answers on that. It displays averages for various welfare state regimes. This classification is based on the Esping-Andersen's typology for 18 OECD countries (Esping-Andersen 1990). He identified three different worlds of welfare: a socialist one (e.g. the Scandinavian countries), a liberal world of welfare (e.g. the USA, Japan and Switzerland) and a conservative world of welfare (e.g. Germany, Austria, France). The inequality is highest in liberal welfare states, whilst the socialist welfare states are still the most equal ones with the highest level of social expenditures. The results for unemployment, employment growth, inflation and economic growth however, are always better in the liberal, market-oriented welfare states. In comparison with the conservative world, the picture is more heterogeneous, twice better and twice worse for the four indicators. The result is evident: the full-developed social democratic welfare state performed much worse than its liberal and more flexible counterpart. It seems as if the emphasis on pecuniary motivations for working in market systems would function better than the public supply service of the advanced welfare states, which in the 90s is more a barrier than a thrust.

A further hypothesis claims that the degree of inequality and the propensity towards market is reflected in the preferences of the voters. Parties then adopt these preferences and translate them into their programmes. Once in government, they will deliver what they have promised in their programmes and introduce reforms in the desired directions. This is the relationship of responsivity and accountability of parties. Parties act in accordance with their constituencies - at least to a certain degree. To identify such a connection the voter level and the party manifestos will be examined. The main focus on the micro level is on the orientations towards social justice.

For the following analysis an indicator, based on surveys in 12 OECD-countries, is constructed, in order to build up an index for "social justice" orientation. The data bases for the index construction are the International Social Survey Programmes 1987 and 1992 (ISSP 1987, ISSP 1992). The index is defined as the sum of the alternative responses to 5 questions, with 1 = "Strongly agree", 2 = "Agree", 3 = "Neither agree nor disagree", 4 = "Disagree" and 5 = "Strongly disagree". The questions that measure "social justice" are: 1. Inequality continues to exist because it benefits rich and powerful. 2. The government has the responsibility to reduce differences between high and low income. 3. The government has to provide everyone with a guaranteed basic income. 4. The government should provide a job for everyone who wants one. 5. Differences in income in the respondent's country are too large. The lower the values for this indicator the higher is the propensity towards social justice.

**Table 3: Party affiliation and Orientation for social justice**

	USA	AUS	CAN	SWE	NZ	UK	D	ÖST	NOR	ITA	All
Far left			n.a.	8.91 (22)			7.80 (5)	8.00 (2)	9.17 (175)	n.a.	9.10 (204)
Left	12.27 (369)	12.13 (972)	n.a.	11.53 (149)	11.06 (496)	9.13 (321)	10.78 (703)	11.05 (326)	10.35 (278)	n.a.	11.21 (3614)
Centre. Liberal	13.59 (403)		n.a.	13.55 (112)	9.00 (21)	10.87 (139)	13.02 (483)	11.94 (233)	10.74 (219)	n.a.	12.50 (1610)
Right Conservative	16.11 (325)	15.07 (829)	n.a.	15.96 (105)	14.21 (429)	14.01 (364)	10.75 (89)	11.11 (79)	14.15 (212)	n.a.	14.57 (2432)
Far right			n.a.				10.50 (2)		11.71 (73)	n.a.	11.68 (75)
ISSP 1992 Average (N) <sup>a</sup>	13.89 (1097)	13.49 (1801)	n.a.	13.16 (388)	12.45 (946)	11.58 (824)	11.61 (1282)	11.37 (640)	11.17 (957)	n.a.	12.45 (7935)
ISSP 1992 Average (N) <sup>b</sup>	13.85 (1130)	13.47 (1997)	13.11 (912)	12.70 (620)	12.45 (1087)	11.48 (948)	11.39 (1862)	11.34 (882)	10.93 (1385)	9.48 (966)	12.07 (11789)
ISSP 1987 Average (N) <sup>c</sup>	14.39 (1309)	13.86 (1496)	n.a.	n.a.	n.a.	11.82 (1054)	11.52 (1103)	10.51 (797)	n.a.	10.02 (983)	<sup>c</sup> 12.30 (6742)

Notes. Data source: ISSP 1992 and ISSP 1987 "Social justice Orientation" = additive indicator consisting of 5 five-item-scale answers. Low values indicate a stronger orientation for social justice. The cells display the means of each category. Number of respondents in brackets. The questions are: 1) Inequality continues to exist because benefits rich and powerful. 2) Differences in income in respondents country are too large. 3) Government: responsibility to reduce differences between high and low income. 4) Government should provide a job for everyone who wants one. 5) Government should provide everyone with a guaranteed basic income. a = with controlling for party affiliation; b = without controlling for party affiliation. c = including Switzerland (mean = 13.3) and the Netherlands (mean = 12.4) changes the overall mean to 12.41

The first aim is to reveal relations between the left-right placement of the voters and their orientation towards social justice. The "voters ideology" variable used in the analysis is based on questions about actual voting behaviour or the party identification of the respondents. The respondents are then classified into 5 categories ("Far left", "Left", "Centre", "Liberal", "Right, Conservative", "Far right"). Table 3 shows the overall mean and the means for all countries and each category of the party affilia-

tion. It is expected that the more leftist a respondent is, the stronger the disposition for social justice will be. However, this is not always correct. People classified as "far right" have a relatively strong preference for social justice. One has to notice the small number of respondents, though. Especially Germany and Austria constitute exceptions. Here the voters of christian democratic parties have strong attitudes in favour a more equal society. New Zealand deviates, too because the liberal classified voters of the Social Credit are situated between Labour and the Conservatives.

The averages for these particular countries can be taken as an overall comparable indicator for the importance of social justice in the distinct societies. From the last two rows of table 3 one can construct a ranking of the examined 12 countries. The USA ranks the lowest, which means that the respondents are not very sympathetic towards social justice. The strongest propensity for it can be observed in Italy. The responsitivity hypothesis suggests a correlation between this indicator and the indicators of inequality. The result is clear: the rankcorrelation for this ranking and the Gini index (disposable income) is  $r_s = -0.76$  ( $n = 11$ ). People wanting more inequality are indeed satisfied and so are those wanting a more equal society.

The next step of the analysis is to look at the positions of the parties towards social justice and a well-functioning market. If parties really do make a difference this should be reflected in their programmatic profiles. Therefore, I am going to examine election programmes of 16 OECD-countries during the post-war period from 1945 to 1988. The data is a result of a long-term research project on party manifestos (Budge et al. 1987, Klingemann et al. 1994). There are two reasons for looking at party manifestos. First, the hypothesis is that different types of parties also have divergent programmatic profiles. Second, if the responsitivity and accountability hypothesis holds, one should be able to identify a significant relationship between the positions of the parties regarding social justice and the equality outcome.

For the purpose of the analysis two indicators are calculated: one for the attitudes for "social justice" and one for "market forces". The values for both variables displayed in table 4 are the averages of the sums of different subindicators (see notes for table 4). For the "social justice" variable 7 subindicators and for the "market forces" variable 9 subindicators (out of 56 variables in the data set) are chosen, which emphasises the importance of these issues for a party (only parties with more than 2 percent of votes are selected). One would expect that, the more leftist a party on the left-right space is, the stronger the posture for "social justice" and the weaker

towards "market forces". The more rightist a party this is vice versa. Such a pattern can be clearly identified, with some minor exceptions only. Regional parties are only relevant in Belgium (except 2 other cases), where they have a strong stance for social justice. A look at different time periods shows that the averages for social justice and for market forces increased in the 80s. The first increase is due to a stronger emphasis of left-wing parties and the appearance of the greens, whilst the other parties remained more or less constant (except the few discontent parties). For the market forces the increase is bigger and the picture is more complex. One sees stronger orientations for a free and functioning market for the conservatives, the discontent and regional parties, the extreme-right and to a lesser extent for socialist parties. A downward shift can be seen for communist parties and agrarian parties. Taking all results into account, one can further conclude that there is no convergence in the party systems as Thomas (1979) once postulated in an analysis. In addition, this also means that the Kirchheimer hypothesis that the major parties are non-identifiable "catch-all parties", must be rejected (Kirchheimer 1965).

**Table 4: Party Families and emphasis social justice and market forces**

Type of party family	Social Justice		Market Forces		Number of Cases	
	1945-78	1979-88	1945-78	1979-88	1945-78	1979-88
Communist/Left-Socialist	27.7	35.4	5.9	4.4	63	25
Socialist	28.9	30.1	9.9	11.9	164	55
Green	-	25.4	-	2.4	-	5
Liberals	21.5	22.4	19.5	19.9	167	53
Religious	23.4	22.4	16.9	17.5	94	31
Conservatives	17.7	16.8	22.9	26.7	126	42
Agrarian	18.5	19.1	22.1	18.4	32	10
Regional/Ethnic	29.4	32.2	8.0	21.6	15	4
Discontent/Protest	8.0	13.0	32.2	37.7	5	7
Extreme-right/Fascist	9.5	8.5	6.2	14.2	8	3
weighted AVERAGE	23.2	24.2	16.0	17.3	674	235

Data source: Volkens DATASET CMPr3, Comparative Manifesto Project. Countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Great Britain, Italy, Ireland, Japan, Norway, New Zealand, Netherlands and the USA. Classifications of parties according to v. Beyme (1984), Lane and Ersson (1991), Lane, McKay and Newton (1991). Cell entries (columns 2 to 7) are averages of the selected content categories ("quasi-sentences"). High values indicate strong emphasis. Only parties with more than 2 percent of vote share are selected. Social justice = v105 (Decreasing military expenditures) + v202 (Democracy) + v503 (Social Justice) + v504 (Welfare State Expansion) + v506 (Education Expansion) + v705 (Underprivileged Minority Groups) + v706 (Non-economic Demographic Groups). Market forces = v303 (Governmental and Administrative Efficiency) + v401 (Free enterprise) + v402 (Incentives for enterprises) + v407 (Protectionism: negative) + v410 (Importance of productivity) + v414 (Economic orthodoxy) + v505 (Welfare State Limitation) + v702 (Labour Groups: Negative) + v704 (Pro Middle Class and Professional Groups).

Looking at the single countries and taking the mean for all parties as an indicator of the overall attitudes of the parties supports our responsivity hypothesis. The correlation between the overall social justice attitude in the different countries (1945-

1988) and the Gini (for disposable income) is high ( $r_s = -0.65$ ). One can conclude that parties deliver - to a certain degree - what they promise. Looking at different time periods and at various indicators there are restrictions in this finding: during the 80s these relationships have not been very stable and significant, maybe due to heavy socio-economic pressure and variations in the manifestos.

Another hypothesis to deal with is the "parties do matter" approach. As shown different values towards social justice and the market can be identified, when one controls for party affiliation on the voter level. Subsequently different positions in the election programmes of the parties have been diagnosed. The next step would be to ask: Whether there are any differences when examining the party complexion of governments? If parties really respond to their constituency, one should be able to identify a higher equality in countries with a strong left-wing participation in government. Taking the overall average share of left-wing portfolios in governments between 1945 and 1994 there is a relation between equality (Gini-index for early 90s) and leftist control of government ( $r_s = -0.54$ ,  $n = 18$ ). If one only takes the golden era of Socialdemocracy (1945-1973) as reference period for leftist strength, the correlation is much higher ( $r_s = -0.69$ ,  $n = 17$ ). What about other party families, like conservative, liberal and centrist parties? As Kersbergen has shown, christian democrats are also likely to produce a considerable large welfare state (Kersbergen 1995). The impact of conservative parties (share of portfolios) on inequality is - if we compare the correlation coefficients for the Gini - stronger than that of the left parties on equality (e.g.  $r_s = 0.74$ ,  $n = 18$ , 1945-1994;  $r_s = 0.78$ ,  $n = 17$ , 1945-1973). After 1973 there seems to have been a change. These relationships decrease for both party families and for various subperiods (e.g. 1973-1994, 1980-1994). A possible explanation may be found in the lower capacity for national governments to act due to the economic crisis, less financial room for manoeuvre and globalisation. However, it should be mentioned, that also centre parties, which are mainly christian democrats, have a positive impact on equality, too. Finally, the relationship between party complexion of governments during the 80s and the change in inequality have revealed that the colour of governments is of less importance. Only some conservative governments pushed towards more inequality.

What are the pros and cons of globalisation with respect to inequality and unemployment? The classical economic theory based on Adam Smith and the comparative advantage theory of David Ricardo suggests positive effects of globalisation for unemployment and increase of wealth. This normally leads in the long run, if one

believes in the Kuznets curve (Kuznets 1955), to a more equal income distribution within the societies. According to this view, grounded on a positive sight of free market, globalisation and international free trade will result to welfare benefits for the whole society.

Nowadays, negative attitudes towards the role of globalisation dominate the political discussion (Martin and Schumann 1996, Neyer and Seeleib-Kaiser 1996, Barber 1996). The perspectives are not very promising, especially for employment and incomes. High-paid workers in western welfare states compete with low-paid workers around the world. Politicians argue for a downward adjustment process of wages and labour costs. The "global players" have created an international marketplace that will result in gains for the poor countries in their fast catch-up process and in losses for the rich welfare states. It is feared that these losses might have negative consequences for political stability. Another point is the strict striving after productivity. Investors and share holders only look at the share holder value of the firms. Business firms with a too low share holder value have comparatively low productivity and will therefore be forced to dismiss staff. For politicians two major problems arise: a diminishing capacity to act paralysed by political problems resulting from extremism in the shadow of unemployment. This is called the globalisation trap: an attack on democracy and the wealth of a nation (Martin and Schumann 1996).

Though globalisation is en vogue, detailed analyses of the combined effects on employment and incomes are rare. Long (1994) is an exception: He compared the employment and income changes in different sectors in three countries. His research is based on microeconomic data from the Luxembourg Income Study. Since statements about globalisation are mainly based on macroeconomic considerations, a macro approach can lead to false conclusions. Long analysed industrial sectors experiencing high levels of international competition in the USA, the UK and Sweden and compared them to the developments in wages and employment in selected industrial sectors with low levels of international competition. His results for the USA were heterogenous: Some workers in sectors with high international competition are winners (e.g. manufacture of electronics), whilst other are losers (manufacture of cars). For the other countries and sectors his result was clear: "Five of six sectors examined support the general hypothesis that international competition has a negative impact on the well-being of families whose primary wage earners work in internationally competitive industrial sectors" (Long 1994: 37 f.). Own simple bivariate correlation analyses with highly aggregated data have shown that countries with a

high dependency ratio (exports plus imports in relation to GDP) are slightly more likely to have a more equal society but the change towards a more unequal one during the 80s has also been stronger in countries with a high international dependency.

### **5. Are the poor really the loser?**

Rising inequality does not necessarily lead to greater poverty or to lower incomes for the lowest decile. There can be redistributions between the different deciles, not leading to losses for the low income groups. It is possible that the rich become even more rich, because of redistribution from the middle deciles to the highest decile. This does also work also the other way round: There might be an overall redistribution from the mid to the lowest income groups. This can result in discontent of the groups in the middle of the income distribution because their relative position is worsened. In general, workers are more upset over a loss in their relative position than they are pleased by an improvement. Their relative distance to the top is enlarged, while they are at the same moment nearer to the bottom. There are interdependencies in the utility of the households regarding their positions, or to be more precise: The attitude of envy drives their consciousness.

The findings of table 5 clarify the development in most OECD countries during the 80s. In only 5 countries the relative distance from the lowest decile to the fifth decile was enlarged (column 2). On the other hand, the distance between the uppermost income decile and the middle income group widened in all examined countries, except for Germany and Belgium (column 5). Combination of the results from table 1 and table 5, leads to the conclusion that a considerable overall increase in inequality has taken place in only a few countries. The relative position of the lowest income groups is not worse in 1993 than it has been in 1980. In most countries even gains can be viewed. There have been relative losses mainly for the middle class and gains for the upper class.

Another commonplace in daily political semantics is a loss in real earnings for the workers. A closer look on the average growth between 1980 and 1993 shows that this can not be maintained. There are real wage in manufacturing during the 80s in most countries: the largest increase was in the United Kingdom (average annual growth 2.43) and the biggest decrease in New Zealand. The USA, too, experienced a decrease in the real hourly earnings in manufacturing. The biggest increase - on average - was to be noted in the conservative world of welfare with relatively high

growth in Germany (1.53). This implies that workers are still improving in absolute terms, though their relative position might be declining. Judging all this is a more or less normative political question: which combinations of unemployment, inequality and earning development are preferred to other ones?

**Table 5: Income distribution in comparative perspective**

	Decile Ratio D5/D1 Change (1980-1993)	Decile Ratio D5/D1 in 1980	Decile Ratio D5/D1 in 1993		Decile Ratio D9/D5 Change (1980-1993)	Decile Ratio D9/D5 in 1980	Decile Ratio D9/D5 in 1993
USA	0.20	1.85	2.05	POR	0.33	2.14	2.47
UK	0.12	1.67	1.79	USA	0.27	1.76	2.03
OST	0.06	1.94	2.00	UK	0.19	1.67	1.86
SWE	0.04	1.30	1.34	ITA	0.14	1.46	1.60
NZ	0.03	1.70	1.73	JAP	0.08	1.76	1.84
NL	-0.01	1.55	1.54	F	0.06	1.93	1.99
BEL	-0.03	1.46	1.43	NL	0.06	1.62	1.68
CAN	-0.03	2.24	2.21	NZ	0.06	1.70	1.76
DEN	-0.03	1.41	1.38	DEN	0.05	1.52	1.57
AUS	-0.05	1.67	1.62	NOR	0.04	1.46	1.50
F	-0.05	1.69	1.64	CAN	0.03	1.79	1.82
POR	-0.05	1.69	1.64	AUS	0.02	1.70	1.72
ITA	-0.06	1.81	1.75	SWE	0.02	1.57	1.59
JAP	-0.06	1.71	1.65	ÖST	0.01	1.78	1.79
NOR	-0.09	1.41	1.32	FIN	0.00	1.65	1.65
FIN	-0.10	1.49	1.39	D	-0.02	1.63	1.61
D	-0.21	1.65	1.44	BEL	-0.14	1.71	1.57
SWI			1.62	SWI			1.67
Mean	-0.02	1.66	1.64	Mean	0.07	1.70	1.76

Note: Data taken from the OECD Employment Outlook (1996b: 61f.). Data are gross earnings.

Inequality and poverty are not equal concepts<sup>3</sup> and they are sometimes confused. However, both are strongly correlated ( $r = 0.77$  for the Gini and the Poverty indicators). The highest poverty is found in the liberal world of welfare, mainly the English-speaking countries. These are the USA, Australia, Ireland and Canada, while the lowest poverty rates are to be found in the Central European countries (the Benelux countries, Germany and Austria). Sweden, the only Scandinavian country in the sample, takes an intermediate position. It is remarkable that countries with christian democratic governments have very low poverty rates.

Looking at correlations with political variables reveals that conservative governments have a negative impact on poverty. Social democratic and centre, mainly christian democratic parties, in government tend to produce low poverty. A striking result is that the strength of unions seems to have no significant influence on pov-

<sup>3</sup> The findings are now based on a relative poverty measure, defining someone as poor, when he is falling beneath a poverty line of 50 percent of median income (data source Förster 1993: 13). The data is originally derived from the Luxembourg Income Study and refers to the mid/late 80s.



erty. This suggests an Insider-Outsider phenomenon. Unions are able to achieve an equal income distribution via their bargaining power, but they are not willing (or able) to create low levels of poverty. Though this is a provoking thesis, some caveats have to be made. First of all, most Scandinavian countries had to be left out of the analysis because of missing data. These countries have usually low poverty rates and a relatively high union density. Secondly, unions sometimes have bargained in their negotiations not only about wages, but also about social programmes and social packages, too. Thirdly, the relative poverty measurement does not consider the absolute level of poverty. Another problem is that home ownership is not reflected in the poverty measurement. Surprisingly countries with high poverty rates have also very high rates of home ownership, like Australia, Canada and USA, which is the private way for social protection.

## 6. Conclusion

The descriptive part of the analysis has revealed a significant relationship between inequality and unemployment during the 80s up to the early 90s. More "unequal" countries experienced a better performance on the labour market. This is analytically combined with the concept of the so-called unemployment trap, implying that certain groups of unemployed have little incentives for re-entering the labour market. Reasons for this major problem lie in the disincentives caused by the tax and benefit system. High marginal tax rates, high replacement ratios, high social benefits and a large tax wedge lead to inflexibilities, though the overall level of taxation is not relevant so far. Mainly low-paid and less skilled workers with families are threatened by these disincentives. The empirical results have shown that both high income inequality and negative incentives can partly explain unemployment and its change.

What causes high inequality and changes in inequality? The first explanation for the change offered in this paper is a shift in the policies of countries that experienced a turn to more inequality. The ideology of Reagonomics and Thatcherism created the opportunities for restructuring the tax and benefit system, leading to less income equality. These market-orientated reforms, often accompanied by privatisations, led to greater flexibilities in the labour market.

Secondly, strong trade unions are able to produce - through their bargaining power - a relatively equal income distribution. Furthermore, institutional arrangements, such as the centralisation of the bargaining structure, the co-ordination

structure and the degree of corporatism matter. This is owed to the opportunity structures of trade unions in such institutional settings (strong corporatism), where they can bargain for similar wage increases. In contrast, bargaining on the plant level is likely to produce a greater variability of wages. Strong trade unions are also more resistant against changes of equality.

The economic performance of the extended welfare states in the 80s and 90s has been rather unfavourable. All core economic indicators have shown worse outcomes of the Social democratic welfare state compared to its liberal counterpart. Countries belonging to this type of welfare family have been able to defend their high standard of equality, though with relatively high financial costs and - what is new - high costs of unemployment. The advanced welfare state itself is therefore an inhibitor against radical changes.

It is, however, not only institutions that matter. The analysis reveals an impact of the preferences of citizens in the different countries. Societies in which people have strong preferences towards social justice get indeed a more equal income distribution. It is also possible to identify differences between the attitudes towards social justice and free market in the election programmes of the parties. Parties respond to the preferences of their voters and when governing they tend to act in accordance with them. An equal income distribution is primarily created by social democratic and christian democratic parties in government, whereas countries governed by conservatives are likely to have more inequality.

Globalisation seems to be a new paradigm. There are strong arguments that an intense global exchange of goods and capital could lead to welfare losses for employees working in sectors with high international competition. On the other hand the classical theory predicts welfare gains. One question to be raised is: What would happen without taking part in this globalisation process? There may be even greater problems in such economies.

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