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DO NATIONS JUST GET THE INEQUALITY THEY DESERVE? THE 'PALMA RATIO' RE-EXAMINED

José Gabriel Palma

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This paper aims to re-examine inequality in the current era of neo-liberal globalisation, with an emphasis on both highly unequal middle-income countries that have already implemented full-blown economic reforms (like Latin America and South Africa), and on OECD countries (like the US) now intent on replicating the inequality heights of the former. i) How do those middle-income countries end up having such unequal distributional outcomes? ii) Since oligarchies all over the world would gladly reproduce the same conditions, why until recently have only a few been able to get away with this degree of inequality? And iii) Why are there suddenly so many new entrants to the high-inequality club, especially from the OECD? In other words, how did Reagan and Thatcher and the fall of the Berlin Wall trigger a new process of "reverse catching-up", by which now it is the highly-unequal middle-income countries showing the advanced ones the shape of things to come? One might even argue that in the US not only is the 1% catching up with their Latin counterparts (who are used to appropriating between a quarter and a third of overall income), but that new developments such as Trump may be part of the same phenomenon: it is now the South that seems to show the North 'the image of their own future'. And regarding that future, it is tempting to say "welcome to the Third World"! We are all indeed converging in this neo-liberal era but, somehow unexpectedly, this convergence is towards features that so far have characterised a number of middle-income countries – e.g. huge inequalities due to mobile élites creaming off the rewards of economic growth, and 'magic realist' politics (that may lack self-respect but not originality). I also discuss why Piketty's persistence with the neo-classical theory of factor shares – a pretty much obsolete 1950s-style approach to the distribution of income – prevents him from bringing our understanding of current distributive affairs forward as much as he might. His neo-classical analysis not only does not 'fit the facts' (he has to resort to questionable parameters), but also leads him into a methodology and social ontology that assumes that particularly complex and over-determined processes (like the distribution of income) are just the simple sum of their parts. Therefore, their account can be reduced to the algebraic description of individual constituents (e.g., inequality as basically an endogenous outcome of r>g – and that would be all). I also outline an alternative narrative regarding why inequality is becoming so extreme in formerly more enlightened affluent societies. I conclude that in order to understand current distributive dynamics what really matters is to comprehend the forces determining the share of the rich — and in terms of growth, what they choose to do with it!

Do nations just get the inequality they deserve?

The 'Palma Ratio' re-examined

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Abstract: This paper aims to re-examine inequality in the current era of neo-liberal globalisation, with an emphasis on both highly unequal middle-income countries that have already implemented full-blown economic reforms (like Latin America and South Africa), and on OECD countries (like the US) now intent on replicating the inequality heights of the former. i) How do those middle-income countries end up having such unequal distributional outcomes? ii) Since oligarchies all over the world would gladly reproduce the same conditions, why until recently have only a few been able to get away with this degree of inequality? And iii) Why are there suddenly so many new entrants to the high-inequality club, especially from the OECD? In other words, how did Reagan and Thatcher and the fall of the Berlin Wall trigger a new process of "reverse catching-up", by which now it is the highly-unequal middle-income countries showing the advanced ones the shape of things to come? One might even argue that in the US not only is the 1% catching up with their Latin counterparts (who are used to appropriating between a quarter and a third of overall income), but that new developments such as Trump may be part of the same phenomenon: it is now the South that seems to show the North 'the image of their own future'. And regarding that future, it is tempting to say "welcome to the Third World"! We are all indeed converging in this neo-liberal era but, somehow unexpectedly, this convergence is towards features that so far have characterised a number of middle-income countries − e.g. huge inequalities due to mobile élites creaming off the rewards of economic growth, and 'magic realist' politics (that may lack self-respect but not originality). I also discuss why Piketty's persistence with the neo-classical theory of factor shares − a pretty much obsolete 1950s-style approach to the distribution of income − prevents him from bringing our understanding of current distributive affairs forward as much as he might. His neo-classical analysis not only does not 'fit the facts' (he has to resort to questionable parameters), but also leads him into a methodology and social ontology that assumes that particularly complex and over-determined processes (like the distribution of income) are just the simple sum of their parts. Therefore, their account can be reduced to the algebraic description of individual constituents (e.g., inequality as basically an endogenous outcome of r>g − and that would be all). I also outline an alternative narrative regarding why inequality is becoming so extreme in formerly more enlightened affluent societies. I conclude that in order to understand current distributive dynamics what really matters is to comprehend the forces determining the share of the rich — and in terms of growth, what they choose to do with it!

Key words: income distribution; inequality; 'Palma Ratio'; homogeneous middle; ideology; neo-liberalism; 'new left'; institutional persistence; Latin America; Chile; South Africa; United States.

JEL classifications: D31, E11, E22, E24, E25, I32, J31, N16, N30, N36, O50, P16.

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[1] Emeritus; also USACH.

Inequality is a choice.
Joseph Stiglitz

I am my choices.
Jean-Paul Sartre

Introduction[2]

The main aim of this paper is to take another look at differences in within-nation income distribution in the current era of neo-liberal globalisation. The emphasis will be on the study of middle-income countries with high degrees of inequality, especially those that have implemented full-blown economic reforms, such as those in Latin America and Southern Africa. I first examine statistically how unequal is inequality across the world in terms of overall inequality as well as of different groups within each country; then, I analyse why there is so much diversity in terms of distributional outcomes across the world. In doing so it would become apparent why the Gini has already served its purpose as a practical index of income distribution (i.e., how it has passed its sell-by date) and why a new index that I proposed in Palma (2011) — which was later christened the "Palma Ratio" by Alex Cobham and Andy Sumner[3] — could be more appropriate to understand issues such as those mentioned above.

The key questions I try to address here are: why is it that Latin America and Southern Africa have the huge inequalities they do? And why is it that while political oligarchies all over the world would be only too happy to lay their hands on a share of the national income as huge as that appropriated by their counterparts in Latin America and Southern Africa, only some seem able to get away with it? Among new entrants to this high-inequality club we now find some countries in the OECD, especially the US, and some in higher-income Sub-Sahara. That is, there seems to be a new (post-Reagan and Thatcher) distributive phenomenon in which now it is the highly-unequal middle-income countries (such as those in Latin America) that are showing *both* the more advanced and the more backward countries the shape of things to come. Many political institutions and

[2] The first draft of this paper was presented at the last Plenary Session of the 17th World Congress of the International Economic Association, June 2014. Joseph Stiglitz was the discussant. I am very grateful for his comments, as well as those from Kaushik Basu and other participants of the 'Shared Prosperity and Growth' plenary session of the IEA meeting. Tony Atkinson, Stephanie Blankenburg, Ha-Joon Chang, Mariana Chudnovsky, Alex Cobham, Jonathan Di John, Jorge Fiori, Juliano Fiori, Samer Frangie, Jorge Friedman, Ester Gonzalez, Daniel Hahn, Geoff Harcourt, Emily Hogan, Pamela Jervis, Jorge Katz, Mushtaq Khan, Javier Núñez, Cristóbal Palma, Guillermo Paraje, Carlota Pérez, Ashwani Saith, Claudia Sanhueza, Paul Segal, Ignês Sodré, Andy Sumner, Bob Sutcliffe, Lance Taylor and Robert Wade have made valuable contributions to my work in this area over many years. My late friends Jaime Crispi, Carlos Díaz-Alejandro, Andrew Glyn and Carlos Lopes also influenced my thinking on this subject. Participants at many conferences and seminars, and current and former PhD students at Cambridge also made very helpful suggestions. The key ideas of this paper were developed while trying to deal with the grief of the sudden death of my life-long friend Gina Malengreau Fiori; I dedicate this paper to her. The usual caveats apply.

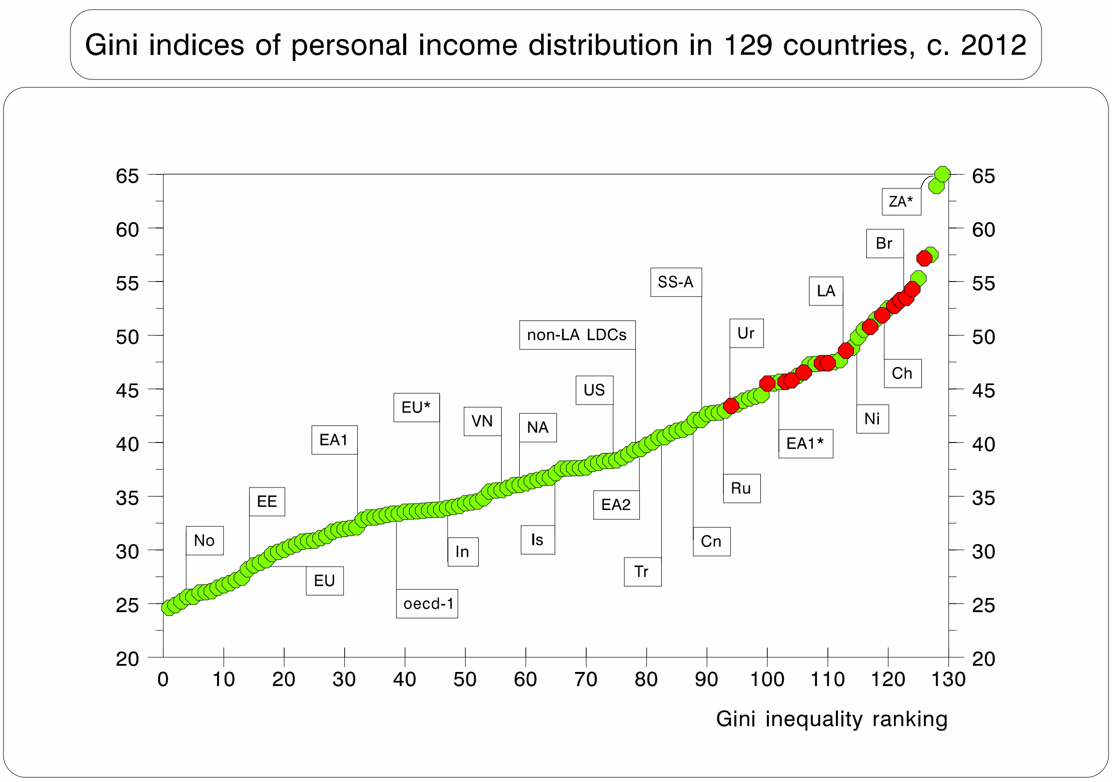
[3] See Cobham and Sumner (2013a and b); see also Fisher (2013, especially the brilliant animation at the end of the article), Fisher (2014, map 7); and Green (2012). See also, Chang (2014).

distributive outcomes are indeed converging in this era of globalisation but, somehow unexpectedly, they are doing so towards features that are characteristic of unequal middle-income countries — especially in terms of their almost unlimited 'tolerance for inequality' — rather than towards those more civilised ones that characterised developed countries in their long post-FDR period, when income and wealth became more equally distributed. I shall conclude that in order to understand these new distributive dynamics what really matters is to try to comprehend the forces currently at work determining the income-share of the rich — and what they chose to do with it!

1.- How unequal is inequality across the world?

Let's start with a rather obvious point: using any measurement of inequality, what one finds across the world is that different economic structures and political settlements provide a remarkably wide variety of distributional outcomes (see Figure 1). Although this is a rather well-known phenomenon, once you really start thinking about it, it becomes difficult to think about anything else.[4] Not surprisingly, Ricardo said that the study of the distribution of income among the classes that contribute to the process of production (workers, capitalists and rentiers) is what economics was really about!

FIGURE 1



[4] However, as Robert Wade remarks, there is still a strange neglect of inequality in *actual* public policy making (Wade, 2014; more on this below).

● Highlighted countries are those of Latin America; the two countries with the highest Gini are South Africa and Namibia (with the former, literally, off the chart at 65.4).

● In the case of regions, the statistic used to measure centrality is the median. **Br** = Brazil; **Ch** = Chile; **Cn** = China; **EA1** = Korea and Taiwan; **EA1*** = Hong Kong and Singapore; **EA2** = Indonesia, Malaysia and Thailand; **EE** = Eastern Europe; **EU*** = Mediterranean EU; **EU** = rest of Continental Europe; **In** = India; **Is** = Israel; **LA** = Latin America[5]; **NA** = North Africa; **Ni** = Nigeria: **No** = Nordic countries; **OECD-1** = Anglophone OECD (excluding the US); **Ru** = Russia; **SS-A** = Sub-Saharan Africa; **Tr** = Turkey; **Ur** = Uruguay; **US** = United States; **VN** = Vietnam; and **ZA*** = South Africa.[6] Unless otherwise stated, these acronyms will be used throughout the paper.

● For the sources of the data, see Appendix. Unless otherwise stated, these will be the sources of all figures in this paper.

Among the countless issues arising from this graph, there are two that stand out. The first is that it confirms the existence of a huge range of inequality across countries — in this case, from two countries with a Gini below 25 to two close to 65. And oddly enough, the two countries at each end of the distribution, Slovenia and South Africa, are not that dissimilar in terms of their level of economic development. The second is that middle-income (mineral-rich) Southern Africa and Latin America (and, increasingly, some higher-income Sub-Saharan countries) are clearly grouped at the wrong end of the inequality ranking.[7]

2.- Inequality and income per capita

2.1 - Evidence from the Gini

Figure 2 analyses income distribution across countries in the traditional way — i.e., vis-à-vis income per capita.[8]

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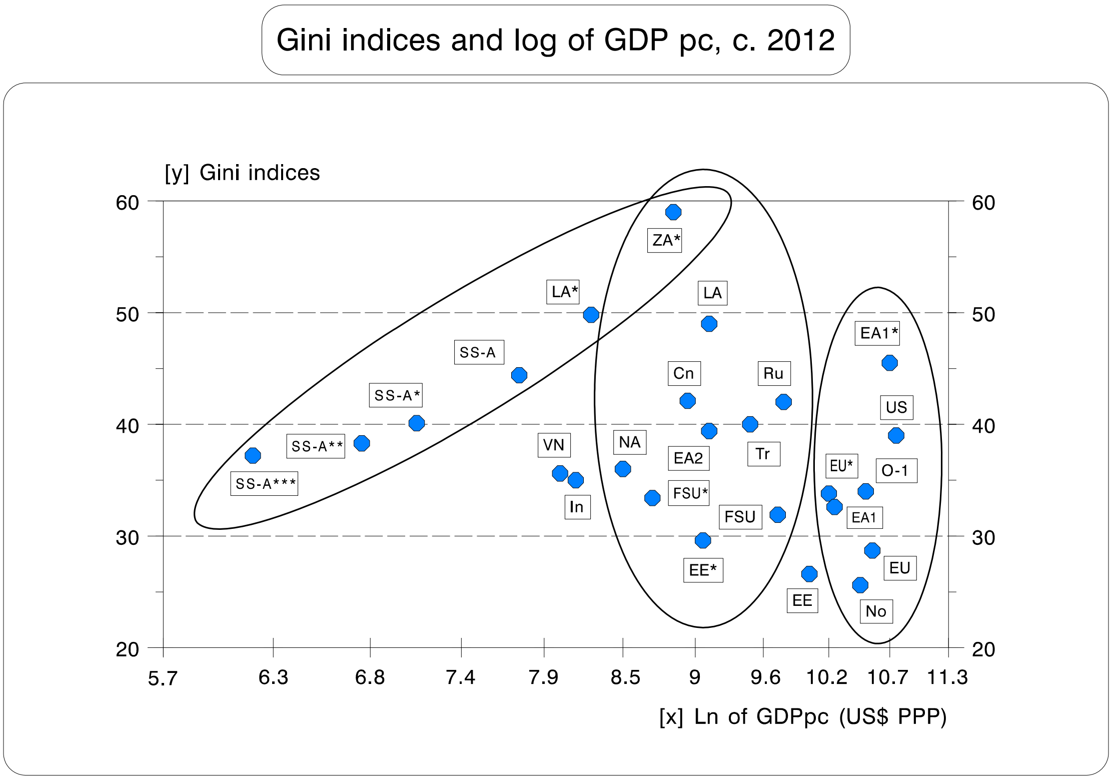
[5] Here Latin America excludes Argentina and Venezuela due to unreliable data (especially in the latter); among the many issues behind this phenomenon, high and repressed inflation inevitably creates significant distortions in household surveys.

[6] If one uses for South Africa the World Bank-WDI dataset (instead of the OECD's), its Gini falls to (the still astonishing level of) 63.1.

[7] On global inequality see Milanovic (2010 and 2013).

[8] When I analyse income distribution across countries from the perspective of their income per capita I do so simply as a mechanism to visualise the geometry of within-country inequality across the world; i.e., it is just a cross-sectional description of cross-country differences in inequality, when categorised by income per capita.

FIGURE 2



• Acronyms as in Figure 1, and **EE*** = Eastern Europe with an income per capita below US$15,000; **EE** = those above that level; **FSU*** = Former Soviet Union with an income per capita below US$10,000; **FSU** = those above that level (excluding Russia); **LA*** = Latin America with an income per capita below US$8,000; **LA** = those above that level; **O-1** = OECD-1 = Anglophone OECD, excluding the US; **SS-A*** ** = Sub-Saharan Africa with an income per capita below US$650; **SS-A**** = those between US$650 and US$1,000; **SS-A*** = those between US$1,000 and US$2,000; and **SS-A** = those above that level. South Africa's actual Gini is 65.4.[9] **GDP pc** = Expenditure-side real GDP per capita (PPPs) in 2011. In this and following graphs, the range of the horizontal axis corresponds to the actual range of GDP pc in the sample.

• Sources: for income distribution as in Appendix; and for GDP pc, the Penn World Table (2014; PWT8.0). Unless otherwise stated, throughout the paper 'US$' will refer to this dollar.

This Figure indicates two basic trends. One is the increasing level of inequality found across Sub-Saharan Africa — from SS-A*** (countries with an income pc below US$ 650), to SS-A (those with one above US$ 2,000); that is, from Mali and Burundi, with a Gini of 33, to Zambia with one of 58 —, followed by lower middle-income Latin America (LA*), and then by middle-income Southern Africa (ZA) – see the 90 degree angle ellipse. The other is a large distributional diversity among both middle- and high-income countries (see vertical ellipses).

The huge distributional diversity among middle- and high-income countries immediately casts serious doubt on the contemporary relevance (if it ever existed) of the

9 In this and following graphs, 'middle-income (mineral-rich) Southern Africa' is proxied by South Africa, as there are only data for this country and Namibia. This is so because the last reported data for Botswana (Gini of 61) only refers to 1994 (so it is not included in my sample; see Appendix). At the same time, the increasing numbers of close inequality-relatives in the region (e.g., Angola and Zambia) still do not qualify properly as 'middle income'.

traditional Kuznets' "Inverted-U" hypothesis in its cross-sectional version (see also Figures 11, 12 and 13 below for further analysis) — and with it, on the phoney excuse used by many academics, politicians and business people in some middle-income countries to justify high levels of inequality: that somehow 'inevitably' middle-income countries are bound to have a high degree of inequality — and that somehow 'inevitably' things are bound to get better on their own accord as income per capita increases. So, it makes more sense (and it is much more efficient) to have a hands-off attitude towards inequality.

The diversity among middle-income countries is mostly the result of the contrast between Eastern Europe (both EE* and EE) and the Former Soviet Union excluding Russia (both FSU* and FSU) on the one hand — although in many of their countries oligarchs are doing their very best to 'modernise' their levels of inequality –, and Latin America (both LA and LA*) and Southern Africa on the other. Moreover, in all probability, many countries of the oil-producing Middle East for which there are no data would share the inequality heights of the latter two regions.[10]

Moreover, and perhaps ironically, some of the worst levels of middle-income inequality are found in countries characterised by the consolidation of democracy, such as in Latin America and South Africa — a process that has often been led by so-called 'centre-left' political coalitions. From this perspective, the common thread in them is that although many economic and political institutions have changed in the recent past — in some significantly — the narrow interests of the élite clearly have not. In the case of Latin America, for example, the unique comparative advantage of its oligarchies seems to lie precisely in being able to use different institutions (often quite astutely) — and in being flexible enough to enlarge its membership to include individuals coming from these 'centre-left' coalitions — in order to keep achieving their fairly immutable goals. In other words, few oligarchies in the world have shown such skills in their struggle for the "persistence of élites" despite the otherwise substantial institutional change. This brings us to the complex issue of "persistence and change in institutions", and in particular to the so-called "iron law of oligarchies" — i.e., how dysfunctional institutions are sometimes so effective in creating incentives for their own re-creation (Acemoglu and Robinson, 2006). And South Africa seems to be following now the same path with a vengeance.

In the case of Chile, for example, a recent study on tax returns (López, Figueroa and Gutiérrez, 2013) shows that after five so-called 'centre-left' governments since the return to democracy in 1990, the top 1% is still able to appropriate about one third of all income (32.8% — in Korea this is just 12%), with the top 0.1% getting one-fifth (19.9%

[10] And when data are available, as in the case of Qatar, it is unlikely that household surveys include the fate of the relatively large numbers of South-Asian temporary migrant workers in the construction industry, or of migrant domestic servants.

— in Korea this is only 4.4%), and the top 0.01%, corresponding to individuals belonging to 300 families, acquiring more that one-tenth of the total (11.5% — in Korea this is just 1.7%).[11] And income distribution data from the same source (tax returns) indicate that some high-income OECD countries are now succeeding in their "reverse catching-up" efforts. As a result — and in contrast to Marx's famous prediction — as far as inequality is concerned (and not just inequality!) now it is the highly-unequal middle-income countries that show the more advanced ones 'the image of their own future'.

For example, in this new "reverse catching-up" phenomenon it is not that Latin American labour markets or tax structures are evolving to catch-up with those of (formerly more enlightened) developed countries, but the other way round — surely the Bush brothers had an advisor from across the Rio Grande to help them engineer the electoral fraud in Florida during the 2000 presidential election... And perhaps the remarkable success of Trump's style politics should not be as surprising as it seems![12]

The most clear case of this "reverse catching-up" phenomenon is what is happening with the distribution of income in the USA, with the top 1% rapidly 'catching-up' with its Latin counterparts (who are used to appropriate between a quarter and a third of overall income) — jumping from being able to appropriate less than 10% of national income before Reagan, to 24% at the time of the onset of the current financial crisis (now it is back to about that level — and rising). In fact, the top 1% in the US captured just over two-thirds of the overall economic growth of real incomes per family over the period 1993–2012. Furthermore, "the share of the top decile in 2012 was equal to 50.4% of overall income, a level that was higher than in any other year since 1917 — even surpassing 1928, the peak of the stock market bubble in the 'roaring' 1920s" (Saez, 2013). In the era of globalisation we are all indeed converging, but not precisely towards the promised land of the Washington Consensus.[13] As someone from my part of the world would be tempted to say, "welcome to the third world!"[14]

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[11] For the Korea data, see The World Top Incomes Database (2015). A recent study on Brazil shows a picture similar to that of Chile, with the top 1% able to appropriate nearly 29% of national income (when the estimate takes into account the whole population); see Medeiros et al. (2014).

[12] Just think about the collection of political leaders that initiated neo-liberal economic reforms in Latin America ("The Magnificent Seven"): Pinochet, Menem, Collor, Salinas, Fujimori, Alemán and Bucaram.

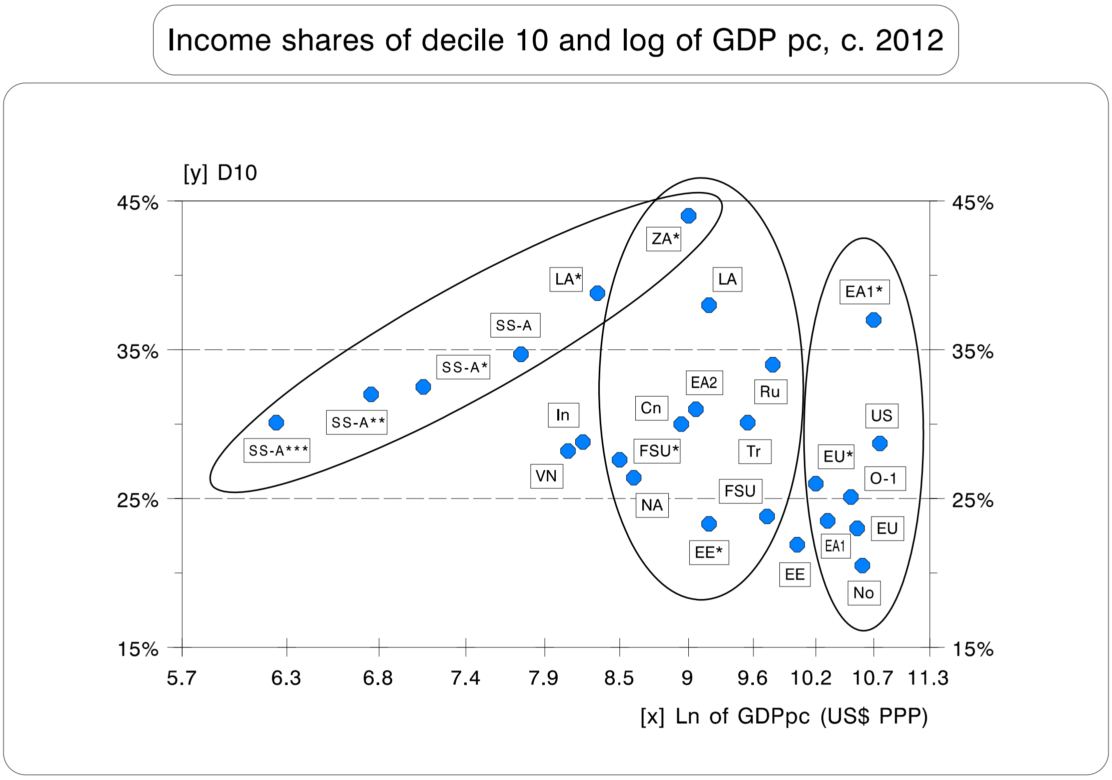
[13] In the current one-sided scenario, where capital clearly has the total upper hand (one in which the outcome of the distributional game resembles a 'winner-takes-all' scenario able to deliver a Nash equilibrium characterised by the 'pure strategy' of the rich), a good deal of the civilisation brought to us by the vigorous economic, social and political struggles since events such as the London Dock Strike of 1889, the Ford-T, the fear of contagion from the utopian ideals of the first 'soviets', the New Deal, the Marshall Plan, the British National Health Service and the Welfare State is fading away.

[14] So many people were shocked to learn in the last Oxfam report that the richest 1% now have more wealth than the rest of the world combined; and that the richest 62 people in the world now have as much wealth as the poorest half of the global population (Oxfam, 2015, and 2016). But Latin-American readers of the report would think instead "tell me something new". In Chile, for example, according to a recent study, four family-groups (including that of a former President)

2.2 - Peering into the Gini

One issue I addressed in my 2011 paper is that the Gini, as a summary inequality statistic, is particularly obscure regarding some of the dynamics that are happening 'inside' each country's distribution. And there are obviously important benefits to focusing on dynamics *within* those distributions. See Figures 3 to 7.

FIGURE 3



• South Africa's actual income-share for D10 is 54.4%. Acronyms as in Figures 1 and 2.

Starting with D10, Figure 3 indicates that there is a particularly close correlation between the distributional geography of the Gini (Figure 2) and that of the income-share of the top decile. In turn, Figure 4 shows the same phenomenon for the regional distributional structure of the income-share of the bottom 40% (D1–D4).

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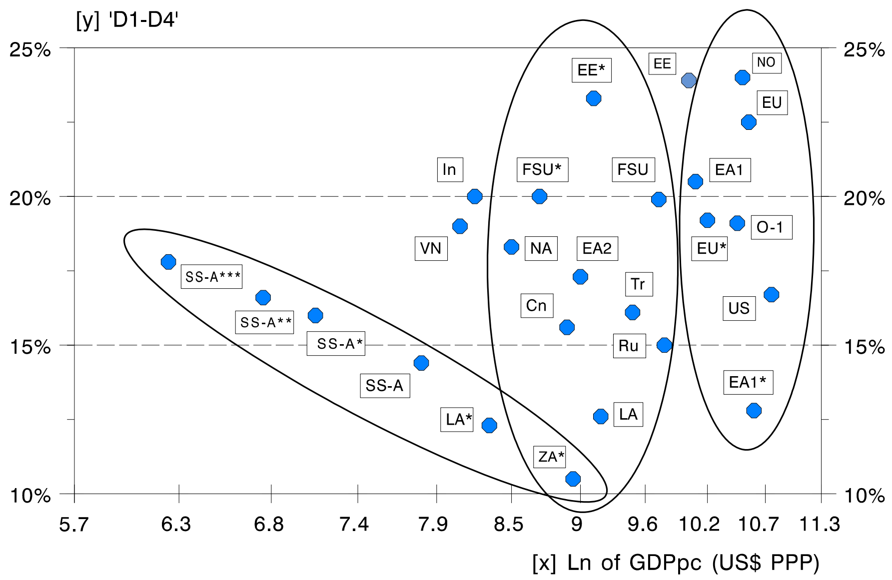
control 47% of the assets traded in the Chilean Stock Exchange; see http://www.emol.com/noticias/economia/detalle/detallenoticias.asp?idnoticia=430194. According to the Forbes Wealth Report (see Forbes, 2014), in relative terms, no other main region in the world has created in the last ten years so many millionaires of all types as Latin America (i.e., individuals with US$ 30 million or more in terms of net assets, excluding their principal residence; cent-millionaires — those with net assets of more than US$ 100 million; and billionaires). And there was no fastest surge at the top than in those countries of South America where either the 'old'-left or the 'new'-one are in government, as in all three categories Venezuela, Brazil, Chile and Argentina came top (in different order according to the category). Meanwhile, 'right-wing' Mexico had an increase in these three categories which was only one-fourth to one-sixth those in the 'old-left' or 'new-left' countries — the Mexican capitalist élite seems to have been rather short-sighted when they opposed and (according to many reports) also helped steal a presidential election from the 'new-left' not once but twice...

FIGURE 4

Income share of the bottom 40% and log of GDP pc, c. 2012



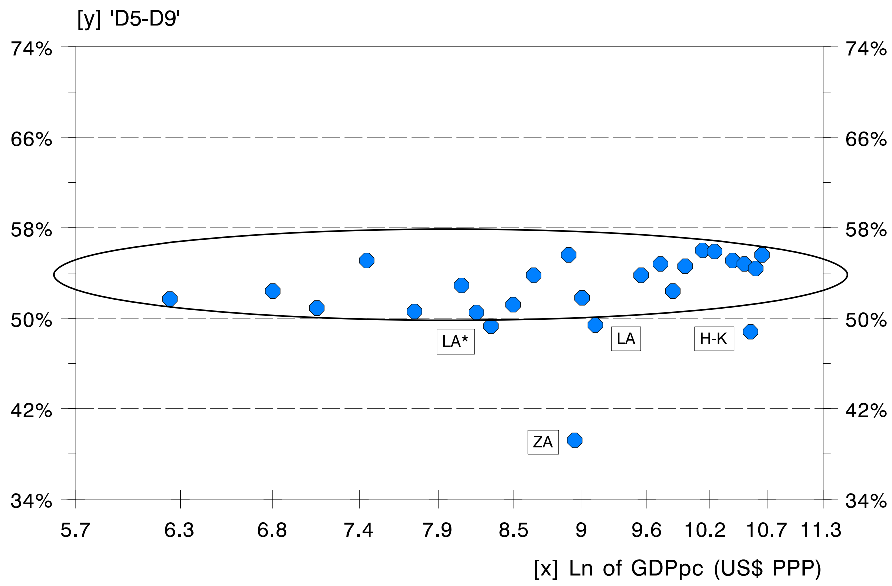
- South Africa's actual income-share for 'D1-D4' is 6.4%. Acronyms as in Figures 1 and 2.

Now the geometry is the mirror image of that of the Gini (and D10), with Latin America and middle-income Southern Africa in a similarly iniquitous position — followed these days by Singapore and Hong Kong (EA1*) on the high-income side, by Russia (Ru) on the middle-income one, and by many Sub-Saharan countries with an income per capita above US$ 2,000 (SS-A) on the low-income side.

It is therefore clear that the Gini scene for regional inequality (Figure 2) reflects accurately the distributional disparities across countries at both ends of the income distribution (D10 and D1-D4). But what about *the other half* of the population in each country — that *between* D10 and D1-D4?

FIGURE 5

Income shares of the 'middle and upper middle' (D5-D9) and log of income pc, c. 2012



● Acronyms as in Figures 1 and 2, and **H-K** = Hong-Kong. Countries, group of countries and regions as in previous figures.

Figure 5 shows one of the key contributions made in my 2011 paper: the distributional picture changes completely when one looks at the 50% of the world's population located within D5–D9 — the 'middle and upper-middle classes', sometimes called the "administrative classes" in institutional economics. Now the distributional geometry suddenly changes from one of huge diversity to one of a surprisingly similarity. In fact, this Figure indicates that the degree of *homogeneity* across regions/countries regarding the share of income that the middle and upper-middle classes are currently able to appropriate is truly remarkable. Perhaps equally striking is the fact that no-one seems to have noticed this before. The homogeneity in the middle and upper-middle is most prominent among rich countries — i.e., no more diversity here (Hong-Kong apart), as opposed to the huge diversity found in the Gini and in the top and bottom deciles. Moreover, Eastern Europe (both EE and EE*), and countries from the former Soviet Union (both FSU and FSU*) are no longer outliers; and Latin America's median country in both sub-groups (LA and LA*, currently at 49.3% and 49.2%, respectively) are just about to join the '50/50 club' — 50% of the population getting 50% of the national income (or just above). In fact, even Hong Kong is not that far away (48.8%), and Singapore (its partner in EA-1*) already qualifies (51.8%). Only South Africa, with Namibia, Zambia and most likely Botswana are living in a world entirely of their own in this respect.[15]

The case of South Africa is particularly remarkable as it has simultaneously the second *lowest* aggregate share for D5-D9 in the whole sample (Namibia is 'top 1') while having the *highest share in the world* for one of the components of this D5-D9 group: its 'civil-service-crowded' D9.[16]

As is evident in Figure 5, the current high degree of homogeneity in the income share of D5-D9 is reflected in the fact that its measures of central tendency are almost identical: the harmonic mean is 51.8%, the average is 52.1%, the median is 52.5% and the mode is 52.6%. In turn, the coefficients of variation of the top 10% and bottom 40% are almost four times higher than the one of this group (see Table 1 below).

Furthermore, the current similarity in the income-shares of D5–D9 across countries is even more remarkable in the 'upper middle' 30% of the population (D7–D9). See Figure 6.

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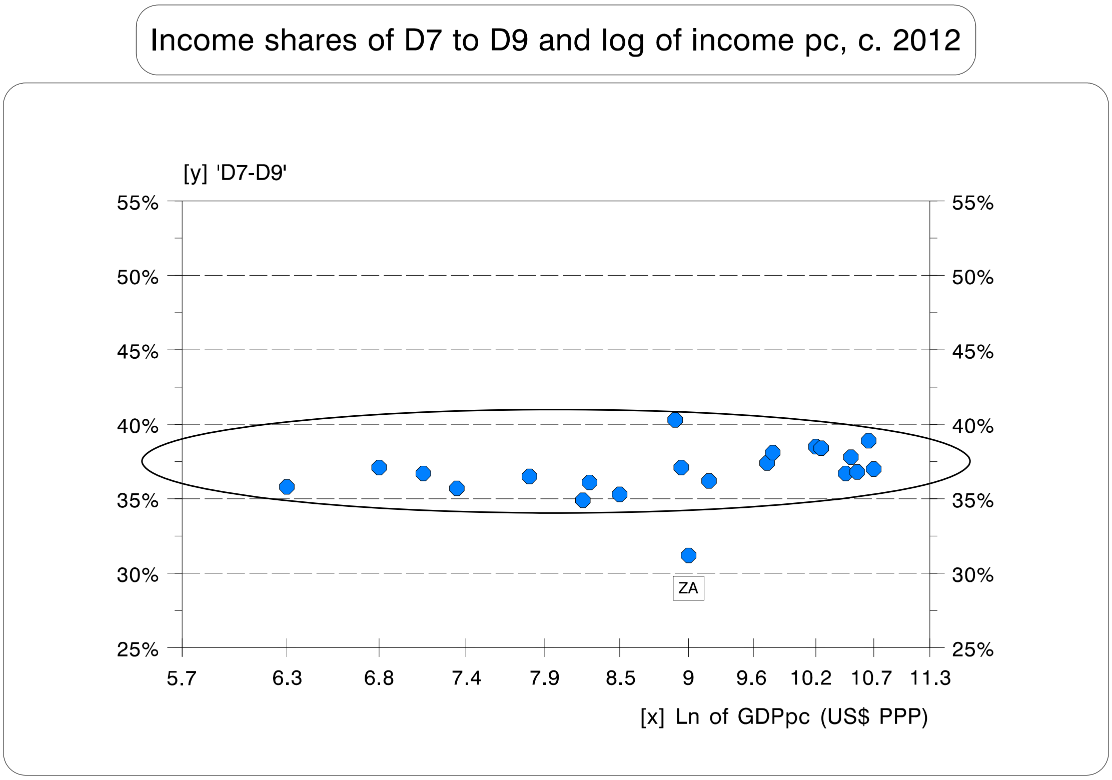
[15] The only other countries with a low share for D5-D9 in the whole sample (say, one below 47%), are Rwanda, Central African Republic, Guatemala, Honduras and Chile — for the (somewhat surprising) low share in Chile, see Palma (2011 and 2014).

[16] As a result, after 20 years of democracy and continuous 'centre-left' ANC rule, the top quintal gets no less than 75% of overall income! In this country the drop in income-shares below D9 is so sharp that D8 already gets less than half the share of D9. For an analysis of this remarkable phenomenon, see Appendix 3 of my 2011 paper. Basically, although democracy has opened up opportunities for many non-white new business people and professionals, the 'black empowerment' policy has mostly succeeded in bringing new entrants into the top 1%, and a particularly large number of new entrants into a much enlarged administrative class — and in bringing them to the same relatively high level of wages (and benefits) held previously by white bureaucrats when these administrative jobs were reserved for whites, mainly Afrikaners (at the time of Mandela's release from prison, one third of the economically active white population was employed in the public sector, with Afrikaners constituting the largest number of public employees).

FIGURE 6



• Acronyms and sources as in Figures 1 and 2. Countries, group of countries and regions are again the same as in previous figures.

In this case, the overall homogeneity is even more intense — and now Latin America has already made it (both LA and LA*), and also Hong Kong.[17] The measures of central tendency are practically identical, with the harmonic mean at 36.7%, the average at 36.8% and the median at 36.9% — and the coefficient of variation is just one-fifth those of the other two groups at the tails of the distribution (difficult to believe that this is just a twist of fate).[18]

As I mention in the 2011 paper (and discuss more in detail in Palma, 2014) — and confirmed here with data for c. 2012 — it seems that a schoolteacher, a junior or mid-level civil servant, a young professional (other than economics graduates working in financial markets), a skilled worker, a middle-manager, or a taxi driver who owns his or her own car (London apart), all tend to earn at the moment the same income across the world — as long as their incomes are normalised by the income per capita of the

[17] The only countries with a share for D7-D9 below one-third, other than the three already mentioned (South Africa, Namibia and Zambia) are Rwanda and the Central African Republic. And the only ones with a share that reaches 40% are China (40.3%, included in the graph), and Israel (40.4%).

[18] Among the many issues that emerge from this homogeneity in the middle and upper-middle vs. the heterogeneity in the tails is the mistake of reporting income distribution data in quintiles, as the top one is the blend of two very different components — while D9 has the most homogeneous share of all deciles, D10 has a hugely heterogeneous one. Therefore, there is a major (and easily avoidable) loss of information if these two deciles are reported together.

respective country.

If such homogeneity across the world were also to take place among the income share of the top 10% — let alone for the top 1% —, at least for the Latin American oligarchies (as well as for that of the US), this would be analogous to communism!

Basically, in middle income countries with huge inequality, what is really happening is that while the top 10% has succeeded in appropriating a level of income which is similar *in absolute terms* to those of their counterparts in rich nations (see also Sutcliffe, 2001, and Milanovic, 2010), the middle and upper-middle have done so *in relative terms* (shares in national income). Meanwhile, the bottom 40% has a very — very — long way to go, as currently their income per capita is more akin to the average income of Sub-Saharan African countries.[19]

The key issue here is that in these so-called 'middle income countries', only those in the middle and upper middle have 'middle-income' earnings — as many of those at the top have already succeeded in a premature catching-up with their counterparts in rich nations, while those at the bottom 40% are still facing the challenge of a *massive* 'catching-up' — just to get to 'middle-income' levels. "Convergence", therefore, seems to be a far more complex phenomenon than is implicit in neo-classical models.[20]

Another issue that is important to clarify, as this aspect of my ideas has led to misunderstandings, is whether this homogeneity in the middle and upper middle implies that distributive outcomes are basically the end-result of a battle of the tails, from which the middle and upper-middle are somehow able to shield themselves. In other words, the key question in this respect is whether those in D5-D9 are simply spectators of a rough distributive game played by the top and bottom struggling for their share of the other half — like Roman plebs enjoying the (distributional) circus from the safety of their seats —, or whether they are very much part of the distributional struggle (down in the arena, rather than up in their seats). As I discuss in detail in my 2011 and 2014 papers, there is no 'lack of history' in how these middle and upper-middle groups have converged towards the '50-50 rule' (their half of the national income), and in how now they have a hard struggle ahead to keep it — as they have to face these days the new (post-neo-liberal-reform) rampant voracity of the top income groups.

That is, the current '50-50' position of the middle and upper-middle is not the

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[19] In the case of Chile, for example, a country that in 2014 had a GDP pc in current dollars of US$15,000 – and of US$ 23,000 in PPP terms (IMF, 2015; and GGDC, 2015) – 25% of men and 43% of women (i.e., one-third of the working population) take home wages equivalent to less than US$11 per day. At the time when the traditional OECD countries had the current GDP pc of Chile, their hourly minimum wage was on average twice as much that of Chile today – perhaps this is what some call 'progress' these days. See specially Durán and Kremerman (2015).

[20] The same is true for output: in many 'middle-income' countries while the level of productivity for their resource-based activities are among the highest in the world, that of many other activities resemble those of low-income countries (see Palma, 2010; see also Katz, 2004).

result of some sort of prophecy of the type "Thou shalt keep half of the overall product of the sweat of the collective brow; no more, no less", but a somehow surprising phenomenon in an otherwise very diverse set of distributional outcomes — the roots of which have some components which are still an intriguing mystery.[21]

Due to lack of space, I can only summarise here one of my main hypotheses regarding this contrast between the homogeneity in the middle and upper-middle vs. the heterogeneity in the tails: basically (and in terms of after taxes and transfers income distribution data), while across the world the bottom 40% of the population has *very* different capacities to appropriate the output generated by their energy, creativity, and skills − that is, has very different degrees of property rights over their human capital and efforts, and, therefore, over the value of their marginal productivity −, the middle and upper-middle (especially the "administrative classes") seem to have both a similar *relative* level of productivity across the world (i.e., relative to the income per capita of the country), as well as a similar degree of property rights over their skills. Finally, although the top 10% has a similar strong capacity to appropriate the pre-tax output of its efforts and skills across the world, it has a very *different* one in different countries when it comes to its post-tax share, as well as its capacity to appropriate what is not theirs (such as the value of the marginal productivity of others − especially that of the bottom 40%). If this is the case, these phenomena would not only explain a good deal of the distributional diversity across countries, but also the different degrees of incentives to acquire skills found among the bottom 40% across the world. For example, in highly unequal middle-income countries, what would be the point for the bottom 40% to make the effort to acquire further skills if the additional output is bound to be fully (or almost fully) appropriated by others?[22] This phenomenon, reflected in stagnant (or nearly stagnant) blue-collar wages — an anti-efficiency wage scenario —, which has characterised many economies in Latin America since their economic reforms (see Palma, 2005 for the case of Mexico), is becoming common in high-income countries as well, especially in the US.

Regarding the middle and upper-middle, in order to be able to get their (relatively similar) shares of income they have had to form different types of political alliances to help them get (and defend) their half. And when these politico-economic alliances have broken-down, the share of D5-D9 has changed significantly. For example, while in Latin America the middle classes seek to defend their share of income with different forms of

[21] The next task should be to check whether this new finding of an overall homogeneity in the middle and upper-middle across countries is corroborated by datasets that measure inequality using sources other than (post-tax and transfers) household surveys, such as pre-tax and transfers data (Solt, 2015), tax returns (when these cover a large proportion of the working population), or industrial pay (as in the UTIP-UNIDO data set).

[22] However, if 'positive' incentives for the bottom 40% to acquire skills are missing (as they have little claim over the additional output resulting from their efforts), 'negative' ones are in abundance… That is, often the bottom 40% has to acquire skills just to remain where they are (i.e., in badly paid and insecure jobs).

alliances with the élite, in India the 'administrative classes' do so mostly via clientelist alliances with the poor (which gives them the political power to mediate in the different conflicts between the capitalist élite and the state).[23] In turn, in South Africa the fortunes of the middle classes appear to be uniquely different as the dominant (redistributive) political alliance has turned out to be that between the new 'empowered' élite, the upper stratum of the new administrative classes, and the bottom 40%. While the latter may have gained a lot in political terms, in distributional ones this alliance has only succeeded in increasing the income-share of the top (both D9 and D10) at the expense of the middle.

In sum, what is crucial to remember is that the regional distributional structure currently suggested by the Gini only reflects the income disparities among half the world's population — those at the very top and at the bottom of each country's distribution. It tells us little – or rather nothing – about the remarkable distributional homogeneity of the other half.[24] This raises serious questions regarding how useful the Gini index is as an indicator of overall income inequality, especially because (from a statistical point of view) the Gini is more responsive to changes in the middle of the distribution.[25] That is, the most commonly used statistic for inequality is one that is best at reflecting distributional changes where changes are least likely to occur! As a result, the overall geometry of inequality as shown by the Gini may well distort the nature of income disparities across countries, and (most importantly) obscure its fundamentals.

The problem is that the most common alternative inequality statistics, those that have the advantage of being more responsive to changes at the top and bottom of the distribution — such as the Theil — tend to have the huge disadvantage of being extremely vulnerable to measurement errors precisely at the tails of the distribution (and, above all, at the top; see Ibid.).

As a result, given the remarkable homogeneity in the middle and upper middle (see especially Table 1 below), I suggested in my 2011 paper that instead of the Gini we should use a new inequality statistic — one that simply indicates the ratio of the income-share of the top 10% over that of the bottom 40%. The obvious advantage of this inequality-indicator is that it measures inequality where inequality exists; it is also simple, intuitive, transparent and particularly useful for policy purposes — i.e., especially helpful for policy-targeting, as for anyone aiming at lowering inequality the implications of this ratio are as crucial as they are straightforward. In other words, the mere fact of its simplicity — i.e., one that purposely avoids all the often redundant (and even

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[23] See, for example, Khan (2000).

[24] For a criticism of the Gini, a '19th Century statistics', see Cobham and Sumner (2013c). See also OECD (2013, especially Shepherd, 2013).

[25] See, for example, Paraje (2004).

counterproductive) algebraic sophistication of alternative inequality statistics — becomes its main strength.[26] It is also better at highlighting the unique voracity of some oligarchies and, especially, their capacity to get away with it (see below Figures 8, 12 and 13). It was later called the "Palma Ratio" by Alex Cobham and Andy Sumner.

Table 1 presents a set of statistics for the whole sample (129 countries), confirming the huge contrast between the homogeneity in the middle and upper-middle of the distribution of incomes across the world and the heterogeneity at the tails.[27]

TABLE 1

Measures of Centrality and Spread for Income Groups, c. 2012

	h mean	median	average	st dev	c o var
D10	29.1	29.4	30.5	6.9	0.227
D1-D4	16.4	18.0	17.5	4.0	0.230
D5-D9	51.8	52.5	52.1	3.4	0.066
D7-D9	36.7	36.9	36.8	1.7	0.047

● **h Mean** = harmonic mean; **st dev** = standard deviation; and **c of var** = coefficient of variation.

Of all the statistics in Table 1, the coefficient of variation is of course the one that really matters: it best shows the current distributional contrast across countries between the homogeneous middles and the heterogeneous tails — as already mentioned, the coefficients of variation for both D10 and D1–D4 are nearly four times greater than that for D5–D9. Furthermore, they are five times larger than that for D7–D9.[28] This suggests that regardless of the per capita income level of the country, the characteristics of the political regimes, the quality of their institutions and of their educational systems, the economic policies implemented, the structure of property rights, or whether or not they belong to countries that managed to get their prices 'right', their institutions 'right', or their social capital 'right', in almost all countries the 50% of the population located in 'D5–D9' seems to have currently the capacity to appropriate in the distributional struggle about half the national income. This is even clearer in the case of those in D7-D9 regarding their just over one third of the pie.[29]

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26 The opposite is the case of the Theil; according to Sen, this statistic "... is an arbitrary formula, and the average of the logarithms of the reciprocals of income shares weighted by income shares is not a measure that is exactly overflowing with intuitive sense." (Sen, 1973: 36).

27 Bob Sutcliffe calls this contrast "Palma's Law".

28 Alex Cobham, Luke Schlogl and Andy Sumner revisit the empirical basis of the relative stability of the middle and upper-middle with an expanded dataset across and within developing and developed countries; see Cobham et all. (2015).

29 Note that as far as the ex-communist countries are concerned, this became so only when in 'full transition' (see Palma, 2014). Also, this homogeneity seems to be *a group characteristic*, as individuals within the group — as evidenced in household surveys — can easily be upwardly or downwardly mobile.

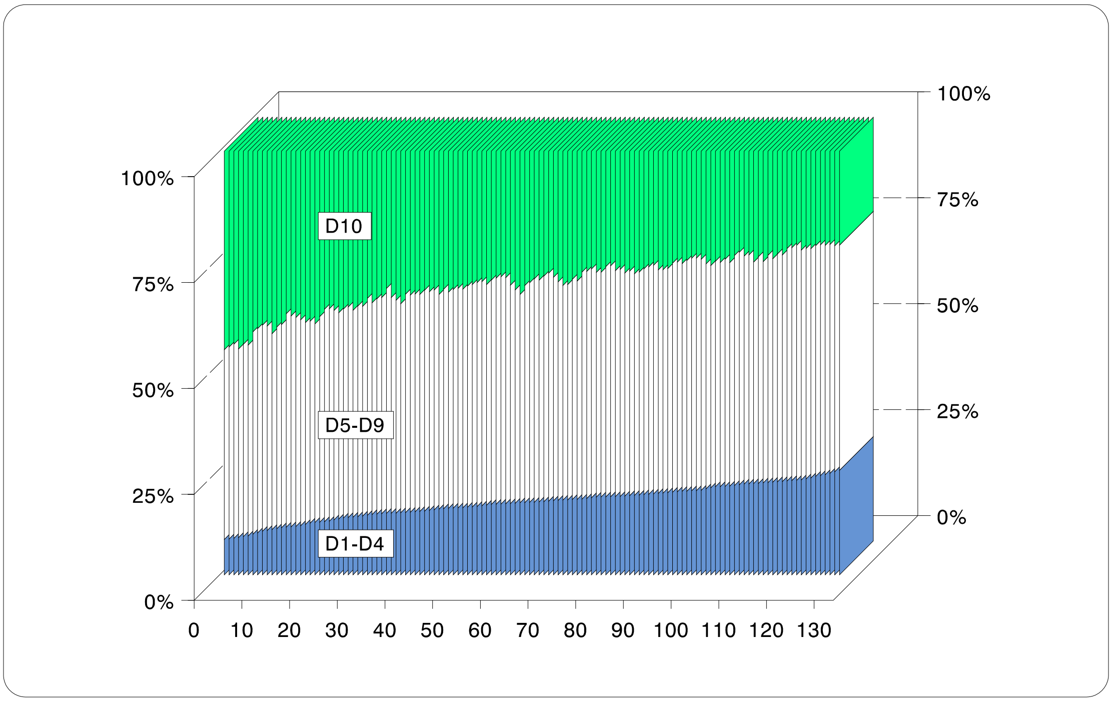
In turn, for the bottom 40% characteristics such as those mentioned above can make the difference between getting as much as one-quarter of national income (as in the Nordic countries and in some countries of Eastern Europe), or as little as a tenth — or even less, as in South Africa, Namibia and Honduras (6.4%, 8.2%, and 9.3%, respectively).

Finally, for D10 the sky is (almost) the limit, with some oligarchies managing to appropriate a share above 50% of national income (as in Namibia and South Africa), or close to it (as Zambia, Central African Republic and Honduras).

But as any summary statistics can hide diversity among its members, let’s look at this contrast between the homogeneity in the middle and upper-middle and the heterogeneity in the tails in the whole sample; see Figure 7.

FIGURE 7

The homogeneous middle vs. the heterogeneous tails in 129 countries, c.2012



- Countries are ranked according to the income share of D1-D4.

It seems patently obvious that the huge diversity of distributional outcomes across the world is almost entirely due to different shares for the top 10% and bottom 40%.

3.- Is the share of the rich what it's all about? The Palma Ratio

Obviously, a lot more research needs to be done on the forces shaping the income shares of different groups along such different paths — particularly in such opposite 'centrifugal' and 'centripetal' directions (D10 and D1-D4, and D5-D9, respectively). Remarkably, this simple observation does not seem to have been noticed before. Moreover, it seems odd that most of the recent literature on 'income polarisation' has produced indices that emphasise distributional changes around the middle of the distribution, exactly where there is greater income-share homogeneity. Wolfson, for example, started the whole 'polarisation' literature by developing an index that cuts the Lorenz curve right in the middle![30] In fact, the higher the degree of homogeneity in the middle and upper-middle of the distribution of income, and the higher the degree of heterogeneity at the very top and bottom, the more statistically and analytically meaningful simple income ratios (like that suggested by the Palma Ratio) become as indicators of distributional disparities across the world. Following this logic, Doyle and Stiglitz made a proposal to include a 'Palma target' in the UN's post-2015 framework for global development (a Palma Ratio of 1 by the year 2030; see Doyle and Stiglitz, 2014). In turn, Engberg-Pedersen (2013) suggested that countries should aim to halve the gap between their starting point and a Palma of 1 by 2030.[31]

In fact, it could even be argued that as the sum of all shares has to be equal to 100, the '50-50 rule' implies that the share of decile 10 could suffice as an inequality statistic for the whole distribution. This is precisely the reason why the subtitle in my 2011 paper stated that "the share of the rich is what it's all about". However, I believe that the ratio of the two components that creates diversity in inequality (the share of decile 10 over that of deciles 1 to 4) is a more informative statistic of inequality, as it highlights better the rôle of the two 'offending parties'.[32]

One interesting result of this homogeneity in the middle and upper-middle

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[30] See, for example, Wolfson (1997).

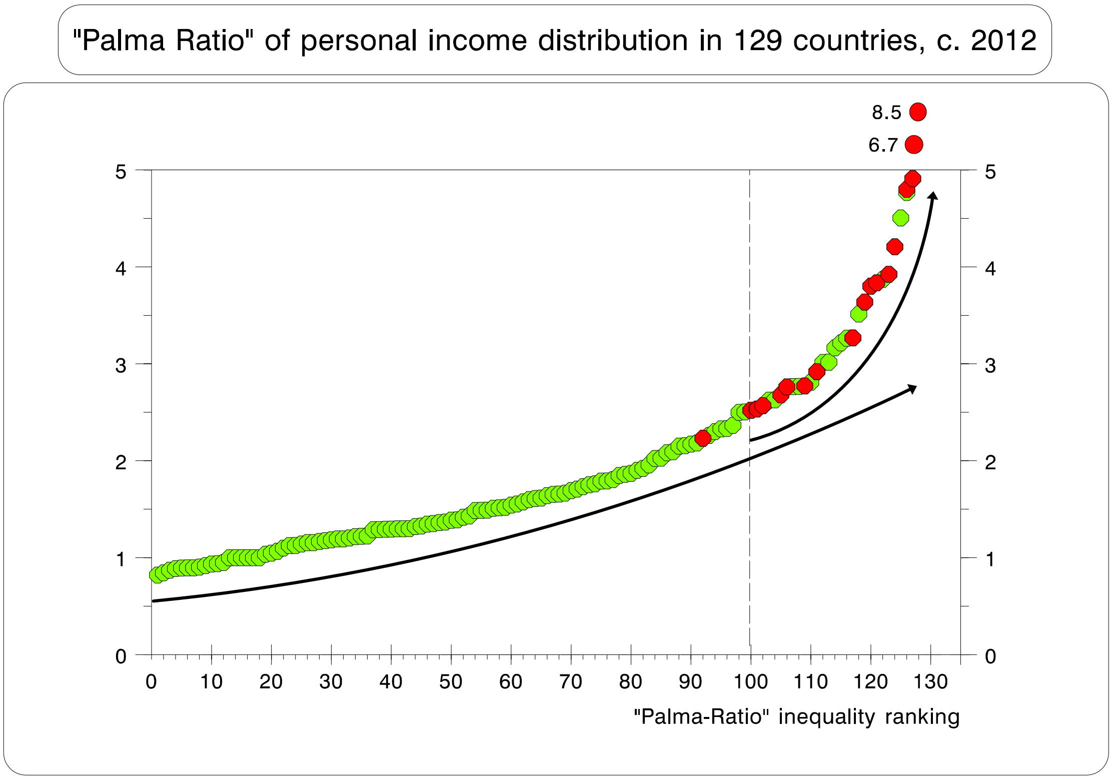
[31] As indicated by Cobham et all. (2015), "Data for the Palma Ratio is now listed and updated as standard measure of inequality in the OECD Income Distribution database (see Cingano, 2014 and OECD, 2014) and the UNDP annual Human Development Report (See UNDP, 2014), as well as by some national statistical offices, e.g. the UK (ONS, 2015). Further, interest in the Palma Ratio is evident among NGOs and international agencies alike (see for illustration, EC, 2014; OECD, 2014; Oxfam, 2014; UNDESA, 2013)."

[32] This implies, as Cobham et all. (2015) remark, that "the Palma is 'blind' towards intra-middle variation. However, this shortcoming might be offset by other desirable characteristics it has as a measure of income concentration. We know that by construction the Gini is over-sensitive to the middle; but in practice it is equally insensitive to the middle as is the Palma; so the implication would seem to be that the Palma Proposition holds sufficiently strongly to overcome the Gini's bias (possibly exacerbated by weaknesses in constructing Gini series from limited quintile data). That leaves a choice between a measure which by design is oversensitive to the 'wrong' bit of the distribution, but in practice tells us nothing about it; and a measure which by design and practice, deliberately tells us nothing about it. If you want to know about the middle, the Gini seems to be little good to you – but may fool you that it is."

regarding the Gini, as Tony Atkinson remarked in his comments on a draft of my 2011 paper, is that if D5-D9 gets half the income, then the Gini coefficient (in percentage points) is 1.5 times the share of the top 10% (in percentage points) minus 15. In this case the Gini has a maximum of 60% (although it may be slightly larger on account of inequality within the groups, since this calculation linearises the Lorenz curve).

Figure 8 shows the inequality-ranking of the 129 countries in the sample according to the Palma Ratio.

FIGURE 8



● Highlighted countries are those of Latin America and (mineral rich) middle-income Southern Africa. The last two, Namibia and South Africa, are (again) literally off the chart![33]

The most important stylised fact revealed by Figure 8 — a phenomenon that was not evident in the Gini-ranking of Figure 1 — is that inequality across the world, as measured by this ratio, increases first relatively slowly, and almost linearly, only to switch gear when Latin American countries enter *en masse* (around ranking 100); to then increase rapidly and geometrically.[34] In fact, as the lower arrow in the graph indicates, had the 'steady pace' found in the first 100 countries continued in the last quarter of the sample, the most unequal country in the world today would have posted a Palma Ratio of about 3

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[33] If one uses the World Bank-WDI dataset (instead of the OECD's), South Africa's 'Palma Ratio' falls to (the still dismal level of) 7.1 — in fact, since the Fall of Apartheid in 1994 and the beginning of democracy, inequality in South Africa has increased among *all* races and geotypes (see Leibbrandt, et al, 2010; and Palma, 2011).

[34] The only Latin American country in this sample ranked below 100 is Uruguay (94).

rather than one that is nearly three times as much!

4.- Income distribution and education: a more multifaceted relationship?

Among the many analytical issues that need to be re-examined following the detection of this remarkable stylised fact – the distributional homogeneity in the middle and upper-middle – the intriguing relationship between human capital and income distribution is a prime candidate, as this relationship is likely to be far more complex than the rather straightforward one usually assumed in mainstream economics and UN reports.[35] According to this approach, education — both in terms of equality of opportunities and of overall excellence — is not just one of many variables in the determination of income inequality, but *the* crucial one. However, in all regions of the world (developed and developing, Latin American and non-Latin American), the top income decile is made up of individuals with relatively high levels of education, while those in the bottom four deciles have either relatively little schooling, or (in the more advanced countries) schooling of a very doubtful quality. So why do these two relatively *homogeneously* 'educated' groups (one homogenously 'highly-educated', the other homogenously 'little-educated') have the greatest distributional *diversity* across countries? In turn, if most of the world's educational-diversity (both in terms of quantity and quality) is found among the half of the population between D5-D9 — e.g. in terms of the share of the population with secondary and (especially) tertiary education — why does one find extraordinary *similarity* across countries in the shares of national income appropriated by this educationally highly *diverse* group?

Chile, for example, with a gross tertiary enrolment of no less than 71% (World Bank-WDI, 2015; together with Argentina and Venezuela a country that has the largest tertiary education enrolment among all non-communist and non-ex-communist developing countries in the world), the 30% of its population between D7-D9 are currently only able to appropriate the 7th *lowest* income share in the whole sample (33.7%; with only Namibia, South Africa, Zambia, Rwanda, Central African Republic and Guatemala posting an even lower share). In fact, some countries with income-shares for D7-D9 similar to Chile have rather different tertiary enrolment rates — in fact, some in single digits. That is, Chile, with 71% rate for gross tertiary enrolment, ends up generating an income-share for D7-D9 similar to that of the Central African Republic (with an enrolment of just 3.1%), and Rwanda (7.1%). Perhaps it is time for the "it's all about education" distributive-brigade to go back to the drawing board.

And despite the fall in Chile's overall inequality between 2003 and 2011 (the Gini fell from 0.55 to 0.51, while the Palma Ratio did so from 4.1 to 3.3), the share of D7-D9

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[35] See, for example, Neal and Rosen (2000). See also ECLAC (2010a and b).

remained invariant in its particularly low levels despite the rapidly growing numbers of new graduates entering the labour market. So, in terms of the rôle of education in the distribution of income it is important not to lose sight of the multifaceted nature of the relationship between increased equality of opportunities and of better quality in education, and increased distributional-equality — and of the fact that education (or any other factor that may be influencing the distribution of income for that matter) can only operate *within specific institutional dynamics*. Needless to say, a lot more work is urgently needed in this challenging area, and one that would recognise properly the huge complexity of the relationship between inequality and education.

5.- Why is the mainstream of the economic profession so fixated on changes in the middle of the distribution – and so reluctant to analyse changes at the top?

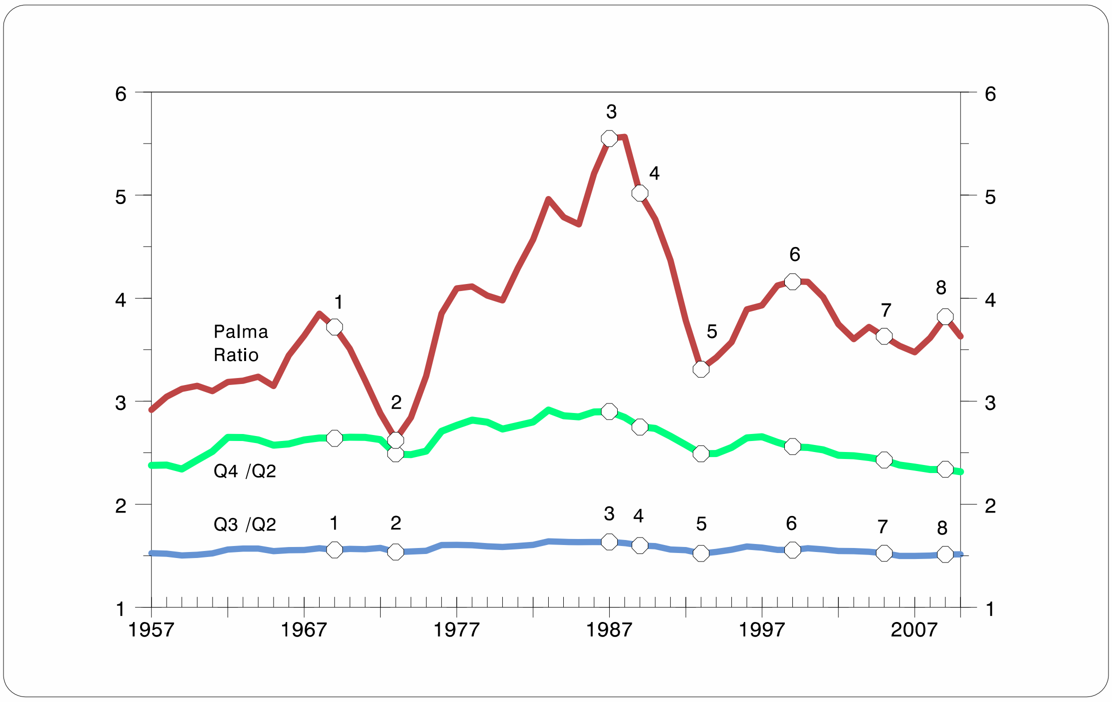
With the above evidence it is somehow perplexing to find that both the early Washington Consensus' explanation of high inequality ('60s and '70s), and the one developed later in the '90s, were somehow obsessed with blaming 'excess' inequality in Latin America with what was supposedly going on in the *middle* of its distribution. This phenomenon, which characterised for so long most mainstream distributional theories, began to change only very recently thanks to the new tax-based distributional data produced initially by Saez, Piketty and Atkinson (among others). Until then, mainstream theory was surprisingly uninterested in what was going on at the top; as John Kenneth Galbraith once remarked, "of all classes the rich are the most noticed and the least studied" (1977: 44). It now looks as though a certain cat is finally out of a certain bag.

For example, those of my generation will remember the '60s and '70s mainstream hypothesis concerning the supposed inequalising rôle of import-substituting industrialisation (ISI); the emphasis of the analysis was placed in the distortions created by ISI, leading to "labour aristocracies" in regions such as Latin America. This hypothesis was later recycled in the '90s in an attempt to explain away the increased inequality that followed economic reforms; now the focus was on import-liberalisation creating problems such as 'skill-biased technical change'. But the myopic focus was always the same: to explain diversities of inequality across the world the emphasis in the analysis had to be placed on issues explaining (supposed) diversities between the middle and the bottom of the distribution, not those that would help us understand cross-country diversities at the top.

In the case of the "labour aristocracy" hypothesis, widely invoked by the emerging Washington Consensus of the time, it was argued that one of the main causes of inequality in Latin America was the price distortions associated with ISI. These were supposed to have misaligned the values of marginal productivities across sectors, allowing for artificially high wages in manufacturing (à la Stolper and Samuelson). That is, wage differentials were much larger than if free trade had predominated.[36] However, there was little then (as now) to differentiate Latin America from the rest of the world — developing and developed, ISI and non-ISI — in terms of the income shares among groups that would include 'aristocratic' and 'non-aristocratic' labour. Furthermore, as the case of Chile indicates (see Figure 9), the abrupt end of ISI in 1973 (point number 2 in the graph) had little or no impact on Q3/Q2, an income-share ratio that could be used to proxy wage differentials between 'aristocratic' and 'non-'aristocratic' labour (see line at the bottom of the Figure).

FIGURE 9

CHILE: Palma Ratio, Q4/ Q2 and Q3 /Q2, 1957-2010



• **Q** = income-quintiles. **1** = election of Allende; **2** = Pinochet's coup d'état; **3** = the year Pinochet called a plebiscite seeking a mandate to remain in power for another eight years; **4** = first democratic government (centre-left coalition) that took office in 1990 after Pinochet lost his 1988-plebiscite (and was forced to call presidential elections at the end of 1989); **5** = second democratic government (same centre-left coalition, but a return to more 'free-market' distributional policies); **6**-**7** and **7**-**8** = next two governments by the same coalition. 3-year moving averages.

• Source: calculations done by Pamela Jervis and myself using the FACEA (2012) database. Chile is one of the very few countries in the developing world that has a relatively robust set of historical data for such a long period of time — at least for the 'Greater Santiago', where almost 40% of Chile's population live. 2010 was the last year for which data were available.

In fact, Q3/Q2 ended up in 2010 exactly where it started in 1957, even though trade and industrial policies, especially tariffs — and almost everything else — could not have been more different (and 'liberalised') by then. The remarkable stability of this ratio between

[36] See, for example, World Bank (1987) and Krueger (1983).

the ISI and post-ISI periods (despite the fact that both development strategies took particularly extreme forms in Chile) — as opposed to what was happening at the tails of the income distribution — contradicts the above mentioned hypothesis (unless one were to believe that the ISI wage-distortion was immediately and perfectly matched by the post-ISI increased wage differentials due to shortages of skilled labour).

The latter proposition (one that yet again tries to explain high inequality by looking at diversities between the middle and the bottom of the distribution) was developed by many mainstream economists in the post-ISI liberalisation-cum-globalisation era; it was basically a recycled version of the previous (distortions-due-to-ISI vs. an ideal world without ISI) approach. It tried to explain away the (supposedly) unexpected increase in inequality in many developing countries after the implementation of policies aiming at trade and financial opening and neo-liberal economic and political reforms in general. These increases in inequality, following greater integration into the world economy by now 'flexible' economies, were the exact opposite of the unambiguous predictions made by those circling around the Washington Consensus at the time.[37] Hence, it was argued that these (previously unforeseen) neo-liberal-reform-related increases in inequality were taking place because although trade liberalisation had had the highly positive impact of bringing in higher imports of modern capital goods with latest technologies embodied in them, these (regrettably) were intensive in the use of skilled workers – a scarce factor in most LDCs. As a result wage differentials between skilled and unskilled workers had increased, and so had inequalities. However, as is obvious in Figure 9, what really differentiates Latin America's inequality was again not located where skilled and unskilled workers are likely to be located, but more towards the tails of the distribution of income. Then, even if import liberalisation did allow for an increase in the importation of capital goods which introduced new production techniques that made intensive use of skilled labour, evidence suggests that this does not alone account for much of the region's increased inequality after economic reforms.[38]

In fact, assuming that skilled workers — i.e., those able to handle new technologies — are located as high as Q4, while unskilled ones in the formal sector are probably relegated to Q2, Figure 9 indicates an intriguing scenario: first, during the immediate post-ISI period (a highly inequalising period between 2 to 3 in Figure 9, which was characterised by radical reforms) the Q4/Q2 ratio did actually increase. However, this period was actually characterised by low (instead of high) demand for skilled workers due to remarkably low levels of investment (on average, just 16.9% of GDP), and low levels of imports of new capital goods (see Palma, 2012) — leading to little technological

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[37] See, for example, Lall (1983).

[38] Among those that favour this hypothesis, see for example Cline (1997, this book has a very useful survey of the literature). For critiques of this literature, see Krugman and Lawrence (1993), Atkinson (1997), and Paraje (2004).

change, productivity stagnation (on average output per worker grew just at 0.3% p.a.), and a stagnant or even negative TFP growth (according to how one measures it; see Fuentes, Larraín and Schmidt-Hebbel, 2006). In turn, afterwards — during the less fundamentalist reform-period, which included the return to democracy and the 'roaring' '90s (from 3 to 6 in Figure 9) — wage differentials between skilled and unskilled workers (proxied by Q4/Q2) actually *decreased* from 3.1 to 2.5, despite high demand for skilled workers. This was due to high investment rates (high at least for Latin American standards — 24% of GDP), and high levels of imports of capital equipment, leading to rapid technological change, rapid productivity growth (4.8% p.a.), and particularly high TFP growth (see Ibid.). In fact, even the ratio of the upper-middle (D7-D9) vis-à-vis that of the bottom 40% (a ratio not included in the graph) *fell* from 4.1 to 3.1 during this period of high demand for skilled workers due to dynamic technological change.[39]

And for the rest of Latin America, blaming inequalities on increased imports of capital goods is even less credible given their appalling investment records since the beginning of economic reforms; for example, in Brazil and Mexico their 2013 level of investment per worker (the last year when data are available) was actually 20% below their 1980 one – and it is not as though that level was particularly high to begin with! Furthermore, in the case of Mexico this is so despite having had one of the highest (if not the highest) levels of FDI per worker in the World. For the whole of Latin America, this statistic fell (on average) 10% during this 33-year period (i.e., in constant 2005 US$, it fell from US$ 4,377 in 1980 to US$ 3,924 in 2013 – commodity price boom and all; see Palma, 2015). During this period, in fast-growing Asia investment per worker jumped 4 times in Korea, 5 times in India, and 26 times in China – the latter showing that in economics one can also have too much of a good thing! No much danger of that happening in Latin America, where the average rate of investment has struggled to reach even 20% of GDP since around 1990 (when most countries of the region opened up their economies to trade and finance). Of this meagre percentage, investment in machinery and equipment contributed less than half of the total (in Brazil, for example, it has amounted to just 6% of GDP since the beginning of economic reforms in 1990). And in all likelihood only about half of that was imported. Not surprisingly, even during the twelve-year period of commodity and financial bonanza after 9/11 and the Fed's reflationary response, GDP growth in Latin America was so mediocre that on the expenditure side five-sixths of that growth was simple expansion of consumption (and of the debt to fund it), and on the product side more than two thirds was simple expansion

[39] The real world seems to insist in contradicting the often mechanical reasoning of so much of mainstream economics. The message we get (which we are supposed to have understood since John Stuart Mill) seems to be always the same: no matter what ideological perspective you are coming from, either you are able and willing to take seriously the complexities of social realities, or you may spend the rest of your life just 'delving deeply into the surface of things'.

of employment (almost entirely in technologically-challenged services and construction; see Ibid.). So, it should not surprise either that in Chile, a country that is so often highlighted as the best performer of the region, the average annual rate of TFP-growth for the last two decades has actually been nil (Ibid). Not precisely a vision of a region struggling to cope with the upheavals of a high-tech modernity!

Therefore, the effects of ISI on inequality during the former period, and of imports of modern capital equipment in the latter one, seem to be far more complex than the above mentioned one-dimensional and reductionist hypotheses — reductionist in the sense of the philosophical position that often characterises mainstream economics, which holds that a complex system is nothing but the sum of its parts, and that an account of it can be reduced to accounts of individual constituents. Figure 9, therefore, indicates that if one really wants to understand distributional change, rather than continue to be distracted by the middle of the distribution of income and wage differentials among production workers, it would be much more productive to focus on the tails, especially the top one — as the work of Saez, Piketty and Atkinson (among others) has done, as my 2011 paper tries to do — and the resulting Palma Ratio highlights —, and as Piketty's latest remarkable book (2014) does again. So, let's not just 'notice the rich', but concentrate instead on the study of how they manage to appropriate such diverse shares of national income across the world, and why do they do such different things with their shares afterwards.

Obviously, the 'usual suspects' won't like if the mainstream analytical focus turns to them,[40] but as long as the share of the middle and upper-middle remain relatively homogenous across countries, we have little choice but to keep reminding ourselves of what I believe to be the most fundamental of all distributional stylised-facts (which, as mentioned above, I highlighted in the sub-title of my 2011 article): "the share of the rich is what it's all about". And if one not only wants to understand why inequality is so diverse across the world, but also get closer to the understanding of why growth is also so dissimilar, what we should write in our notice-boards is: "It's all about the share of the rich, and what do they do with it".

[40] Piketty's recent visit to Chile highlights this point: right-wing economists and political commentators spared no effort and expense to criticise his emphasis at analysing what was going on at the top of the distribution (sometimes even in abusive terms); see for example http://www.elmercurio.com/blogs/2015/01/17/28610/Estamos-o-no-hasta-el-Piketty.aspx.

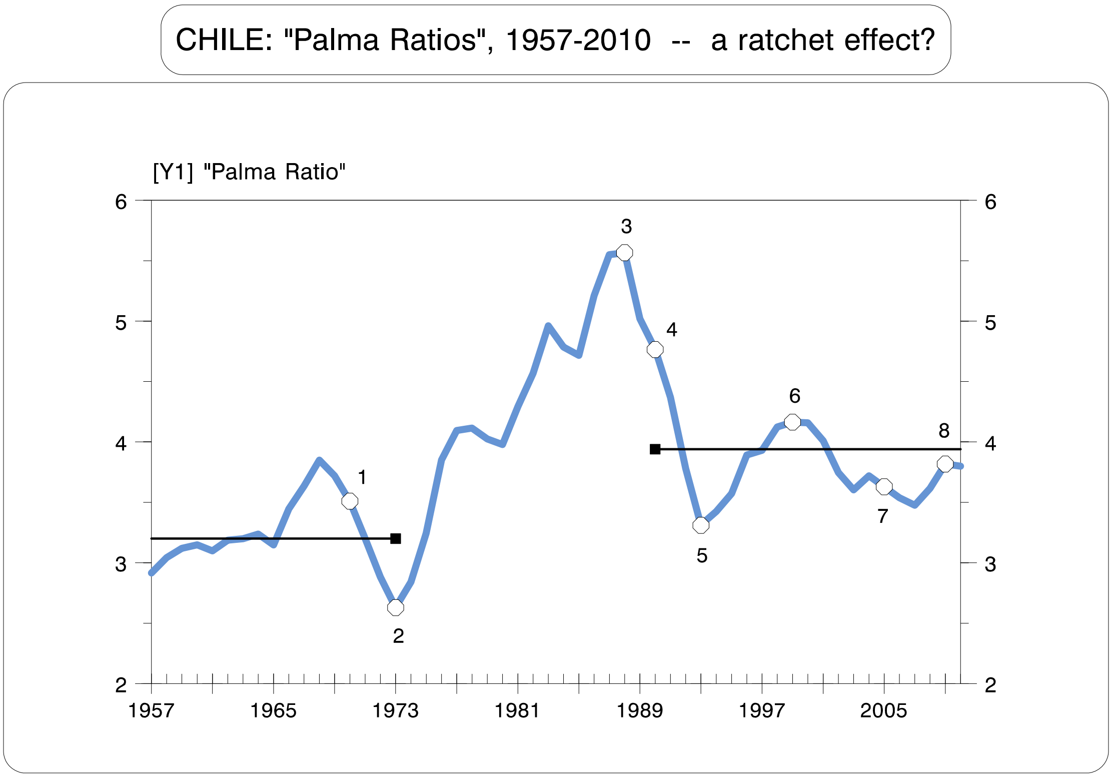
6.- Why is inequality still so extreme in Latin America, and why is it getting even more obscene in South Africa? How does it affect growth?

When one wants to study the causes and consequences of extreme inequality, there is an obvious place to start: Latin America. However, due to problems of space in this section I can only (and briefly) analyse three of the many issues that are at play in them.

6.1.- Is there a 'ratchet effect' in action?

In Latin America there seems to be a tendency towards an inequalising 'ratchet effect' following (unfortunately rather common) negative distributional shocks; see Figure 10.

FIGURE 10



● From 1 to 8 and source as in Figure 9. 3-year moving averages. Black (horizontal) lines are harmonic means between the pre- and post-Pinochet periods (i.e., between 1957 and the *coup d'état* in 1973; and the return to democracy and 2010).[41]

The evidence of the dataset available for this period of over half a century points in the direction of a 'distributional ratchet' effect. This seems to result from the fact that in Latin America improvements in inequality have tended to be temporal (e.g., from 1 to 2, and from 3 to 5), while deteriorations have tended to have more permanent effects (from 2 to 3, and from 5 to 6). In other words, the dice is loaded in the sense that the rich tend

[41] Remember that we have to stick to Chile owing to lack of systematic historical data for other Latin American countries (or South Africa).

to be more capable than the poor at making their gains more permanent. That is, the well-known restrained ability of human processes to be reversed once certain things have happened seems to apply only to increases in inequality.

Brazil seems to be another example of this negative 'distributional ratchet' effect, though there are no data as systematic as that for Chile to prove this; the evidence that exists (mostly thanks to Albert Fishlow; see for example Fishlow, 1972) also indicates that the huge deterioration in the distribution of income that took place immediately after the 1964 coup remained in place almost unchanged for the next forty years! So, although Brazil has apparently been moving in the right direction in the recent past (unlike South Africa), it has a long way to go to get to the levels of inequality found in that country pre-1964.[42] In fact, according to its Palma Ratio (based on household surveys) it still ranks today as the 120th most unequal country in this sample of 129 countries. As is often the case, perhaps too many bottles of champagne have been opened prematurely; and from a political point of view, as a result of the small improvements that have taken place among the bottom 40%, inequality has lost what for Wittgenstein was the key requirement needed for success in policy matters: a sense of urgency. As a result, the need to do something here and now about the distribution of income has dropped massively in the list of priorities in comparison to poverty reduction. And as the experience of Chile shows, in a middle-income country one can reduce poverty significantly without affecting the distribution of income.[43]

What has happened in the past in Chile and Brazil in terms of their 'ratchet effects' makes me wonder how sustainable really are the recent relatively minor improvements in inequality in some countries of the region (which are only statistically significant if one uses the traditional, but somehow unambitious, 'α'). As mentioned above, evidence suggests that in Latin America those that benefit from reduced inequality are nowhere near as capable of retaining their gains as are those who benefit from increased inequality

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[42] Although Brazil's progressive social policies (such as rising the minimum wage significantly, its efforts to increase the formalisation of jobs, and its "Bolsa Familia" subsidy to the poor) has succeeded in increasing the share of the bottom 40%, there is still a huge controversy regarding what is happening at the top. For example, according to Forbes (2014), since the Workers' Party took office in 2003, the number of millionaires, centa-millionaires and billionaires (as defined by Forbes) have increased by 273%, 274% and 256%, respectively. In 2013, for example, according to this Report one additional person became this type of millionaire (an individual with US$ 30 million or more in terms of net assets, excluding their principal residence) every 27 minutes — in a country with a remarkably sluggish economy. Also, the already mentioned study of income distribution based on tax records (Medeiros, et al., 2014) shows not only a much larger concentration of income at the top than studies based on other sources, but also one that has been actually rising (as opposed to what household surveys say).

[43] This became evident during the first 16-years of the centre-left coalition that followed the return to democracy in 1990 (la 'Concertación'). While poverty rates were cut by more than half (from about 40% to less than 20% of the population), the Gini stood immobile. Basically, when high middle-income countries define poverty in such an unambitious way as they do in Latin America, programmes of poverty reduction are so cheap that they can be carried out easily without affecting the bulk of the distribution – in Brazil, for example, the rather effective "Bolsa Familia" programme has had an annual cost of approximately just 0.5% of GDP (Fiori, 2010).

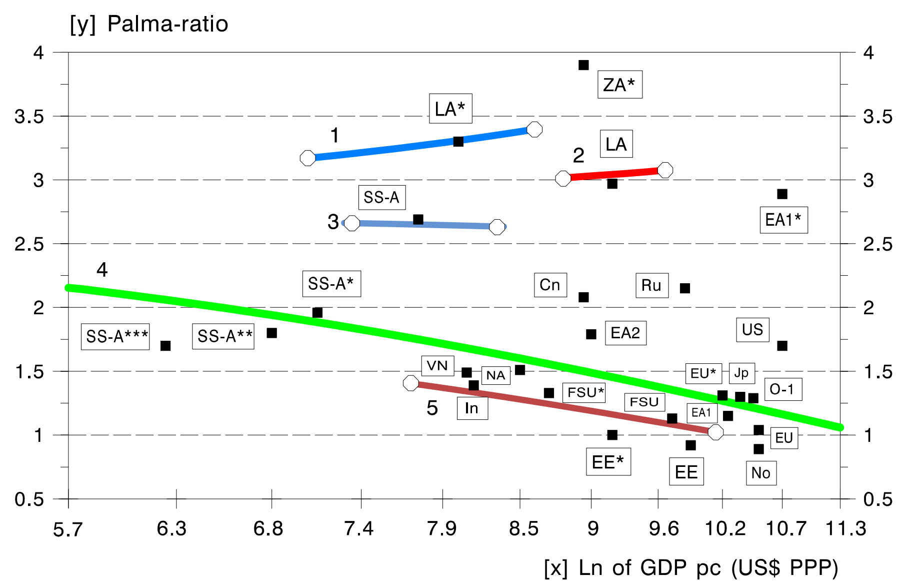
when, sooner or later, the pendulum swings in the opposite direction.[44] The current economic and political crises in Brazil will be a good test of this ratchet effect hypothesis in terms of indicating the capacity of the poor to hold on to their previous gains.

6.2.- Is the top 10% in Latin America — and Southern Africa — unique?

When Tony Atkinson read an early draft of my 2011 paper, his first question was whether I thought that the top 10% in Latin America is just simply better at getting a higher proportion of national income than most, or whether they are a different kettle of fish altogether. The uniqueness of Latin America's and Southern Africa's political settlement and distributional outcomes becomes evident in Figure 11, when the Palma Ratio is tested as dependent variables against income per capita.

FIGURE 11

Palma-ratios and log of GDP pc, c. 2012



• **ZA*** = South Africa's actual 'Palma Ratio' is 8.5. The regression has four intercept dummies: Southern Africa (South Africa and Namibia), Eastern Europe and the former Soviet Union (EE, EE*, FSU and FSU* — line **5**), Qatar, and the EA1* (Hong-Kong and Singapore). It also has three slope dummies (LA*, line **1**; LA, line **2**; and SS-A, line **3**). Line **4** = base regression. All parameters are statistically significant at the 1% level (i.e., pretty unlikely to have occurred by chance). This regression has only one main explanatory variable (GDP pc squared), because if GDP pc is also included both explanatory variables become not-significant even at the 5% level (and if only one is included, GDP pc squared is the one that is more significant and meaningful). 't' statistics are based on 'White's heteroscedasticity adjusted standard errors'. The R^2 of the regression is 69%. Regional dummies are reported only within the GDP per capita range of its members (and the base

[44] For a detailed analysis of this issue, see Appendix 1 in my 2011 paper.

regression is also reported only within the range of the sample).
● Acronyms and sources as in Figures 1 and 2.

Taking into account the usual structural instability of this type of cross-country regressions, Figure 11 shows that the result of such an exercise produces a regression which indicates that SS-A, LA*, LA and ZA are following their own unique inequality-paths — proxied here by their highly significant dummies (an intercept one for South Africa and Namibia, and slope ones for the other three groups). These countries are not only highly significantly more unequal, but they even seem to be moving in a different direction altogether — with Hong-Kong and Singapore apparently catching up with them. Moreover, South Africa and Namibia (and in all likelihood Botswana as well), with their Palma ratios of 8.5 and 6.7, are (literally) beyond the pale of this graph.[45]

However, it is important to emphasise that the regression in Figure 11 is simply meant to be a cross-sectional ***description*** of cross-country inequality differences, categorised by GDP per capita. That is, they should not be interpreted in a 'predicting' way, because there are a number of difficulties with a curve estimated from a single cross-section — especially regarding the homogeneity restrictions that are required to hold.[46] This is one reason why the use of regional dummies is so important, as they can provide crucial information regarding the required homogeneity restrictions — and their evidence points in a different (heterogeneous) direction. Hence, regional dummies are reported only within the income per capita range of its members.

In the regional dummies there are two opposite paths. In one, Latin America, but especially LA*, inequality gets, on average, slightly worse as countries achieve higher income per capita (lines 1 and 2), even though some countries in Latin America have already reached high middle-income level status. At the same time, highly unequal SS-A (countries in Sub-Sahara with a GDP pc above US$ 2,000 — line 3) seem to be copying not only Latin American-style football, but also other less pious features of the region. The other path, followed by Eastern Europe and the former Soviet Union (EE, EE*, FSU, and FSU* — line 5), is characterised by inequality getting, on average, systematically better as countries have higher income per capita. However, it is important to emphasise that this downwards slope — as well as that of the base regression — does not necessarily mean that the distribution of income within *individual* countries is currently improving as they get richer; it only means that although the distribution of income within many of these countries is currently deteriorating, we still find today as a stylised fact that the richer the country the lower the level of inequality (as a group).

As the relationship between inequality and income per capita is not homogenous

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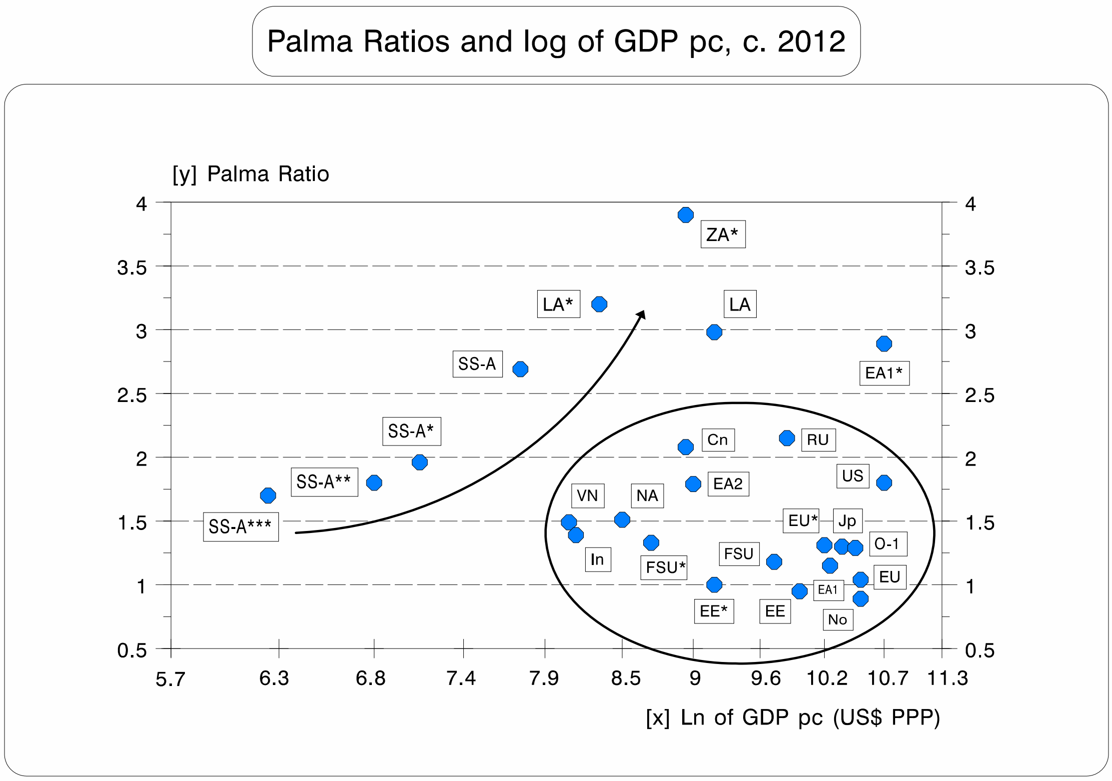
[45] As mentioned above, the last reported data for Botswana is from 1994 (therefore, not included in this sample); these data shows a Palma Ratio of 5.7.
[46] See Pesaran, Haque and Sharma (2000).

across regions and countries, the homogeneity restrictions that are required to hold in a cross-section for 'prediction' are visibly not fulfilled. Therefore, not only analytically but also statistically there is no reason to expect that Latin America and Southern Africa will improve their remarkable inequality simply because their income per capita increases — i.e., this is likely to occur simply because this is what happened in other countries in the past.

However, as is often the case, when work of this nature produces such statistically interesting and significant results, this "[...] involves the evolution of knowledge as well as ignorance" (Krugman, 2000). Is the cross-sectional-scenario that emerges from Figure 11 really the most appropriate way in which to represent the geography of inequality across the world? What about if the Sub-Saharan African countries with a GDP pc below US$ 2,000 (i.e., SS-A***, SS-A** and SS-A*) are best represented differently than by the base regression of Figure 11? For example, what about if what they have in their horizon is what is happening in richer Sub-Sahara (SS-A), Southern Africa and Latin America rather than the rest of the sample? Closer inspection of the data (following what is already indicated in Figure 2 to 4) seems to suggest that a different narrative regarding Sub-Saharan Africa, Southern Africa and Latin America is not just possible, but in fact likely to be more accurate – see Figure 12.

FIGURE 12

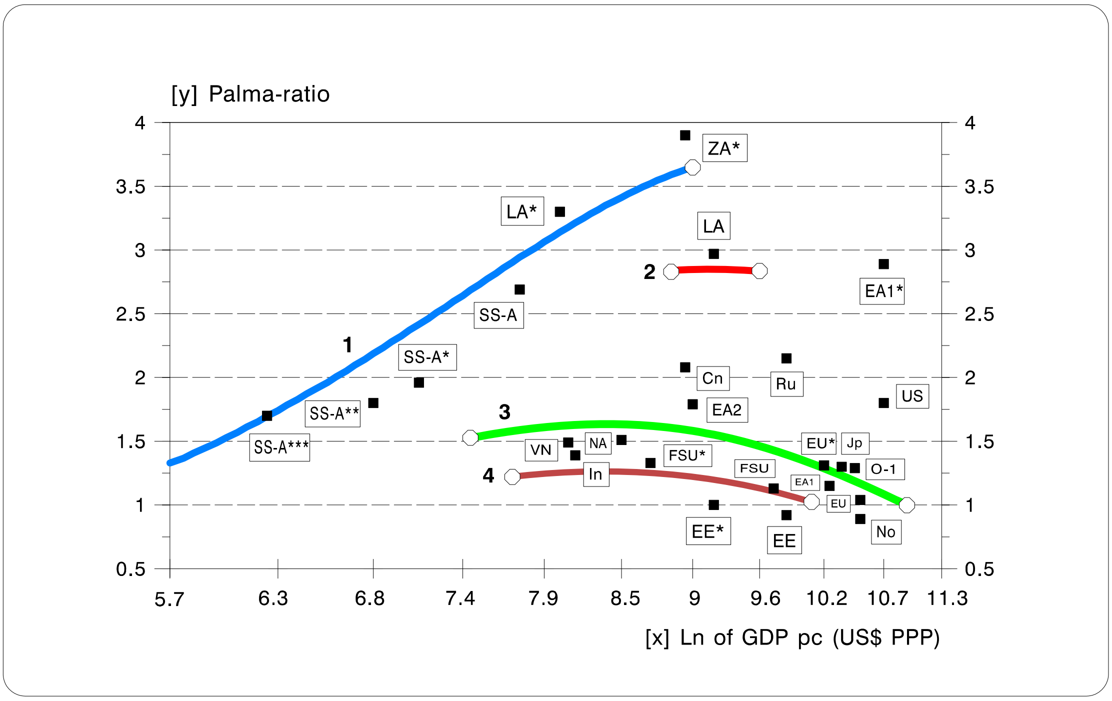


• Acronyms and sources as in Figures 1 and 2.

Figure 13, in turn, illustrates the cross-sectional representation of this new scenario.

FIGURE 13

Palma-ratios and log of GDP pc: "two parallel universes"?, c. 2012



- The regression now has three intercept dummies: Eastern Europe and former Soviet Union, excluding Russia (EE, EE*, FSU and FSU* — line **4**), Qatar, and the EA1* (Hong-Kong and Singapore). It also has two slope dummies (on the GDP pc square variable); one includes all four groups of Sub-Saharan African countries (SS-A***, SS-A**, SS-A* and SS-A), as well as Southern Africa (including South Africa and Namibia), and Latin American countries with a GDP pc below US$8,000 (LA*) — line **1**. The other represents the rest of Latin America (LA — line **2**). Line **3** is the base regression. All parameters are statistically significant at the 1% level (in this regression, GDP pc and GDP pc squared are included as main explanatory variables). 't' statistics are based on 'White's heteroscedasticity adjusted standard errors'. The R^2 of the regression is 67%. Regional dummies are reported only within the GDP pc range of its members. The base regression is reported from Bangladesh to Norway (i.e., the whole span of the non-Sub-Saharan Africa sample, except for Ethiopia and Nepal on the low GDP pc side, and Qatar one the other side).
- Acronyms and sources as in Figures 1 and 2.

What a statistical paradox. Two such different econometric scenarios as those of Figures 11 and 13 have practically the same statistical support in the sample (at least in terms of R^2s and high significance of all parameters).[47] And in this new "two parallel universes" narrative (Figure 13), the answer to Tony Atkinson's question seems straightforward: yes, Sub-Saharan African, Southern African and Latin American oligarchies seem to be a different 'social organism' altogether. One could even borrow a metaphor from the Darwinian concept of "living fossils" — both in the sense that these oligarchies do not

[47] All parameters are statistically significant at the 1% level. A good example for my econometric lectures, section "why should one always be careful when interpreting econometric results". Econometrics is all about competing specifications, and sometimes, for all practical purposes, there can well be a draw! However, as the second equation does not fully nest the first, the comparison is more complicated than what one would like.

seem to have close 'living relatives' in other regions of the world (other than in the Middle-East, and lately in EA1* — i.e., Hong-Kong and Singapore), and that they appear to be similar to social and political 'organisms' otherwise only known to us from the study of (social and political) fossils from the past history of more advanced economies — when their wealth and income inequality was extreme and persistent, a phenomenon that lasted until about the First World War.[48] In other words, these odd 'species' (anomalous oligarchies) may only be in existence today because they have been exposed to less severe competition from below, and/or they are probably better equipped than oligarchies in other regions in the world to resist major social and political evolutionary upheavals. As mentioned above, in some of these countries many economic and political institutions have changed with the onset or the return to democracy (in some even significantly), but the underlying distribution of political power has not (or not in a major way from the point of view of inequality) — and neither have the narrow interests of the élite (even when there are new members). In fact, the unique comparative advantage of these oligarchies seems to lay precisely in being able to use different institutions (sometimes quite astutely) to achieve their fairly immutable goals.[49] As emphasised above, few oligarchies in the world seem to have such skills in their struggle for the 'persistence of élites' despite significant institutional change.

At the same time, Latin American and Southern African distributional outcomes are so extremely unequal that they seem to provide little evidence in support of Pigou's law of "diminishing marginal utility", or "less intense wants" at work, at least as far as income distribution (or status, power, or greed) is concerned. That is, not much evidence of 'diminishing returns' here; perhaps not least because (as a brilliant Argentinean cartoonist has put it) "it's become so outrageously expensive to be rich nowadays!" So, perhaps Adam Smith was closer to the mark when he said that as far as issues such as income distribution are concerned, "[...] it is the vanity, not the ease, or the pleasure, which interests us." (1759). Vanity indeed. And as Nietzsche reminded us, "vanity is the fear of appearing original: it is thus a lack of pride, but not necessarily a lack of originality".[50]

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[48] See Piketty (2014, chapter 10). According to Darwin, "living fossils [...] like fossils, connect to [...] orders now widely separated in the natural scale. [... but] they have endured to the present day from having [...] been exposed to less severe competition". (1859)

[49] See also Arantes (2007); and Oliveira (2003).

[50] *The New York Times* reported recently on a meeting with a Chilean businessman, describing him in the following way: "With his custom-designed Zegna suits, pink tie with matching Brioni handkerchief and colored diamond cufflinks [...] [he] boasted of having five Hummers, a private jet, a Caribbean island getaway, a wristwatch designed for him by Cartier at the request of Prince Albert of Monaco, even a Rolls-Royce Phantom Drophead convertible [for which] he paid $2.2 million [...]. [Also] he paid more than $400,000 to be the first South American to travel into space as part of Richard Branson's Virgin Galactic tour [...]. He built a large home overlooking Santiago with 24-carat-gold-trimmed tiles in the swimming pool. He threw outlandish parties, including a 15th wedding anniversary celebration last November that cost $4 million and involved 600 entertainers, including Brazilian carnival dancers, and the musical acts Donna Summer and Air Supply. [...] he was now considering offers from companies to buy a majority of his mining assets

Nearly a century ago, the Spanish philosopher José Ortega y Gasset stated that "[many in Latin America] have a narcissistic tendency to use reality as a mirror for self-contemplation" (1918). He was struck to find "so many self-satisfied individuals" — a phenomenon that for him was a major obstacle for progress, as "[...] human history is the product of discontent" (Ibid.). Perhaps there is no better way to summarise what is wrong with Latin America's élites and with the current political settlements and distributive outcome than Ortega's observations, as (for reasons beyond the scope of this paper) with the new neo-liberal ideological, political and economic paradigms in vogue in the region, these regional features have been revitalised with a vengeance.[51]

And let's remember: the unremitting trend towards increasing inequality found in the left-hand side of Figure 13 *has little or nothing to do* with the share of the middle or upper middle of the distribution. Except for South Africa and Namibia (and probably Botswana), all groups qualify or are at the edge of the '50-50 rule'. So, it's all in the tails! For example, the already mentioned tax-return data confirm this inequality 'uniqueness': in Chile (in round figures) the top 1% is able to appropriate 33% of national income, while the top 0.1% gets 20%, and the top 0.01% gets 12% of the total – while their counterparts in Korea were only able to appropriate 12%, 4% and 2%, respectively. And very recent (although preliminary) data for Brazil indicates that the top 1% manages to appropriate nearly 29% of national income. Given the apparent capacity of the middle and upper middle to defend their half, it's the bottom 40% that needs to be squeezed accordingly.

Basically (and with a nod to James Bond), for most oligarchies in Latin America, Southern Africa, and increasingly so for those of higher income Sub-Sahara as well as the US (and some other OECD countries, especially the Anglophone ones) the new family motto should be: "The World Is Not Enough" — as they move into a distributional outer space, propelled into dark matter by their insatiable greed, while finding their neoliberal ideology most helpful in this endeavour (as it facilitates the rationalisation of their highly inefficient greed).

It is also important to remember that the share of the rich in Latin America's national income is so much higher than those of many other middle-income countries — such as those found in North Africa, the second-tier NICs, the former Soviet Union, and Eastern Europe (among others) — even though these middle-income countries often have even more markets rigidities; often have prices, institutions and social capital that are

[because] "I am not so happy working so much, it's very stressful," he said." (http://www.nytimes.com/2010/11/20/world/ americas/20chile.html). The common moaning among the Latin American élite that "work is so stressful" reminds me of Groucho Marx's assertion: "Money frees you from doing things you dislike. Since I dislike doing nearly everything, money is handy."

[51] For an analysis of this issue, and of the main features of what I call the "Anglo-Iberian" neo-liberal paradigm, see Palma (2010).

less 'right'; often have property rights which are less well-defined and less well-enforced; often have more educational segmentation, and educational systems for the poor which are equally depressing; where often there is even more gender discrimination, and more shortages of skilled labour; and where often there are democracies which are more 'low-intensity', and with more problems of 'governance'; where success or failure in business depends even more on political connections and corruption; and so on. And despite all this, their income distributions are significantly better than those in Latin America. So, perhaps it is time for those who have deforested half of the Amazon through publishing so much literature blaming Latin America's high inequality on issues such as those above to go back to the drawing board as well.

At the risk of stating the obvious, political and institutional factors, and the nature of the political settlement, are likely to have a far greater influence on the determination of income distribution than factors such as those mentioned above. These factors may well be part of the conditions that, for example, give Latin America's inequality its specificity, but this can only be understood through the movement of its institutional dynamics. That is, rather than thinking in terms of the *concrete effects* that factors such as those mentioned above may have on its inequality, it would be more illuminating to understand the *concrete expressions* that these factors may find in that inequality. Some of the pieces of the distributional puzzle in Latin America and Southern Africa may well be the same as those of other parts of the world, but the way they fit together is certainly different. The specificity of inequality in these regions stems from the particular ways in which distributional struggles have manifested there, the different ways in which oligarchies have faced and temporarily overcome them, and the ways in which this process has created further distributional challenges, and so on.

In fact, the monotonous insistence of so many economists and politicians on blaming Latin America's huge inequality on 'exogenous' factors is very much like using a pair of scissors to cut an (analytical) knot that cannot be unravelled. Among the most recurrent 'exogenous' factors appearing in most of the relevant literature, we find the already mentioned high demand for skill labour due to new technologies (although such high demand is supposedly taking place in a region with one of the lowest investment rates in the world)[52], problems with the educational system, the abundance of natural resources, market distortions resulting from erroneous policies or regulation (how could it possibly not be the fault of governments!), and the unfortunate institutions created at the start of the colonial past, half a millennium ago, such as the 'mita' and the 'encomienda' (an institution that was already pretty much gone by the end of the 16th

[52] In Chile, for example, 86% of all new jobs created since 1980 took place in services (especially in trade, restaurants, hotels and personal services), activities not usually known for their exorbitant demand for skilled labour (of the type assumed in mainstream literature).

century).[53]

As in so many other areas of knowledge, it is analytically far more productive for the understanding of why inequality is so unequal across the world to reject mechanical determinisms and the blaming of 'exogenous' factors. Explanations such as some of those in vogue today may actually help contribute to the understanding of a really complex phenomenon; but as inequality is surely an 'over-determined' whole, one thing is to recognise a probable condition, quite another to claim that that condition is a sufficient one. And from this perspective over-determination makes the analysis of inequality particularly problematic for many of the traditional methodologies used in economics, as it complicates the standard counterfactual understanding of causation.

How can we understand, for example, that after taxes and transfers in Chile the Gini only improves by 2.5 percentage points (or 4.9), while in Sweden and Ireland the Gini improves by 25 percentage points (or by 51% and 47%, respectively — i.e., 10 times more)? And while in Denmark, Finland, Norway, Belgium and the Netherlands the Gini falls by about 46%, in Peru its income distribution gets even more unequal after taxes and transfers?[54] So, let's also concentrate on individuals and societies' ultimate freedom of choice and *responsibility* in this. If we have the income distribution we do in Latin America, and the levels of poverty we still have (despite often high middle-income levels), as Stiglitz has stressed (see epigraph), it's basically *our choice*.[55] And, as Sartre kept reminding us, *we are our choices*, (see also epigraph); i.e., nothing seems to define us better than our choices — and none more so than the income distribution we (collectively) choose to have (and often justify).

This idea (rather a worldview) is also emphasised by Simone de Beauvoir: "Life is nothing but a relation to the world, and the individual *defines* himself by making his own

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[53] Few phenomena have had so many explanations of the 'exogenous'-type as inequality; some have even blamed Latin America's huge inequality on the lack of major wars in the region — as supposedly in OECD countries (especially Europe and Japan), and in some of the first-tier NICs (namely Korea and Taiwan) income distribution is supposed to have improved *only* due to the horror and anxieties of major conflicts (as well as the destruction of wealth that these have created). Others, instead, keep insisting on looking at what happened in Latin America's distant colonial past — as if 'path-dependency' had to be the inevitable recourse for every complex social and ideological process too complex to analyse (for an investigation that stretches the concept of path dependency well beyond its breaking point, see Sokoloff and Engerman, 2000; see also Cornia, 2012. For a view, which I endorse, that attributing Latin America's current inequality to historical persistence is just a myth, see Williamson, 2009).

[54] See Solt (2015).

[55] As an ECLAC study shows (2010), in 6 countries in Latin America (Argentina, Brazil, Chile, Costa Rica, Panama and Uruguay), the total cost of a monetary transfer equivalent to 'one poverty line' (the cost per capita of two baskets of basic foods) to *all* the unemployed, *all* people over 64 years of age, and *all* children under 15 years living in vulnerable households, is only equivalent to between 1.8% and 2.7% of GDP. If this subsidy is given only to each child and adolescent between 5 and 14 years of age, the total cost is 1% of GDP or below for those six countries; and if the subsidy is only given to each unemployed person, the total cost is below 1% of GDP for thirteen of the sixteen countries studied — and just one-third of a percentage point of GDP or less, in eight countries — i.e., not such an insurmountable task! For an analysis of the ample scope that middle-income countries have to eradicate poverty, see Ravillion (2010); and Tregenna (2012).

choices through the world about him." (1972; emphasis added).

Among the many issues at stake in the increasing-inequality trend found in the left-hand part of Figure 13, the one I want to highlight here is the already mentioned phenomenon that although the bottom 40% of the population has very different capacities across the world to appropriate the value of their marginal productivity, in Latin America, Sub-Saharan Africa and Southern Africa they seem to have almost none.[56] As the middle and upper-middle usually can keep their half, the top 10% tries to appropriate all the increase in the other half of national income.[57] In Southern Africa, in turn, the top 10% can also (and uniquely) compress the share of the middle.

And the well-rehearsed argument that all that is needed to deal with these huge inequalities is yet more of the same neo-liberal reforms sounds increasingly hollow.

6.3.- On multiple stable equilibria. Why the note in our notice-boards should remind us that "it's all about the share of the rich — and what they do with it"

Income polarisation between the tails in Latin America and Southern Africa — no matter how extreme — only tells us half of the story. The other half is that (despite the huge share of national income appropriated by the top earners, abundant finance, fairly well-defined and enforced property rights, and 'pro-market' reforms) every time private investment in Latin America or South Africa manages to rise much above 15% of GDP, the capitalist élite starts experiencing feelings of vertigo.[58] The key point is that huge inequality and mediocre growth are likely to be closely connected in the most unequal countries accounted for by the dummy on the left-hand side of Figure 13. From this perspective, the most striking difference between these countries and fast-growing Asia is found in their contrasting relationships between private investment and income distribution, for which Figure 14 shows two different steady states.

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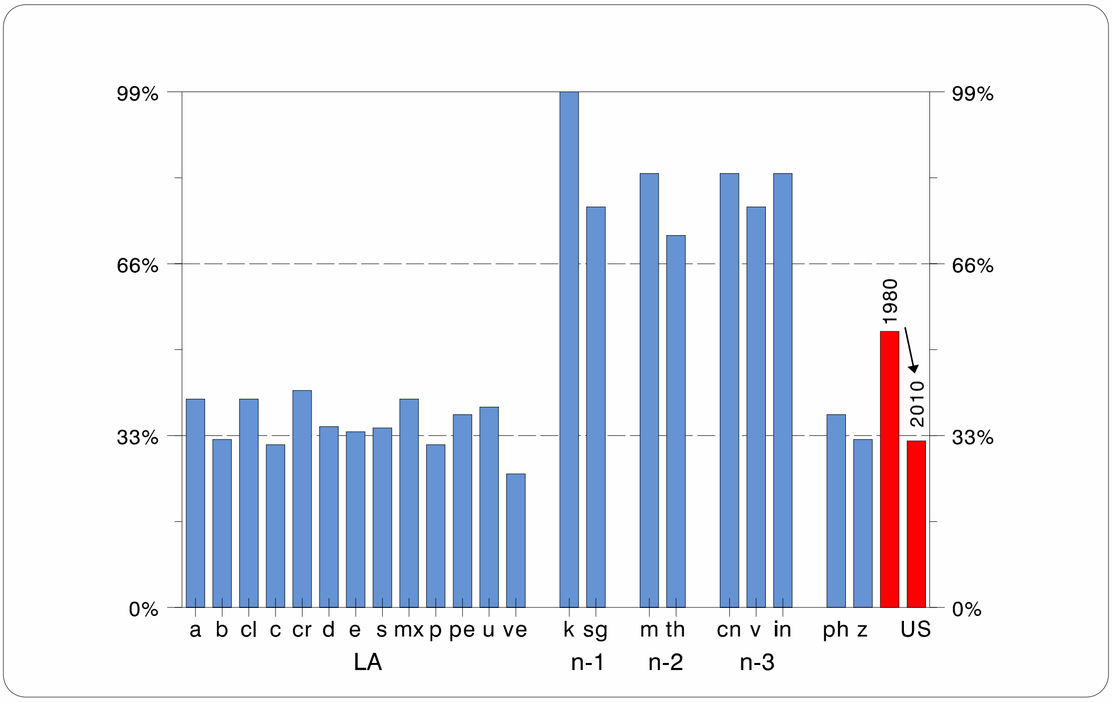
[56] That is one of the reasons why the level of the minimum wage is so important, as well as the degree of its enforcement – as it is a key policy to counterbalance this.

[57] As mentioned above, this phenomenon becomes evident in the decoupling of productivity growth from wage growth.

[58] Kaldor (1959) was the first to discuss the contrast between Chile's high share of profits in national income and the country's low levels of saving and investment (see Marcel and Palma, 1989).

FIGURE 14

Private Investment as a percentage of the income share of the top decile, c. 2010



- **LA** = Latin America (**a** = Argentina; **b** = Brazil; **cl** = Chile; **c** = Colombia; **cr** = Costa Rica; **d** = Dominican Republic; **e** = Ecuador; **mx** = Mexico; **p** = Paraguay; **pe** = Peru; **s** = El Salvador; **u** = Uruguay; and **ve** = Venezuela); **n-1** = first tier NICs (**k** = Korea; and **sg** = Singapore); **n-2** = second-tier NICs (**m** = Malaysia and **th** = Thailand); **n-3** = third-tier NICs (**cn** = China; **in** = India; and **v** = Vietnam); **US** = United States (in 1980 and in 2010); **P** = Philippines; and **z** = South Africa.
- Sources: for the share of the top 10% as in Appendix (except for the US, which is Alvaredo, Atkinson, Piketty and Saez, 2014 — this different source complicates the comparison of the US ratio with that of other countries in the graph). And for private investment data, the IMF-WEO databank (IMF, 2015).

It is often acknowledged that the only historical legitimacy of capitalism — i.e., the legitimacy of a small élite to appropriate such a large proportion of the social product — rests on its capacity to use it *productively* (i.e., its capacity to develop society's productive forces). And it can *only* do so by reinvesting — out of competitive market's 'compulsions' rather than Samaritan tendencies — most of that huge share.[59] So, no

[59] As discussed in Foucault (2004); Khan (2005); Woods (1999); and Palma (2009), classical capitalism is characterised not just by the presence of market opportunities but by competitive 'market compulsions', which are necessary to ensue that these are taken up! As a result of these compulsions both capitalists (of all sizes), and workers (of all skills) have to continuously strive to improve their performance in order to remain in the market. In no other economic system does continued existence depend on *the systematic improvement of labour productivity*. Only in this system are there continuous pressures of this kind from competitive struggles, which lead to the constant improvement of the forces of production. Therefore, like in *Alice in Wonderland*, only in capitalism (but only when there are proper competitive pressures, and the rules of the game have to be followed by all) it is always necessary to run just to remain in the same place. However, something rather different is happening today in this cosy blend we now call 'capitalism', where big business, particularly in financial markets, want to have their cake and eat it; i.e., have all the

other statistic seems to reflect so neatly the difference between Latin America's 'sub-prime' capitalism and fast-growing Asia's capitalism — one that has a remarkable capacity for productivity-growth, despite all its many problems, financial fragilities and contradictions (and hypocrisies). While in Latin America the ratio of private investment vis-à-vis the income share of the top 10% tends to hover around one third, in most of Asia it has a value of at least double that (e.g., Thailand), or even higher (with Korea's ratio close to 1). In turn, as Figure 14 indicates for the US, no other statistic seems to reflect so neatly the process of "reverse catching-up" being currently followed (at different speed) by many advanced countries. However, this should not be confused with "reverse-evolution": it is proper evolution, but one in which some of the disagreeable ghosts of the past have re-emerged triumphantly, but now resembling features that characterise current unequal middle-income countries.

Many emerging economies in Asia, instead, would be the equivalent today to what Keynes saw happening in continental Europe, especially Germany, between about 1870 and the First World War — i.e., during the 'Third Technological Revolution', or third great surge of industrialisation, that of the 'Age of Steel, Electricity and Heavy Engineering' (Pérez, 2004), when the US and Germany overtook Britain:

> Europe was so organised socially and economically as to secure the maximum accumulation of capital. […] The new rich of the nineteenth century were not brought up to large expenditures, and preferred the power which investment gave them to the pleasures of immediate consumption. [...] Herein lay, in fact, the main justification of the capitalist system. If the rich had spent their new wealth on their own enjoyments, the world would long ago have found such a régime intolerable. [...] Thus this remarkable system depended for its growth on a double bluff or deception. On the one hand the labouring classes [...] were compelled [...] into accepting, a situation in which they could call their own very little of the cake that they and nature and the capitalists were co-operating to produce. And on the other hand the capitalist classes were allowed to call the best part of the cake theirs and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice. (Keynes, 1919).

Not much danger of finding these progressive tendencies in the capitalist élites of Latin America or Southern Africa — where instead of the power given by productive investment, 'the discreet charm of these bourgeoisies' comes from the power emanating from the despotism of finance, and from the rent-seeking practices of oligopolistic capital, leading to the pleasures of immediate consumption, little market discipline and the easy pickings of financial speculation. And all this helped by the appropriation of rents from natural resources, the continuous exploitation of market failures by traders, and so on. Nor much chance to find these days much of those progressive tendencies mentioned by Keynes in their re-emerging close relatives in the US and some of Europe either. In turn, Figure 14 also indicates that in South Africa — in so many respects, Latin America's honorary middle-income country in Africa, and in The Philippines (the honorary one in

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benefit that capitalism can offer, but none of its compulsions (just the carrots, but none of the sticks). The resulting lack of productivity growth should then come as no surprise…

Asia), a similar low ratio for private investment as a proportion of the income share of the top decile indicates that their capitalist élites are similar to their Latin American counterparts — specially in their preference for having their (rather large) cake and eating it.

In other words, Figure 14 indicates a great example of multiple stable equilibria. That of Asia (especially East Asia), where highly profitable opportunities are usually opened up − and then taken up − by their almost uncanny predisposition towards the reality principle − with its insistence on high investment rates, constant absorption of new technologies, high risk taking, and strong macro-policy stands. And that of Latin America, where the gravy trains of easy opportunities tend to be opened up not by our predisposition to the reality principle, but rather by our innate tendency towards the pleasure principle. With the latter so easily satisfied by an endless supply of low-hanging fruits such as effortless asset bubbles, highly profitable market failures, vast rents from natural resources (which almost invariably are appropriated for free by the few), timid institutions, an obliging macro, a considerate progressive intelligencia (with a disturbingly high tolerance for inequality), and an instinctive aversion to competition or any other form of market compulsion. Who needs sticks when political elites are so good at solving the collective action problem of how to share the carrots!

And one of the many reasons why the sub-optimal equilibrium found in middle-income Latin America shown by Figure 14 is fairly stable − and profitable − for the élite, as explained so eloquently by Churchill many years ago, is that low wages (and the resulting inequality) is the best possible subsidy for inefficient producers:

> It is a national evil that any class of Her Majesty's subjects should receive less than a living wage in return for their utmost exertions… Where you have what we call sweated trades, you have no organisation, no parity of bargaining, the good employer is undercut by the bad and the bad by the worst. … Where these conditions prevail you have not a condition of progress, but a condition of progressive degeneration. (Hansard HC, vol 155, col 1888; 24 April 1906).

In other words, inequality is not only a critical choice, but one that matters for more reasons than one — not least because of the likelihood that inequality is as much a twin of inefficiency as the law of gravity is of the apple.

From this perspective, the 64,000-dollar question for Latin America and South Africa is how to get from their sub-optimal but fairly stable equilibrium to the more dynamic one found in Asia. The only thing that is patently clear is that the invisible hand of unfettered market forces is unlikely to do the trick.

Finally, although Latin America's (and South Africa's) capitalist élites seem to have now this unique preference for accumulation via 'mobile' assets (rather than via a more challenging scenario of 'fixed' capital formation), on the positive side easy access to mobile assets has at least helped them to become more democratic, as mobile assets provides them with an easier 'exit' option (see especially Boix, 2003).

7.- Why is inequality becoming so extreme in an increasing number of high-income countries?

7.1.- Piketty's explanation for increased inequality among advanced countries

It is unfortunate that Piketty — an author who has made some of the most important empirical contributions to our knowledge of the income and wealth shares of the rich — seems to be leading the debate over increased inequality in most OECD countries since the fall of the Berlin Wall in the wrong analytical direction (as the head of a hunt that is leading the pack in the wrong direction). This is so because in his book he gives too much emphasis in his analysis to the neoclassical theory of factor shares (see Piketty's otherwise brilliant book, 2014). And by doing so, most of the analytical debate on the forces leading to increase inequality that followed the publication of his book has got stuck there. This neo-classical theory is still based in the (by now pretty much obsolete) 1950s' Solow-Swan model, which (as most of the related growth theory) not only assumed properly competitive markets (in danger of extinction these days), but also that the growth rates of some inputs (such as labour and knowledge), and the portion of production going to others (such as saving and investment) are constant and exogenous − in a magical realist world where prices are always 'right', there are no market failures, and everybody is paid the value of their marginal productivities (i.e., the rich get no more than that, and the poor get no less than that). In this imaginary world, there are also constant returns to scale and diminishing returns rule; in fact, in this fantasy world an autonomous and *permanent* increase in the saving and investment rates produce only a *temporary* increase in the growth rate of output per worker (try to explain that in Asia). Furthermore, in this world the only reason why financial markets exist is to fuel the real economy.[60] The rate of depreciation is also constant (i.e., not subject to shocks such as the emergence of new technological paradigms). Furthermore, there is no government, increasing returns in manufacturing, unemployment, spare capacities, diversity of goods, natural resources or institutions − or Latin American-style oligarchies.

Furthermore, the world that this theory tried to disentangle was rather different than the current one because profits were then made almost entirely in the real economy, and financial markets then had levels of liquidity which were able to handle without the need to accumulate more risks than was privately, let alone socially, efficient. This was basically the outcome of effective financial regulation and tough capital controls — i.e.,

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[60] This is perhaps the only Keynesian component of this model, as it follows Keynes idea regarding the role of finance: "Credit is the pavement along which production travels and the bankers if they knew their duty, would provide the transport facilities to just the extent it is required in order that the productive powers of the community can be employed at full employment." Keynes (1930)

the Solow-Swan world was clearly a 'pre-financialised' one.[61] And it was one in which there was also highly progressive taxation. There was also a close symmetry between total corporate capitalisation (equities and bonds) and the replacement cost of tangible assets; in fact, the ratio of these two statistics, representing one version of the Tobin's 'Q', hovered around 1 — as opposed to the pre-2008 financial crisis levels which was well above 2 (see Bichler and Nitzan, 2009; see also Palma, 2009). This type of growth theory also had in mind economies that were dealing with the 'maturity' stage of a specific surge of industrialisation − one that was related to automobiles, oil, and mass production for mass consumption — and not economies struggling to adapt both to a remarkable new technological revolution, and to a rapidly changing international order.[62]

In this 1950s-type neo-classical theory what mattered most for the distribution of income was the link between the capital intensity of production and the share of profits in total output; and in this model (whose 'best before date' is well gone) the nature of this link depends on the elasticity of substitution between capital and labour. In this scenario, if this elasticity is greater than unity, an increase in the capital-output ratio leads to an increase in the share of profits in national income (and, therefore, to higher levels of inequality).

As Piketty trapped himself in this type of logic, the only way he can explain the increased share of wealth-owners in national income is by assuming both a process of vibrant accumulation of capital, and high levels of substitution between capital and labour. In other words − and against considerable evidence to the contrary − by choosing to work within this (1950s) analytical framework, Piketty has to conclude that we are supposedly living in a world in which increasing inequality is due to too much real investment and high elasticities of substitution. That is, Piketty can only square the neo-classical circle by resorting to questionable assumptions.[63] Not only his assumption of a high elasticity of substitution makes no sense for the increasing-inequality scenario since 1980 − perhaps one day it will make sense, if the world that is believed to be round the

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61 I understand for "financialisation" the rise in size and dominance of the financial sector relative to the non-financial sector, as well as the increasing diversification towards financial activities in non-financial corporations.

62 See especially Pérez (2004).

63 After the publication of his book, Piketty tried to justify in an interview his controversial assumptions, especially the elasticity one, saying that "If you were to take the standard neoclassical model, with a single good production function and perfect competition, etc., the only possible logical way to explain these two moving together [the capital/income ratio and the capital share of national income] would be an elasticity of substitution somewhat bigger than 1, say on the order of 1.5 […]". (http://potemkinreview.com/pikettyinterview/). Some misunderstood this logical conclusion of the need for an elasticity higher than unity (necessary to square the neo-classical circle), and took it as a 'proof' that wages in highly unequal middle-income countries, such as Chile, should remain low; otherwise, labour could easily be substituted via capital intensive techniques (see, for example, De Gregorio, 2015). For empirical estimates of this elasticity of substitution, which show a rather different picture than the one assumed by Piketty, see for example Semienniuk (2014) and Rognlie (2014).

corner, full of fairy tale robots, ever materialises; but so far it certainly does not −, but also all the evidence indicates that the opposite is also the case regarding his assumption on investment. In the US, for example, non-residential private investment during the last decade reached just 12.2% of GDP on average (12.5% since 1990, and 12.8% since 1980). Rather than 'over', this is what I would call 'under'-accumulation.[64] Basically, in the US and Europe there has been *too little* real (non-residential) investment and *too much* financial gains since the neo-liberal reforms, which more often than not have resulted from the ever greater bargaining power of rentier-capital — following the surprisingly successful post-Reagan and Thatcher and post-Berlin Wall process of *re-legitimisation* of capital. And all this not only has had a massive impact on the volume (and concentration) of wealth, but also has had negative impacts on the real economy — as most of the above distortions tend to create negative productivity shocks.

And as profits are so strong and real investment so remarkably weak in the US, Europe (except for France) and Japan, the sectoral balance of the corporate sector has bizarrely become positive − in Japan has reached 8% of GDP! So any type of mergers and acquisitions, share buybacks, executive pay, bonuses, political contributions, and corporate-sponsored retirement plans (in the US, retirement assets of just 100 CEOs add up to as much as the entire retirement account savings of more than 116 million people at the bottom of the pay scale) can now be easily financed. Furthermore, the combination of low levels of corporate investment and rising corporate net saving is one of the main factors driving the growing mismatch in financial markets between abundant liquidity and a relative shortage of solid financial assets − making the ease of performing a transaction in a hollow security or instrument the trademark of the current process of "financialisation". Wishful thinking has truly become delusional.

In the above mentioned interview Piketty argues that although he does not believe in the neoclassical model, he thinks "[…] it is a language that is important to use in order to respond to those who believe that if the world worked that way everything would be fine."[65] I understand that, but why did he not then move on in his analysis to a more enlightening analytical scenario after doing that? The point is that if the 1950s neoclassical model (and most of its sequels) do not help us much in the understanding of the relatively recent huge increase in inequality in many OECD economies, especially in the US, why then stick to it after having had his engagement with the mainstream? Of course there is more than one way to skin the (inequality) catfish, but if one wants to explain the dynamics of the universe, what would be the point of sticking with a Ptolemaic

[64] Investment rates for EU countries were at best similar, and sometime even lower than those of the US (IMF, 2015). On this line of critique of Piketty's book, see specially Rowthorn (2014). See also Taylor (2014); and Harcourt (2015). For investment rates in the US, see US Department of Commerce (2015).

[65] http://potemkinreview.com/pikettyinterview/.

model after having shown that it is a wrong worldview, and it is based on false assumptions?[66]

For many OECD countries since Reagan and Thatcher, the key stylised fact in this respect has been the contrasting dynamics of *wealth* and *productive capital*, as a significant proportion of the rapid increase in wealth since then has been of the non-productive nature. That is, wealth owners have been getting richer and richer not by doing something socially useful, but by succeeding in developing more effective forms of rent-extraction. They not only have managed to increase greatly their market power, but they have also increased their ability to exploit that market power (including via extensive abuse of corporate power and systematic abuse of consumers).[67] The increased share of the financial sector in GDP, together with pervasive financial mischief (like the mis-selling of financial products, money laundering and help in tax evasion), and outright fraud (especially due to the incentives provided by the new "too big to jail" phenomenon) are also important parts of this story.[68] The transfer of under-priced assets from the public to the private sector, and that of huge liabilities the other way round after each financial crisis, has also increased private wealth massively — but not necessarily productive capital. At the same time, by succeeding in getting new forms of regressive taxation, and by governments turning a blind eye to ever greater (and often more imaginative) degrees of tax evasion and avoidance, including 'tax-inversion' (as someone famously said: "We

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[66] Although the Solow-Swan model does not fit the data, or the dynamics of the new globalised, financialised, and technologically revolutionised world, some new models in this tradition have proved to be even less relevant to the analysis of current rising inequality, such as the case of 'representative-agent' models in which each individual owns an equal share of the capital stock! Oddly enough, in these models the inequality $r > g$ also holds true in the steady-state equilibrium. But as my Cambridge colleague Ha-Joon Chang (2014) says, "It is a mark of where we are in our political discourse that even to say "neoclassical economics is not the only school" seems radical".

[67] In terms of the abuse of consumers there is again some "reverse catching-up" going on towards what has characterised unequal middle-income counties for a long time — although rich nations still have a long way to go in this direction… In Brazil, for example, a recent study made by the Federation of Commerce shows that real interest rates on credit cards were above 200% a year in real terms at the time (see http://finance.yahoo.com/news/Creditcard-debt-may-threaten-apf-3046211331.html?x=0). And an OECD study shows that in Chile we pay for the internet twice as much, but only get half the speed, of the OECD's average — a good example of what I like to call the "2 x ½" style capitalism, where many corporations accumulate rents by charging twice as much for providing services which only have half the required quality (i.e., a preference for the creation of rents via 'predator'-type behaviour rather than profits as 'producers'). As the former head of Chile's largest holding company and former President of the Confederation of Chilean Industry (and current head of the board of directors of a mayor retail company) explains, lack of effective competition plays a crucial rôle in this: "[Chile] is a market economy in name only. Competition has disappeared; mergers and acquisitions have led to a huge degree of oligopolistic concentration." (http://www.atinachile.cl/node/ 4629).

[68] When it was discovered that HSBC had become the bank of choice of Mexican drag-cartels (how much worse can it get!), the bank only received a fine and no one went to prison. The same happened when Standard Chartered bank was discovered wilfully flouting US sanctions against suspected terrorist organisations. The same with bankers that were discovered rigging the LIBOR, the exchange rates markets, commodity prices, and so on. What a difference with FDR's way of dealing with financial fraud! (For the current impunity of financial fraudsters, see the blog of Rowan Boswell-Davies, a former Scotland Yard Fraud Squad detective, in http://rowans-blog.blogspot.co.uk/).

don't pay taxes; only the little people do"), those at the top have managed to capitalise a much larger share of their incomes than during the more enlightened post-FDR Keynesian period — leading also to the creation of more dynastic wealth. And as Tony Atkinson has put it, "inequality of outcome in one generation leads to inequality of opportunity in the next" (Atkinson, 1998; quoted in Segal, 2014). As discussed above, the top 1% has also improved significantly their ability to exploit the poor and the human capital of others (e.g., flexible labour markets with precarious jobs and 'modern' practices such as widespread sub-contracting and 'zero-hours contracts', in which there is no obligation for employers to offer work). Financial liberalisation has also played a crucial rôle in the colossal accumulation of non-productive capital in the countries studied by Piketty, not least because (as Stiglitz has explained) "Globalization opened up opportunities to find new people to exploit their ignorance. And we found them".[69] And so on.

Furthermore, due to the constraints of the neo-classical model, in his analysis Piketty cannot allow properly for other aspects of financialisation and for the rôle of asset bubbles (including tax-free capital gains from housing), which have also helped to develop a disproportionate increase in the market value of certain assets in the last three decades. This type of analytical model cannot account either for the rising inequality of labour earnings due to exploding top managerial compensation, as only a few neo-classical ideologues can still believe that this has happened because these rocketing earnings truly represent equally rising senior executives' value of marginal productivities. Perhaps increased bargaining power is more relevant. Nor can this model incorporate convincingly the inequalising effect of the growing number free-lunches and political rents that wealth-owners get from obliging governments.[70]

The debate that followed Piketty's book has also overemphasised the rôle of

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[69] http://bigthink.com/videos/joseph-stiglitz-on-the-fall-of-lehman-brothers. He also discusses some of these issues in https://www.youtube.com/watch?v=RO8KWTb2iPM&feature=youtu.be.

[70] These not only include the already mentioned colossal amounts of funds devoted to (unconditional) bailouts when things have gone wrong, (following the famous "heads I win, tails you lose" new style of accumulation), but also include those that resulted from the new logic of state-agency. The main aim of this was to reverse the post-FDR, post-war, Keynesian-type state agency — one in which the key component of the interaction between political power and markets was a rôle for the state as a 'constrainer' of the rent-seeking practices of oligopolistic capital (in order to foster competition and rationalise financial markets). The *de facto* outcome of this transformation was a new rôle for the state as a facilitator of the rent-seeking practices of big business. Not only Bush asked polluters to write environmental regulation, but when Blair and Brown created a new regulatory body for the financial industry in the UK (the Financial Service Authority – FSA), they set it not only as an "independent non-governmental body" (i.e., a company limited by guarantee), but one that was actually financed by the financial services industry and run by financial-industry insiders (ex-bankers became Chairperson and Chief Executive Officer). That is, they set the FSA as operationally independent of Government, funded entirely by the financial corporations it was supposed to regulate, and led by financial-industry insiders. I suppose this was an attempt to solve the problem of 'regulatory capture': if lobbyists inevitably succeed in capturing the regulators, why not make them the regulators in the first place? As Foucault envisaged, by projecting the logic of unregulated markets into the heart of government, the new framework resulted in "[a] state under the surveillance of the market, rather than a market under the surveillance of the state" (2004:120).

wealth destruction during the Second World War on falling inequality, as Piketty's own data show that in the US there was a similar decline in inequality to that of Europe despite the fact that the first and only air attack by Japanese planes on the US mainland during the war took place when they dropped incendiary bombs on an Oregon state forest in 1942. Finally, by now Piketty also agrees that he gave too much emphasis to what he called in his book "the fundamental structural contradiction of capitalism", or "the fundamental force for divergence": the by now legendary "r>g":

> "I do not view r>g as the only or even the primary tool for considering changes in income and wealth in the 20th century, or for forecasting the path of income and wealth inequality in the 21st century. Institutional changes and political shocks – which to a large extent can be viewed as endogenous to the inequality and development process itself – played a major role in the past, and it will probably be the same in the future" (Piketty, 2015).

Therefore, the question remains: why did he not then move on analytically to these other spheres properly?[71]

Had he done that, perhaps he could have addressed properly some key questions regarding the sustainability of the highly unequal system we have (artificially) created since 1980 – such as whether capital-output ratios and shares of wealth in the national income can continue to diverge for ever. Also, can rents really make up an ever increasing share of profits? Or can the gap between the return to financial and physical capital, or that between productivity-growth and wages, continue to increase for ever? Can the gap for the "r" for the rich (who can invest more in information, who have better access to financial markets and political rents, and who can mitigate better the agency costs of their investment), and the "r" for the rest (who are mostly life-cycle savers for retirement) grow for ever? Or can the resulting gap between the average "r" and the marginal "r" also continue to grow and grow? Can the return to the wealth of the rich continue to remain exorbitantly high in the face of the enormous and continuous increase of financial wealth? That is, for how long will this neo-liberal ideology be able to continue being 'the art of helping the rich make huge amounts of money by playing the rest of us for suckers'?

Figures 15 and 16 illustrate just two of these issues in the build-up of the 2008 financial crisis: rapidly rising inequality seems to have had a crucial rôle both in the meteoric rise of the value of financial assets, and in the related post-1980 increased decoupling between the real and financial worlds – one that has led to weak investment performance. First, Figure 15 shows a remarkable cointegration (also confirmed by the appropriate tests) between the increase of inequality and the stunning rise of the value of the stock of financial assets.

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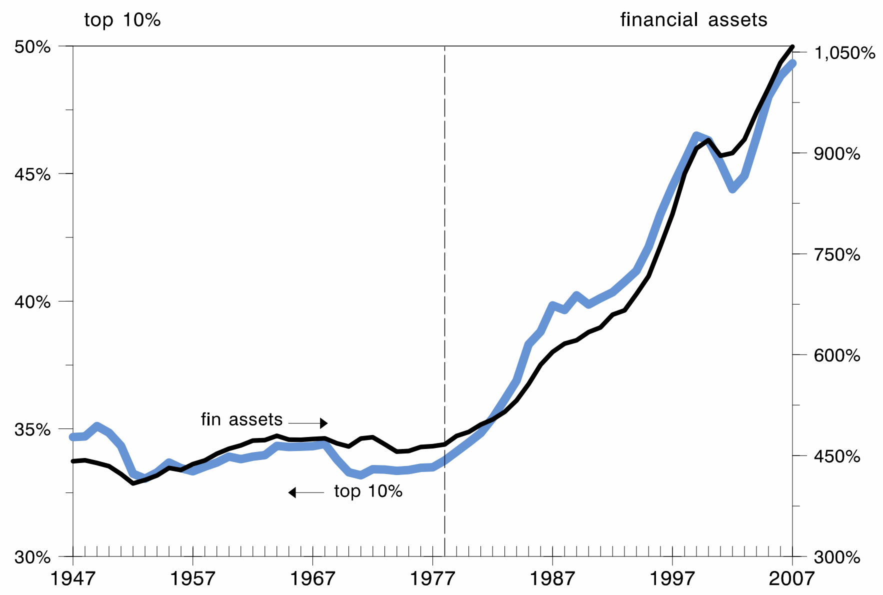
[71] On the rôle of institutional changes and political shocks on inequality, see, for example, Acemoglu and Robinson (2014).

FIGURE 15

US: income share of the top 10% and value of financial assets as % of GDP, 1947-2007



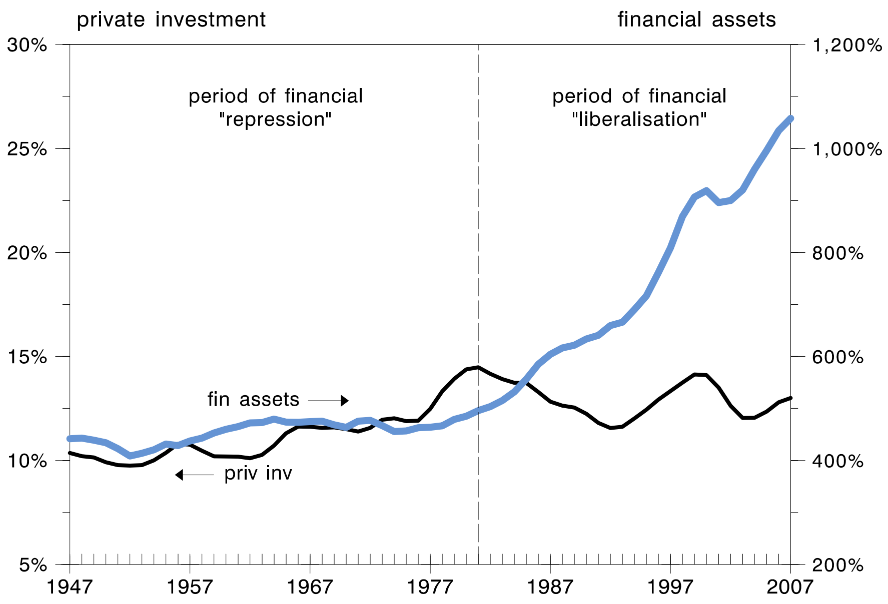
- **fin assets** = value of the stock of financial assets as percentage of GDP; and **top 10%** = income share of the top 10% (includes realised capital gains). 3-year moving averages.
- Sources: Alvaredo et. all. (2014), and US Federal Reserve (2014).

The huge increase in inequality has concentrated income at the top to such an extent that it became one of the major contributors to the increased liquidity in the US financial markets (a factor far more important in the lead up to the current global financial crisis than the famous Asian 'savings glut'). This increased liquidity has transformed financial markets into fundamentally fragile institutions, totally unable to self-correct.[72] Therefore, the 2008 global financial crisis may have had many roots, but (as discussed in more detail in Palma, 2009 and 2012) a crucial one relates to rapidly rising inequality – a factor that has also made the attempts to recover from that crisis extremely problematical. Figure 16 shows the related post-1980 increased decoupling between the real and financial worlds.

[72] On the recurrent rôle of excess liquidity in the lead up to financial crises, see especially Kindleberger (2000). On the associated financial fragility see Minsky (1992). On the role of increased inequality on the current financial crisis, see Palma (2009).

FIGURE 16

US: stock of financial assets and non-residential private investment as % of GDP, 1947-2007



- **fin assets** = value of the stock of financial assets (all sectors); and **priv inv** = non-residential private investment (excludes inventories). Both series are expressed as percentage of GDP. 3-year moving averages.
- Sources: US Department of Commerce (2015), and US Federal Reserve (2014).

During the period of so-called "financial repression" that followed the Bretton Woods agreement in 1944 — one in which there was a deliberate attempt to create an economic environment that would help generate strong linkages between financial and productive capital — total financial assets remained relatively stable as a share of GDP for about three decades, while non-residential (and overall) private investment experienced some acceleration (for non-residential one the two extreme points in the cycle were 9.8% of GDP in 1951 and 14.2% in 1979 and 1980). The subsequent period of "financial liberalisation", a period of huge asset inflation, led to a more unstable rate of investment, with an average of 12.8% from 1980 to 2014 — 13% from 1980 to 2007). During this period the value of financial assets not only decoupled from the real economy, but the abundance of finance and the associated asset-price-led 'irrational exuberance', instead of having a positive pulling effect on private investment, seems to have had instead the effect of 'friendly fire' (except for some recovery during the Clinton years).[73] Therefore,

[73] But even then, it did not manage to get back to the levels at the end of the 'financial repression' era… Regarding the current struggles to recover from the global financial crisis, following Keynes' analysis of the 1930s crisis, what is needed is a greater degree of linkage between financial and productive capital: "[t]here cannot be a real recovery, in my judgment, until the ideas of lenders and the ideas of productive borrowers are brought together again. […] Seldom in modern history

there is not much evidence here to support the McKinnon and Shaw-type argument in favour of financial liberalisation – one of the founding ideas of the Washington Consensus.

In sum, and as opposed to what Piketty suggests when working within the framework of his neo-classical model, there is little evidence that increased inequality since 1980 has been the outcome of too many Schumpeterian entrepreneurs rising the share of profits by investing an increasing share of GDP in real capital formation, in a world in which flexible firms use technologies that can easily substitute capital for labour (reacting to changes in the relative productivity or the relative cost of the two factors). Instead, increased inequality in high-income countries during this period (both in income and wealth) seems to have been mostly the result of the *artificial* creation of an economic and political environment in which (paraphrasing Oscar Wilde) anyone who wanted to become rich by doing something socially useful simply lacked imagination.

By placing his engagement with the mainstream at the centre of his analysis – almost as if that was the only thing that really mattered analytically – Piketty, despite his remarkable empirical contribution, missed a unique opportunity to move forward the analytical debate on rising inequality since Reagan and Thatcher in a significant way.

7.2.- Some elements of an alternative narrative regarding why inequality is becoming so extreme

As mentioned above, and as the data coming out of "The World Top Incomes Database" indicates, these days it is the highly-unequal middle-income country that seems to be showing the more advanced ones the shape of things to come. Borrowing again the language of Darwinian evolution, in what could be one of the supreme political ironies of all time, the Latin American oligarchies – "the living fossils" – may after all end up having the last (evolutionary) laugh, as several of their lost relatives, like that of the US, may be experiencing what in palaeontology is called a "Lazarus taxon": an organism that, having disappeared from the fossil record, inexplicably reappears sometime later. In the case of the US, for example, although it is true that rather than plantations now we have speculative finance, the present bears more than a passing resemblance to what might have happened in the US had the South won the Civil War... However, as mentioned above, this should not be confused with "reverse-evolution": it is proper evolution, but one in which some of the unpleasant ghosts of the past have re-emerged jubilantly, but (as the world has certainly moved on) resembling now some features that characterise current unequal middle-income countries. In other words, I believe that analytically it is

has the gap between the two been so wide and so difficult to bridge" (1931, p. 146; also quoted in Pérez 2002, 167).

more fruitful to think about the increasing concentration of wealth an income in developed countries in terms of "reverse catching-up" with high middle-income countries of the Latin-type, rather than with a return to their pre-1914 existence.

The remarkable redistributive success of the top 1% tends to confirm the hypothesis that there is a huge contrast between the sophistication of neo-liberalism as a technology of power — maybe the most effective one ever — and the lack of sophistication of neo-liberalism in terms of economic policies (Palma, 2009). Perhaps this ideology is just shorthand for 'the art of getting away with such remarkably asymmetric distributional outcomes within democracies'. Or (as discussed in detail in Palma, 2009, and suggested above), in the language of game theory 'a technology of power capable of transforming a particularly asymmetric set of distributive strategic choices, and the corresponding payoffs, into a Nash equilibrium built around the pure strategy of the élite'. And in part this was achieved by convincing the majority that there is no point in trying to challenge this Nash equilibrium while the all-too-powerful top income players keep their strategy unchanged. As a result, there has been a huge increase in the 'tolerance for inequality'. The latter is particularly true in Latin America, where neo-liberalism is now capable of achieving extreme forms of inequality by means other than the more crude 'old-fashion' forms of social conflict resolution.

The key point here is that the élite in many middle- and high-income countries is now able to achieve this Nash equilibrium by far more imaginative forms of ideological conviction. So much so that one could argue that in many countries it has got to the point where it is no longer really necessary to threaten the majority credibly with the idea that they have too much to lose and little chance of winning by challenging the top player's strategy. By ideologically convincing them that neo-liberalism is the only workable game in town (or, in Mrs. Thatcher's terms of "TINA" – that 'there is no alternative'), the élite can now get away with such remarkably asymmetric distributional outcomes mostly through *a spontaneous consensus type of hegemony* (in the Gramscian sense): a hegemony that is able to deliver such an unequal distribution of income through non-openly violent means. As a result, in Latin America military regimes — the traditional hedge against a progressive distributional challenge by the majority — has become obsolete (at least for the time being...).

As it happened, in many developing countries the new process of legitimisation of capital has become so remarkably successful, and the new technologies of power so surprisingly effective, that neo-liberalism has been able to turn the tables on progressive forces and has become ('low-intensity') liberal-democracy's best friend.

The main issue here is that there is a big difference between the great majority in many middle- *and* high-income countries entering into such an unfavourable Nash equilibrium because they are faced with overwhelming odds against the likelihood of succeeding in challenging the 'pure' distributional strategy of the élite, and what is happening now when the majority seems to have entered into this Nash equilibrium mostly out of ideological conviction. Mrs. Thatcher was certainly right when she once branded 'New Labour' as "my finest creation". If this is the case, the distributional game has probably ceased to be one of 'chicken' (or 'hawk-dove') — at least for the time being. In fact, all evidence suggests that (except for some spontaneous outbursts) the great majority in many countries in Latin America is now ideologically prepared to put up with such an unequal distributive outcome as if it was simply their lot in life. A much heightened degree of economic uncertainties (of all sorts) has undoubtedly helped in this endeavour.

Indeed, it could be argued that this component of the current ideology — its ingrained belief that 'there is no alternative' — synthesises the fundamental success of the 'Anglo-Iberian' neo-liberal discourse. In terms of its distributive angle, the post-1980 new attitude towards inequality was also best summarised by Margaret Thatcher: "It is our job to glory in inequality and to see that talents and abilities are given vent and expression for the benefit of us all" (quoted in Wade, 2014). Or, as Robert Lucas stated it, "of the tendencies that are harmful to sound economics, the most seductive and […] poisonous is to focus on questions of distribution". The same for Martin Feldstein: "[those who oppose increases in income at the top are spiteful egalitarians". (Ibid.)

This discourse resembles an argument put forward long ago by Callicles, a character in Plato's *Gorgias* (dialogue): 'it is natural and just for the strong to dominate the weak, and […] it is unfair for the weak to resist such oppression by establishing laws to limit the power of the strong'. In Callicles' opinion (as in the neo-liberal critique of what was going on pre-1980), 'the stronger, more aggressive and domineering by nature, has been defanged and domesticated by the legal institutions of the weak demos'.[74]

A key issue here is that despite delusional fantasies of the 'top' 1%, the 'strong' are not so by nature but by 'environment'. This is the core insight of the Darwinian idea that a subset of members of a population may come to flourish relative to other members simply because they possess a feature, which others do not, that renders them relatively suited to some *local environment*. The question of the intrinsic worth of those who flourish most is not relevant to this story.[75] The essence of Neo-liberalism is it deliberate attempt to create *an artificial* economic environment that is most suited to those features that capital has (especially financial capital) and others do not: in the jungle, capital is king! And extremely mobile. For having achieved this most unlikely of Nash equilibria in democracies by a spontaneous consensus type of hegemony, the Latin American élite —

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[74] See http://www.classicallibrary.org/plato/dialogues/15_gorgias.htm.
[75] See especially Lawson (2003).

and those of other countries where lost relatives are re-emerging — surely becomes strong contenders for an entry in the Guinness Book of Political Records!

And as soon as the 1% succeeded in convincing the majority of its 'unfettered-markets supremacy-cum-trickledown' distributional discourse, there could be only one outcome — as in (so-called) 'free' markets (a term reserved these days for those with little market discipline due to lack of competition, 'self-regulation', mounting bargaining power of capital, multiple artificially-created political and economic rents, lavish finance, and little supervision due to 'sterilised' governments) there can only be one distributional winner. In turn, financial gains from multiple asset bubbles, and easy access to an almost unlimited amount of credit may have helped confirm the 'trickledown potentials to the middle' part of the story — and help explain the relative stability of the '50-50 rule' — and why it has facilitated enough popular support from the middle and upper-middle for the 'unfettered-markets supremacy-cum-trickledown' discourse.[76] However, although this stable '50-50' share may help to explain the 'popularity' of neo-liberalism among these groups, one should not underestimate others elements of the neo-liberal discourse that are also particularly appealing to middle and upper-middle — such as the promotion of 'order' based on freedom, individual initiative, strong enforcement of property rights, 'sound' macroeconomics, fighting paternalism vis-à-vis the poor, and so on.

These insights that emerge from an approach expressly centred (among other factors, of course) on the issues discussed above are probably more productive workable hypotheses to explain the huge levels of inequality found in some middle-income countries, and the increasing levels of inequality found in some OECD countries since 1980, than the neoclassical theory of factor shares. These factors relate to the creation of a purposely built economic, political and legal environment (both local and international) that helps deliver such a degree of inequality; key characteristics of this new environment are:

i) that it artificially favours capital – especially of the non-productive type;

ii) that it creates artificial market dynamics by which workers end up having little or no property rights over their human capital, efforts and creativity – and as a result, end up having little capacity to claim the value of their marginal productivity. That is, an environment purposely constructed so that the low income-share of the bottom 40% is not due to a supposed low value of their marginal productivities, but about them having

[76] Regarding the famous "disappearing middle", one should never confuse the declining level of welfare that that share of the middle and upper-middle middle in high-income countries can offer — given the massive increase in the cost of education, health, housing and debts in general, the declining levels of pensions, regressive taxation, and so on — with a non-existing declining share of income of these groups. As discussed above (and in more detail in Palma, 2014), all evidence indicate that this share has reminded highly stable in OECD countries around the '50-50 rule' (and in the rest, there has been a process of convergence towards that level). But that is not the case with what that share can offer in terms of levels of welfare.

little capacity to claim it;

iii) in this environment, however, the middle and upper-middle have been still able to get a relatively stable share of income (their half); furthermore, these groups have also benefited from financial gains via asset bubbles and easy-access-to-credit − the politically significant 'trickle-down' part of the story for them; and

iv) ideologically, within this environment the majority is still unable to break from the straightjacket of that part of the neo-liberal distributional discourse that tells them that they have no choice but to put up with this remarkably unfair situation − it is their lot in life ('there is no alternative'). This (among other things) helps the élite to get away with such a remarkably asymmetric distributional outcome through *a spontaneous consensus type of hegemony* — and has helped neo-liberalism so far to become the most effective technology of power ever.

In sum, Piketty's neo-classical approach is not only inadequate when it comes to the analysis of rising inequality since Reagan and Thatcher because it does not 'fit the facts' (evidence indicates that his assumptions on capital-output rations and elasticities of substitution are simply wrong), but also because complex (and over-determined) systems (such as the distribution of income) are not just the simple sum of their parts. Therefore, an account of them cannot be reduced to the (algebraic or otherwise) description of their individual constituents. That famous dictum "long story short, we hear a story too good to be true – it ain't", it also applies to economic theory!

Conclusions

Building on my 2011 paper, I have analysed issues such as the contrasting nature of the centripetal and centrifugal forces at work in terms of income distribution (the former at the middle and upper-middle, the latter in the tails), as well as those relating to wealth, and how only few oligarchies have so far got away with the levels of inequality found in some middle-income countries. However, we now seem to live in a changing world where increasingly in some high-income countries a process of "reverse catching-up" is taking place − and not just as far as the distribution of income is concerned! I have also discussed why Piketty's 1950s neo-classical approach does not help us much to understand current distribute affairs (and not just because it does not 'fit the facts'), as well as outlined some elements of an alternative narrative regarding why inequality is becoming so extreme.

And given the remarkable homogeneity found in the shares of the middle and upper-middle, I have suggested the use of an alternative inequality statistic — one that simply indicates the ratio of the income-share of the top 10% over that of the bottom 40%. The obvious advantage of this inequality-indicator is that it measures inequality where inequality exists; it is also simple, intuitive, transparent and particularly useful for policy purposes — i.e., especially helpful for policy-targeting, as for anyone aiming at lowering inequality the implications of this ratio are as crucial as they are straightforward. This is a very important issue, because as Gramsci insisted, more often than not battles of this kind are won or lost on the field of ideology.

Taking a lead from Sartre's ideas, one should always reject mechanical determinisms and 'external' factors — characteristic of so many explanations of the increasing inequality found currently across many regions in the world — and insist on individuals and societies' ultimate freedom *and responsibility*: "I am my choices" was his worldview. "I am my freedom" was the key passage in one of his plays. It would be difficult to state more emphatically than this the dimensions of human freedom and individual (and collective) responsibility. For him, every act is a self-defining one — and probably none more than the distribution of income; and no act of this kind can truthfully be blamed primarily on 'external' or 'exogenous' factors (see, for example, Sartre 1981).

From this point of view, for how long so many in mainstream economics — and neo-liberals in general — are going to insist in their search for some sort of 'exogenous Holy Grail' that explains (and possibly justifies) huge inequalities in many parts of the world? They have tried lots of them, and with little success. As Einstein once said, "Insanity is doing the same thing over and over again and expecting different results."

While explanations such as those found in neo-classical economics, structuralism, Post-Keynesianism, and path-dependency may help contribute to the understanding of a really complex (and surely 'over-determined') whole, ultimately (as Stiglitz has stressed), "inequality is a choice". However, it is not always clear who can act upon that choice, what that choice is really about, and what making that choice will really achieve. Also, as someone famously said in his analysis of events in France in 1848, "people make their own history, but they do not make it as they please; they do not make it under circumstances they themselves have chosen, but under given and inherited circumstances with which they are directly confronted". Yet, the norm is that usually there are many more degrees of freedom than is generally acknowledged. For example, there can be little doubt that 'choice' — and 'taking responsibility for the outcomes of one's actions', as opposed to blaming exogenous factors — has something to do with the fact that Croatia has a median wage that is double that of Chile, even though both countries have the same GDP pc.[77]

You've really got to hand it to the Latin American capitalist elite. In the 1950s and 1960s they convinced the progressive forces of the region (including important sectors of the left) that there was nothing more progressive and 'anti-imperialist' than to provide

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[77] See Duran, G. and M. Kremerman (2015).

them with vast rents and subsidies via ISI (huge import tariffs, negative interest rates, subsidised utilities, cheap inputs from state-owned firms in steal, petrochemicals, and so on); and that these huge rents, as opposed to what was happening in East Asia at the time, should be given to them without *any* form of performance-related conditionality. And now, post-economic reform, with the help of a narcissistic ideology, their process of legitimisation has been so successful and their new technologies of power so sophisticated that they have again convinced the majority (including most of the left) not only of "TINA" ("there is no alternative"), but that they actually deserve every privilege and reward, and any rent (including those of natural resources, of course) that they can extract – building up to a share of income not far from one-third.

So, we need to understand what makes us take particular choices when confronted with specific inherited circumstances. What helps form collective beliefs? How do spontaneous consensus types of hegemonies emerge? And how can they be changed?

The same issues, but from the narrower perspective of the recurrent debate between 'structure vs. agency', as far as income distribution is concerned I am clearly on the side of agency — although strongly emphasising that this agency may well fail if it fails to understand structure (and therefore fails to adopt the right political and economic strategy to fight for change). For example, and as opposed to Piketty, I do not believe that 'r' is currently so much greater than 'g' simply because this is an inevitable outcome of the workings of the invisible hand; rather, human agency is what is really at work here! The huge diversity of distributional outcomes across the world seems to support this view.

Pope Francis, in his surprisingly politically candid address to new Vatican ambassadors in May 2013, seems to support the view that democracies today resemble the government of the 1%, for the 1%, and by the 1% for self-constructed reasons:

> "While the income of a minority is increasing exponentially, that of the majority is crumbling. This imbalance results from ideologies which uphold the absolute autonomy of markets and financial speculation, and thus deny the right of control to States, which are themselves charged with providing for the common good. A new, invisible and at times virtual, tyranny is established, one which unilaterally and irremediably imposes its own laws and rules." (http://w2.vatican.va/content/francesco/en/speeches/2013/may/documents/papa-francesco_20130516_nuovi-ambasciatori.html)

Tyranny indeed!

However, one should not underestimate (of course) the many obstacles facing the assemblage of the necessary social constituencies for a progressive distributive agency in middle-income countries (or in high-income ones), as history teaches us that these struggles – given the fierce opposition that they are bound to encounter from the 'usual suspects' – have only succeeded when supported by a broad-base constituency. This is particularly true regarding the obstacles ahead in Latin America for this region to be able to go further in its current (rather timid) attempts to reduce inequality, given the remarkable stability of the sub-optimal and highly unequal distributional Nash-equilibrium found there today — a good example of a Nash Equilibrium that is not 'Pareto Optimal', as all players' payoffs could well be increased from perspectives such as that of efficiency wages.

So far, telling stories about the middle (à la Washington Consensus) has proved to be mostly a distraction, although a rather effective one — brilliant storytelling has been the key to the success of the neo-liberal ideology, because as one group of Native Americans used to say, "those who are good at storytelling will dominate the world".

And the fact that democracies get to be more and more something resembling the government of the 1%, for the 1%, and by the 1% (Stiglitz, 2011 and 2012) — and as the type of 1% found in the advanced countries after FDR and the Second World War, especially in the Nordic countries is a species in serious danger of extinction (if not already extinct), and as this type of 1% has never existed in highly unequal middle-income countries (and is highly unlikely to emerge now) — the choices of an ever more weird minority, able to impose their will in the distributional struggle by ideology, force (including financial force), and the help of sterilised governments and heightened uncertainties for the rest, seem increasingly to be what really counts. And part of their success in being able to impose their own brand of choices on society rests on their continuous success in convincing (otherwise) 'progressive' forces that under the current domestic and international constraints, the assemblage of the necessary social constituencies for progressive agendas is off the political map.

As is often the case, Warren Buffett explains all this beautifully and succinctly: "There's class warfare, all right, but it's my class, the rich class, that's making war, and we're winning." The Chief Economist of the IMF said something similar recently (although, of course, in a more polite way): "Stagnant pay and rising inequality has created a sense that the rewards of economic growth has been creamed off by mobile elites, the owners of capital, leaving the majority behind". But what neither Buffett nor Obstfeld explained is what Keynes (following a long tradition) tried to elucidate: when this happens, capitalism not only becomes lacklustre, but also self-destructive – particularly if financial markets are flooded with liquidity and allowed to run amok. Furthermore, in some important aspects this has also led to a process of "reverse catching-up" towards some unfortunate features of highly unequal middle-income countries. So much so that today it is not unreasonable to ask whether the highly-unequal middle-income countries that are the ones trying to move from what North has called their "Limited Access Order", to the more enlightened 'open access' one (that once upon a time characterised developed countries), or are we now converging towards a world in which an increasing number of features of the "limited access" one are becoming the rule – including for the industrialised world?[78]

And in terms of 'choice', in the same way that more often than not "every nation gets the government it deserves" the same relates to income distribution. In turn — as Solt's database shows — the same could also be said for fiscal policy, one of the key instruments for dealing with inequality. From this point of view, Schumpeter's assertion: "The fiscal history of a people is above all an essential part of its general history" (1918), could not be more accurate today, as the above mentioned contrast between Sweden (or Ireland, Denmark, Finland, Norway, Belgium, Netherlands or Germany) and Chile (or Colombia and many other Latin American countries) indicates: after taxes and transfers, in the former the Gini improves about ten times more than in the latter. And in Peru they have no effect (in fact, there is a slight further increase in inequality). Hence, today it would be more accurate to say, "The fiscal *and distributive* histories of a people are above all essential parts of its general history".

Appendix: Sample

In this paper, in order to construct my sample I use the following sources:

i).- OECD (2015) for high-income OECD countries, and other non-Latin American countries for which this dataset provides information (Czech Republic, Estonia, Hong-Kong, Hungary, Israel, Poland, Russia, Singapore, Slovakia, Slovenia, South Africa, and South Korea);

ii).- SEDLAC (2015) for all Latin American countries;

iii).- Taiwan (2015) for Taiwan; and

iii).- World Bank-WDI (2015) for the rest. In this source, I only included countries with data *after 2002* (as a result, Botswana, Trinidad and Tobago, Turkmenistan and Zimbabwe were excluded). I also excluded countries with a population of less than 1 million (Belize, Bhutan, Comoros, Djibouti, Fiji, Iceland, Luxembourg, Maldives, Montenegro, Saint Lucia, Sao Tome and Principe and Suriname).

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[78] See North et al. (2007).

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