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WHY IS INEQUALITY SO UNEQUAL ACROSS THE WORLD?

PART 1.

THE DIVERSITY OF INEQUALITY IN DISPOSABLE INCOME: MULTIPLICITY OF FUNDAMENTALS, OR COMPLEX INTERACTIONS BETWEEN POLITICAL SETTLEMENTS AND MARKET FAILURES?

José Gabriel Palma

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This is a two-part paper. Part 1 addresses the diversity in the distribution of disposable income across the world; and Part 2, that in market income (i.e., before taxes and transferences). There are many underlying questions to these phenomena: does the diversity of inequality in disposable incomes reflect a variety of fundamentals, or a multiplicity of power structures and choice? Is rising market inequality the product of somehow 'exogenous' factors (e.g., $r > g$), or of complex interactions between political settlements and market failures? If the latter, how do we get through the veils obscuring these interactions and distorting our vision of the often self-constructed nature of inequality? Has neoliberal globalisation broadened the scope for "distributional failures" by, for example, triggering a process of "reverse catching-up" among OECD countries, so that now highly unequal middle-income countries like those in Latin America embody the shape of things to come? If so, are we all now converging towards features such as mobile élites creaming off the rewards of economic growth, and 'magic realist' politics that lack self-respect if not originality? (Should I say, 'Welcome to the Third World'?) In Part 1 I also develop a new approach for examining and measuring inequality (distance from distributive targets). In turn, Part 2 concentrates on three issues: why there has been such a deterioration of market inequality among countries of the OECD, why this has led to a growing asymmetry between their distributions of market and of disposable incomes, and why inequality seems to move in "waves". The main conclusion is that to understand current distributive dynamics what matters is to comprehend the forces determining the share of the rich — and, in terms of growth, what they choose to do with it (and how they are allowed to do it).

Why is inequality so unequal across the world?

Part 1. The diversity of inequality in disposable income: multiplicity of fundamentals, or complex interactions between political settlements and market failures?

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¹ This article is the updated and expanded version of the first part of a paper presented at the 2018 Development Studies Association Conference in Manchester, UK, as the Development and Change Annual Lecture. I am grateful to Alex Cobham and Andy Sumner for their contributions to my work on inequality, and also to many friends, colleagues and students who have made valuable contributions to my work on inequality. The usual caveats apply. Interactions at an early stage in my career with Carlos Díaz-Alejandro, Tony Atkinson, Nicholas Kaldor, Joan Robinson, Joseph Stiglitz and — especially — Charles Kindleberger were a great inspiration. Finally, above all I would like to thank Ignês Sodré: as in *Far From the Madding Crowd*, whenever I looked up from the fire, there were you. The article was written while trying to cope with the long illness and death of a close relative, Maria Penco; I dedicate it to her.

Inequality is a choice
Joseph Stiglitz

I am my choices
Jean-Paul Sartre

Introduction

Perhaps one of the most important analytical failings of current economic theory (despite recent significant progress) is our modest understanding of inequality, especially why there is such a huge diversity of disposable income inequality across the world, and why there has been such an enormous deterioration of market inequality among the OECD countries. Indeed, Krugman (2011) identified the latter as one of the two greatest analytical challenges today.² This paper attempt to address these conundrums: is the vast diversity of disposable income inequality a reflection of a variety of fundamentals? Or is it mostly the outcome of a multiplicity of power structures and choice? Are contemporary patterns of inequality the product of somehow 'exogenous' factors (e.g., stocks of assets, such as human capital and knowledge, and their degree of adaptability to the new technological paradigm, or the impact of a 'fundamental force of divergence', such as $r > g$)³, or a new cycle of Milanovic's "Kuznets waves";⁴ or are these patterns mainly the outcome of complex interactions between political settlements and market failures? And if the latter, how do we get through the set of veils which typically obscure these interactions, and could easily distort our vision of the often self-constructed nature of inequality? Finally, has the current neoliberal era broadened the scope for greater inequality by exacerbating 'distributional failures' around the world?

In order to address these questions, I shall look at nine distributional stylised facts of the current spectrum of inequality; five of them relate to disposable income inequality (analysed in Part 1 of this two-part paper), and four relate to market inequality (Part 2).⁵ After identifying several layers of misunderstanding, I shall categorise seven types of 'distributional failures', three relating to the former, and four to the latter. On the distribution of disposable income, I suggest that diversity mostly reflects a variety of outcomes in the distributional struggle in just one half of the population, over just one half of the

² Latin America's perennial underperformance is the other (I give a tentative answer to this conundrum below). For recent contributions, see Atkinson (2015); Bourguignon (2015); Galbraith (2016); Milanovic (2016); Ocampo (2019); Palma (2011 and 2016a); Piketty (2014); Scheidel (2017); Taylor (forthcoming 2020).

³ r = return on capital; g = growth of income.

⁴ Milanovic (2016).

⁵ For Part 2, see Palma (2019c).

national income, and that these outcomes can be broadly classified in seven categories of inequality. And on market inequality, I suggest in Part 2 (of this two-part paper) that globalisation and financialisation⁶ triggered a new process of 'unequalisation' across the OECD, which resembles a 'reverse catching-up' with highly unequal middle-income countries (such as those in Latin America), in the sense that the latter countries now seem to show the advanced ones the shape of things to come. We are all indeed converging in market inequality, but we are converging towards features typical of highly unequal countries, such as mobile élites creaming off the rewards of economic growth, and 'magic realist' politics that lack self-respect if not originality. I shall conclude that in order to understand distributive dynamics in either type of inequality, what really matters is to comprehend the share of the rich — and, in terms of economic growth, what they choose to do with that share, and how they are allowed do it.

In this paper I also put forward a new approach for examining and measuring inequality post-taxes and transferences — distance from distributive challenges — that is closely related to the index I suggested in Palma (2011) which was later christened the 'Palma ratio' by Alex Cobham and Andy Sumner,, and I develop a new concept of "distributional waves".⁷ I shall conclude that inequality is a particularly complex (and surely over-determined) phenomenon, which is often blurred by layers of distorting veils which sometimes make it resemble a hall of mirrors (which often conceal its frequent arbitrariness). If this essay helps to make inequality more transparent by clarifying some of these layers of possible misunderstanding, it may hopefully help us take more responsibility as society for our distributional choices.

⁶ By 'financialisation' I understand the rise in size and dominance of the financial sector relative to the non-financial sector, as well as the diversification towards financial activities in non-financial corporations.

⁷ See Cobham and Sumner (2013), and Cobham, Schlogl and Sumner (2015); see also Chang (2014); Green (2012). Following the logic of the Palma ratio, the World Bank (2016) coined a related statistic, the 'Palma premium' — an index resembling the first derivative of the Palma ratio (as it primarily tells us about its direction of change).

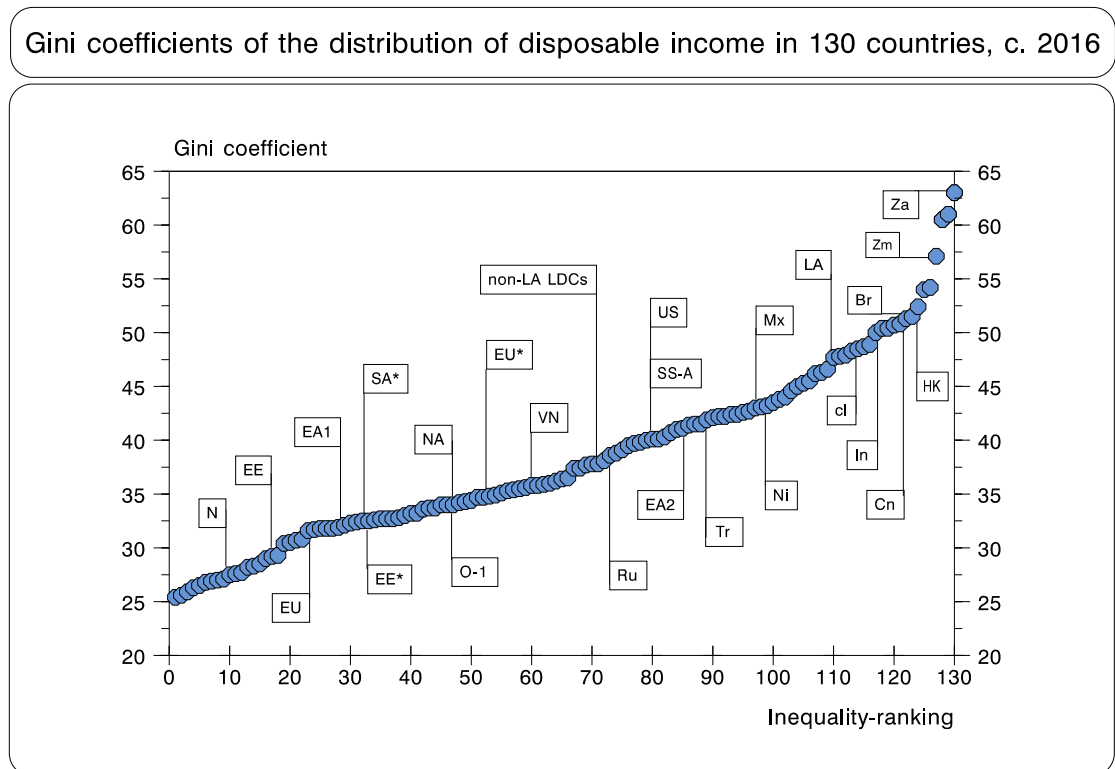
1.- The distribution of disposable income across the world

In examining the distribution of disposable income across the world according to survey data, five stylised facts and three 'distributional failures' can be identified.⁸

i).- Stylised Fact 1: Inequality after taxes and transfers is highly unequal across countries

This is the best known of the stylised facts, with some countries posting a disposable income Gini below 25, while for others the figure is nearly 65. In terms of the Palma ratio (see below), the range spans from below 1 to 7. Figure 1 highlights this using the traditional Gini.

FIGURE 1



• The statistic used to measure centrality in regions is the harmonic mean.⁹ *Country abbreviations* are those for internet domains:

• **Br** = Brazil; **cl** = Chile; **Cn** = China; **EA1** = Korea and Taiwan; **EA2** = Indonesia, Malaysia and Thailand; **EE** = Eastern Europe with GDP per capita above US\$ 20,000 (PPP); **EE*** = those below that; **EU*** = Mediterranean EU; **EU** = rest of Continental Europe; **HK** = Hong-Kong; **In** = India; **LA** = Latin America;

⁸ On problems with household surveys, see Meyer et al. (2015).

⁹ For the non-specialist, this is one of the three Pythagorean means. It is more appropriate for the average of ratios as it mitigates the impact of outliers; it also contains more information than the median. It is the reciprocal of the arithmetic mean of the reciprocals.

LDCs = developing countries; **Mx** = Mexico; **N** = Nordic countries; **NA** = North Africa; **Ni** = Nigeria; **O-1** = non-US Anglophone OECD; **Ru** = Russia; **SA*** = South Asia, excluding India; **SS-A** = Sub-Saharan Africa; **Tr** = Turkey; **US** = United States; **VN** = Vietnam; **Za** = South Africa; and **Zm** = Zambia.

• *Sources*: see Appendix 1. Unless otherwise stated, this will be the source for all figures in this paper.

As suggested above, the question that arises is whether this multiplicity of outcomes is the result of a 'fundamentals-at-work' scenario via fairly deterministic cause-effect interactions (such as Piketty's neoclassical ' $r > g$ '), or whether the diversity is mainly the outcome of different interactions between political settlements and market failures.¹⁰

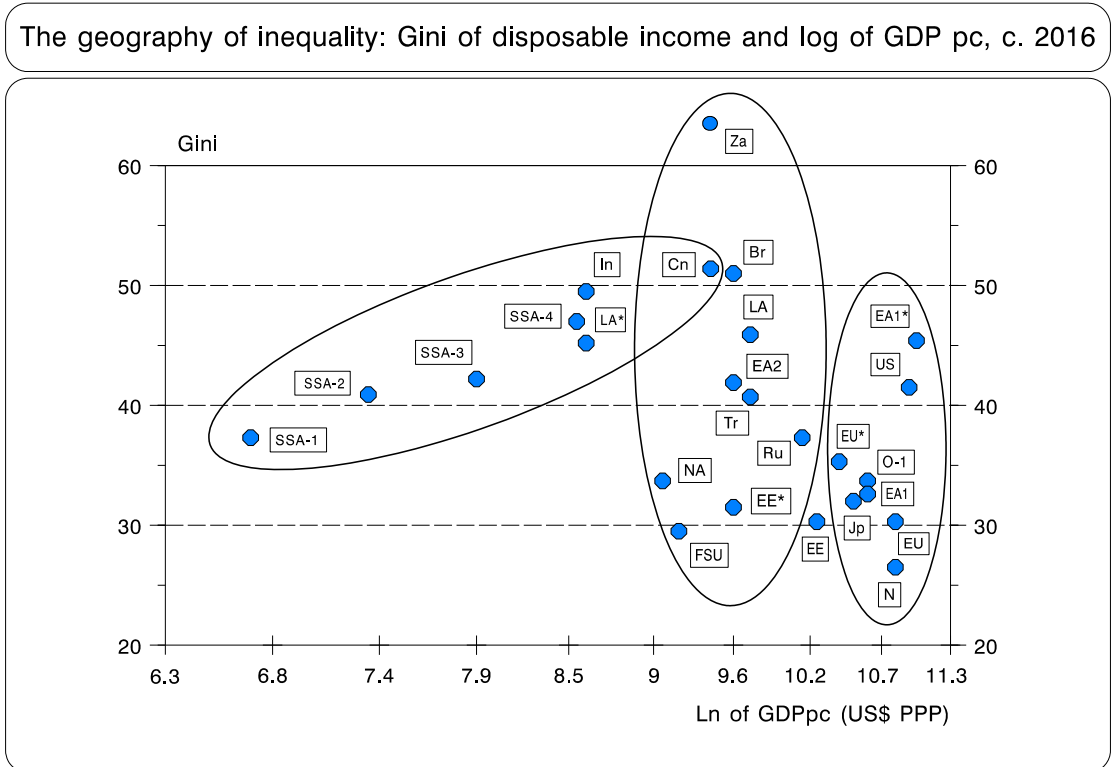
ii).- Stylised Fact 2: Inequality is particularly disparate among middle-income countries, with some increasing diversity also found among high-income countries

Figure 2 shows the above distributional diversity when categorised by GDP per capita (GDPpc).¹¹

¹⁰ Piketty (in his otherwise superb 2014 book) comes down on the side of the former, but later he argues that other (endogenous) factors may be more plausible explanations of inequality. He explains that although he does not actually believe in the deterministic neoclassical model he uses in the book, this 'is [just] a language that is important to use' (see *Potemkin Review*, 2014: 6). Unfortunately, his explanation of why it is so important to use a Ptolemaic language — such as the now obsolete neoclassical theory of factor shares of the Solow–Swan 1950s variety — is not convincing. Despite this ambiguity, his analysis of inequality makes at least three important contributions: it helps us to learn from history, it shifts the focus to capital, and it provides much needed new data. For more on this, see Appendix 2 below.

¹¹ When I analyse income distribution across countries from the perspective of their GDPpc, I do so simply as a mechanism for visualising 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 characterised by GDPpc.

FIGURE 2



- Acronyms as above, and **FSU** = Former Soviet Union (excluding Russia); **Jp** = Japan; **LA*** = LA with GDPpc below US\$ 9,000 (PPP); **LA** = those above that; **SSA-1** = SS-A with GDPpc below US\$ 1,000 (PPP); **SSA-2** = those between US\$ 1,000 and US\$ 2,000; **SSA-3** = between US\$ 2,000 and US\$ 3,500; and **SSA-4** = above that. South Africa (Gini = 63) is also a proxy for Botswana and Namibia. The range of the horizontal axis is that of the sample.

- *Sources:* see Appendix 1; and PWT (2018).

The Figure confirms that middle-income countries are found across the whole distributional range (from Slovenia, 25, to South Africa, 63) as shown in the first vertical ellipse; so are high-income countries (from Iceland, 26, to Hong Kong, 52). It seems that this alone reveals a lot of choice. The distributional geometry of low-income countries is different (45-degree-angled ellipse), as inequality trends move upward vis-à-vis GDPpc from Mali and Liberia (33), to Zambia (57). This increasing trend is followed by India, lower-middle-income Latin America and China.

The huge middle-income diversity indicates that higher GDPpc countries are more able (and willing) to take advantage of the distributional range at their disposal — for better or for worse. This casts doubt not only on the Kuznets’ ‘Inverted-U’, but also on deterministic theories — typical of the earlier Washington Consensus, although still influencing policy — which purport to explain why middle-income countries are bound to be unequal. These theories

advocate patience and a hands-off attitude, with 'premature' falls in inequality dismissed as unsustainable, even counterproductive. This multiplicity of middle-income outcomes is highlighted by the contrast between high-inequality Southern Africa, Latin America, India and China, and low-inequality Eastern Europe and Former Soviet Union—although in the latter, oligarchs are trying to 'modernise' inequality.¹² It also highlights the contrast between China and India, and low-inequality earlier East Asian industrialisers, such as Korea and Taiwan.

Paradoxically, some of the worst middle-income inequality appears in countries which have seen a recent consolidation of democracy, led by 'centre-left' coalitions (such as Latin America and South Africa) — countries where democracy has been achieved but is yet to be accomplished. Although many institutions have changed, the narrow interests of the élite have not. The comparative advantage of these oligarchies lies precisely in being able to use different institutions to achieve their fairly immutable goals, in part by co-opting key new members. Few have shown such skills for the 'persistence of élites' despite institutional change. The 'iron law of oligarchies' rules: dysfunctional institutions tend to rebuild (Acemoglu and Robinson, 2006).¹³

In turn, the growing spectrum of disposable income inequality among high-income countries (despite their convergence in terms of market inequality; see below) highlights the contrast between those defending pre-neoliberal reforms achievements (e.g., Nordic countries and some in Europe, both East and West), and those happier to sail along on unequalising winds (e.g., Anglophone countries, Hong Kong and Singapore).

iii).- Stylised Fact 3: The broad spectrum of cross-country distributional diversity suddenly changes when each country's population is divided into halves: the middle and upper-middle (deciles 5–9), and the top and bottom (deciles 10 and 1–4)

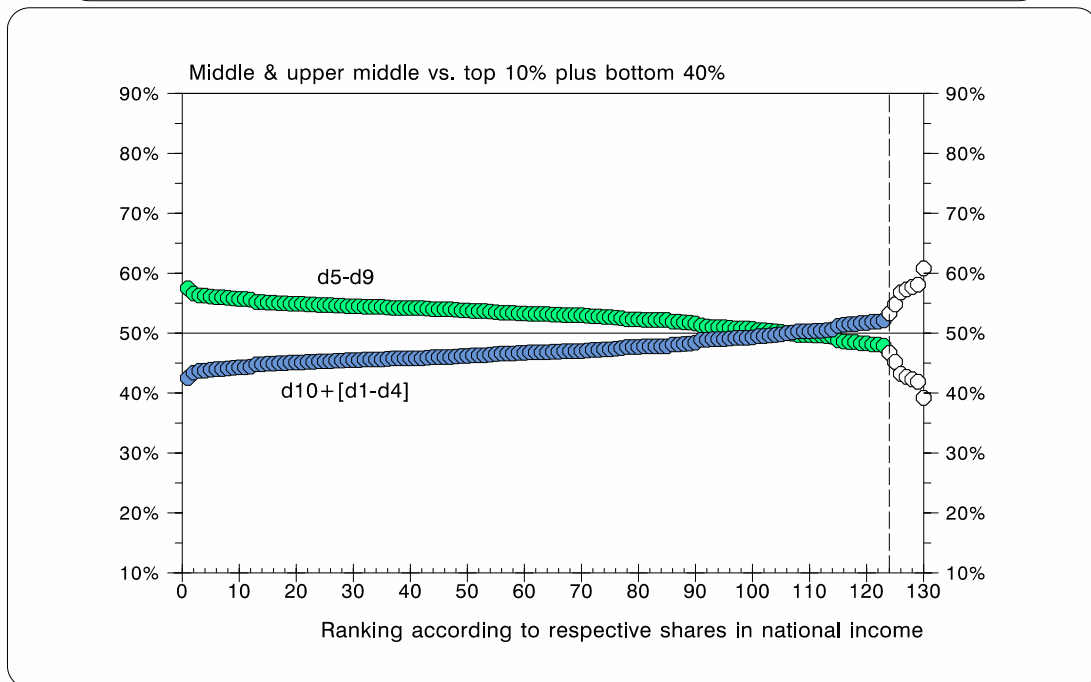
This stylised fact refers to the huge contrast between the multiplicity of outcomes when inequality refers to *the whole population* (as in the Gini above), and when it refers to the income shares of two halves of the population. This is clearly illustrated by Figure 3.

¹² The oil-producing Middle East (for which no data are available) is likely to share the inequality heights of Southern Africa.

¹³ For an analysis of the changing strategies followed by the Chilean élite to accomplish this, see Palma (2011, Appendix 1). Had this élite shown the same skills in economic affairs, the country would not have been stuck in its middle-income trap for as long as it has been (Palma, 2019b).

FIGURE 3

Percentage of income appropriated by two halves of the population



- **d** = decile. Countries at the tail-end are from LA and Southern Africa.

The distributional contrast between Figure 3 and Figures 1 and 2 is remarkable. The diversity of the whole (Gini) turns into an amazing uniformity of the two halves! Furthermore, they divide the national income in a fairly 'equitable' way, getting roughly half each. Surprisingly, no-one seems to have noticed this before my previous work (e.g., Palma, 2006, 2011, 2016).¹⁴ The exceptions to this rule, as always, are just a small number of countries in Latin America and Southern Africa.

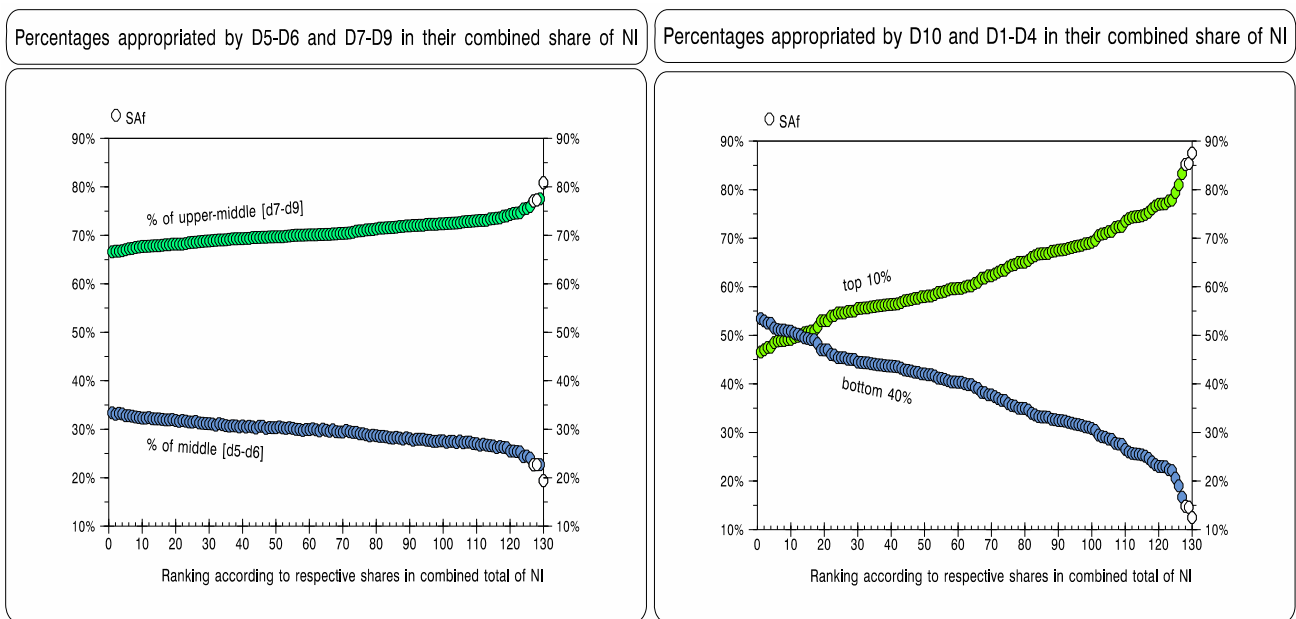
What is implied by this contrast between the whole and the halves — a first layer of possible misunderstanding — is that the diversity of the former must emerge from what happens distributionally *within* these two halves. That is, it must reflect the way in which each half divides its share among its members.

¹⁴ Although, inevitably, one or two experts are now insisting that they knew all about it: they just forgot to mention it in their work. This common phenomenon is called 'hindsight bias'.

iv).- Stylised Fact 4: Although both halves of the population tend to get a similar income share across the world (about half), they divide it among their own constituents very differently

There are three aspects to this stylised fact. The first (we might call it '4a') concerns the contrast between the *homogeneous* middle and upper-middle, and the *heterogeneous* tails (see Figure 4).

FIGURE 4



• **SAf** = Southern Africa.

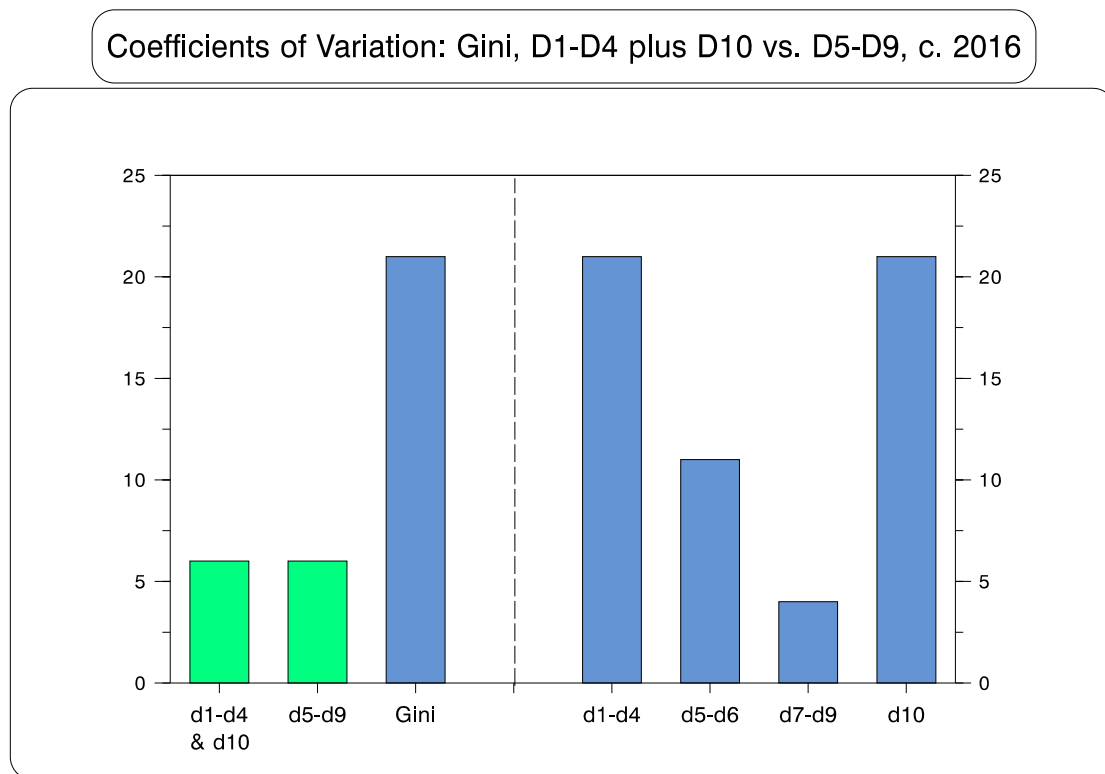
While D5–D9 distributes its half of the income pie uniformly between the middle (D5–D6) and the upper-middle (D7–D9), the opposite is the case for the top and bottom deciles. The left-hand panel of Figure 4 shows that (except for Southern Africa) there is little variation in how D5–D9 splits its share between its middle and upper-middle strata. The right-hand panel, meanwhile, indicates a huge diversity of outcomes in the distributional struggle between top and bottom: ranging from D10 getting *less* than D1–D4 (Finland), to D10 getting nearly nine-tenths of the combined shares (Southern Africa again...). That is, while the homogeneity of D5–D9 as a whole (hereafter — and just for analytical convenience — the 'administrative classes') is replicated in its parts, the homogeneity of the combined share of D10 and D1–D4 across the world, instead, becomes highly heterogeneous in terms of what each one gets.

Thus it appears that the diversity of inequalities shown by the Gini is basically a reflection of a tooth-and-nail distributional fight *in just one half* of the

population, *for just one half* of the national income. Of all the veils obscuring our vision of inequality, this is probably the one that has led to most misunderstanding.

It seems, then, that the key aim of the administrative classes is to protect (as a group) their overall share of income, while in the other half of the population, the top 10 per cent is bent on enlarging its share at the expense of the bottom 40 per cent. One narrative of this remarkable contrast between the distributional dynamics of these two halves of the population can be found in Appendix 3 where, using simple game theory language, I argue that this contrast between what happens distributionally *within* the middle and upper-middle, and *within* the top and bottom deciles resembles the contrast between 'coordination' and 'anti-coordination' games. This is confirmed in Figure 5.

FIGURE 5



- Coefficients are multiplied by 100.

While the coefficients of variation of the shares of the two halves *when together* are very low, those of the two components of the tails *when separate* are remarkably high, and much larger than those of the two administrative strata.¹⁵ In fact, D10 and D1–D4 individually have a coefficient of variation that is almost

¹⁵ Cobham et al. (2015) undertake a detailed statistical analysis of the stability of the income share of D5–D9.

four times larger than when combined.¹⁶ This heterogeneity in the distributional outcomes at the tails is what dominates the Gini, as it ends up having *exactly* the same variability as them — implying that the Gini (despite its supposed statistical properties) turns out to be unmoved by the distributional homogeneity of the middle and upper-middle. That is, by mixing (homogeneous) pears with (heterogeneous) apples the Gini ends up being blind to the homogeneity of one half of the population. By contrast, the Palma ratio, *by design*, only attempts to measure the heterogeneity at the tails — that is, it measures inequality *at source* (see discussion on '4c' below). As these phenomena were not known before, the relevant literature — especially the econometric literature — by using indices such as the Gini, has failed to see that the huge diversity of inequality across the world is basically about the many outcomes of the struggle between the top 10 per cent and the bottom 40 per cent. In turn, neoclassical analysts need to explain how is it that if ' $r > g$ ' rules, why would it all be in the tails? Why would this be a 'fundamental force of divergence' for only *one half* of the population?¹⁷

The second part of stylised fact 4 — we can call it '4b' — takes the form of a question: *has the homogeneity of the middle and upper-middle been stable over time?* One controversy that followed my earlier findings was the issue of whether the current distributional homogeneity of D5–D9 has some 'path-dependent' roots. Has D5–D9 always been able to appropriate about half of national income — as a sort of 'right' — leaving the other half to be contested between D10 and D1–D4? The data available indicate that at least in OECD countries and in some middle-income countries there does seem to be a remarkable stability over time in the share of D5–D9, despite massive upheavals (see Appendix 4 below; see also Palma, 2014a). However, as the Chilean case in Appendix 4 indicates, those in D5–D9 are not immune from major political shocks — there is no 'lack of history' here. But, in general, those in D5–D9 are surprisingly successful in fighting for their 'rightful' half (irrespective, for example, of the amount and quality of their schooling; see below).

As Tony Atkinson remarked in his comments on a draft of my 2011 paper, another interesting implication of my findings is that if D5–D9 gets half the income, then the Gini is 1.5 times the share of the top 10 per cent, minus 15. In

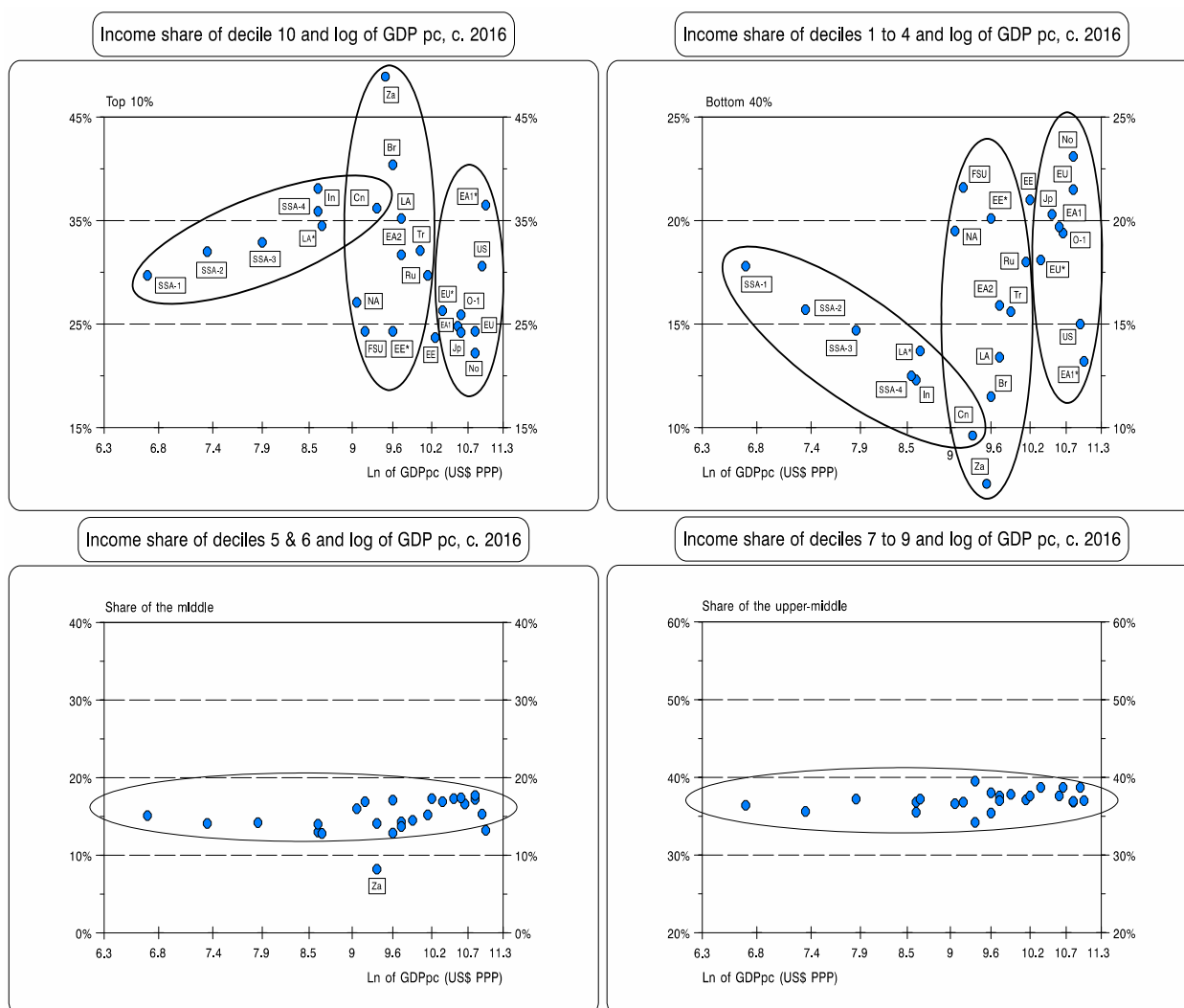
¹⁶ In this half of the population (the tails), while the difference between the mean and mode when together is 2.5 times that between mean and median, when separate this multiple jumps to over 9 times for D10 and 11 times for D1–D4. This does not happen in D5–D9, where this multiple is similar whether its two constituents are analysed together or separately.

¹⁷ Perhaps Solow and Swan, by being concerned in their neoclassical (aggregate) production function with capital accumulation and technological progress, forgot all about the administrative classes—which often have little to do with either.

this case it 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.

The third part of stylised fact 4 (let's call it '4c') concerns heterogeneity at the tails and the Palma ratio. Figure 6 neatly shows the logic of the Palma ratio, which is based on this contrast between the heterogeneity in the top and bottom vs. the homogeneity in the middle and upper-middle. Here the shares of the respective four groups are ordered according to GDPpc.

FIGURE 6



● Countries and Regions in the bottom panels are the same as in the top. Acronyms as above, except for **No** = Nordic countries (individual countries as internet domains).

The high degree of homogeneity in the two components of D5–D9 (lower panels) is reflected in the fact that the measures of central tendency in this 130-country sample are almost identical.¹⁸ However, in the top and bottom deciles these are

¹⁸ For D5–D6, the harmonic mean is 15 per cent, the geometric mean is 15.2 per cent, the arithmetic mean is 15.3 per cent, the median is 15.7 per cent and the mode is 16.4

rather different.¹⁹ The coefficients of variation in Figure 5 indicated the same. So, it seems that a schoolteacher, a mid-level civil servant, a young professional, a skilled worker, a middle-manager, or a taxi driver who owns a car, all tend to earn the same as each other across the world — as long as their incomes are normalised by respective GDPpc. That is certainly not true for the top 10 per cent and bottom 40 per cent.

Basically, in unequal middle-income countries, such as those in Latin America, the top 10 per cent has succeeded in getting an income similar *in absolute terms* to their counterparts in rich nations (often by artificially augmenting the value of their marginal productivity, and by directly appropriating a share of the income of others). Meanwhile D5–D9 has done so *in relative terms* (shares of income). The bottom 40 per cent, on the other hand, have an income more akin to the average income in sub-Saharan Africa, in part a result of the inability of labour to claim the value of its marginal productivity due to a lack of property rights over its energy and skills (Pagano, 1997).²⁰ In other words, in so-called ‘middle-income countries’, only those in the middle have ‘middle-income’ earnings, as the top 10 per cent have prematurely caught up with their rich counterparts, while those in the bottom 40 per cent face a massive uphill struggle *just to get to ‘middle-income’ levels*. Per capita income convergence, therefore, seems far more complex than implied in neoclassical models.²¹ In sum, the broad spectrum of disposable income inequality across the world emerges basically from what happens within only one half of the population — the half mainly made up of the capitalist élite and their consiglieres at one end, and workers at the other.

Among its many implications, this finding is relevant, for example, for the debate about the OECD’s ‘disappearing middle’. This debate has confused a declining relative level of welfare among the middle and upper-middle with D5–D9’s share stability (see Appendix 4). The huge increase in the cost of necessities (like health, education and housing), the accumulation of debts, meagre pensions, more regressive taxation, and so on, mean that despite the

per cent. For D7–D9, the equivalent figures are 36.9 per cent, 36.9 per cent, 37 per cent, 37.4 per cent and 37.7 per cent, respectively.

¹⁹ See footnote 16 above. Furthermore, since in D10 the mean > median > mode, while in D1–D4 it is the other way round, their distributions are skewed differently—one positively, one negatively. The skew in D5–D6 and D7–D9, instead, is not only very slight, but it also takes the same direction (negative).

²⁰ This also distorts incentives to acquire skills among the bottom 40 per cent. What would be the point of making the effort in unequal middle-income countries if the *additional* output is bound to be appropriated by others?

²¹ The same is true for productivity convergence, due to huge diversity across sectors within countries (Palma, 2010; and 2019b).

stability of the income share of D5–D9, this (stable) share is only able to provide a declining level of well-being.

Among the many other issues that need re-examining, the relationship between human capital and income distribution stands out, as *diversity* in distribution is found among those with *uniformity* in education, and vice versa. While those at the top are able to buy a lot of 'education' everywhere, those at the bottom have access to little schooling or education of doubtful quality. However, this educational *uniformity* across the world (the top always having a lot, those at the other end similarly little) is associated with distributional *diversity*. The opposite is the case for D5–D9: although most of the world's educational diversity (quantity and quality) is found among these deciles, they have *similar* income shares across the world, irrespective of their stock of human capital or any other recurrent factors in neoclassical models.²²

This contrasting scenario in the two halves of the population also opens up huge analytical challenges for the growing econometric literature which tries to 'explain' the variance of the Gini. By regressing it in panels against a set of (ever more imaginative) explanatory variables — (hopefully 'predetermined', if not at least weakly exogenous, even Granger causality) — what is ignored is that these variables are bound to relate statistically very differently to what is happening distributionally in the two halves of the population. By using the Gini (or similar) as a dependent variable, these economists are trying to explain *two contrasting distributional dynamics* at once, and with the same set of 'explanatory' variables, and this would be a specification error. It's time to open up the Gini and start peering inside.

A different issue, of course, is whether one should still think of complex, over-determined, and surely 'open' subjects, such as inequality, in terms of methodologies that somehow resemble 19th century Newtonian physics — methodologies of mechanical determinism and simple causalities.

Inevitably, the analysis that emerges from such econometrics is typified by 'antecedent causation' and 'inert consequences'. The priority of exogenous over endogenous factors is established (via *unidirectional* cause–effect interactions), thus almost metaphysically separating the two sides of the

²² For example, tertiary enrolment in Chile (90 per cent) is very different from that in Uganda, Kenya, Tanzania or Malawi (5 per cent or less), but the income shares of D7–D9 are identical — despite this group in Chile overflowing with 'education' (WDI, 2019). This also helps us understand the spurious nature of the 'skill-biased technical change' type explanation for increased inequality (for a critique, see Atkinson, 1997). A different issue, of course, is that this extra education may well have significant positive externalities (not reflected in the income of those in this group), as externalities accruing to society from increased government investment in educating the children of the poor. From the perspective of this article, the key issue is who pockets the benefits of those externalities.

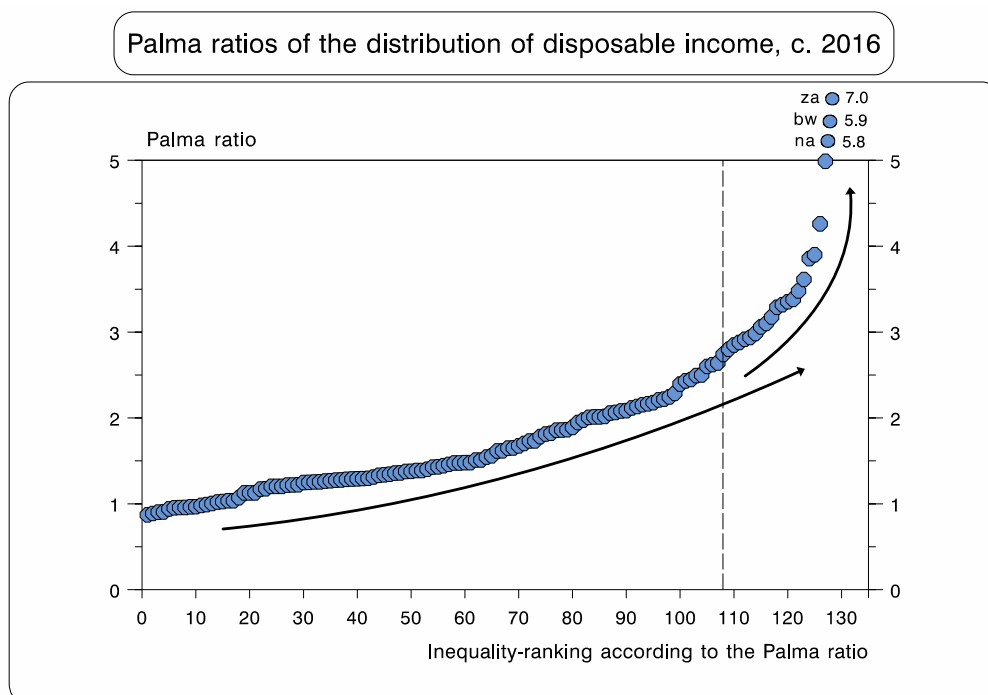
opposition and thereby losing the notion of movement through the dynamics of the interaction and contradictions between them. Furthermore, any factor that may interact with inequality can only do so within *specific* institutional dynamics. In addition, 'over-determination' complicates the standard counterfactual understanding of causation.²³

Figure 6 helps demonstrate the logic of the Palma ratio as an index of inequality. By dividing the top 10 per cent's share with that of the bottom 40 per cent, it aims to measure inequality where it exists — 'at source'.²⁴

In the case of the Gini, the geography of inequality ends up being only a mirror image of the distributional diversity of D10 and D1–D4.²⁵ The Palma ratio, meanwhile, attempts to make the *actual* distributional struggles more transparent.

According to the Palma ratio, inequality increases first relatively slowly, and almost linearly, only to switch gear at the tail-end of the distribution (around ranking 110), when it starts increasing rapidly and eventually geometrically (Figure 7).

FIGURE 7



²³ An analysis of these major methodological and social ontological issues is well beyond the scope of this article, but see, for example, Lawson (2015).

²⁴ Cobham et al. (2015: 1–2) indicate that: 'Data for the Palma Ratio is now listed and updated as standard measure of inequality in the OECD database, ... the UNDP Human Development Report, ... as well as by some national statistical offices, e.g. the UK ... Further, interest in the Palma Ratio is evident among NGOs and international agencies alike'.

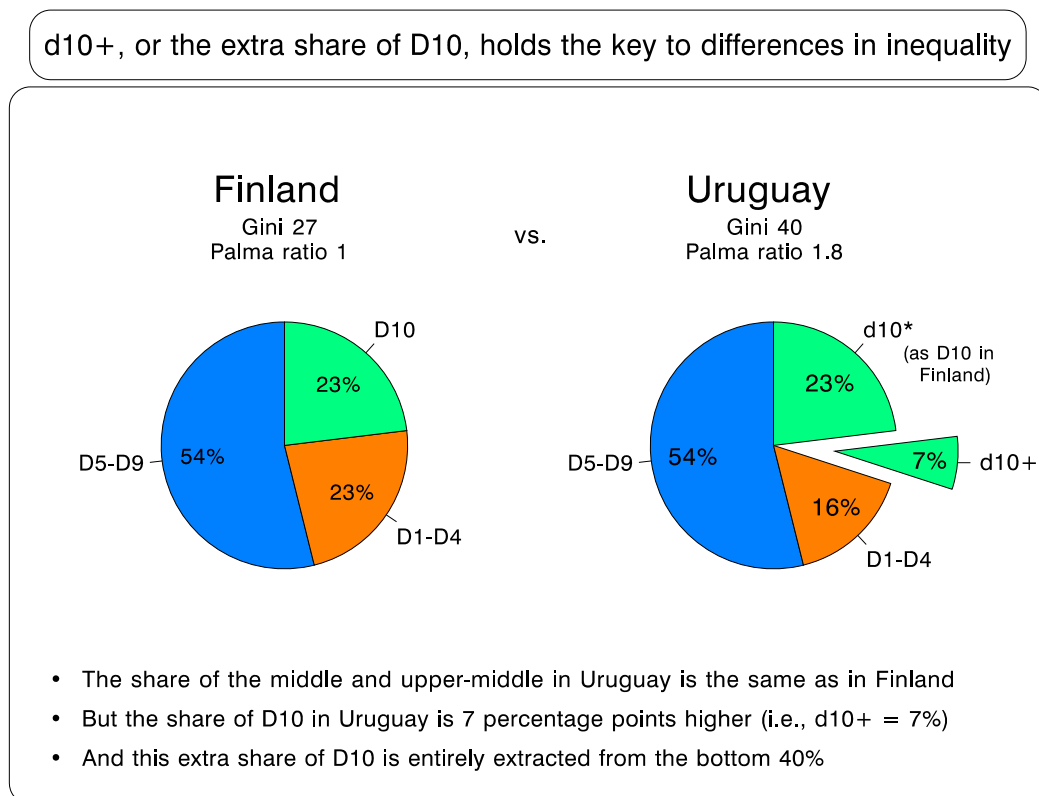
²⁵ As Cobham et al. (2015: 8) remark: 'We know that by construction the Gini is over-sensitive to the middle; but in practice ... tells us nothing about it ... If you want to know about the middle, the Gini seems to be little good to you — but may fool you that it is'.

- **bw** = Botswana; **na** = Namibia; **za** = South Africa.

In fact, as the lower arrow on Figure 7 indicates, had the 'steady pace' of deterioration in inequality found in the first (approximately) 110 countries continued, the most unequal country (South Africa) would have posted a Palma ratio barely higher than 3. Instead, it has a ratio of 7. This unveils another layer of possible misunderstanding, as this rapid deterioration of inequality at the tail-end — only 14 countries post a Palma ratio of 3 or above — inevitably casts doubts on traditional theories of inequality which have little to say about this sudden surge of inequality in just a few countries (which are also located in two specific regions). It would even be tempting to say that these countries should probably be the subject of 'extreme value analysis' (of the type that focuses on values above a threshold). I will take on this challenge in the next subsection.

A clear example of the logic that underpins the Palma ratio is found in the comparison of Finland and Uruguay (Figure 8).

FIGURE 8



- Lower case "d" refers to sectors of D10.

According to their Gini (27 and 40) they don't have much in common. However, the Palma ratio — and a new simple statistic of inequality that I am introducing

here, and calling 'd10+' — point in a different direction, which is characterised by as many similarities as contrasts.

The apparent considerable distributional difference between them (13 Gini percentage points) is all about the extra share of the rich in Uruguay (d10+) — gained *entirely* at the expense of the bottom 40 per cent. The actual size of d10+ will of course vary according to the benchmark. The benchmark I suggest is what is necessary in order to achieve a Palma ratio of 1 (as in Finland)—that is, what must be transferred from D10 to D1–D4 in order to achieve this. Following Pigou (1920: 81), this transfer should be welfare-improving since:

[It] is evident that any transference of income from a rich to a relatively poor man of similar temperament, since it enables more intense wants to be satisfied at the expense of less intense wants, must increase the aggregate sum of satisfaction. The old 'law of diminishing utility' thus leads securely to the proposition: Any cause which increases the absolute share of real income in the hands of the poor ... will, in general, increase economic welfare.

Figure 8 also shows how the information provided by d10+ complements that of the Palma ratio, as both statistics together provide fairly comprehensive information regarding a given country's degree of inequality. While it is not intuitively clear where Uruguay's extra Gini inequality comes from, knowing that its Palma ratio is almost twice that of Finland, and that its d10+ is 7 per cent of national income, tells a much more focused, transparent and informative story. And (with very few tail-end exceptions) its thrust is that the distributive struggle relates mostly to D10 trying to appropriate an extra income share by shrinking D1–D4's share (that is, by increasing d10+).

Therefore, the size of d10+ is also a proxy for the capacity or otherwise of D1–D4 to resist D10's insatiable appetite. As suggested above, the 64,000 dollar question is obviously whether the size of d10+ in Uruguay is the fairly inevitable outcome of its 'fundamentals', or whether d10+ is *self-constructed*, reflecting *choice* and the nature of a more unfair political settlement, characterised by Uruguay's greater tolerance for inequality. If the former, as discussed above, this would still require an explanation for why these fundamentals impact only on the income share of one half of the population. If, alternatively, what really matters is the nature of political settlements and the (often) 'tailor-made' market failures supporting them, then d10+ would reflect the specificity of Uruguay's political economy and (convenient) inequality-driving market failures.

The distributional information provided jointly by the Palma ratio and d10+ — especially by focusing the distributional struggle on a fairly specific arena, a phenomenon that is blurred by all those veils obscuring our vision of inequality — can help illuminate this message, while also helping to create awareness of the dimensions *and specificity* of inequality. This can be very useful for policy making,

since with these two indicators it becomes evident where inequality is located, *and what must be done* if one wants to eradicate the 'extra' inequality (i.e., that above a Palma ratio of 1) in countries such as Uruguay. In other words, its minimalism — purposely avoiding all the algebraic sophistication of alternative inequality statistics — becomes its main strength, as transparent information such as this can be crucial. As Gramsci rightly said, more often than not battles of this kind are won or lost on the field of ideology (something triumphant 1970s' neoliberals know better than anyone).

Consequently, I would likewise venture that d10+ is also a proxy for the size of Uruguay's 'distributional failure', as I cannot see any (positive or normative) reason why a country such as this should have a level of disposable income inequality greater than a Palma ratio of 1. That is, I see d10+ as a 'distortion'; therefore, I shall henceforth call d10+ 'distributional failure 1'. This new evidence suggests that we all still have some analytical work to do — especially those who argue that the 'extra' inequality, such as Uruguay's, somehow reflects the inevitable outcome of its (given) inputs.

And even more work is required from those who still support high inequality from an economic efficiency point of view. Of course, as in any other area of economics, one can always construct a suitable shopping list of potential fundamentals that might be statistically associated in a significant way (from an econometric point of view) with the very different levels of inequality found across the world, and then speculate about how (say) globalisation might have impacted on them (keeping everything else constant, of course). But even in this scenario, some explanation is required as to why they affect the two halves of the population so differently.²⁶ At the same time, an explanation is also required as to why only some governments are willing and able to tackle market inequality systematically via taxes and transfers and whether, when they do so, they are violating some distributional order of the universe, at the cost of efficiency (see more on this below).

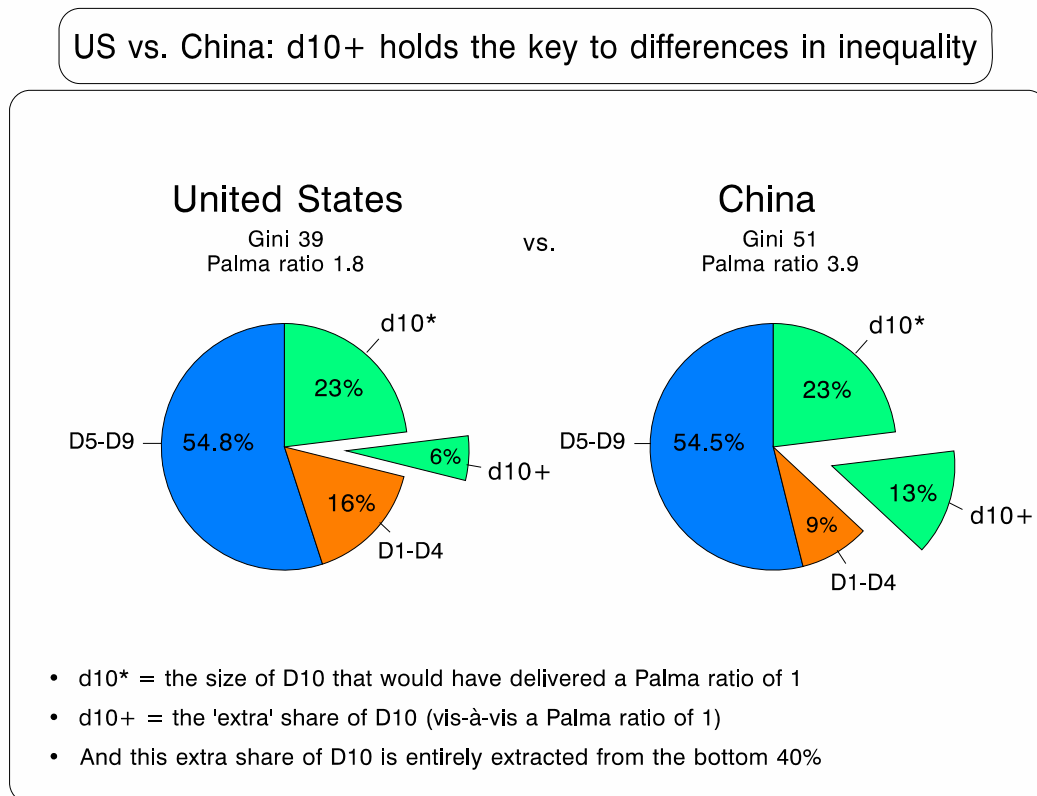
For a long time analysts (especially those justifying higher levels of inequality) were reluctant to study the share of the rich, the most likely driver of inequality. This was the trademark of the classical Washington Consensus. As John Kenneth Galbraith remarked: 'Of all classes the rich are the most noticed and the least studied' (Galbraith, 1977: 44). Fortunately, it is beginning to look as though a certain cat is finally out of a certain bag.

²⁶ One guess could be that the administrative classes may be less affected by the transformations brought about by globalisation, such as the breakdown of the value-chain, increased capital (and labour) mobility, and so on.

In fact, since the sum of all shares has to be equal to 100, and given the distributional homogeneity of *and within* D5–D9, the share of decile 10 alone could be a very simple but highly informative statistic for *the whole distribution*.

In sum, according to survey data, and with the sole exception of a few extremely unequal countries, the size of d10+ can explain the essence of the difference in within-nation inequality, even in countries that have little else in common, such as the USA and China (Figure 9).

FIGURE 9



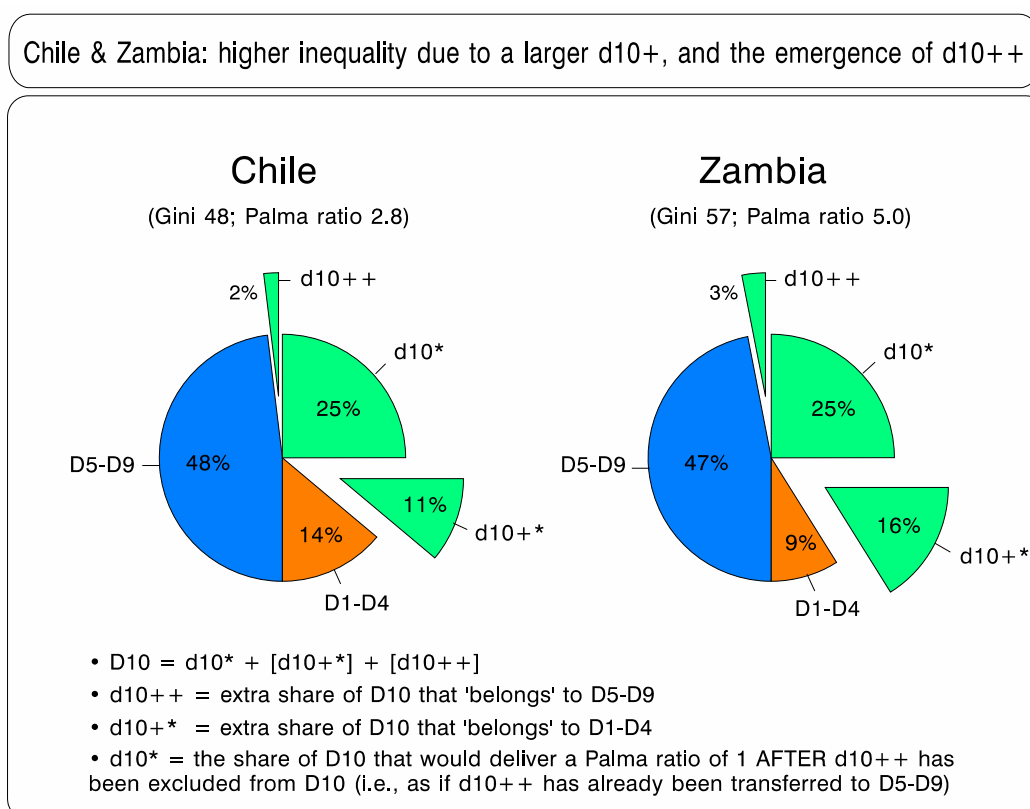
• Percentages may not add up to 100% due to rounding.

v).- Stylised Fact 5: In a few countries inequality becomes extreme because D10 is not only able to squeeze D1–D4 even further, but it also can bring the share of D5–D9 into play: The emergence of 'd10++'

The next issue for analysis is what happens at the tail-end of the distribution, where the explosion of inequality takes place — the analytical challenge mentioned above. At the tail-end of the distribution, increased inequality is not only about an even larger d10+, but there's an added twist: in a small number of countries (mostly in Latin America and Southern Africa), D10 is not only able to squeeze the share of D1–D4 even further, but it can also shrink the share

of D5–D9 below 50 per cent of national income. That is, in these countries the arena in which the wasteful 'anti-coordination' distributional game is played out is enlarged to include what in the great majority of countries belongs to D5–D9. Here the administrative classes are not able to protect themselves from D10; the strength provided by their 'coordination' is not enough to defend their half. A good example of the distinction between unequal countries where D5–D9 is able to protect its half and those where it struggles to do so is the contrast between Uruguay (above) and Chile and Zambia (Figure 10).

FIGURE 10



• When 'd10++' > 0, I change the notation for 'd10+' to 'd10+*' to reflect that this sector now refers only to the extra share of D10 associated with D1–D4. That is, what would be necessary to transfer from D10 to D1–D4 in order to get a Palma ratio of 1 *after* 'd10++' has been transferred from D10 to D5–D9 (where it belongs).²⁷ Thus, when 'd10++' = 0, 'd10+' and 'd10+*' are the same (in my methodology both 'd10+' and 'd10++' can only take positive numbers; so, when they become negative, they are assumed to be zero). But when 'd10++' > 0, they are different (and 'd10+' > 'd10+*').

While in Uruguay, as in most countries, higher inequality is about the size of d10+, in Chile and Zambia the top 10 per cent also succeeds in appropriating a new sector of the pie: 'd10++' (2 per cent in Chile, 3 per cent in Zambia and as much as 11 per cent in Namibia). Therefore, to make inequality more

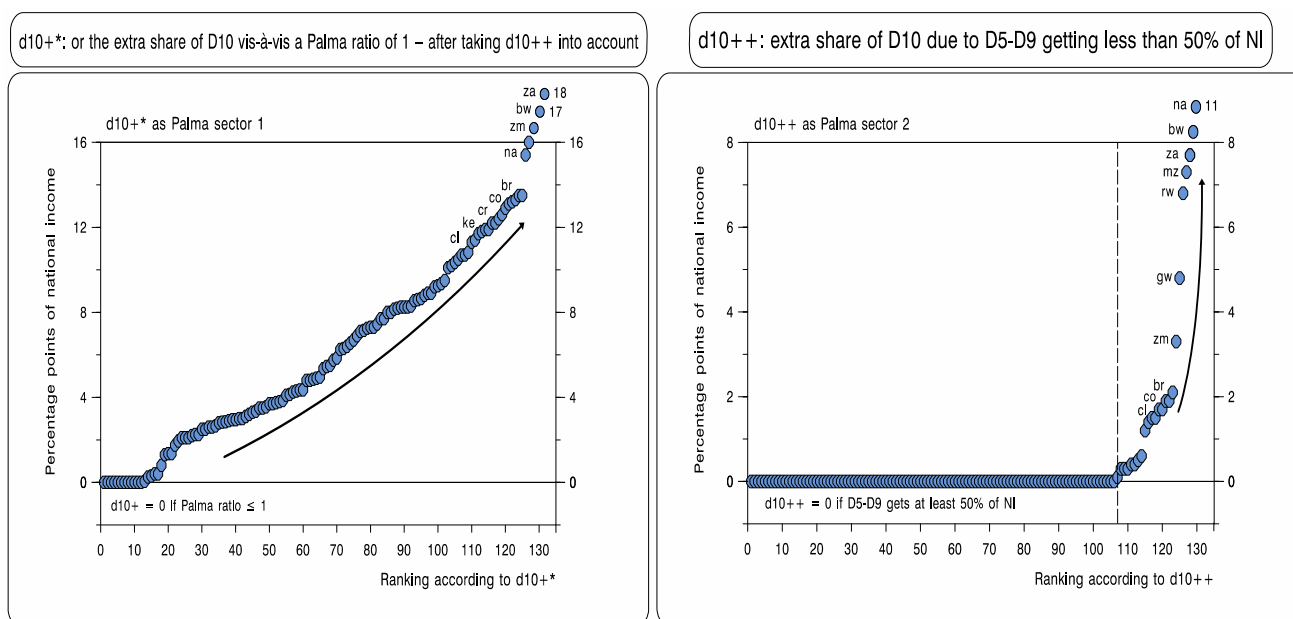
²⁷ Therefore, 'd10+' = $\{(D10 + [D1-D4])/2 - (D1-D4)\} = \frac{1}{2}(D10 - [D1-D4])$. In turn, 'd10+*' = $\{[(D10 - d10++) + (D1-D4)]/2 - (D1-D4)\} = \frac{1}{2}([D10 - d10++] - [D1-D4])$.

transparent in extremely unequal countries, one should identify another distorting veil and differentiate what part of the *extra* share of D10 'belongs' to D5–D9, and what to D1–D4. When D5–D9 does not get at least its half (that is, when $d10++ > 0$), I shall call this 'distributional failure 2'. In Chile, the overall 'extra' share of D10 adds up to 13 per cent of income; 2 per cent extracted from D5–D9, and 11 per cent from D1–D4. In Zambia, these figures are 3 per cent and 16 per cent, and in South Africa they reach 8 per cent and 18 per cent. In more civilized Uruguay, meanwhile, as $d10++ = 0$, the extra share of D10 is made up only of $d10+$ (7 per cent), reflecting both the greater strength of Uruguay's administrative classes in defending their (at least) half of national income, and of the bottom 40 per cent in restricting $d10+$ to single digits. Finland, meanwhile, meets both yardsticks, and achieves a Palma ratio of 1 as both $d10+$ and $d10++=0$. As $d10+^*$ and $d10++$ are areas of the income pie enclosed by two radiuses and an arc, they will be referred to as 'sectors'. And as their logic is derived from the Palma ratio, it has been suggested that they should be called 'Palma sectors' 1 and 2, respectively — but this should be so only when they are calculated in the scenario of what is needed in order to get a Palma ratio of 1, when D5–D9 gets at least its half of the national income.

Note that in my methodology there is room for D5–D9 to get more than 50 per cent as it often does, but by a very small margin — the average for D5–D9 in this sample is 52 per cent, and as we already know, its coefficient of variation is tiny. In such cases, a country can still fulfil both targets, and get a Palma ratio of 1. However, this inevitably opens up the possibility that D5–D9 could get 'too much'. Within this 130-country sample, in only six countries does the share of the administrative classes get to 56 per cent, and four of these are the 'usual suspects' on the shores of the Mediterranean: Greece, Italy, Spain and Croatia (with a fifth, Macedonia, next door). This is a different type of distributional failure, number 3 — 'the rentier-middle and upper-middle' distributional failure. But further analysis of the 'retire-well-at-50-with-Mediterranean-diet' bureaucrat — in which academics can retire early and with 80 per cent or more of their final salary (making us all green with envy) — is beyond the scope of this (already long) article.

The new methodology ($d10+^*$ and $d10++$) helps answer the conundrum of Figure 7 above — the burst of inequality at the tail-end of the Palma ratio ranking. Its geometric increase arises from there now being two sources boosting the share of D10: a greater $d10+^*$, and the emerging — and then outburst — of $d10++$. (Figure 11).

FIGURE 11



● **co** = Colombia; **cr** = Costa Rica; **gw** = Guinea-Bissau; **ke** = Kenya; **ls** = Lesotho; **mz** = Mozambique; **rw** = Rwanda. **NI** = national income.

Bringing the share of D5–D9 into play is a crucial component of the outburst of inequality in Latin America (e.g., Brazil, Chile and Colombia), in some sub-Saharan countries (e.g., Zambia and Mozambique), and in Southern Africa’s three distributional basket cases. D10+* (or the ‘extra’ share of D10 that ‘belongs’ to D1–D4, after deducting for d10++) now grows in a steady, linear form right up to the very last five countries (the usual three, plus Lesotho and Zambia; see bottom left-hand panel).

As there is virtually no more tail-end burst in this sector of the pie (d10+*), it becomes evident the ‘explosion’ of inequality at the tail-end of the Palma ratio is almost entirely due to d10++ (see bottom right-hand panel). From this perspective, d10+* and d10++ complement the information provided by the Palma ratio for understanding why inequality is so unequal across the world, and why it increases exponentially at the tail-end (issues blurred in the Gini, and also in the Theil).²⁸

Following Adam Smith (1759), I suggest that the surge of d10++ with a still-growing d10+*, rather than statistics indicating just a burst of inequality, should also be understood as a burst of vanity:

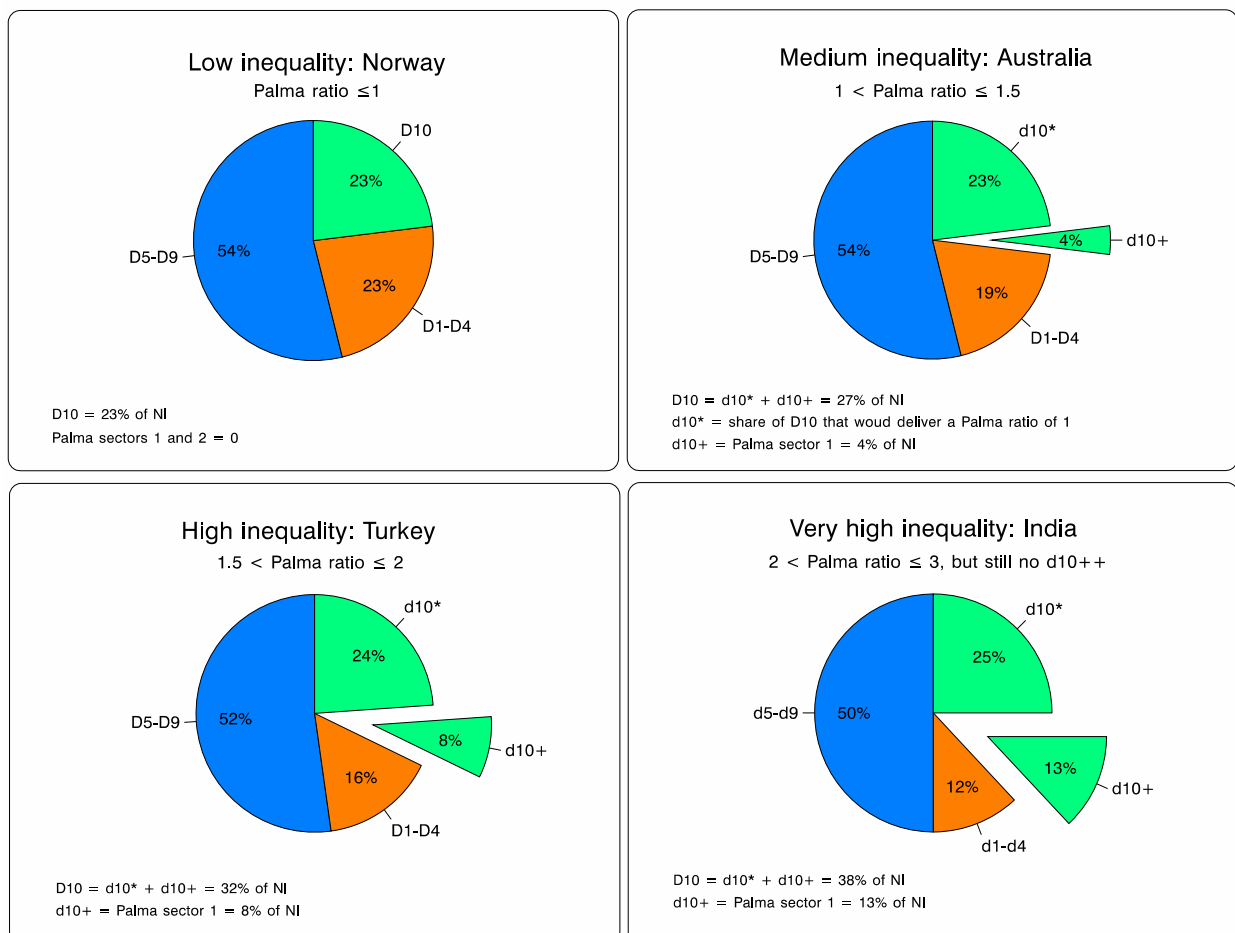
²⁸ As Amartya Sen (1973: 36) emphasises, the Theil ‘is an arbitrary formula, and the average of the logarithms of the reciprocals of income shares weighted by income shares is not a measure that is exactly overflowing with intuitive sense’.

[W]hat is the end of avarice and ambition, of the pursuit of wealth, of power, and pre-eminence? Is it to supply the necessities of nature? The wages of the meanest labourer can supply them [W]hy should [some] ... regard it as worse than death, to be reduced to live, even without labour, upon the same simple fare with him ...? ... It is the vanity, not the ease, or the pleasure, which interests us. (I.iii.2)

2.- The Seven Patterns of Disposable Income Inequality in Survey Data across the World

The five stylised facts of inequality discussed so far, and the new methodology put forward above, help differentiate seven patterns of disposable income inequality. Leaving aside the case of the very few Mediterranean rentier-bureaucrat countries, in the remaining six almost everything boils down to the share of the rich. That is, how far can D10 squeeze the shares of D1–D4 — and then, in a few countries, also those of D5–D9? Figures 12 and 13 take one example to illustrate each category.

FIGURE 12
The first four patterns of inequality



'Low inequality' refers to countries with a Palma ratio equal to or lower than 1 — those that do not fall into either of the first two distributional failures above (a total of 17 countries). 'Medium inequality' — that is, countries having a mild form of distributional failure 1 — are those in which d10+ emerges, but the Palma ratio does not exceed 1.5 (44 countries). 'High inequality' refers to countries with a Palma ratio between 1.5 and 2 (20 countries), and 'very high' inequality encompasses those with a Palma ratio between 2 and 3, but still without d10++ (23 countries).

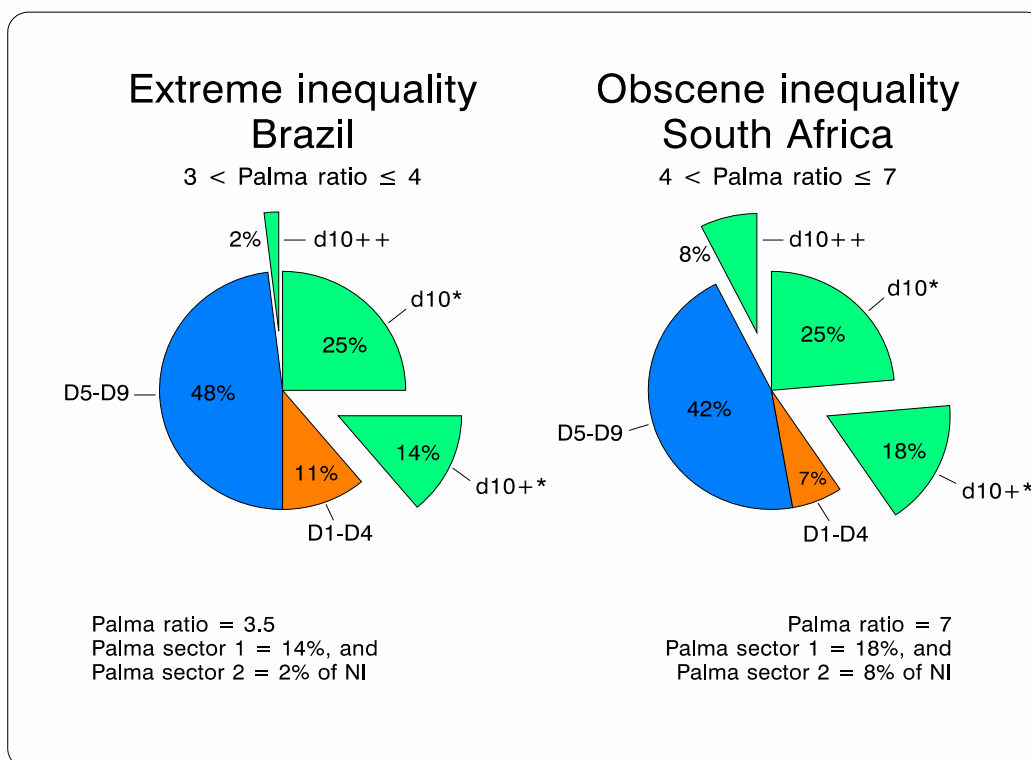
Then comes the fifth category, the very few 'Mediterranean rentier middle' countries — the exceptions to the rule that it's all about the share of the rich. In these countries the extra share of the administrative classes tends to come at the expense of the bottom 40 per cent. In Spain, Greece and Italy, for example, the share for D5–D9 is 56 per cent and the Palma ratios are 1.5, 1.5 and 1.4, respectively — and this is associated with a relatively low share for D1–D4 (18 per cent, 18 per cent and 19 per cent, respectively).

Exactly the same picture is found in next-door Macedonia (a Palma ratio of 1.4, and an 18 per cent share for D1–D4). In Croatia, however, the extra share of D5–D9 is extracted from both sides of the distribution.²⁹

The sixth category ('extreme inequality') comprises countries with a Palma ratio between 3 and 4 (15 countries), but this category also includes six countries with a ratio just below 3 in which d10++ > 0. Finally, the seventh category ('obscene inequality') refers to those with a Palma ratio above 4: South Africa, Botswana, Namibia, Zambia and Lesotho (Figure 13).

²⁹ To avoid double-counting, these countries have not been included in the categories based on the Palma ratio.

FIGUR 13
Extreme Inequality and Obscene Inequality



In South Africa, the top decile — now including many who rose through the ‘Black Economic Empowerment’ programme — gets more than half of national income.³⁰ It does this not only by squeezing the share of D1–D4 all the way down to a bizarre 7 per cent (the lowest in the world, and less than a third of its share in the Nordic countries, and in some countries in Eastern Europe and the FSU), but also by shrinking D5–D8 to a quarter of national income (also the lowest in the world — this is a proper ‘disappearing middle’). However, as the share of its civil-service crowded D9 is also the highest in the world (18 per cent), South Africa’s top quintile appropriates nearly 70 per cent of national income (see also Palma, 2011: Appendix 3) — not surprisingly, the highest in the world and approximately *twice* the equivalent share in Iceland, Norway, Belgium, Finland, Slovakia, the Czech Republic, Slovenia and others. In fact, since the end of apartheid, inequality has increased among *all* the ethnicities recognised in the South African Constitution (Leibbrandt et al., 2010). It is no small analytical challenge to try to understand how one of the outcomes of that most remarkable of liberation struggles is such mind-boggling levels of inequality.

³⁰ For the ANC, redistribution of assets and opportunities towards non-whites was needed to make them representative of race demographics.

Regarding Brazil, what is most striking about its inequality — like that of the rest of Latin America — is that it is much higher than in many other middle-income countries such as those found in Asia, North Africa, the FSU and Eastern Europe (among others). This is true, even though the latter often have even more market rigidities than Latin America; prices, institutions and social capital that are less 'right'; property rights over physical assets that are less well-defined and less well-enforced; educational systems that are more segmented, with the poor often getting an even more dismal deal; gender discrimination that is even more acute; greater shortages of skilled labour; democracies that are even more 'low intensity', and with more problems of 'governance'; and an even greater dependence than in Latin America on political connections and corruption to achieve success in business.

The experience of Latin America thus shows that rather than thinking in terms of the possible *concrete effects* that such factors may have on inequality, it would be more illuminating to try to understand the *concrete expressions* that these factors may find in inequality. Some of the pieces of the distributional puzzle may well be the same, but the way they fit together may differ. The specificity of Latin America's inequality stems from the particular ways that distributional struggles have manifested there, the different strategies that oligarchies have adopted to face and temporarily overcome these struggles, the further distributional challenges created by this process, and so on. Indeed, the monotonous insistence of many on blaming Latin America's huge inequality on 'exogenous' or crude path-dependency factors is akin to using a pair of scissors to cut an analytical knot that they can't untie.³¹

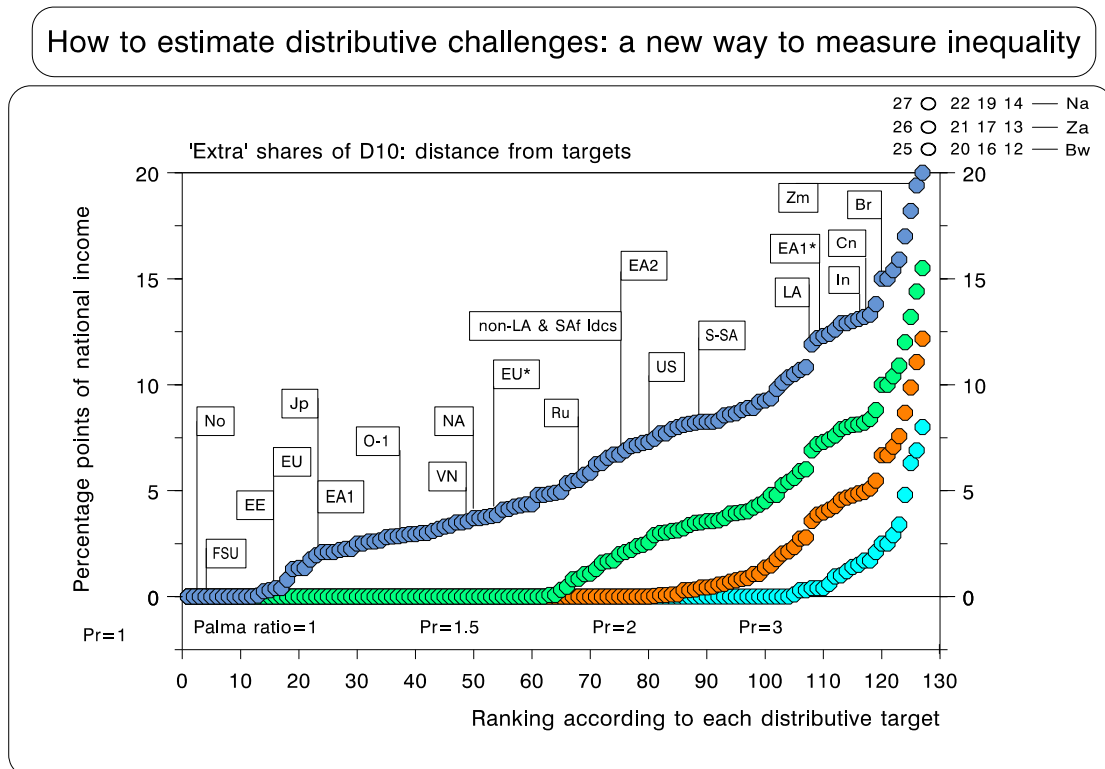
3.- Another Method for Measuring Inequality: Distance from Distributive Targets

The analysis so far also helps in formulating a new method for measuring inequality: distance from 'distributive targets'. Following the logic of the Palma ratio — including the fact that there seems to be no objective reason for any country to have a Palma ratio above 1 — Doyle and Stiglitz (2014) proposed including a 'Palma target' in the post-2015 UN framework for global development: a Palma ratio of 1 by the year 2030. Similarly, Engberg-Pedersen (2013) suggested halving the gap between the starting point and a Palma ratio of 1.

³¹ Some still blame even colonial institutions of half a millennium ago (e.g., *mita* and *encomienda*) for Latin America's inequality. For Williamson (2009) — quite rightly — this is just a myth.

However, these targets (neither of which, unsurprisingly, was accepted by UN delegates — they were too difficult to fudge) did not take into account that in a few countries D5–D9 does not get its half of national income. I therefore suggest that a more comprehensive target should also take into account the size of the Palma sector 2 (d10++); in that case, we need two yardsticks, one for d10+, and one for d10++ (Figure 14).

FIGURE 14



- These targets also include, when necessary, that 'd10++' is also transferred to D5–D9 (i.e., that 'd10++' becomes 0). **Pr** = Palma ratio. Independent rankings (although for most countries rankings are the same in all targets). When a country fulfils the target (or better) it is shown at zero. Acronyms as above.

For clarity, South Africa, Botswana and Namibia are shown at the top right-hand corner.

Figure 14 shows four alternative yardsticks for d10+, always including (when necessary) what it takes to make d10++ = 0. The first measures the 'excess' share of D10 — in terms of 'extra' percentage points of national income — from the point of view of reaching the target of a Palma ratio of 1 (that is, how far countries are from getting both d10+*, and d10++ equal to zero). This would be a scenario in which there would be no distributional failures 1 or 2. The other three are 'watered-down' yardsticks for d10+, while keeping the same target of d10++ = 0.

In round numbers, when the yardsticks are both Palma sectors = 0, only 17 countries fulfil the targets (as above in the 'low inequality' category). When relaxed to a Palma ratio of 1.5, 65 countries meet the targets; when 2, 90. Finally, with a Palma ratio of 3, 110 countries are within these parameters, and only the usual three still have a distributive challenge in double digits. The distance from these targets provides a new way of measuring inequality, at the same time as furthering insights into how inequality increases throughout the world.

Conclusions

I am the first to acknowledge that there is more than one way to skin this (inequality) cat — especially from the perspective of different types of income data. In terms of the distribution of disposable income across countries, I have identified five stylised facts: i) inequality is highly unequal across countries; ii) inequality is particularly disparate among middle-income countries, with some increasing diversity also found among high-income countries; iii) diversity changes into homogeneity when each country's population is divided into halves: the middle and upper-middle, and the top and bottom; iv) although both halves tend to get a similar income share (about half), they divide it among their own constituents very differently; v) in a few countries inequality becomes extreme because D10 can also bring the share of D5–D9 into play.³²

In turn, the methodology I suggest to make sense of the diversity of inequality in disposable income tries to remove several layers of misunderstanding — that is, some of its veils and distorting mirrors — by breaking down this inequality into what I believe are its two main components: the extent to which the top decile can squeeze the share of the bottom 40%, and in some countries even that of the middle and upper middle. In doing this, this contribution not only helps to refocus the study of inequality on the share of the rich, but also reveals how far greater inequality should be understood as distributional failures: d10+* (or Palma sectors 1), and d10++ (or Palma sector 2) — plus the 'anti-utopian' 'Mediterranean rentier-middle'. It has also helped us identify seven categories of inequalities across countries.

These several categories of inequality also reinforce the view that there is a significant amount of *choice* and *self-construction* in this respect, particularly at middle- and high-income levels. The remarkable transformations that have taken place in the last four decades may have helped create a wide variety of

³² In terms of the distribution of 'market' income across countries (i.e., after taxes and transferences), see the Part 2 of this paper in Palma (2019c).

opportunities for increasing inequality, but not everyone has taken them up — although in a large number of countries, rentiers (including those who live from extracting the value created by others, from self-destructing finance, by capturing policy and avoiding taxes, by tormenting consumers, or by appropriating the rents of natural resources, and so on), have done so very effectively.

Regarding choice, although it may not always be clear what that choice is really about, who can act upon it, and what making that choice may achieve — especially in ‘chicken game’ scenarios, where the brinkmanship of the top can easily push things to the very edge (see Appendix 3) — everything seems to indicate that there are far more degrees of freedom in the distribution of income than is generally acknowledged. However, as famously suggested in ‘The Eighteenth Brumaire of Louis Bonaparte’, 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. We therefore need to understand what leads us to make particular choices when confronted with specific inherited circumstances. What helps in the formation of collective beliefs? How do spontaneous consensus types of hegemony emerge? How can they be changed? And although I am strongly on the side of agency, it is obvious that as far as income distribution is concerned, agency could easily fail if it does not understand structure.

Nevertheless, there can be little doubt that differences in ‘power structures’, ‘choice’ and ‘agency’ must be playing a key role when, for example, Croatia has a median wage that is twice that of Chile, even though both have the same GDPpc (Duran and Kremerman, 2015). We now know that in the former this is in part due to its Mediterranean rentier-middle preferences. In the latter, meanwhile (despite good intentions), the little effort that has actually been made to improve inequality since the return to democracy in 1990, despite five ‘centre-left’ governments, reminds us that ‘choice’ can also end up taking the form so clearly expressed by a Chilean president at the beginning of the 20th century: “in this life there are only two types of problems: those that will get solved by themselves, and those that have no solution”.³³

One thing that has happened in many countries of Latin America since the turn of the millennium (and in many other parts of the world), is that improving

³³ Quoted on the webpage: www.country-data.com/cgi-bin/query/r-2410.html. If one changes President Ramón Barros Luco’s statement to ‘only two types of problems: those that will get solved by markets, and those that have no solution’, one gets a good sense of what the Washington Consensus is all about, including inequality. And if one changes it to ‘only two types of problems: those that will get solved by markets, and those for which we should be able find a complementary solution’, one gets a good feel of what Keynesianism is all about.

inequality began to lose what for Wittgenstein was the crucial factor for success in public policy: a sense of urgency (Malcolm, 1993). The unsurprising “rebound effect” of this (using Hirschman’s terminology – see Hirschman, 1982) was an increase in political unrest that has helped to bring inequality back to centre stage.

As the epigraphs at the start of this article suggest, inequality is about *choice*. And Sartre would argue that one must always reject mechanical determinisms (characteristic of most orthodox explanations of inequality) and insist on our ultimate freedom and responsibility. ‘I am my freedom’, says a character in one of his plays. Every act is a self-defining one, and no act can really be blamed on ‘external’ factors (Sartre, 2004). Therefore, nothing could reveal who we truly are more transparently than the inequality our society collectively chooses to construct. As the title of my 2016 paper indicates (Palma, 2016), each country actually deserves the inequality it has: it is just not credible any longer to keep claiming that we are innocent bystanders of exogenous fundamentals.³⁴

Perhaps it is finally becoming ‘common sense’ (in Gramsci’s definition) that the ever-increasing market inequality that has characterised the global landscape since Reagan and Thatcher has been a self-constructed, highly distorting and an extremely inefficient distributional failure. Buffett explains this clearly and succinctly (see Stein, 2006): ‘There’s class warfare, all right, but it’s my class, the rich class, that’s making war, and we’re winning’. Fundamentals? What fundamentals?

³⁴ The all-time classic quotation on this matter is provided by Shakespeare, in a speech in *King Lear*: Edmund, Act 1, Scene 2 (132): ‘This is the excellent foppery of the world...’. See: www.online-literature.com/shakespeare/kinglear/3/

APPENDIX 1: DATA SOURCES

In Part 1 and Part 2 of this paper, the source for the survey-based data on disposable income inequality is WDI (2019) — the last year for which this source reports information (but only if after 2005).³⁵ Countries with a population of less than 1 million were excluded. However, for China and India, I use OECD (2019), as the data seem far more credible, and also similar to Solt (2018) and LIS (2018). For four countries for which the WDI does not provide information, I used the following: Hong Kong (2019), New Zealand (2019), Singapore (2019), and Taiwan (2019). For country acronyms in the Figures, I use abbreviations that are used for internet domains (see especially Figures 1 and 2).

APPENDIX 2: PIKETTY'S EXPLANATION FOR INCREASED INEQUALITY

It is unfortunate that Piketty, in his otherwise remarkable book (2014), by unnecessarily relying on the neoclassical theory of factor shares, leads the debate over increased inequality in most OECD countries since Reagan and Thatcher, and the fall of that dishonest wall, in the wrong analytical direction — like the head of a hunt that leads the pack on the wrong path.

Basically — and unlike Kuznets's original proposition, or of Milanovic's 'Waves' — Piketty believes that there is no natural tendency for inequality to decline when a country reaches economic maturity. Rather, increasing inequality is intrinsic to a capitalist economy irrespective of its level of development. For him, it took 'accidents' such as two world wars and a massive depression to disrupt this pattern. Remarkable stuff, but why did he have to trap himself inside a neoclassical modelling straightjacket to explain this? This neoclassical approach is based in the 1950s' Solow–Swan model (whose 'best before date' is long gone), which not only assumed properly competitive markets, but also that the growth rates of inputs such as labour and knowledge, and the GDP share of saving and investment, are constant and *exogenous*. In other words, this is a world where prices are always 'right', where there are no market failures, everybody gets the value of marginal productivities, and there are constant returns to scale and diminishing returns, in finance as well as in manufacturing. Furthermore, an autonomous and *permanent* increase in investment rates is supposed to produce only a *temporary* increase in the growth rate of productivity (people in emerging

³⁵ On tax returns data, see WID (2019) and Alvaredo et al. (2018); and on payroll data, see UTIP (2019).

Asia must think that this is a Western joke). In turn, this theory assumes that the only role for financial markets is to fuel the real economy, and that the rate of depreciation is constant, that is, not subject to shocks such as new technological paradigms. Moreover, in this approach there is no government, no increasing returns on manufacturing, no unemployment or spare capacities, no diversity of goods, no natural resources or institutions, and no Latin American-style oligarchies.

Furthermore, the world of the 1950s that this 'factor shares' theory (rightly or wrongly) tried to disentangle was rather different; profits were made almost entirely in the real economy, and financial markets only had the levels of liquidity they were able to handle without accumulating more risks than was privately, let alone socially, efficient. There were effective financial regulations, tough capital controls, progressive taxation and pro-growth macros. There was also a close symmetry between total corporate capitalisation and the replacement cost of tangible assets: the Tobin's 'Q' hovered around 1, as opposed to the pre-2008 financial crisis level which was well above 2 (Bichler and Nitzan, 2009; Palma, 2009). This growth theory was intended for economies in the 'maturity' stage of a specific industrialisation paradigm — related to automobiles, oil and mass production for mass consumption — and not economies struggling to adapt to a new technological revolution and a rapidly changing international and financial order.

In this neoclassical theory, what mattered most for distribution of income was the link between the capital intensity of production and the share of profits in national income; and the nature of this link depended on the elasticity of substitution between capital and labour. In this framework, this elasticity needs to be greater than unity if an increase in the capital-output ratio is to lead to an increase in the share of profits in national income — and higher inequality.

As Piketty's neoclassical model does not 'fit the facts', the only way left for him to square the circle was by linking the actual increased share of profits in national income since 1980 with a virtual rise in the capital/income ratio and (a non-existent) high level of substitution between capital and labour.

In other words — and against considerable evidence to the contrary — he was forced to assume that we are living in a world in which increasing inequality is due to *too much* real investment and *too much* production flexibility (Harcourt, 2015; Palma, 2016, Rowthorn, 2014; Taylor, 2014, 2020). That is, in this neoclassical logic if one has too much of a good thing (in fact, in this case two good things), one unfortunately ends up with higher inequality. It would be very difficult to put a better spin than this on increasing inequality.

Furthermore, this type of neoclassical logic relies on a methodology and social ontology that assumes that particularly complex and over-determined processes, such as the distribution of income, are just the simple sum of their parts; therefore, their account can be reduced to the description of individual constituents and the algebraic representation of the supposedly simple causality interconnecting them (e.g., $r > g$). Thus, this approach can ignore the complex interactions between political settlements and market failures that define contemporary patterns of inequality.

Piketty also overemphasised the role of wealth destruction during World War II in falling inequality; the US saw a similar decline in inequality to that experienced in Europe, despite the fact that the only wartime destruction on the US mainland was an air attack by Japanese planes on Oregon in 1942.

However, after the publication of his book, Piketty recants: 'I do not view $r > g$ as the only or even the primary tool for considering changes in income and wealth... . 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: 48).

The other spheres that he mentions (institutional changes and political shocks), which he rightly views as *endogenous* to the inequality and development processes themselves, could have helped him address questions such as: can rents make up an ever-increasing share of profits, and growth still be sustainable? What are the effects of a greater bargaining power of rentier capital on negative productivity shocks and other collateral damages? Can the gap between the return on financial and physical capital, or that between productivity growth and wages, continue to increase forever? Can the resulting gap between the average 'r' and the marginal 'r' also continue to grow and grow? And in particular, can the gap between the 'r' for the rich — who can invest more in information, who have better access to financial markets, to political patronage and rents, and who can better mitigate the agency costs of their investment — and the 'r' for the rest (mostly lifecycle savers for retirement) grow for ever?

As mentioned above, despite his unfortunate choice of modelling, Piketty's (2014) analysis of inequality makes at least three invaluable contributions: it shifts the focus to capital, it helps us learn from history, and it provides invaluable new data.

APPENDIX 3: ONE NARRATIVE OF THE DISTRIBUTIONAL CONTRAST BETWEEN THE TWO HALVES OF THE POPULATION; 'COORDINATION' VS 'ANTI-COORDINATION' GAMES

Simple game theory language can help explain the contrast shown in Figure 4 (above) between the distributional dynamics found within the middle and upper-middle, and within the top and bottom deciles. While the distributional homogeneity among the constituents of the administrative classes resembles outcomes of 'coordination games', what emerges from the heterogeneity in the other half is a scenario of 'anti-coordination' games.

An example of the outcome of a coordination game is when players agree which side of the road to drive on. An illustration of an anti-coordination game would be players engaged in 'playing chicken' (i.e., which player yields first) as in the film *Rebel without a Cause*: stolen cars are raced towards an abyss, and whoever jumps out first will be deemed a 'chicken'.

This is an 'anti-coordination' game because the shared resource is understood as *rivalrous* — that is, sharing comes at a cost (subject to negative externalities).

The homogeneity found in the left-hand panel of Figure 4, and the heterogeneity of the other panel, may well reflect these asymmetries, as 'chicken' games are by nature more unstable and their outcomes more diverse, while in coordination games players tend to choose similar or corresponding strategies, leading to positive externalities. For example, the administrative classes, by prioritising the defence of their overall half, do not contest much among themselves on how to distribute that half between the middle and the upper-middle. That is, the strength given by their unity enhances their capacity to build effective political coalitions to defend their half.³⁶ In the other half, by contrast, the perennial rivalry between D10 and D1–D4 could easily lead to negative externalities. From a Marshallian/Keynesian perspective, of course, this does not have to be the case at all, as (for example) increasing wages can be a great incentive for productivity growth, given low elasticities of substitution and positive feedback loops with effective demand. But how to explain that to Latin-style oligarchies, more concerned with defending privileges than with the construction of challenging processes of positive cumulative causations between growth and distribution?

One effective tactic in 'chicken' games is to signal one's intentions convincingly enough, so that the game becomes one of brinkmanship — a

³⁶ In Latin America, mostly by allying with the rich, and in India by allying with the poor: see Di John (2006); Khan (2004); Lieberman (2003). For Chile and South Africa, see below, and Palma (2011).

strategic move designed to avert opponents switching to aggressive behaviour. Since credible threats — no matter how irrational — can be very effective, the set of institutions and rules within which a distributional struggle is played out, which promote the credibility of one or another party, becomes very important. In fact, one way of understanding post-1980 neoliberal transformations is in terms of the creation of an institutional scenario where the brinkmanship of the top — irrational though it may be — should be taken very seriously by workers and the state.

By now it seems clear that these neoliberal transformations had little to do with increased efficiency, and a lot to do with helping capital to regain the upper hand which it had lost in the depths of the 1930s to the determination of FDR, the horror of war, and the genius of Keynes. The new reforms were intended to have a debilitating effect on workers and the state by creating an institutional environment in which life for them would be permanently unstable and highly insecure. In this scenario, a mobile and malleable agent (financial capital) could achieve an unrivalled dominance. In the jungle, capital is king! In this context, any progressive nationalist development agenda, or the exercise of Keynesian forms of state agency capable of (productivity-enhancing) ‘disciplining’ of the capitalist élite, carried the risk of becoming collective suicide pacts.

This brings to mind Foucault’s (2004) proposition that neo-liberalism is not really a set of economic policies but a new, more effective technology of power (see also Frangie, 2008; Palma, 2009, 2014b). For Walter Benjamin (1966), all class society is in a permanent state of emergency because rulers are always under threat; neo-liberalism could therefore also be understood as an ideology and praxis that attempts to create a class society in which rulers escape from this threat by their ability to debilitate the rest of society enough by imposing on them a continuously insecure life.³⁷ So workers are now back to old-fashioned precarious jobs, permanently threatened with transfers of those jobs to low-wage countries; safety nets are increasingly porous; easy access to persecutory debt leads to what Krugman (2005) calls ‘the return to a debt-peonage society’;³⁸ governments have little or no space for policy options; and so on. And the uncertainties of a new technological paradigm have not helped either, giving massive opportunities to financial capital and a few particular skills, while bringing further uncertainties to the majority of workers and the state (Pérez, 2002).

³⁷ On ‘states of emergency’, see Arantes (2007).

³⁸ What Thatcher had in mind was probably not a property-owning democracy, but rather a ‘mortgage-owning’ one.

The bottom line for neo-liberalism is how to reconstruct an economic and institutional scenario in which everybody knows that capital can pull the plug whenever it wants to. Under these circumstances, ideological acceptance of the 'pure' (game) strategy of the rich could be considered 'smart', rather than 'chicken', making such an unfavourable position more bearable. Shared pain can even feel reassuring. As Benjamin also reminds us, before all philosophy comes the struggle for material existence (Thompson, 2013). In developing countries, the challenge for capital to develop more effective forms of legitimacy, and more sophisticated technologies of dispossession, has been even greater. In the new complexities of a post-Cold War scenario, just having a Pinochet or two is no longer enough.

The neoliberal discourse may have burst onto the world stage during the thirst for new ideas in the 1970s, promoting 'order', market efficiency, individual initiative, non-paternalism, sound macroeconomics and a new concept of the state. However, what was ultimately on offer for workers and the state was a permanent life on the edge, and a high-risk and unstable 'order' in which only mobile capital can thrive, with the state mostly reduced to a 'fire-fighting' role. In a way, Keynes was about fighting these types of inefficient and old fashioned 'anti-coordination' games, searching for more efficient and stable cooperative outcomes. The mass production for mass consumption technological paradigm also helped, especially as it was in its mature stage (Mazzucato, 2013, 2018; Pérez, 2002). However, if 'chicken' games turned out to be inevitable, it was imperative to prevent a player prone to 'irrational' behaviour — e.g., financial capital — from getting the upper hand. Oscar Wilde warned us about people who knew the price of everything but the value of nothing.

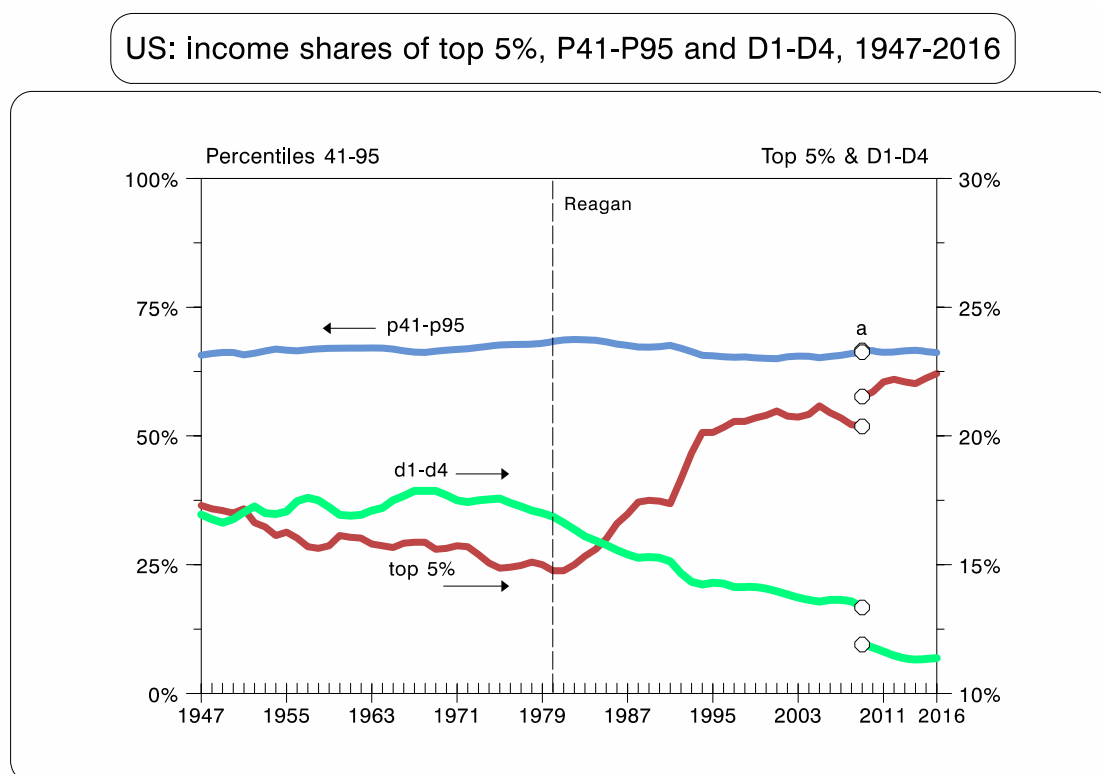
So, perhaps unsurprisingly, what we find in Figure 4 (above) is distributional homogeneity within the administrative classes, and heterogeneity in the struggle between the top and bottom — and the latter is what leads to the diversity of overall inequality across the world shown by the Gini in Figures 1 and 2. The sequence of distorting mirrors and veils that characterise inequality tend to blur this fundamental fact.

APPENDIX 4: HAS THE HOMOGENEITY OF THE MIDDLE AND UPPER-MIDDLE BEEN STABLE OVER TIME?

As mentioned above, the limited historical data available indicate that, at least for high-income OECD countries and some middle-income ones, the income share of D5–D9 has been fairly stable over time. In the case of the US, for example, the

stability in the middle vs. the instability at the tails tends to have some clear past-dependency roots (Figure 15).

FIGURE 15



- Unfortunately, these data sets do not provide information for D10. **a** = change of methodology. **p** = percentile. 3-year moving averages.
- *Sources:* from 1947 to 2009, US Census Bureau (2010); and from 2005 to 2016, US Census Bureau (2018), with a changed methodology.

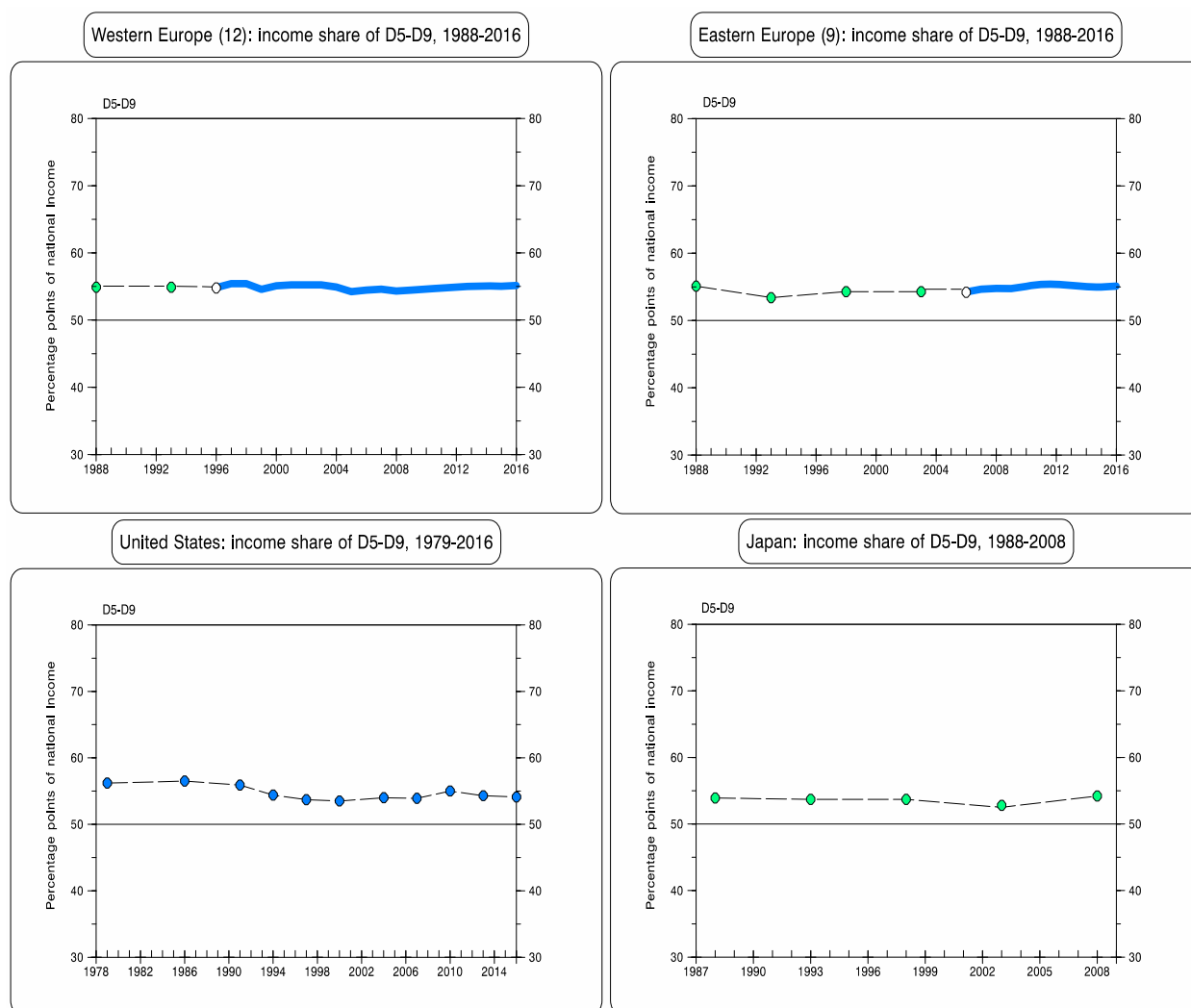
Since, surprisingly, the US Census Bureau only reports quintiles and the top 5 per cent, I have no choice in Figure 15 but to divide the population in a slightly different way than I would have preferred (top 5 per cent, and enlarged middle and upper-middle which now contains percentiles 91–95, and bottom 40 per cent).³⁹ This reveals the changing fortunes of the top 5 per cent and bottom 40 per cent: starting in 1947, when both had the same income share of about 17 per cent, the bottom 40 per cent initially improved their lot at the expense of the top 5 per cent — a degree of civilisation that would be unimaginable today! Later, and especially after the stagflation that followed the 1973 oil shock, the top 5 per cent began ‘the revenge of the rentier’. This gathered pace in 1979 with the Federal Reserve’s radical monetarism and Reagan, and by 2016 it had over 11

³⁹ When doing the same in a previous paper (because of the same data restrictions), it led to an absurd confusion among some critics, who asked whether the homogeneous middle and upper-middle was D5–D9 or some other larger group.

percentage points more than the bottom 40 per cent. However, the 55 per cent making up the 'enlarged middle' (percentiles 41–95) appropriated a stable share throughout — not affected by all the many political and economic shocks in between, or even by the change in methodology.

Thus, in the US, the last 40 years seem to have been associated with two distributional dynamics: a (better-known) 'centrifugal' force in terms of the income shares of the top and bottom deciles, and a (lesser-known) stability of the income share of this slightly enlarged middle and upper-middle. Again (as above), there is not much evidence of the so-called 'disappearing middle'; rather, we find a middle and upper-middle with a remarkable capacity to hold its own. Other data sets indicate a similar stability in the share of the middle and upper-middle in OECD countries and Eastern Europe (see Figure 16).

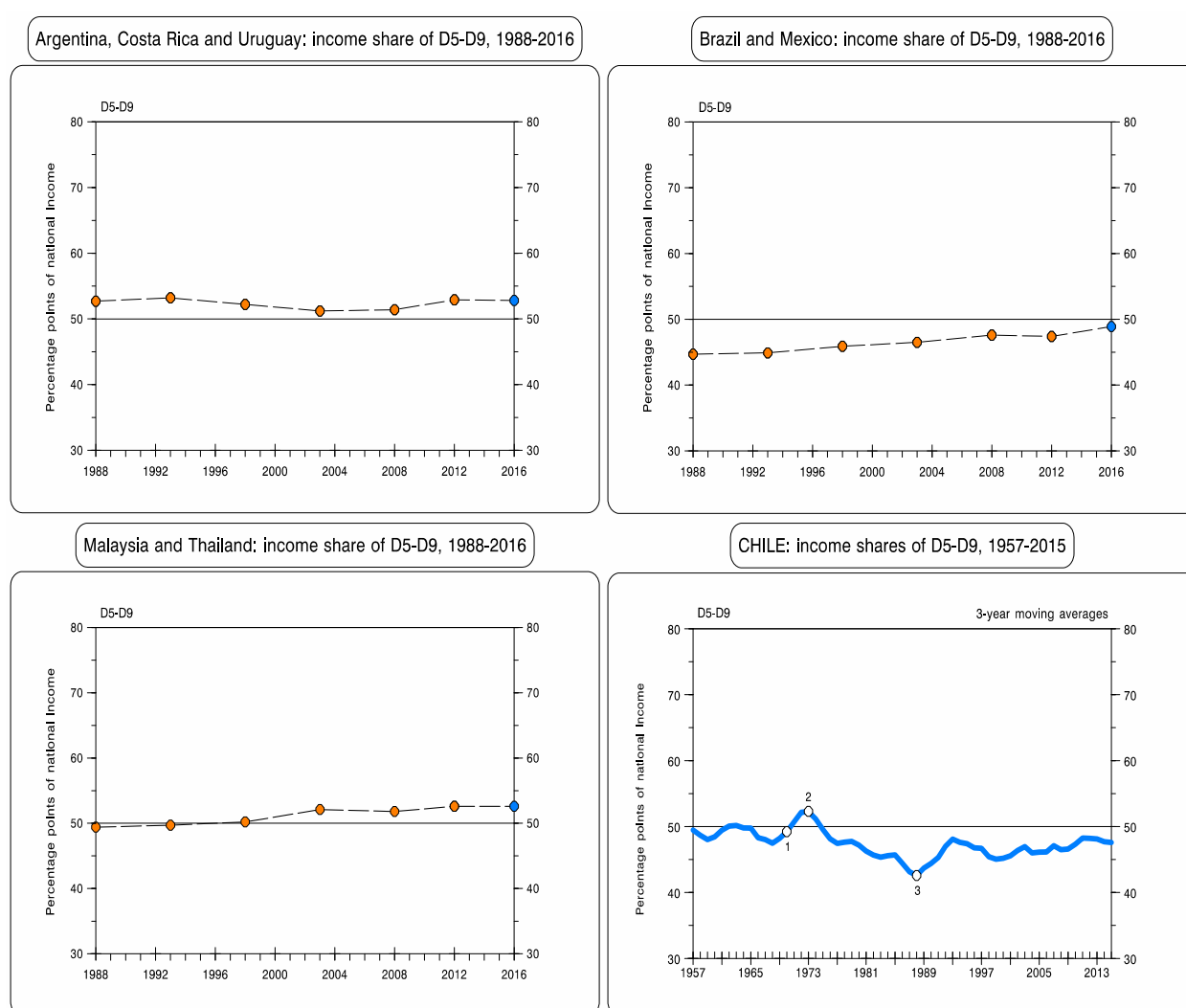
FIGURE 16



• *Sources*: for the US, all years for which WDI (2019) provides information (note that the source for the US is different in this figure than in Figure 15); for Europe, Eurostat (2019); for Japan (and for the period before which Eurostat provides information), WPID (2013; 5-year interval data).

Furthermore, the little information we have indicates that in many developing countries the relative stability of D5–D9 around 50 per cent also holds; and where it does not, in some countries there is a centripetal movement towards the ‘50–50 rule’ (50 per cent of the population in the middle and upper-middle getting at least 50 per cent of national income). The former applies to some Latin American countries that had already reached the ‘50–50’ level in the 1980s (Figure A4.3, top left-hand panel) — and again, this stability has taken place despite massive upheavals — while the latter is found in unequal countries such as Brazil and Mexico, as well as Colombia, Ecuador, Guatemala, Honduras, Paraguay and Peru (Figure 17, top right-hand panel).

FIGURE 17



• **1** = election of Allende; **2** = 1973 coup d’état; **3** = Pinochet loses his plebiscite to remain in power. Data on Chile in 3-year moving averages.

• *Sources:* for Latin America (except Chile) and East Asia c. 2016, WDI (2019); WPID (2013) before that. In the case of Chile, calculations done by Pamela Jervis using FACEA (2012); includes ‘Greater Santiago’, or about 40 per cent of overall population; see Palma (2016).

Due to this 'centripetal' movement in Latin America, its average D5–D9 has now finally reached the 50–50 mark. The same has happened in some countries of other regions, such as in Malaysia and Thailand. Finally, Chile indicates that the share of D5–D9 can also be fragile to major political turmoil. First, until the election of Allende in 1970 this share hovered around 50 per cent. Then, during his short presidency, it increased to 53 per cent, only to collapse to 43 per cent at the end of the long dictatorship. Finally, with the return to democracy, this share recovered but settled just below 50 per cent. Unfortunately, lack of data makes it difficult to look at other developing countries for a similar period of time, but Chile indicates that the income share of D5–D9 is not immune to major political and economic shocks. In sum, there is strong evidence from some countries of a stable D5–D9, and of some catching up to the '50–50' rule as well — but not assured immunity against brutal shocks.

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