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INEQUALITY

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ABSTRACT

This paper reviews five striking facts about inequality across countries. As Kuznets (1955) famously first documented, inequality first rises and then falls with income. More unequal societies are much less likely to have democracies or governments that respect property rights. Unequal societies have less redistribution, and we have little idea whether this relationship is caused by redistribution reducing inequality or inequality reducing redistribution. Inequality and ethnic heterogeneity are highly correlated, either because of differences in educational heritages across ethnicities or because ethnic heterogeneity reduces redistribution. Finally, there is much more inequality and less redistribution in the U.S. than in most other developed nations.

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1. Introduction

The insight that economics impacts politics as much as politics impacts economics lies at the heart of political economy. This circle of causation is at the center of research on the political economy of inequality. Democracy, political stability and executive constraints all appear to be more feasible in more equal societies. Public policies towards redistribution and human capital can make societies more equal.

In Section II of this paper, I review the causes of inequality. Recent increases in inequality in the developed world are in part the result of skill-biased technological change (Katz and Murphy, 1992), but government policies influence how these technological changes impact different developed countries (Hanratty and Blank, 1992). Long-standing differences in inequality across countries may reflect colonialism and patterns of agriculture, but initial differences in inequality also influenced political institutions, policies, and structures, which may have exacerbated economic inequality (as in Moore, 1966, Engerman and Sokoloff, 2002).

In Section III of this paper, I review the second half of the causal chain between inequality and politics— the impact of inequality on government. In medial voter models, inequality predicts more redistribution. However, greater inequality can mean that the wealthy have more resources which can be used to reduce influence. Great gaps between rich and poor may also hurt democracy and rule of law if elites prefer dictators who will protect their interests or if the disadvantaged turn to a dictator who promises to ignore property rights.

In the last section of this review essay, I turn to the special question of "American Exceptionalism," which in this context refers to the question of why there is so much less redistribution and more inequality in the U.S. than in Europe. The differences between the U.S. and Europe in inequality and redistribution have troubled authors like Friedrich

Engels, Werner Sombart and Martin Lipset for more than a century. American exceptionalism appears to be the result of ethnic heterogeneity and European political institutions, which have been influenced by numerous revolutions and two World Wars. A large body of evidence supports the hypothesis that ethnic heterogeneity reduces support for welfare, and the U.S. is far more ethnically heterogeneous than Europe. The U.S. also has political institutions including a majoritarian government, federalism, and checks and balances which have limited the expansion of the American welfare state, while European countries lack comparable institutions. These institutional differences are not exogenous, but rather reflect the fact that many European constitutions were rewritten by left wing politicians when earlier monarchies were defeated militarily.

2. The Political and Economic Causes of Inequality

Most studies of inequality focus of income, but inequality can also be calculated based on wealth, consumption or any other reasonable proxy for well-being. Wealth or consumption have the advantage that they are less subject to short term income shocks, and the inequality of lifetime earnings is probably more important than the inequality of transitory earnings. However, because wealth and consumption data are not available in enough circumstances, most of the empirical work focuses on inequality of annual income. Consequently, I focus my empirical discussion on that variable. Nevertheless, improving inequality measures by improving the measurement of permanent well-being is certainly one research frontier.

Measuring income inequality also requires transforming the distribution of income or wealth or consumption into a single measure that can be used in standard empirical work. The literature on this issue parallels the industrial organization literature on market concentration. The most popular measure of income inequality is the Gini coefficient which is the difference between the 45 degree line and the Lorenz curve that shows the cumulative distribution of income. A second measure is the share of total national income possessed by various subgroups of the population, i.e. the share of total wealth owned by the richest 5 percent of the population. In some cases, these variables will actually reveal much more than a Gini coefficient, especially if we are interested in knowing whether inequality matters because the rich are particularly rich or because the poor are particularly poor. As different measures are usually highly correlated, different empirical studies that use these different measures often produce quite similar results (e.g. compare Persson and Tabellini, 1994, with Alesina and Rodrik, 1994).

Inequality over Time

These empirical measures are then used by empirical researchers, who have provided a series of facts about the correlates of inequality. Perhaps the most famous relationship is the Kuznets (1955) curve shown in Figure 1. Income inequality first rises and then falls as countries get richer. This curve points to the initial period of industrialization as the point of development where inequality is maximized. Indeed, U.S. history shows a "great compression" during the middle decades of the 20th century (Goldin and Margo, 1992) as the relatively equal period between 1950-1975 followed the far greater inequality of the Gilded age and pre-depression America. Figure 1 also illustrates American exceptionalism as the U.S. is much more unequal than other countries of comparable income.

The Kuznets curve is not just an economic phenomenon; it also reflects political factors. The general pattern in industrializing nations is that there are few public efforts to redistribute during early industrialization. During this period, traditional private providers of charity (churches, charities, families) are expected to look after the bottom end of the income distribution. As industrialization proceeds, governments almost universally started taking a more active role in redistribution, which is one reason why inequality declines with development. Development increases redistribution for at least three reasons: development is generally associated with greater government size, probably due to increasing governmental competence; development is associated with greater education and political skill on the part of poorer citizens, and development transforms a dispersed agrarian workforce into clustered industrial workers who can readily be organized.

Somewhat surprisingly, given the Kuznets curve, the great compression was followed within the United States, and elsewhere, by a significant increase in inequality since 1975. Katz and Murphy (1992) conclude that the period of rising inequality in the U.S. appears to be have been driven by rising demand for more skilled workers. The rise in demand for the skilled might be the result of a number of different changes including skill-biased technological change, increasing trade and globalization, the decline of manufacturing, and unions. Pride of place appears now to be given to changing technology (Autor, Katz and Krueger, 1998) as the cause of greater inequality, but other factors also matter.

While most authors seem to believe that rising inequality within the U.S. is the result of economic as opposed to political changes, the impact of these economic changes is determined in part by a political filter. Technological changes and increases in world trade should impact most developed countries in similar ways. Yet the U.S. has experienced a much more striking increase in inequality than most other comparable countries (Picketty and Saez, 2003, Blau and Kahn, 1996, Hanratty and Blank, 1992), and economic forces alone do not appear to explain why inequality rose so much more within the U.S.

Political factors surely played some role in the greater increase in inequality with the U.S. At the top of the income distribution, less progressive taxation in the U.S. made it easier for Americans to become rich and increased the incentives for Americans to acquire large fortunes (Picketty and Saez, 2003). Stronger unions and centralized bargaining in Europe increased equality there among industrial and other middle income workers (Blau and Kahn, 1996). Unions have generally fought inequality among their members, perhaps because heterogeneity breaks down union cohesion or because of the quasi-democratic nature of most unions. At the bottom of the income distribution, general unemployment benefits and restrictive labor market regulations ensure that more of the less productive European workers leave the workforce and are therefore excluded from measures of wage inequality.

Inequality across Countries

If changes in inequality within the U.S. and other countries are primarily the result of changing returns to skills and government responses to those changing returns to skill, differences in inequality across countries are more often caused by differences in the distribution of skills. In particularly egalitarian countries, like in Scandinavia, the population is generally well educated and the distribution of skills is quite compact. Conversely, particularly unequal developing countries like Brazil have enormously heterogeneous skill levels between educated urban elites and less educated agricultural workers.

But if the inequality of skills underlies the inequality of income, then the primary puzzle becomes understanding why skill inequalities are so different across country. Skill levels today are themselves result both of government policies, and long-standing cultural forces, like religion or ethnicity, but patterns of national inequality appear to predate the era of large-scale government schooling (the 19th century). As high levels of inequality often predate significant government redistribution or schooling, cultural, and religious causes are probably the first causes of inequality across countries.

Protestant churches sought legitimacy in the Bible (as opposed to the traditions of the Catholic church) and these churches encouraged literacy to increase familiarity with the Bible (Weber, 2001). Protestant communities worked to create widespread education that would ensure that everyone could read, which increased both the level of education and decreased its variance by raising the lower tail of the distribution.

More importantly, skill inequality seems to come mostly from the juxtaposition of ethnicities with different educational traditions, and in particular the extent to which new world countries are made up primarily of Europeans or of mixtures of Europeans and non-Europeans. As Figure 2 shows, the correlation between ethnic fractionalization and income inequality is quite strong. Europeans who came to the New World had a significant educational advantage over the natives they conquered, at least in terms of skills that became valuable in developed economies. Even the great empires of the pre-Columbian Americas lacked basic modern skills; the Incas had no alphabet.

Inequality then depends significantly on the extent to which nations are populated by Europeans or mixtures of Europeans and natives. Engerman and Sokoloff (2003) argue that countries with a comparative advantage in cash crops, such as sugar or tobacco, attracted small numbers of Europeans who then relied on local and slave labor to farm these crops. Those countries are less equal to this day. Acemoglu, Johnson and Robinson (2001) argue that settler mortality determined whether countries attracted large European migrations (which then largely eradicated the existing native populations) or smaller scale migrations that then interacted with native and slave labor. Galor, Moav and Vollarth (2004) present a more general theory of land distribution and long run inequality.

If populations with heterogenous educational backgrounds are the initial condition determining modern inequality, the actual distribution of income today also depends on a large number of government policies towards schooling and redistribution since that point. Many Asian countries, which once had small European elites and large masses of uneducated natives, are now both well educated and egalitarian. These transformations reflect the results of government policies towards education in countries like Singapore, Taiwan, and South Korea. By contrast, initial skill differences in countries in ethnically heterogeneous countries were often widened, not eliminated, by subsequent educational policies which favored the European elites.

Figure 3 shows the strong negative correlation between inequality and social welfare spending across countries. This correlation reflects both that social welfare reduces inequality and more initial inequality leads to less redistribution. While some of this relationship reflects reverse causality, and omitted variables (like income and fractionalization) that drive both variables, there is little doubt that governments do have the power through tax policy and through spending to alter the income distribution of their country.

Understanding income inequality across countries also requires understanding the reasons that a government decides to invest in its children, or to invest in redistribution more generally. Two factors, apart from inequality itself, appear to be important: ethnic heterogeneity, and political institutions. Ethnic and racial fractionalization limits the tendency to redistribute income either because people are less willing to support transfers to those who are ethnically different, or because ethnic differences provide a means of demonizing policies that help the poor (Alesina and Glaeser, 2004). Individual data on opinion polls and voting behavior, cross-state outcomes within the U.S., cross-national data, and history all support the view that ethnic heterogeneity reduces redistribution. Luttmer (2001) shows that people are more likely to support redistribution when they live around poor people of the same race and less likely to support redistribution when they live around poor people of a different race. Holding income constant, there is also a huge impact of race on the willingness to support redistribution and vote democratic, suggesting the significance of race in politics.

Across states within the U.S., the percentage of the population that is black strongly predicts less generous welfare systems and across countries, ethnic fractionalization strongly predicts less redistribution; across countries, redistribution also declines with ethnic heterogeneity (Alesina and Glaeser, 2004). The history of redistribution within the U.S. points to the importance that race has played at several critical junctures, such as the fight against the Populists in the 1890s (see Woodward, 1955).

Political institutions, like proportional representation and majoritarianism, also impact the level of redistribution (Persson and Tabellini, 2003, Miles-Feretti, Perotti and Rostagno, 2002). This literature suggests that majoritarianism induces governments to cater to the needs of the median voter, while proportional representation ensures the election of representative who may be particularly focused on the desires of the poor for more transfers. Likewise, federalism limits redistribution because out-migration of capital and the wealthy serves as a break on the tendency to redistribute income (Qian and Weingast, 1997), except if the government actually wants the rich to flee because the rich represent its electoral opponents (Glaeser and Shleifer, 2004). Checks and balances are another force that has tended to restrict the growth of welfare states.

While there is little doubt that political institutions do matter for the level of redistribution in society, the greater question is whether these institutions should be taken as first causes or as endogenous factors that reflect deeper social forces (Glaeser, LaPorta, Lopes-De-Silanes and Shleifer, 2004). Political institutions are hardly all that permanent. France acquired proportional representation in 1946, with the Fourth Republic, lost it after the failed right wing coup that ended that government and put DeGaulle in power, re-acquired it under Mitterand and then lost it when the socialists realized that proportional representation was helping right-wing extremists. The relative stability of Anglo-American traditions has often led scholars to vastly overstate the degree to which political institutions are durable. I will turn to the causes of institutional change in Section IV when I compare the U.S. and Europe.

3. The Impact of Inequality on Politics

There are three different ways in which inequality might impact political outcomes. First, rising inequality should impact inequality even within a median voter framework, where rising inequality leads to a greater desire for redistribution. Second, higher inequality might reduce redistribution and public good provision because economic resources determine not only preferences, but the ability to influence political outcomes as well. Third, economic inequality might influence the whole structure of political institutions (like democracy) themselves.

The most straightforward prediction of the median voter literature (summarized by Londregan in this volume) is that redistribution will be popular when the mean income is higher than the median income (Meltzer and Richard, 1981). If income follows a Pareto distribution, then an increase in variance will be associated with an increase in the gap between mean and median income. Two of the more influential papers that examine inequality within a median voter context are Persson and Tabellini (1994) and Alesina and Rodrik (1994), which both argue that greater inequality will lead to greater preferences for redistribution, and show a negative empirical connection between inequality and growth.

The open question with these papers is whether inequality actually increases redistribution. As shown in Figure 3, empirically there is a strong negative relationship between inequality and social welfare spending, which seems to contradict this claim. While this negative correlation might reflect that more redistribution reduces inequality, it is also possible that more inequality leads to less redistribution rather than more because in unequal societies the poor lack the resources to push their political agenda.

The median voter model also can explain a connection between inequality and public good provision. Greater inequality should work like any form of heterogeneity and decrease the demand for common public goods (Alesina, Baqir and Easterly, 1999). For example, the rich might want a legal system focused on protecting property while the poor might be more concerned with preventing interpersonal violence in disadvantaged areas. Because these groups disagree, there is less willingness to invest in a common legal system than there would be if the population shared a common set of legal needs.

This is certainly one interpretation of the finding that crime is higher in more unequal societies (Fajnzylber, Lederman and Loayza, 2002). One natural interpretation of this connection might be that as inequality rises, the returns to crime increase for the poor (because rich victims because richer) and the opportunity costs of crime are lower (because the poor are poorer). Another interpretation is that more unequal societies have less policing, which does appear to be the case. For example, there are 12,000 police officers in Bogota, Columbia, and 28,000 police officers in New York City. These two cities have similar populations, but Columbia is a particularly unequal nation.

While the most cited papers on inequality and policy outcomes have focused on results within a median voter context, inequality of resources will also change the political clout of different groups. Indeed, the most important impact of inequality may be changing the power with which the rich and poor can impact outcomes. For example, if the rich can influence political outcomes through lobbying activities or membership in special interest groups (Prat in this volume discusses the influence of pressure groups), then more inequality could lead to less redistribution rather than more. This negative correlation can be seen in Figure 3. According to this view, as the rich become richer, they acquire a greater ability to influence policy and achieve the policy goals that they want.

Glaeser, Scheinkman and Shleifer (2003) provide one connecting inequality of resources with the ability to manipulate political institutions. This model focuses on bribing judges. It suggests that when the judicial system is sufficiently weak, so that the expected penalty facing a judge who accepts a bribe is small, then the ability to bribe will determine the outcome in court. This work emphasizes the subversion of legal and political processes and argues that this subversion will be more likely in societies where different actors have unequal access to the resources needed for subversion. Inequality may lead courts to break down or, as in the Engerman and Sokoloff examples, rich magnates may use their economic power to make a mockery of popular democracy.

These arguments are related to a third literature on the connection between inequality and political outcomes which emphasizes that inequality will lead to different political institutions, and in some cases less democracy (the Przeworski chapter in this volume discusses the determinants of democracy). Indeed, stable democracy is much more common in highly equal societies. Dividing the world into more and less equal countries based on World Bank Gini coefficients shows that 95 percent of the more equal countries are classified as democracies by Jaggers and Marshall (2000) and only 75 percent of the less equal societies are classified as democracies.

While the correlation between inequality and democracy might be the result of reverse causality where democracy reduces inequality, Engerman and Sokoloff (2002) provide compelling historical evidence showing that initial inequality seems to deter the development of democracy in the new world. Inequality, which was itself the result of long-run economic factors, led many seemingly progressive groups to oppose extending the franchise. Educated urban workers feared extending the franchise in many cases because this would empower rural magnates who would totally control the votes of their poor employees.

There are many models that predict a causal link between equality and democracy. It may be that in less equal countries, elites are less willing to share power with the poor because of fear of expropriation. Alternatively, potential enemies of democracy may find it easy to build support among the poor. While there is a great deal of history providing support for both phenomena (Finer, 1962), little empirical work exists to assess the relative importance of the different stories.

Inequality is not only correlated with dictatorship, but also with other measures of political problems. For example, Figure 4 shows that inequality is positively correlated with subjective assessments of the risk of governments expropriating private wealth. Most similar measures of property rights protection show a negative correlation with inequality. You and Khagram (2004) indeed find a connection between inequality and corruption. Again, causal inference is impossible but these correlations are strong and suggestive and they at least raise the possibility that inequality may be causing bad government.

4. American Exceptionalism

Few topics in the political economy of inequality have as rich a heritage as the study of American exceptionalism— why the U.S. is less equal than Europe and why the U.S. never developed a full fledged European welfare state. Although DeToqueville (1835) is rightly seen as the first scholar of American exceptionalism, the modern literature really begins with Friedrich Engels (1959) and Werner Sombart (1976) who asked "why is there no socialism in the United States." Seymour Martin Lipset (1966) continued this tradition and became the expert in understanding why socialism never flourished within the U.S.

Economic, political, and sociological factors could all potentially explain American exceptionalism. The economic explanations focus on the allegedly higher levels of economic opportunity within the U.S. Americans do believe that they live in an open society, and Europeans believe that they live in a closed society. After all, only 29 percent of Americans surveyed believe that the poor are trapped in poverty while 60 percent of Europeans believe that the poor are trapped. 60 percent of Americans believe that the poor are lazy, while only 26 percent of Europeans share that belief (Alesina and Glaeser, 2004).

But there is little reality behind those views. Gottschalk and Spolaore (2002) look at income mobility in the U.S. and Germany and find that 60 percent of the members of the bottom quintile of the income distribution in the U.S. in 1984 remained in that quintile in 1993, while only 46 percent of Germans in the bottom quintile of their income distribution remained in that bottom quintile 9 years later. Checchi, Ichino and Rustichini (1999) find similar results when comparing intergenerational mobility in the U.S. and Europe. Alesina and Glaeser (2004) survey a wide range of evidence and find little evidence supporting economic explanations for American exceptionalism. In the next section, I will discuss why views about economic mobility differ so much between the U.S. and Europe when reality doesn't look all that different.

Standard median voter theory provides little ability to explain the differences between the U.S. and Europe. The U.S. income distribution is more variable and skewed to the right than the European income distribution. In a standard median voter model, both of these factors predict that there should be more redistribution in the U.S., not less. There is no evidence that the U.S. tax system is more inefficient than European tax systems. Privately, Americans are much more generous than their European counterparts, so it is hard to believe that the lack of an American welfare system just reflects some lack of American generosity.

Two factors appear to explain America's low level of redistribution and greater level of inequality: ethnic heterogeneity and political institutions. As I discussed above, ethnic fractionalization appears to be strongly correlated with low levels of redistribution across countries, and America is far more ethnically heterogeneous than Europe. European countries are remarkably homogenous, either because nations engaged in strong homogenizing policies or because current nations reflect ethnically homogenous areas that broke away from former empires. America is a nation of immigrants and kidnapped slaves, and there has never been a policy of homogenization comparable to that followed in France, for example, in the late 19th century.

The importance of ethnic fractionalization is not only seen in cross-national regressions. As mentioned above, there is a significant correlation between the percentage of the population that is black in a state and less generous welfare payments. Opinion polls within the U.S. also confirm the role of race in attitudes towards redistribution. Perhaps most convincingly, there is abundant historical evidence showing the role that racial divisions have played in stemming the rise of the American left. The New York City Draft riot, which was America's bloodiest riot and labor uprising, petered out in part because the German rioters turned on the Irish. In the 1870s and 1880s, conflicts between natives and immigrants bedeviled the labor movement. In the 1890s, Southern conservatives used racism to discredit their populist opponents whose policies would have enriched poor blacks. In 1928, anti-Catholicism was used against Democrat Al Smith in the 1928 election. In the 1960s, the powerful Democratic political coalition fell apart over issues of race and civil rights in the South. Racial divisions do not automatically breed dislike, but they do make it possible for political entrepreneurs to build distrust and even hatred.

Using the coefficient from an international regression where redistribution is regressed on ethnic heterogeneity and other controls, the differences in ethnic heterogeneity between the U.S. and Europe can explain one-half of the difference in redistribution between these two regions. Of course, the view that America's ethnic fractionalization explains the lack of redistribution is not new. Friedrich Engels himself emphasized the divisions between natives, immigrants and blacks as a reason why America didn't have a socialist party.

But racial heterogeneity is not the only reason for American exceptionalism. There are a number of differences in political institutions between the U.S. and Europe that also help explain the smaller U.S. welfare state. As discussed earlier, there is a strong link across developed countries between proportional representation and the level of redistribution. This link shouldn't surprise any student of European history—in the early 20th century, workers' parties regularly lobbied for the introduction of proportional representation because they thought that this would strengthen their electoral chances. Using the coefficient on proportional representation from cross-country regressions, the difference in this one institution between the U.S. and Europe can explain the smaller U.S. social welfare state (Alesina and Glaeser, 2004).

The strong relationship between proportional representation and redistribution across countries reflects more than just a causal effect of this one institution. Proportional representation tends to accompany a wide range of institutions which together supported the rise of the welfare state in Europe, and American majoritarianism is accompanied by many other political institutions which have helped stem the growth American redistribution. For example, U.S. traditions of federalism which gave power of welfare to the States seem to have checked the rise of welfare spending as states limit redistribution to keep rich people in and poor people out. Checks and balances within the U.S., which are often weaker in many European countries, also appear to check the growth of redistribution. In the 1930s, the conservative bloc in the Senate (combining Southern Democrats and Northern Republicans) blocked the continuing expansion of the New Deal. In the 1990s, the interactions between Gingrich's house and Clinton's presidency ended "welfare as we know it."

America also has institutions that are not particularly democratic and that represent past political views more than current popular enthusiasms. Both the Senate and the Supreme Court have at various times presented serious roadblocks to the growth of the American welfare state, particularly in the 1930s, but also in the 19th century when the Supreme Court repeatedly declared that the income tax was unconstitutional. In the late 20th century, conservative railed against a liberal activist court, but prior to 1950, the Supreme Court was a steady break on the growth of government regulation, taxation and redistribution.

While there seems little doubt that American political institutions help us to understand why the U.S. has much less redistribution and more inequality, these institutions are themselves hardly the root causes of the differences across the Atlantic. Institutions are rarely the first causes of anything, but rather just reflect more exogenous differences between countries. A comparison of European and American political institutions in 1870 would surely tell us that the U.S. has the most liberal, not the most conservative, institutions among wealthier countries. The United States had widespread suffrage and gave more power to popular democracies than most European nations. France had an Emperor, Prussia its King and even England had a powerful entrenched House of Lords. In the 19th century, the U.S. had institutions that were particularly progressive, not particularly conservative.

The big difference in political institutions between the U.S. and Europe is the result of radical change of political institutions in 19th century Europe and the relative stability of the U.S. Almost every major country in continental Europe had either a full-fledged revolution (as in Germany, Austria, Portugal, Russia), a general strike whose impact was quasi-revolutionary (as in Belgium, Sweden, Finland, Switzerland), a civil war (Spain), or a post-war constitutional revision that completely revamped pre-existing institutions (France, Italy). Some European countries had more than one of these events.

In small, dense countries, these violent uprisings succeeded in forcing institutional chane even without externally produced chaos. Belgium, Finland and Portugal all revamped their institutions (and established proportional representation) before the First World War. In larger countries, big armies made up of soldiers who were socially isolated from strikers or revolutionaries served to repress domestic uprisings before 1914. The real watershed was the First World War, when ancient dynasties were first defeated in battle and then upended by domestic uprisings. Demoralized armies that were made up of civilian draftees rather than professional soldiers were unwilling or unable to suppress revolution or strikers in Russia, Germany, Austria-Hungary, Turkey, and Italy. As left wing groups gained control at the expense of defeated dynasties, they crafted political institutions that would entrench left-wing power for decades to come. The European welfare state is, in many cases, built on political institutions which are the legacy of the chaos and defeats of 1918.

The U.S. then is exceptional, not because it lacked violent strikers or because it lacked a labor movement, but rather because these groups were unable to force change in the American constitution through strikes or revolutions. In the late 19th century, in the New York City Draft riots, in the Homestead strike, and in the Haymarket riots, police and Pinkertons successfully stopped uprisings. Moreover, because of America's vast size, these uprisings happened far from the corridors of power, so they did not really threaten America's political leadership. In the 20th century, when the Bonus marchers moved on Washington, the undefeated, professional America easily dispersed these straggling veterans with force. America kept its 18th century constitution, with its strong respect for property rights, because the country did not lose a war on its home soil and the forces of the government were always easily up to the task of repressing left-wing uprisings. In Europe, political institutions reflect the chaos of 20th century Europe and the power of socialist forces during that chaos.

Beliefs about Inequality

This discussion still leaves one final puzzle: why do Americans and European have such different beliefs about the nature of inequality in their countries. Why do sixty percent of Americans believe that their poor are lazy and have tremendous opportunities, while sixty percent of Europeans believe that the poor are trapped? There is no evidence suggesting that the American poor work less hard than their European counterparts. Indeed, far from being lazy the bottom quintile of the American income distribution works far more hours than their counterparts in many European countries.

Differences in mobility rates or hours worked do not explain the differences in beliefs. A far better explanation is that beliefs about inequality and its sources reflect the steady indoctrination of schools and political leaders. Left-wing leaders find it in their interest to convince people that the poorer beneficiaries from left-wing policies are good people sadly beset by forces outside of their control. Right-wing leaders find it equally in their interest to convince people that the poor are cheats and wastrels and that money spent on welfare is useless spending on morally deficient individuals.

There is abundant evidence that in schools, speeches, and writing, Americans have regularly heard the message that they live in a land of opportunity. Interestingly, Europeans who lived in the right wing regimes of the 19th century heard the same thing. The textbooks of the French Third Republic featured a shoemaker named Gregoire who was working his way up the social ladder. The Kaiser was just as adamant that his schools teach people that working hard will lead to success. The difference between American and European indoctrination appeared with the triumph of the European left. Already in the 1890s, German teachers' unions fought with the Kaiser to teach a different ideological message. In the aftermath of the First World War, schools in Europe came to steadily spread Marxist messages of class immobility and consciousness.

As such, beliefs about income mobility and inequality reflect indoctrination and the political success of the right in the U.S. and the left in Europe, more than they do anything about reality. This final point provides a fitting caution with which to end this essay. Much of the academic discussion of inequality is based more on ideology and indoctrination than on reality. Much of the hostility towards inequality (especially the wealth of the very rich) reflects political objectives more than hard academic research about actual costs of that inequality. Likewise, those who argue that using redistribution to fight inequality will seriously destroy economic growth, often reflect their political preconceptions more than empirical evidence. Hopefully, future research on inequality will focus more on objective truth and depend less on the ideological orientation of different researchers.

5. Conclusion

Inequality remains a fascinating topic of research. Across countries, inequality levels differ wildly and inequality is correlated with a number of important variables. Inequality appears to be determined by the level of development in a non-monotonic manner. Inequality also seems to be the result of ethnic heterogeneity, which impacts inequality both directly, since different ethnicities have different skill levels, and indirectly through political channels, as people seem less eager to transfer money to people from a different ethnic group. Inequality is correlated with dictatorship and with governments that fail to respect property rights. These correlations at least raise the possibility that inequality is actually a causal variable that leads to worse political outcomes, but we are far from confident that causality runs from inequality to politics.

The implications of inequality research for public policy are far from clear. Alesina and Rodrik (1994) suggest that inequality deters growth because inequality leads to costly redistributionary policies. Even if this were the right interpretation of the small inequality-growth correlation, then it would hardly make sense to try to fight inequality with redistribution since, according to this model, redistribution is the problem that inequality creates. The literature on the political economy of inequality does not give clear answers on policies, but it does suggest that shifts in inequality may influence polities in far-ranging, substantial, and often unpredictable ways.

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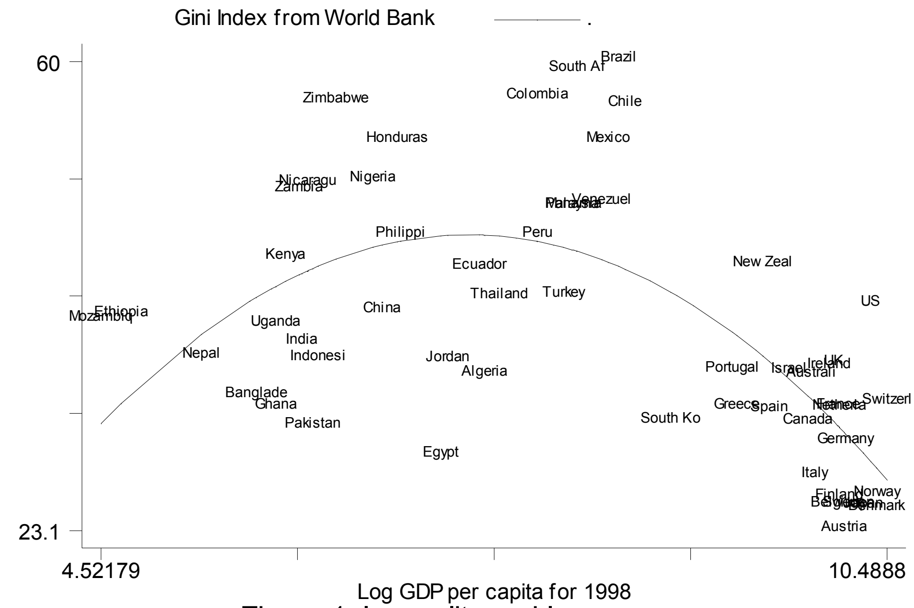

Figure 1: Inequality and Income

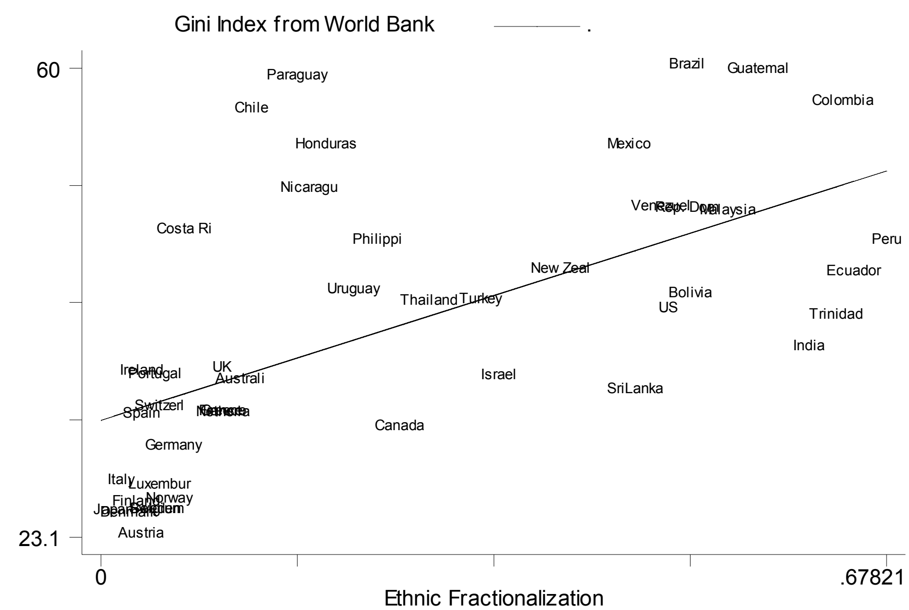

Figure 2: Fractionalization and Inequality

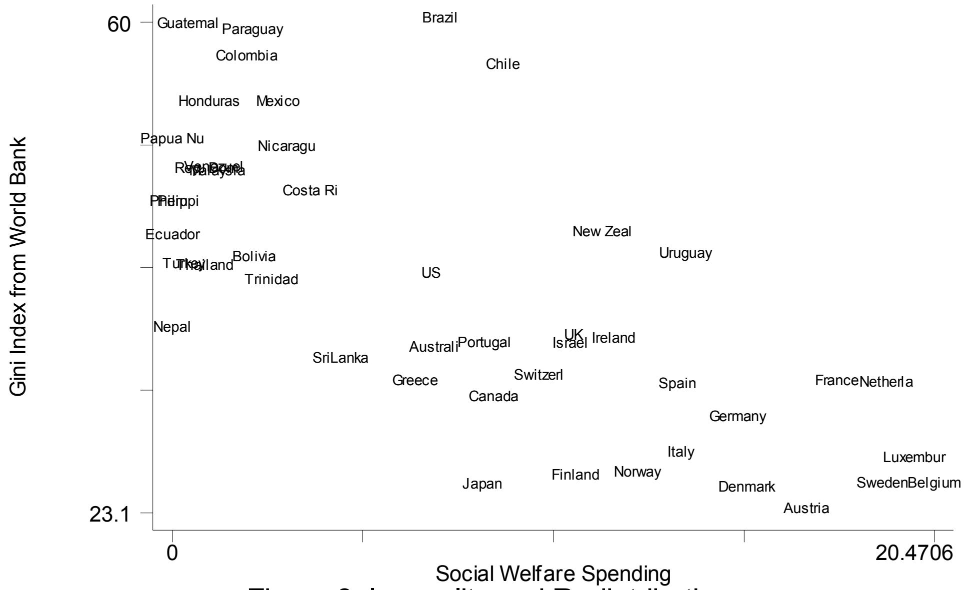

Figure 3: Inequality and Redistribution

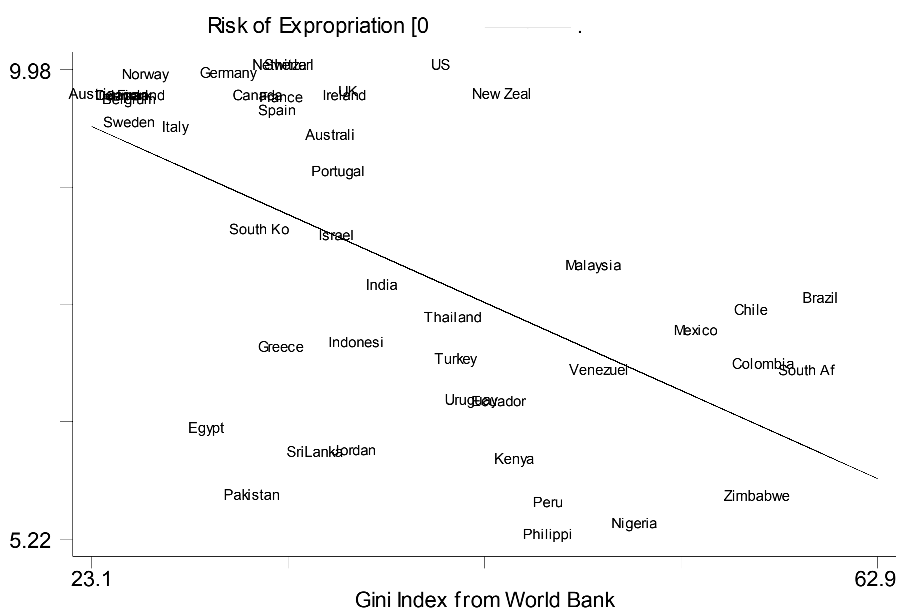

Figure 4: Inequality and Expropriation