Four models of growth and inequality

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1.1 Introduction

The issue of income inequality has increasingly become an object of interest as globalisation has progressed. Two different trends have distinguished themselves in the literature. The first concerns the curtailing of differences between advanced and underdeveloped economies. One of the main interpreters of this perspective is Angus Deaton (2013), the Nobel laureate in economics. According to Deaton, global economic growth has had positive effects on the incomes and well-being of less advanced economies, producing an improvement in the living conditions of that part of the global population that has succeeded in the great escape from poverty (Deaton, 2015). While highlighting the progressive convergence between countries, he does not conceal, however, that the narrowing of the gap is, to a large extent, attributable to the marked improvement in the economic conditions of Asian countries, while the permanence of disparities is still strongly conditioned by the lagging development of the African continent.

The second trend highlighted by studies on inequality concerns the growth of differences within countries. Among the many authors who have dedicated time to this area of study, we can refer to the work of Branko Milanovic (2016; 2019). He argues that the third wave of globalisation, the one that gained momentum with the 1980s and which the economist Dani Rodrik (2011) has termed "hyper-globalisation", has produced completely different effects compared to the previous ones. If, as Deaton points out, the distance between countries has been reduced, hyper-globalisation has increased inequality within countries. This is the result of the tendency towards social polarisation that has been evident in the major advanced economies at least since the second half of the 1990s. Where income and wealth are concentrated at the top of the social pyramid, the share of income available to the middle classes shrinks and the conditions of the less well-off deteriorate.

We aim to analyse the institutional causes of this phenomenon, with two specifications. First, we will focus on the welfare model and industrial relations, namely on the redistributive interventions that characterise the different

countries. Second, unlike other approaches that focus only on inequality and welfare, or exclusively on institutional factors affecting growth (e.g. studies on the "varieties of capitalism"), we propose to focus on the relationships between growth and redistributive policies. We will thus propose a typology that is based on more or less dynamic and more or less inclusive models of growth.

1.2 Inequality and economic growth: a typology

To move in this direction, it may prove valuable to ponder the observation that income inequality in advanced countries, albeit a general trend, neither increases with the same intensity nor reaches the same levels. This suggests that besides the common exposure to the effects of globalisation (offshoring, growth of international trade, and cost competition, etc.), a major role is played by differences in endogenous institutional factors, such as welfare and industrial relations.

We took the significant differences in income inequality levels in advanced countries as a starting point. Examining the 18 major advanced economies[1] between the mid-1980s and 2018, the Gini index[2] of disposable income after taxes and transfers shows that inequality increased from around 0.27 to 0.30.[3]

Over the past 30 years, the social structure has forked wider and wider, both in countries that were already characterised by strong inequality – such as the United States and the United Kingdom – and in the countries that in the early 1980s had more egalitarian societies – such as Sweden and Germany (Figure 1.1). However, also noteworthy is the fact that significant
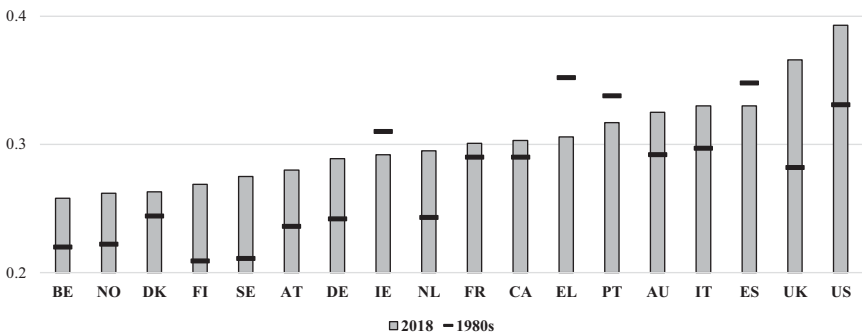

Figure 1.1 Dispersion of disposable income after taxes and transfers (Gini index, 2018 and 1980s).

Note: The value for the 1980s may vary from 1983 to 1987. The source is the Gini project, with the exception of Finland, Greece, and Norway (OECD data), and Portugal, where the source is the World Bank.
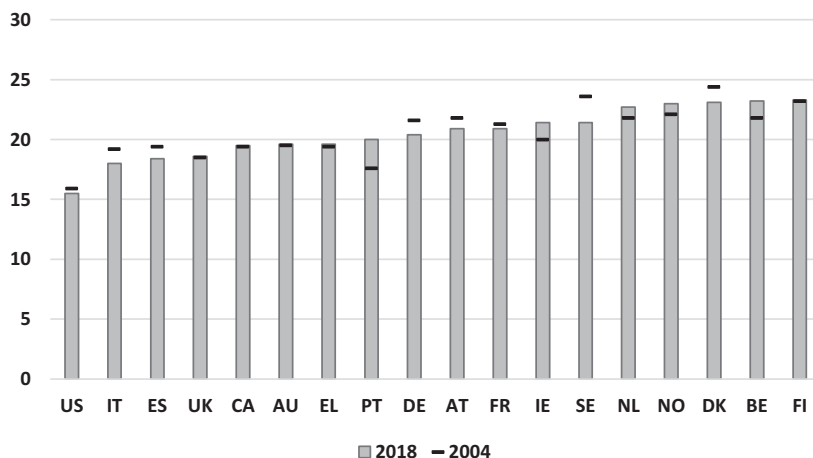
Source: OECD.

Figure 1.2 Share of income held by the 40% of the population with the lowest incomes (2018 and 2004).

Note: Income is the disposable income of households after taxes and transfers. The indicator measures the amount of income available to the two lowest quartiles of each country's income distribution.

Source: World Bank.

differences in overall levels of inequality within the more advanced countries have persisted, suggesting that this is not just a legacy of the past but that the phenomenon is influenced by institutional and regulatory setups well worth investigating.

Looking at other indicators of inequality – the share of income available to the poorest 40% of the population and the relative poverty rate (Figures 1.2 and 1.3) – these trends are confirmed. Albeit for a diminished time span, both point to a widening gap between the richest and poorest segments of the population and, at the same time, to persistent differences between countries.

From a diachronic perspective, inequality has not grown in a linear fashion. As early as 2005, the Gini index for economically advanced countries reached its current level (0.30). This might suggest that the economic and financial crisis of 2008 has only had a cyclical influence on inequalities and that, consequently, their ultimate must be sought in factors of a structural nature. What we do know is that between the mid-1980s and the mid-2000s, almost all the countries we have considered (14 out of 18) increased their internal inequalities: the Gini index rose by 11.8%, representing an average annual increase of 0.6%.

According to the OECD (2011), the disposable income of households increased over that period, but it was the richest 10% of the population whose
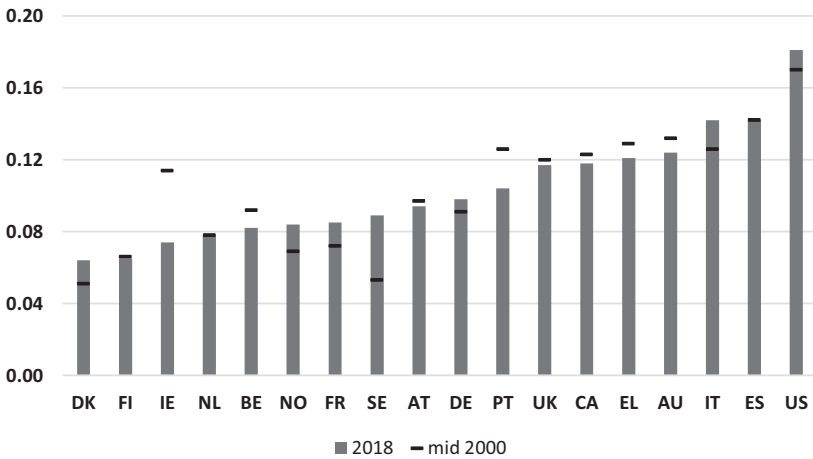
Figure 1.3 Relative poverty rate (2018 and 2000s).

Note: Relative poverty is calculated as the incidence of the population with an income at or below half the median income. Income is the disposable income of households after taxes and transfers. The relative value for the mid-2000s refers mostly to the year 2005, in some cases earlier (Netherlands, Denmark, Canada, Greece) and in others later (Finland and Italy).

Source: OECD.

share of income rose faster than that of the poorest 10%, so much so that in 2007 the average income of the richest decile was about nine times that of the poorest decile. Conversely, the most recent data show that over the last decade, the trend towards income concentration has slowed down (the Gini has increased by only 0.7%), although it has not reversed.

Nevertheless, the benefits of slowing growth in inequality have affected the lower strata of the population less. Suffice it to say that in the decade under review, the relative poverty index increased by 7.4%, the available income of the poorest 40% of the population fell by 1.3%, and the ratio between the income of the richest 20% of the population and the poorest 20% increased by 2.8%. In other words, if the society of the period of the Glorious Thirties could be broadly represented by a pyramid, since the 1980s it has increasingly taken the form of an hourglass.

Only in recent years has this trend diminished, the middle class has started to grow again, but this is rather due to a shift (or perhaps a sliding) in the upper classes than to a rise in the lower classes.

The data presented above show distinctly that levels of social inequality vary significantly from country to country, allowing us to clearly distinguish between different groups: at one end of the spectrum the Mediterranean and Anglo-Saxon countries, which show more marked inequalities, and
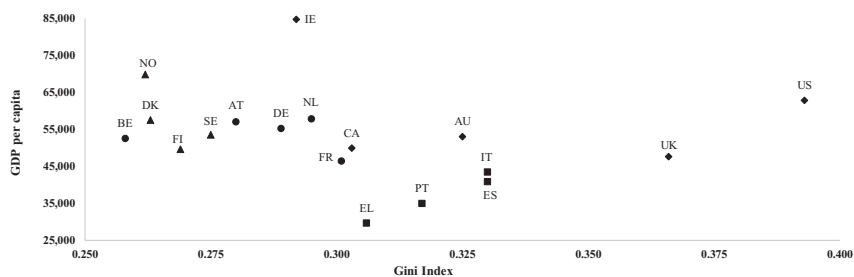
Figure 1.4 GDP per capita and income inequalities in advanced democracies (2018). Legend: Countries belonging to the high income/high inequality growth model are marked with the rhombus-shaped indicator. Countries with high income/ low inequality countries are marked with the triangle indicator. Low income/ high inequality countries are marked with the square indicator.

Note: GDP per capita is expressed in dollars, calculated at current prices and expressed in purchasing power parity (PPP). Income inequality is measured by the Gini coefficient on household disposable income after taxes and transfers.

Source: OECD.

at the other end the northern European countries, in which the social structure continues to be less polarised. The continental European states stand halfway between these two types. But how do the different levels of inequality combine with the degree of development of the economy and its growth rates?

Correlating the levels of inequality measured by the Gini index to the income of the population (Figure 1.4), we may hypothesise a first answer. Considering 18 cases of advanced economies, three ideal types emerge: high income/high inequality; high income/low inequality; low income/high inequality.

We should bear in mind that the two types with higher-than-average per capita income are also those that, generally speaking, have shown higher-than-average income growth over time in the last two decades. The opposite is true for the lowest income countries, which are also the least dynamic (Figure 1.5).

Three clearly distinguishable types of growth emerge from this perspective. On the one hand, there is a first group of countries that we define as "inclusive growth"; on the other hand, there is a second group characterised by "non-inclusive growth". To these two groups should be added the model that gather the Southern European countries that, being characterised by low competitiveness and high inequality, can be defined as countries with "low, non-inclusive growth".[4]

In order to analyse the relationship between growth and inequality, however, it would be opportune to introduce a further dividing dimension within the inclusive growth countries. In the literature, it is well established that
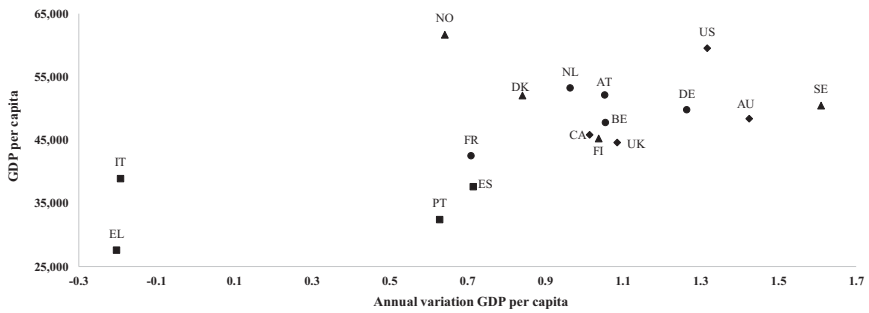
Figure 1.5 GDP per capita (2018) and percentage change in GDP per capita (2001–2018).

Legend: See Figure 1.4.

Note: GDP per capita is in dollars, calculated at current prices and expressed in purchasing power parity (PPP).
The average annual change in GDP is calculated at constant 2010 prices.

Source: OECD.

reforms since the 1990s have diversified the structure of the labour market in continental European countries compared to the Nordic countries and, consequently, the distribution of their incomes (Emmenegger, 2012; Palier & Thelen, 2010; Rueda, 2014; Thelen, 2014). As will be seen in more detail in Chapter 4, continental European countries have witnessed a deregulation of the labour market in the service sector, which, however, has not reduced protection for industrial workers.

In the Scandinavian countries, on the other hand, the lower level of commitment to the safeguarding of traditional work (which nevertheless remains high in comparative terms) has been accompanied by greater protection for flexible workers, ensured by more generous interventions in terms of vocational training, job placement, and social benefits. Based on this different level of labour market "dualisation", it is therefore possible to distinguish between countries with a more unequal distribution of incomes and others where such differences are less pronounced (Figure 1.6).

The typology used throughout the pages to come is described as follows. The first model is that of the countries with non-inclusive growth (NIG), that is, those characterised by high income, high economic growth, and high inequality. The second is that of the inclusive growth (IG) countries because they are characterised by high income, high growth, and lower inequality. In view of the above-mentioned regarding the differences in terms of dualisation, the model can be divided into two variants: egalitarian inclusive growth (EIG), typical of the experience of Northern European countries, and dualistic inclusive growth (DIG) closer to that of continental European countries.
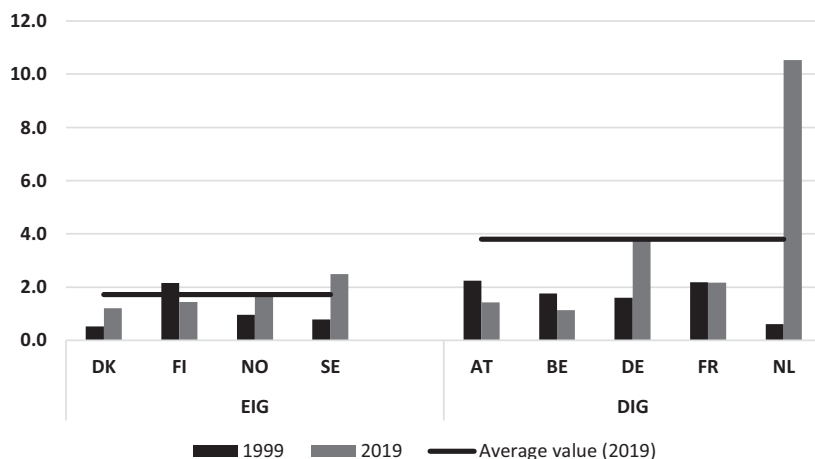
Figure 1.6 Dualisation index for inclusive growth countries (2019 and 1999).

Note: the dualisation index corresponds to the ratio between the EPL (Employment Protection Legislation) for workers with permanent employment contracts and the largesse of the social policy of the job market, calculated as ratio between expenditure for active policies and unemployment rate (Rueda, 2014).

Finally, the non-inclusive low growth countries (NILG) are those in Southern Europe that respond to the configuration of low income, low growth, and high levels of inequality (Figure 1.7).

1.3 Macro-economic differences between growth types

These four types of growth outlined above will be examined more in depth in the chapters to come. Here we introduce some preliminary differences, related to macro-economic variables of particular importance: public expenditure, revenues from taxation, and debt.

In order to identify public spending behaviour, we use two indicators to reveal the quantity of resources governments have devoted to a selected set of items concerning "investment" and "consumption" expenditure. The "consumption" component includes spending on pensions, health, unemployment, and social housing; that is, it refers to traditional social policies implemented to cover what can be termed traditional social risks.

Expenditure on "investment", on the other hand, covers interventions that are also referred to as social investment and includes: expenditure on kindergarten and childcare, education (including tertiary education), active labour policies (training and upgrading/retraining, support for vulnerable groups), as well as research and development policies.[5] The combination of the two
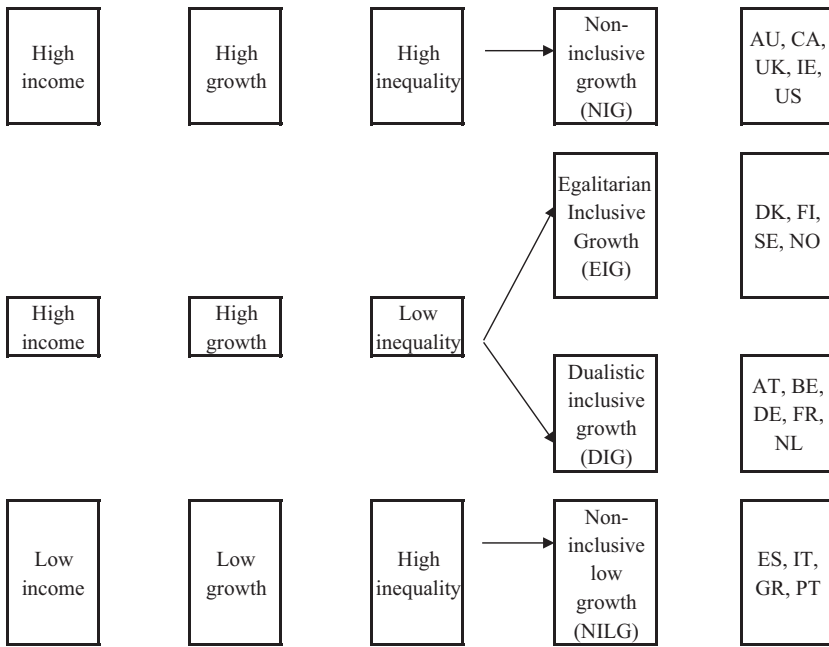
Figure 1.7 Four models of growth and inequality.

indicators defines different styles of intervention that characterise types of growth, highlighting the significance of our typology. NIG countries have relatively low levels of public spending (23.7% of GDP) but show a high incidence of investment in support of social and economic development (0.40). In contrast, EIG countries are characterised by high public spending (34.0% of GDP) combined with a high incidence of investment in consumption (0.50).

The DIG and NILG countries generate yet another configuration. As in the EIG model, they show a high level of public spending (32.7% and 31.5% of GDP, respectively), which, however, tips the balance on the side of consumption compared to investment. Specifically, the incidence of the latter on the former is limited to 0.33 in the DIG and 0.23 in the NILG (Figure 1.8).

The four types also show significant divergences in relation to taxation (Figure 1.9). The group of NIG countries shows significantly lower tax revenues compared to the other types (28.8% of GDP), in line with the levels of public spending outlined above. Conversely, inclusive growth countries offset higher public spending with higher tax revenues. The difference between egalitarian and dualistic variants is marked by the difference in the source of revenues. The dualistic model, with a Bismarckian/occupational welfare
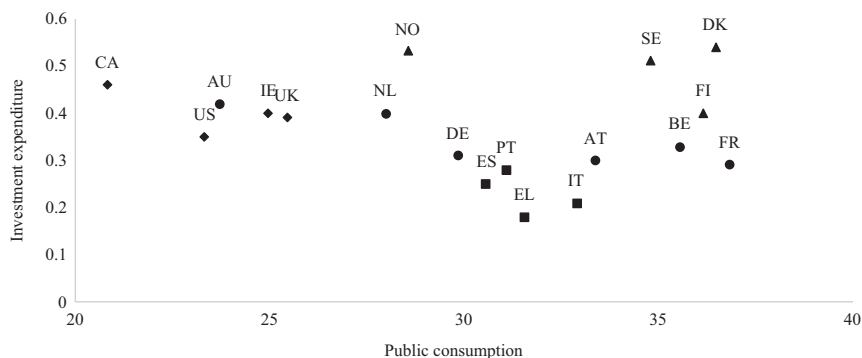
Figure 1.8 Public consumption and investment expenditure as a percentage of total expenditure (2013).

Legend: countries belonging to the NIG model are marked with the rhombus-shaped indicator. Countries in the EIG model are marked with the triangle-shaped indicator. DIG countries are marked with the circle-shaped indicator. Finally, NILG countries are marked with the square indicator.

Note: The consumption and investment considered here cover only a limited number of items. In particular, consumption concerns expenditure on different types of pensions, health, disability, unemployment, and housing, as well as allowances, family allowances, and maternity and family leave. Investment covers public expenditure on active labour market policies, family, children and childcare, education (including tertiary education), research, and development. Public expenditure indicates total consumption and investment expenditure as defined above.

Source: consumption and households: OECD (SOCX); education: World Bank elaboration on UNESCO data; research and development: OECD, MSTI (Main Science and Technology Indicators).

matrix, weighs more in terms of social contributions, which reach 14.6% of GDP, against an overall taxation of 41.7%. In EIG countries, where taxation corresponds to 42.8% of the GDP, social security contributions have a lower average weight (8.0%), ranging from 0.04% of the Danish GDP to 12.1% of the Finnish GDP. The taxation of NILG countries has a matrix more similar to that of DIG countries. In this case, the average incidence of social contributions is 11.2% while tax revenues from taxes and social contributions stand at 37.3%. Within this group, however, the case of Italy is remarkable, with revenue from taxation that is comparable to that recorded in inclusive growth countries.

With a few exceptions, the ten-year trend in income from taxes and contributions is increasing (Figure 1.10). However, a high level of intra-group variance emerges conspicuously. Rather than structural constraints, this indicator therefore seems to be more subject to variances that depend on national political economy choices (as in the case of Ireland and Norway) and exogenous pressures (as in the case of Greece). Last but not least, this
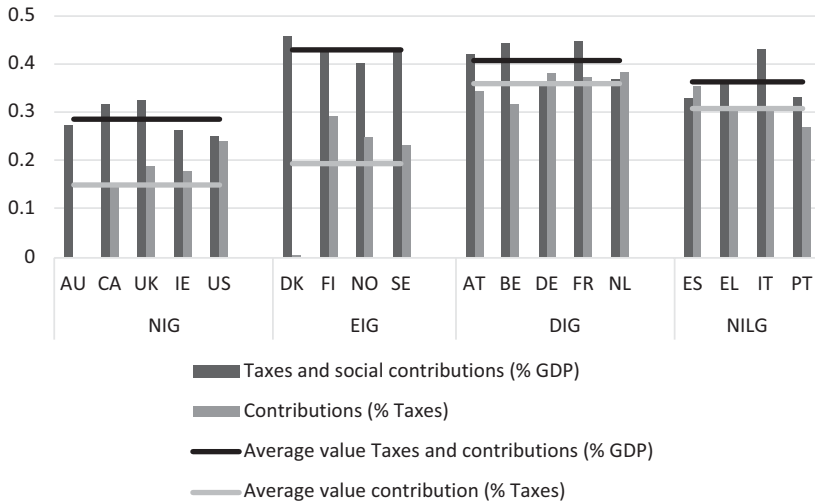
Figure 1.9 Taxes and social contributions per country and per growth model (average 2010–2017).

Note: For Australia, the time range does not include 2017.

Source: Elaboration on ICTD/UNU-WIDER, Government Revenue Dataset, 2018.

indicator is also affected by the effects of the economic recovery of previous years, which increases the tax base of different countries and, consequently, revenues at the same tax rates.

The macro-economic picture that derives from the analysis of consumption and revenues is completed by indicators concerning public budget deficit (Figures 1.11 and 1.12). The average value of the budget deficit over the ten-year period 2009–2018 indicates that the EIG countries have a greater capacity for controlling public accounts, equal only to some of the DIG countries. On the contrary, the NILG countries have recorded decidedly higher deficits, although in the decade considered Italy has settled at levels similar to those of continental European countries, thanks also to a primary surplus that is among the lowest in advanced economies. Countries with non-inclusive growth, some of which (the United States and Ireland) have deficit levels similar to those of the NILG, are characterised by greater irregularity, while in other cases resource management has been more severe. Using the indicator for the stock of public debt, the differences between types are more pronounced. At one end of the spectrum, NILG countries have, on average, accumulated public debt corresponding to about 134% of GDP. At the other end, EIG countries have an extremely low level of debt, corresponding to 54.8% of GDP. The other two growth types are in an intermediate position,
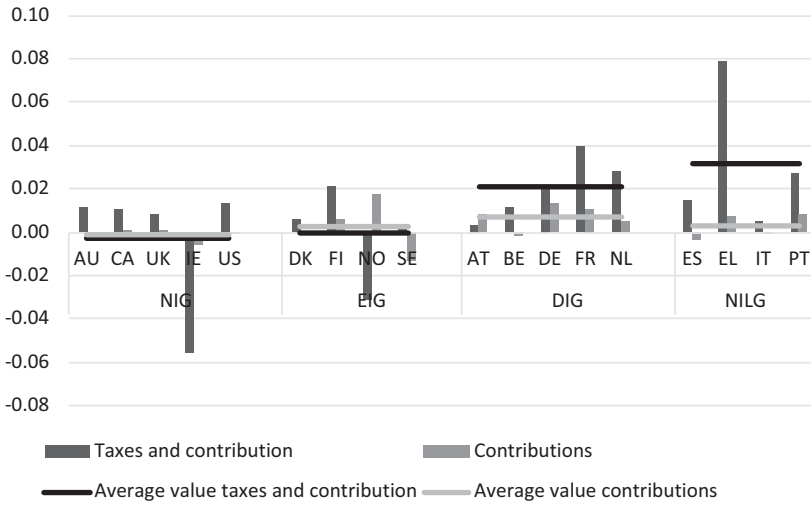
Figure 1.10 Change in taxes and social contributions between 2008 and 2017 by country and model as a percentage of GDP.

Note: for Australia, the time range does not include 2017.

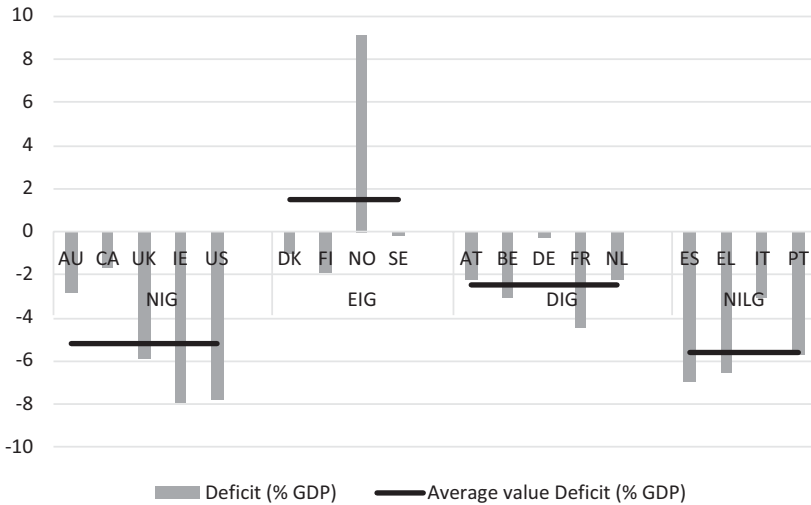Source: elaboration on ICTD/UNU-WIDER, Government Revenue Dataset, 2018.

Figure 1.11 Public deficit by country and by model (average value 2009–2018).

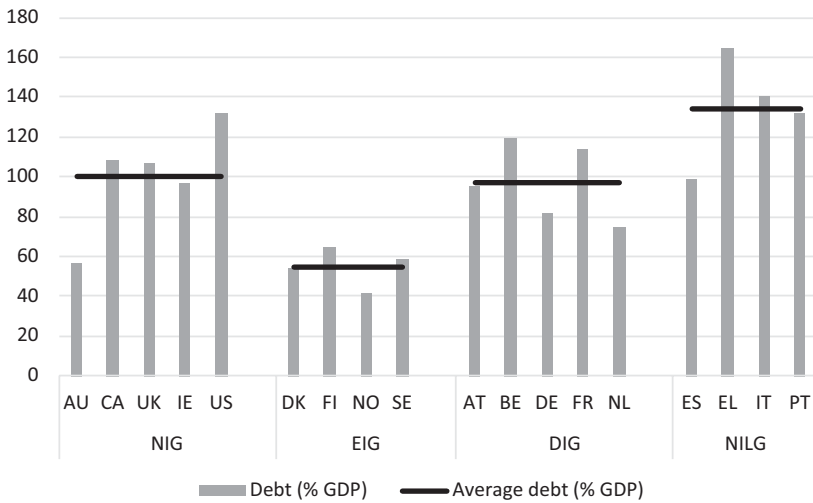Source: OECD data, general government deficit.

Figure 1.12 Public debt by country and model (average value 2009–2018).

Source: OECD data, general government debt.

Table 1.1 Growth models and macroeconomic variables

	Expenditure	Revenues from taxation	Indebtedness
NIG	Low but investment-oriented	Low and fiscal	Medium-high with differences
EIG	High and investment-oriented	High and fiscal	Low
DIG	High and consumption-oriented	High and contributory	High with differences
NILG	High and consumption-oriented	High and contributory	High

although, in both cases, some countries can be clearly identified as departing significantly from the average value. Specifically, Germany and the Netherlands are characterised by much lower debt than the other DIG countries, while the US debt is significantly above the average for its group.

Overall, four differentiated profiles emerge from a cross-reading of macro-economic indicators (Table 1.1). The NIG model is characterised by a combination of low expenditure (but investment-oriented), low taxation, and medium-high debt. The EIG countries have a completely different profile: high investment-oriented public spending, but with a significant share also for consumption, which is matched by high taxation. In this case, deficits and public debt remain under control. The inclusive capacity of DIG countries is supported by expenditure with a higher consumption-oriented component. Revenues from taxation are higher in this case and there is a

higher incidence of social contributions. Public debt is higher, especially in the French-speaking area. Finally, the overall picture of the NILGs shows a system based on a more limited redistributive capacity and even more prone towards consumption than in the countries neighbouring the DIG. As we shall see later, this tendency is accompanied by less effectiveness in reducing inequalities and by greater imbalances between services/benefits and revenues, which must be offset by public finance, with consequences for deficits and debt.

Notes

1   The reference is to countries considered in this research: Australia (AU), Austria (AT), Belgium (BE), Canada (CA), Germany (DE), Denmark (DK), Spain (ES), Finland (FI), France (FR), the United Kingdom (UK), Ireland (IE), Italy (IT), the Netherlands (NL), Norway (NO), Portugal (PT), Sweden (SE), and the United States (US).
2   The Gini index ranges on a scale from 0 to 1, where the lowest extreme represents the greatest dispersion of income and the highest, the greatest concentration.
3   Only four countries (Ireland, Portugal, Greece, and Spain) have curtailed internal differences, most probably due to sluggish economic development. See, among others, Andreosso-O'Callaghan, Lenihan, and McDonough (2014) and Ó Riain (2014) for an interpretation of the exceptional case in Ireland, which in our analyses often emerges as an outlier.
4   "Low growth" refers here to a recent phase and does not exclude that in earlier periods growth may have been more considerable.
5   This is a similar elaboration, with some modifications, to the one presented by Beramendi et al. (2015, 9–10). The "expenditure" indicator used here also includes public expenditure on health, social housing and "passive" household support (family allowances). The "investment" indicator adjoins expenditure on primary and secondary education while, conversely, excluding the private expenditure on research and development.

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