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Growing apart: The comparative political economy of income inequality and social policy development in affluent countries

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7 | Conclusions

In this final chapter I summarise the main findings of the previous chapters. Subsequently, I reflect on how these findings contribute to the academic literature and on their societal relevance in more general terms. Finally, I indicate a number of directions for future research.

7.1 PUTTING THINGS TOGETHER

This dissertation consists of a collection of five chapters aiming to provide insight into determinants and political and economic consequences of rising levels of income inequality and social policy development in affluent countries.

Chapter 2 maps trends in intrasectoral inequality in 19 sectors across 8 OECD countries between 1985 and 2005 based on micro data from LIS. These trends are contrasted with differences in exposure to international trade, technological change, and labour market institutions. The chapter points to the importance of taking note of sectoral trends for our understanding of earnings inequality. On average, the levels of intrasectoral inequality within countries vary as much as the levels of country-level inequality between countries. Moreover, sectors differ widely in their level of exposure to international trade and technological change. Levels of intrasectoral inequality went up in most sectors on average over time. A decomposition shows that intrasectoral inequality developments are significantly more important than earnings differences between sectors for the level of inequality at the country level. Cross-sectional pooled time-series analyses do not provide evidence for associations between total international trade or technological change and intrasectoral earnings inequality. Nevertheless, there are signs of shrinkage of employment in sectors exposed to international trade. The decrease of trade union power at the country level is associated with higher levels of intrasectoral inequality.

Chapter 3 delves into the effects of imports from China in more detail. Given its large volume of low-wage labour, the rapid rise of China on the global economic stage might have inequality-enhancing effects in developed countries. The empirical part of this chapter is based on wage and employment shares across skill groups in 17 sectors for 18 countries between 1990 and 2007. Particular attention is paid to the effects of competition with China in foreign export markets, a channel that has been ignored thus far in comparative

political economy studies. The analysis shows that employment declines in sectors that are more exposed to imports from China. Chinese import competition and competition in foreign export markets have a disadvantageous impact on low-skilled workers, whilst high-skilled workers gain from competition in foreign export markets. This results in higher levels of intrasectoral earnings inequality for sectors more exposed to Chinese import competition. Technological change has no effects on the overall employment size of sectors. Yet, technological innovation contributes to negative employment and wage effects for low-skilled workers whilst the high skilled benefit from it.

Subsequently, Chapter 4 differentiates between multiple channels through which income inequality and redistribution might affect economic output levels in advanced democracies. Inequality as such and the redistribution of taxes and transfers might have opposing or reinforcing effects on economic growth. Inequality might for instance affect growth when it lowers opportunities for people to invest in human capital, or it might push people to put forth additional effort, as relative gains are higher. Redistribution could lower growth by reducing the incentives for individuals to gain income, whilst it might also lower any negative impacts of inequality on growth. Ideally, one would distinguish between these two channels. At least, data should be used that consistently distinguish between income distribution before and after government intervention. The empirical analyses do not point to robust associations between generic measures of income inequality and economic growth, nor between redistribution and economic growth for 25 countries between 1975 and 2009. However, there are positive associations between the share of income held by the top end of the distribution and economic growth, although the coefficients are small.

Chapter 5 comprises an examination of the possible political effects of an often-mentioned culprit suspected of increasing earnings inequality, technological change. Current advancements in information technology involve risks for individuals holding routine intensive task occupations, as these occupations can be automated relatively easily. The chapter finds evidence that supports the implications of a simple theoretical framework in which risk-averse individuals prefer insurance against occupational hazards when markets cannot provide such insurance. As social protection arrangements that offer such insurance are redistributive, this will translate into higher redistribution preferences for individuals more exposed to occupational risks. This analysis is conducted for 21 occupations across 23 European countries between 2002 and 2012. The degree of routine task intensity of an occupation is a significant determinant of the redistribution preferences of individuals. Moreover, the preferences for redistribution resulting from risks of technological change are accentuated by two factors: first, whether individuals are employed in sectors that are more exposed to technological change, and second, whether an individual's income level is higher.

Chapter 6 is a case study of social and unemployment policy development in three countries, namely, Germany, the UK, and Sweden. It aims to add to our understanding of short-term reactions of states to sudden events by analysing the policy strategies adopted by these three countries in response to the Great Recession in 2008 and 2009. These particular countries seem to have fallen back on old habits by adopting social and unemployment reactive policies that can be identified based on their institutional legacies, indicating path dependence. This suggests that reactive policy strategies can be explained by different dynamics than the more structural long-term policy developments that show signs of convergence.

7.2 SOCIETAL AND SCIENTIFIC RELEVANCE

Recently, international organisations and public policy makers have emphasised the importance of improving our understanding of the causes and consequences of the widespread trend towards rising earnings dispersion in affluent countries (IMF, 2007; OECD, 2011a; Cingano, 2014). Examining the causes and consequences of inequality is important from a societal perspective, as a widening of the income differences might evoke social unrest, potentially could affect total economic output, or can be deemed unfair from a normative perspective. Also when rising inequality would be a consequence of changes in labour market landscapes due to technological change or international trade rather than a deliberate political choice, an examination of its causes, consequences, or social policy developments is societally relevant. An improved understanding of who gains or loses from what development, what the consequences may be, and what social policy answers are available will add to our understanding of what is taking place, what can be done about it, and whether redistribution as income compensation for groups that are losing out would make sense. Still, acting in itself by means of redistribution clearly is a political choice.

The empirical findings in this dissertation are in line with theories predicting inequality-enhancing effects of labour market institutions, technological change, and international trade. The bargaining coverage rate of trade unions is associated with a more equal distribution of earnings, but the influence of trade unions in wage bargaining has decreased in most countries over time. Furthermore, international trade, in particular Chinese import competition and competition in foreign export markets, is negatively related to the employment size. Trade competition with China has distributive effects as the high skilled benefit whilst wage shares and hours worked of low skilled employees go down. Governments can choose to compensate the low skilled employees when their disadvantageous labour market position is considered to be undesirable. Furthermore, the influence of trade unions in wage bargaining could be

enforced by states as a means to equalise wages in line with the concept of pre-distribution (Hacker, 2011).

No support is found for negative effects of rising levels of income inequality on economic growth, though clearly, the empirical validity of this finding must be assessed whilst taking into account the complexity of such endeavour. This could imply that a growing dispersion in incomes does not have a clear relation with the total size of the income pie. Of course, inequality can still be considered as undesirable, or the opposite for that matter, on the basis of normative judgement. Furthermore, this dissertation provides evidence for political consequences of labour market trends associated with rising inequality. Individuals in routine jobs who have a higher risk of job loss due to automation prefer higher levels of redistribution. Thus, skill-biased technological change could potentially translate into higher levels of actual redistribution.

Academically, I aim to contribute to the field of comparative political economy in specific ways that are discussed in more detail in the separate chapters. Here I discuss what I consider the two most fundamental contributions. First, in multiple chapters I seek to move beyond generic country level measures of the variables of interest by combining sectoral, occupational, and country level data to sketch a more detailed picture. The analysis is based on multiple measures of income and earnings inequality, and employment and wage shares across skill groups. By doing so, I explicitly regard the significant variation in inequality patterns across sectors, but also the sectoral and occupational differences in exposure to possible causes of earnings dispersion, in particular technological change and international trade.

A second contribution to the field of comparative political economy is the simultaneous and more extensive analysis of potential causes and political consequences of rising wage inequality. In this doctoral thesis a prominent role is played by technological change, which has received considerable attention in labour economics but much less so in comparative political economy. Technological change is a difficult concept to grasp and measure, but the analyses presented here indicate that it can have distributive effects and also influence the redistribution preferences of individuals. This doctoral study also broadens the scope of examining international trade, by analysing the effects of total trade as well as trade competition with China in local and foreign export markets. China's surge in the global economy has not been covered in detail in the comparative political economy literature on wage inequality. Moreover, the competition in foreign export markets has been neglected thus far in this strain of literature, whilst I find it to positively affect the employment and wages of high-skilled employees whereas it has a disadvantageous impact on low-skilled workers. Compared to the labour economics literature on wage inequality with sectoral designs this thesis devotes a relatively large amount of attention to the role of labour market institutions. In this way I hope to contribute to bridging the gap between labour economics and comparative political economy.

7.3 FUTURE DIRECTIONS

A number of lines of future inquiry can be discerned, which are described in greater detail in the different chapters. First, this doctoral thesis only begins to explore sectoral and occupational elements concerning inequality and social policy development. In particular, shifts of individuals between sectors and occupations resulting from exposure to international trade or technological change are not measured, as the analyses are based on time series rather than micro panel data. Also for our understanding of economic and political consequences a micro panel design would be beneficial. For instance, individuals and their redistribution preferences moving away from exposed occupations and sectors are now attributed to non-exposed occupations and sectors. As micro panel data are starting to become available for a larger set of countries and years, this would be an interesting avenue to further explore inequality and its dynamics.

Second, in this doctoral thesis economic growth only enters the analysis as a dependent variable in the examination of effects of inequality on growth. Arguably, the real societal challenge is how to ensure that economic growth delivers prosperity for the population at large. This issue of inclusive growth or trickling down requires an analysis of living standards across the distribution over time, rather than only looking at an average measure of economic progress such as real GDP per capita (Stiglitz *et al.*, 2009; OECD, 2014h). An analysis of inequality measures that only capture relative wage differences, such as Gini indices, also do not reveal trends in absolute living standards of different groups. Such a research agenda might depart from evaluations of periods of inclusive growth across countries over time, which can be contrasted with trends in technological change, international trade, labour market institutions, and social policies in place.

A third and arguably more ambitious research agenda would be to move away from income as the yardstick to evaluate the distribution of living standards and to consider how the resulting income distribution came to be in the first place. Income is an outcome measure. It captures the amount of money a person or household has managed to gather within a certain reference period. Income does not necessarily reveal whether people were in the same exogenously given position to begin with to attain this income, regardless of the educational level of their parents, their race or gender, for instance. Studies of inequality of opportunities try to differentiate between inequality of opportunity and inequality of effort (Ferreira and Gignoux, 2011; Niehues and Peichl, 2014). Conducting such a decomposition requires a definition of what factors cannot be influenced individually as well as quality data that contain extensive information on individual characteristics in addition to income. Yet, for our understanding of the effects of inequality on economic growth, for instance, such a decomposition might be valuable. It is possible that inequality of opportunity hampers growth whilst inequality of effort can provide a boost

by incentivising people. Also for the political issue whether individuals should be compensated via redistribution because of rising inequality it seems important to know whether the distribution is by and large a consequence of rising circumstantial differences or due to a difference in personal effort or productivity.

A final recommendation for future research results from limitations of the study presented here. Although in this thesis income inequality and social policy development are viewed through a magnifying glass, this glass is inevitably blurred. The most fundamental issues stem from the non-experimental character of the research conducted, which is arguably always a problem for research in the field of comparative political economy. Clearly, progress that can be made in order to better differentiate between causes and consequences would be greatly advantageous to constructing effective policies. In the meantime, this thesis points out directions for more detailed examinations of income inequality and social policy development in affluent countries.