

# Political Institutions and Income Inequality, 1900-2000

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# Motivation

**Established arguments** about the political determinants of inequality emphasize factors like partisanship, wage bargaining, and proportional representation

**Existing work:** Focuses on the period since 1970 both for substantive reasons and because of lack of pre-1970 survey data

**Our objective in this paper:** Consider new data over a longer span that reveals large variation over time. Ask whether existing arguments can account for this variation

**Our main conclusion:** We may know less than we thought about the political correlates of income inequality

# Data on Top Income Shares

Collected by authors in Atkinson and Piketty (forthcoming) using information from tax returns, in addition to papers by Moriguchi and Saez (2006) and Roine and Waldenstrom (2006).

**Measures:** Top 10%, Top 1%, Top 0.1%, etc. of pre-tax income distribution for thirteen industrialized countries, sometimes back to 1900

**Advantages:** (1) less heterogeneity (2) a long run view of inequality (particularly important for our purposes)

**Potential disadvantage:** may miss important trends at the bottom and middle of the distribution

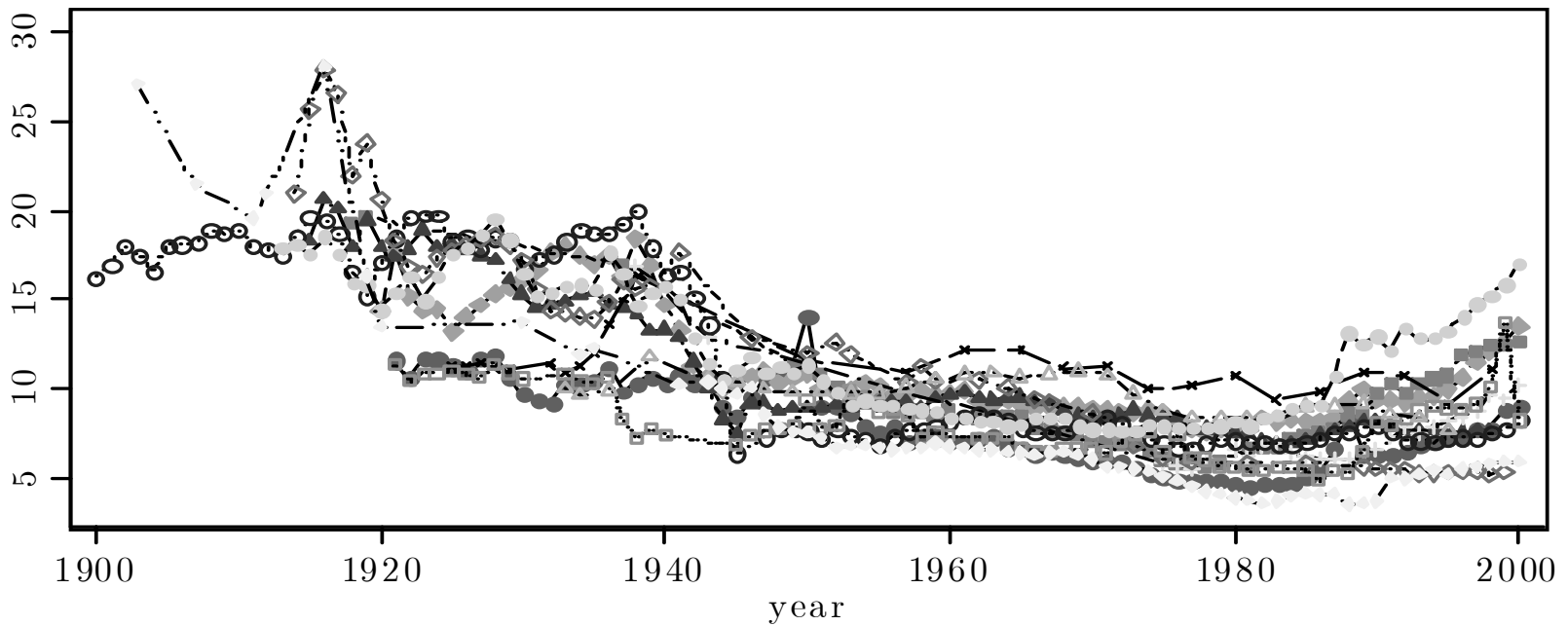
# Potential Political Determinants of Inequality

**Governments of the left** may redistribute more producing lower future pre-tax income inequality (important to consider dynamic context)

**Centralized wage bargaining arrangements** can produce lower inequality (1) by reducing wage inequality (2) by having distributional effects on capital incomes (Przeworski and Wallerstein, 1988)

**Proportional representation** may explain emergence of both left dominance and centralized wage bargaining. It should therefore be associated with less inequality

## Top 1% share from Atkinson and Piketty (2006)



# Empirical Specification (1900-2000 period)

**Dependent variables:** Top 10%, Top 1%, Top 10%- Top 1%

**Key Political Variables:** Dummy for PR systems, Dummy for "left" governments, and three-level classification of wage bargaining centralization. All are coded by the authors

**Two specifications to test the three hypotheses:**

$$TopX\%_{it} = TopX\%_{it-1} + PR_{it} + WageCen_{it} + Left_{it} + Z_{it}$$

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**Estimation method:** Pooled OLS with PCSEs, five-year time periods, with and without country fixed effects, always including time effects

## Institutions and Income Inequality: 1900-2000 Evidence

	<i>Top10</i>		<i>Top1</i>		<i>Top10-1</i>	
<i>TopX<sub>t-1</sub></i>	0.680 (0.077)	0.456 (0.097)	0.619 (0.061)	0.461 (0.076)	0.527 (0.104)	0.341 (0.113)
<i>GDP per capita</i>	-0.075 (0.075)	0.066 (0.139)	0.041 (0.044)	0.094 (0.076)	-0.151 (0.063)	-0.019 (0.106)
<i>Trade Openness</i>	0.007 (0.012)	-0.027 (0.031)	0.006 (0.007)	-0.015 (0.019)	0.005 (0.007)	-0.012 (0.022)
<i>Proportional Representation</i>	-0.239 (0.435)	-0.079 (0.893)	0.155 (0.281)	-0.296 (0.541)	-0.469 (0.319)	-0.449 (0.596)
<i>Wage Bargaining Centralization</i>	-0.769 (0.385)	-0.920 (0.468)	-0.449 (0.187)	-0.574 (0.277)	-0.592 (0.285)	-0.454 (0.336)
<i>Left Executive</i>	-0.312 (0.451)	-0.611 (0.486)	-0.238 (0.281)	-0.286 (0.313)	0.000 (0.389)	-0.315 (0.410)
<i>Non-Democracy</i>	0.567 (0.781)	0.776 (0.767)	1.128 (0.449)	1.444 (0.472)	-0.398 (0.560)	-0.702 (0.569)
<i>Male Universal Suffrage</i>	-0.720 (0.619)	0.178 (0.744)	-0.710 (0.442)	-0.370 (0.538)	-0.161 (0.471)	0.626 (0.637)
Period Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Country Fixed Effects	No	Yes	No	Yes	No	Yes

## Results and further empirical tests

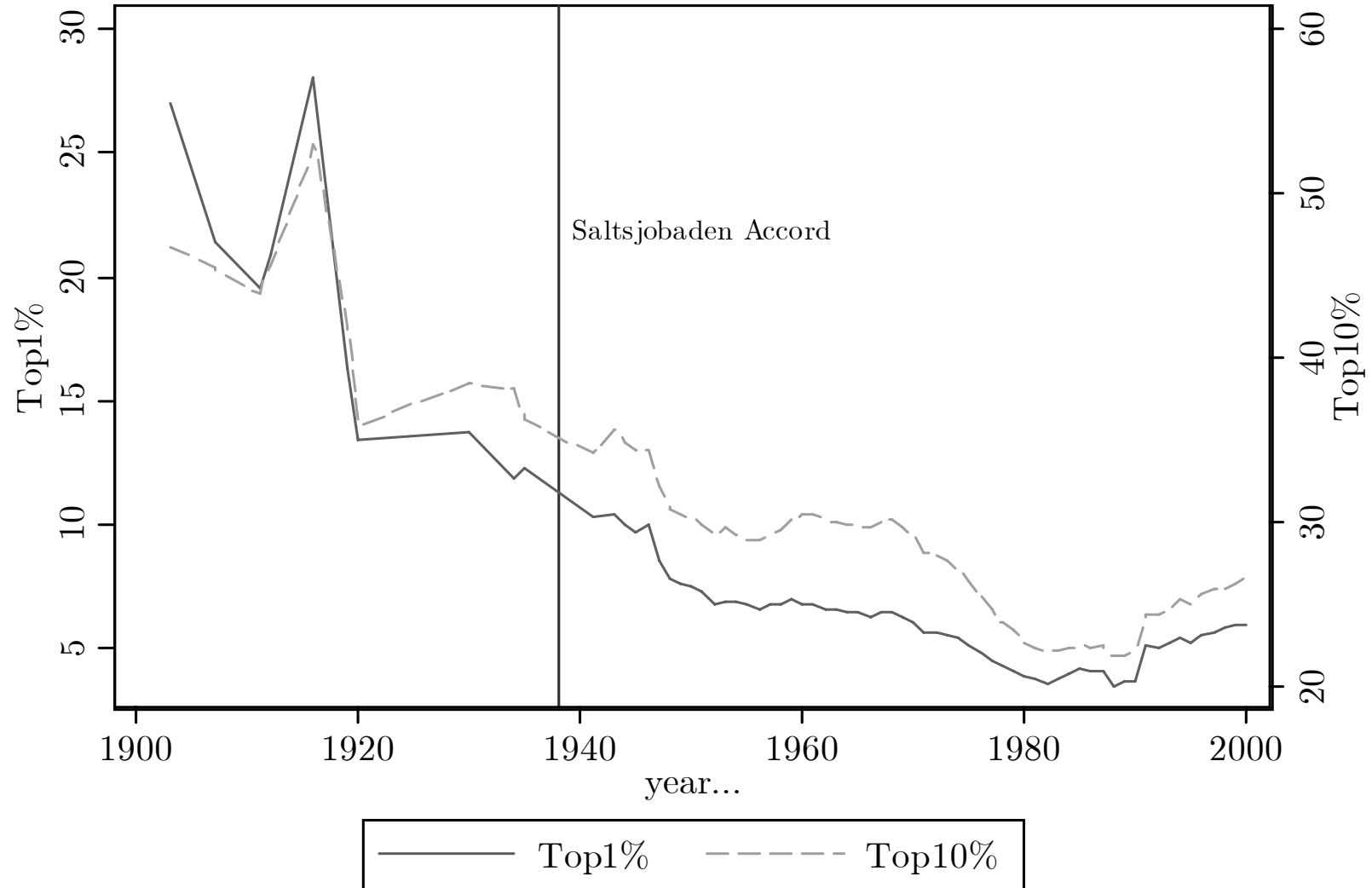
**Pooled estimation results for 1900-2000:** suggest that the only political factor that appears to matter for inequality is centralized wage bargaining.

**Tests using better data for 1951-1975, 1975-2000:** Wage bargaining effect strongest for post-1975 period. Evidence of partisanship mattering post-1975 but not before.

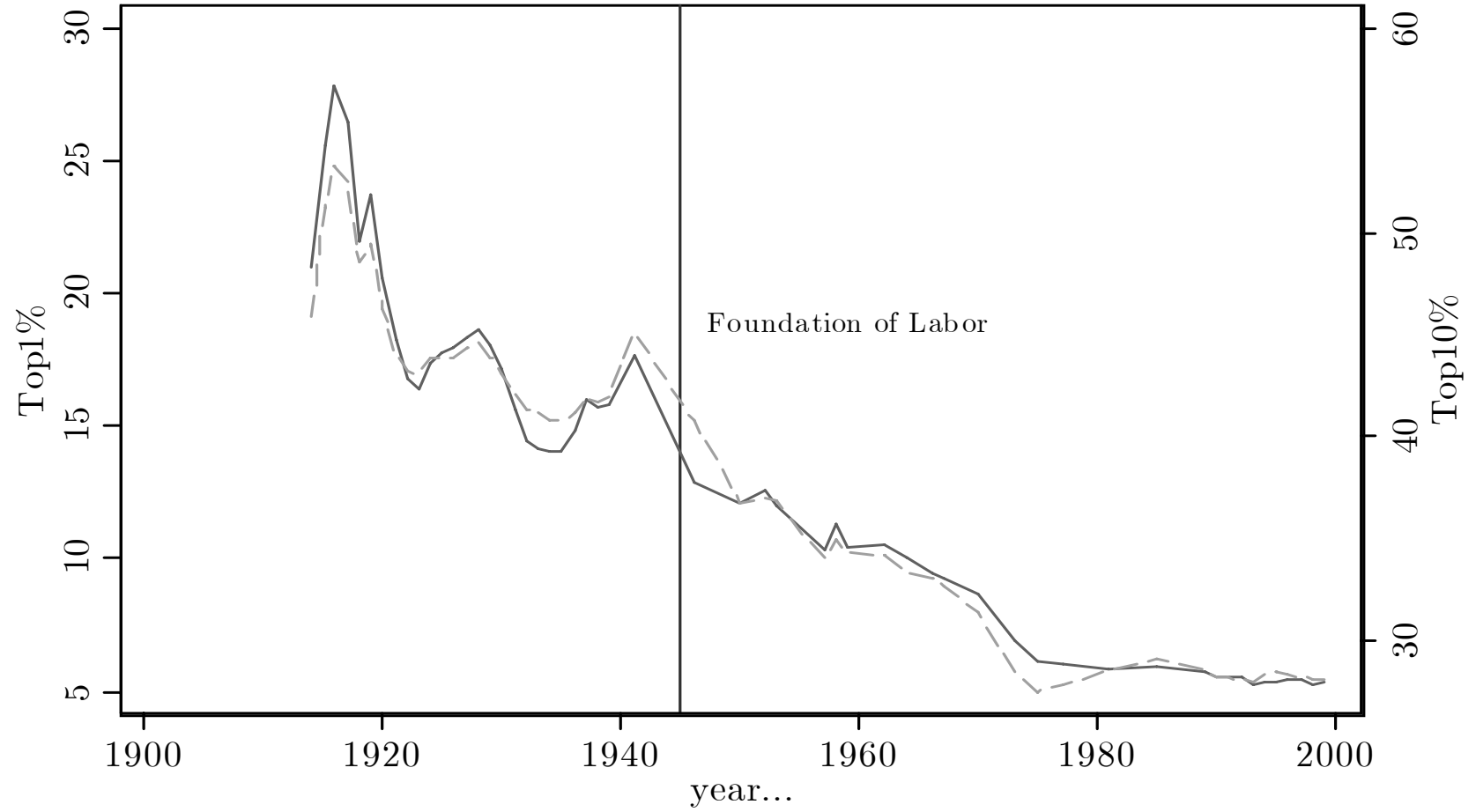
**Next look at individual countries:** Several countries centralized bargaining arrangements during the 1930s and 1940s. Sweden with Saltsjöbaden accord of 1938 is emblematic case, but there are others (the Netherlands, Denmark, Ireland). Did institutional change lead to a structural break in inequality?

**Surprising result:** In all four countries inequality was trending downward well before the institutional change, and little sign trend was altered at this point.

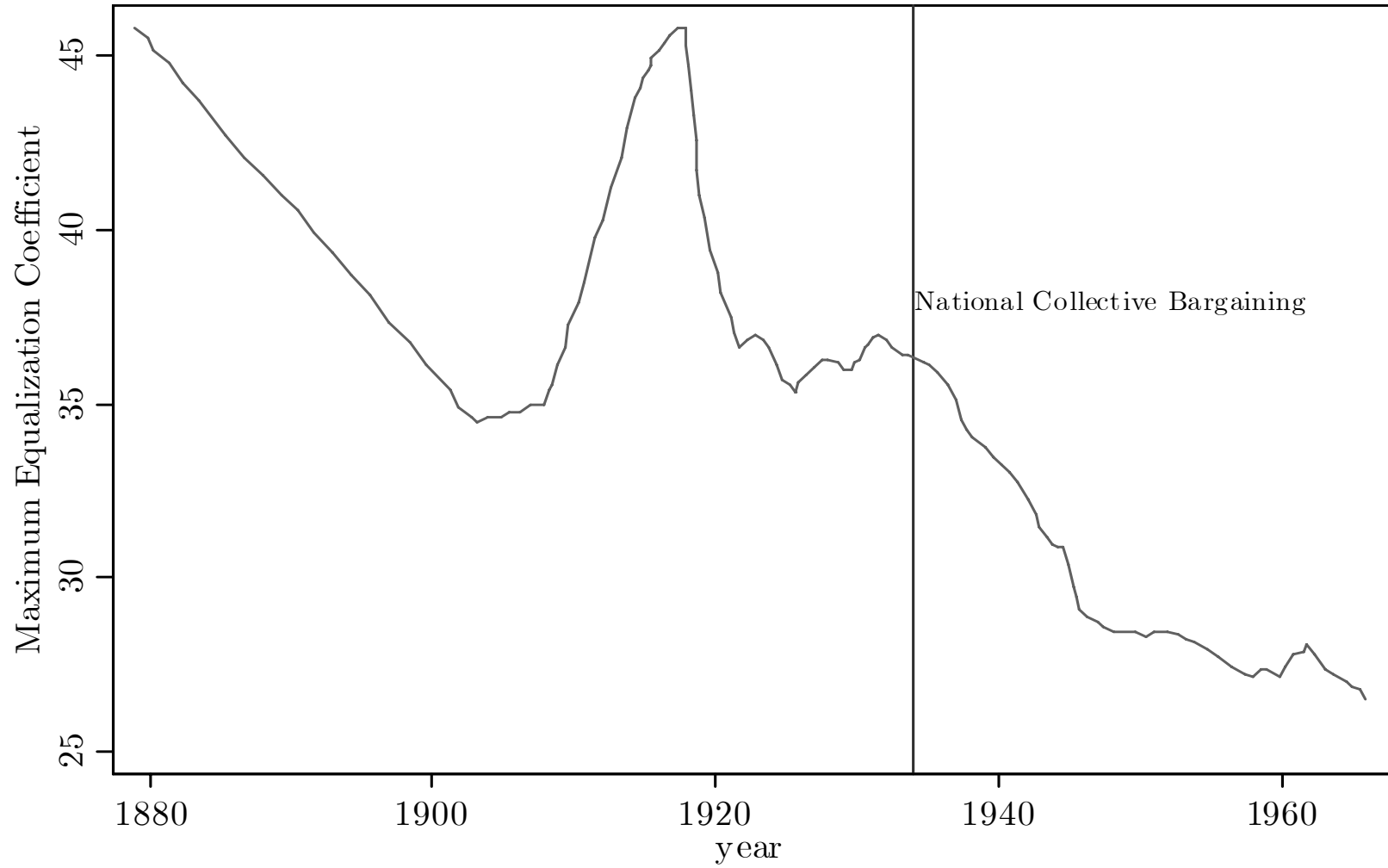
# Centralized Bargaining as a Structural Break in Sweden



# Centralized Bargaining as a Structural Break in the Netherlands



# Centralized Bargaining as a Structural Break in Denmark



# Looking forward

What theory would be consistent with our empirical findings? We very briefly consider three possibilities.

- Both inequality and bargaining centralization are outcomes endogenous to an *underlying* economic process (Benabou, 2004; Acemoglu, Aghion, and Violante, 2001)
- Both inequality and bargaining centralization are outcomes endogenous to an *underlying* political process (could follow Gourevitch 1986 ch.4)
- Effect of bargaining centralization is contingent on type of economic shocks a country faces. Parallel with Blanchard unemployment argument.