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The Political Puzzle of Rising Inequality*

Noam Lupu and Jonas Pontusson

Many theories in political economy posit that government redistribution ought to be a function of the income distribution. The number of citizens who stand to gain from redistribution increases with inequality, so it seems intuitive to suppose that electoral competition would translate this into more redistributive policy. When the market earnings of the affluent increase relative to the market earnings of the less affluent, democratically elected governments ought to compensate low- and middle-income citizens by increasing redistribution. Put formally, the pivotal median income earner will prefer more redistribution as the upper half of the income distribution becomes dispersed and his/her distance from the mean increases (Meltzer and Richard 1981).

And yet cross-national comparisons do not seem consistent with this basic intuition. Instead, government policy actually tends to be less redistributive in more unequal countries (see, e.g., Iversen and Soskice 2009), in what Lindert (2004) famously calls the *Robin Hood paradox*.[1] Defenders of the theory retort that broad inequality measures, such as the Gini coefficient, do not necessarily capture variation in the median–mean distance at the heart of the model, or that its implications should really be tested by looking at over-time changes within countries rather the cross-national variation.[2]

In response, scholars studying how inequality affects citizens' preferences for redistribution and how governments respond to those preferences (including

* For their comments and advice, we are grateful to the contributors to this volume and the anonymous reviewers. We are also grateful to Marc Morgan, Jérémie Poltier, and Jan Rosset for assistance with the data presented in this chapter.

[1] In Lindert's (2004) felicitous formulation, Robin Hood comes out of the woods to steal from the rich and give to the poor only when he is least needed.

[2] For the 1979–2000 period, Kenworthy and Pontusson (2005) find a positive correlation between market inequality and redistribution among working-age households in nine out of ten OECD countries, with the United States as the outstanding exception.

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several contributors to this volume) frame their work in terms of change over time. Income inequality, they argue, especially at the top of the income distribution (Piketty 2014), has risen sharply in advanced capitalist societies in recent decades, and elected governments have failed to compensate low- and middle-income earners for this development. The puzzle, then, is why rising income inequality has failed to translate into either increased demand for redistribution among the public or greater supply of redistributive policies from elected governments.

This chapter begins by taking a closer look at this conventional framing and arguing that it needs to be qualified in two important ways. The first concerns temporality. Income inequality rose sharply in the fifteen years before the financial crisis of 2007 to 2008 in advanced democracies. But there has been no uniform trend of rising inequality in the period since the crisis. The conventional claim that inequality has risen consistently in these countries for the last three decades is somewhat misleading.

The second qualification concerns the effects of government policy on inequality. Although the puzzle of rising inequality is typically framed in terms of governments failing to compensate citizens for a market-driven phenomenon, the data suggest that this trend is partly also a function of policy decisions. Governments across the ideological spectrum reduced the generosity of welfare states during the precrisis period. Tax and transfer systems not only failed to respond to the exogenous forces expanding market inequality, but they themselves became less redistributive and drove inequality higher. In addition, changes to the social structure and labor market meant that existing welfare-state benefits, such as unemployment insurance, also became less redistributive. In other words, the puzzle of rising inequality lies not only in the failures of democratically elected governments to respond to market forces but also in the political choices of those governments to abandon redistributive policies or to ignore societal changes that were rendering welfare states less redistributive.

The conventional story of a steady rise in income inequality generated by market forces and a political failure to offset these forces must be qualified, but it remains the case that advanced capitalist societies are, with few exceptions, more unequal today and their tax and transfer systems are less redistributive than they were in the early 1990s.

Two streams of recent research, developed along separate tracks, shed some light on the political puzzle of rising inequality. The first focuses on elites and the policymaking process yielding unequal representation of voter preferences. Voters may demand redistribution, but it could be that policymakers do not listen. They may fail to perceive the changing winds of public opinion. Or they may just not be all that responsive to the preferences of most voters, acting only upon the priorities and preferences of the very wealthy, especially when it comes to economic issues. This could be because the affluent fund political campaigns and lobbying, because less-affluent citizens are

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less likely to vote, or because elected representatives are typically themselves affluent, among other possibilities.

A second approach to explaining the political puzzle posed by the trend of rising inequality focuses instead on voters' preferences for redistribution. If canonical theories are wrong about the effects of rising inequality on redistribution, then one explanation could be that they wrongly assume that rising inequality will make voters demand more redistribution. This could be because voters lack information about or misperceive rising inequality, because the media offers biased assessments of such economic conditions, or because they prioritize other policy dimensions (such as immigration) or other political considerations (such as partisanship). Alternatively, it could be that voters do respond to rising inequality with stronger preferences for redistribution, but they fail to translate those preferences into votes or mobilize around the issue in ways that might influence policymaking.

This volume seeks to bring these two research agendas into conversation in an effort to better understand what it is about the political process that has led to rising inequality. Doing so allows us to address some of the shortcomings of prior work but also to highlight the unresolved tensions between different arguments as well as their persistent limitations.

One shortcoming of prior research in this field is the isolated way in which research about the United States is typically conducted. Studies of preferences for redistribution have become commonplace among scholars of comparative political economy, and many of these studies use cross-national datasets that are strictly European. At the same time, studies of unequal representation were pioneered by students of the United States, and comparative scholars have only very recently begun to catch up. And yet the puzzle of rising inequality applies as much in Europe as it does in the United States, as we show in this chapter.

If we are going to make strides toward resolving this puzzle, it seems fruitful to bring the United States into comparative perspective. Do the explanations for this puzzle offered by scholars of US politics generalize to other contexts as well? If they do not, this may suggest that other factors are actually more important. Conversely, comparative explanations could benefit from paying more attention to the factors emphasized in American politics. While the United States is certainly different from other affluent democracies in a variety of ways, we do not think it is so unique that it cannot be fruitfully compared. Or, if it is unique, we think social scientists should seek to theorize what it is about the United States that makes it exceptional. Both endeavors require bringing scholars of American politics into direct dialogue with scholars of comparative politics.

The chapters in this volume grapple with finding answers to the political puzzle of rising inequality. They do so by focusing either on the voter side of demand for redistribution or on the elite side of representation and the policymaking process. Many focus either on the US case or on some comparison

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across European cases. But they do so by clearly engaging with theories from across these arbitrary divides, offering a more nuanced and more generalizable set of findings to push forward this important research agenda. Together, they suggest important directions for future research and raise new questions and disagreements about everything from methodological choices to broader interpretations of the implications of their findings.

CHANGES IN INCOME INEQUALITY AND REDISTRIBUTION

Research on unequal representation and the politics of redistribution often begins by noting that income inequality has risen sharply across advanced democracies and proceeds to ask why governments have done so little to offset that trend. This conventional framing serves useful heuristic purposes but also misses important nuances.

The Luxembourg Income Study (LIS), the European Union Statistics on Income and Living Conditions (EU-SILC), and the World Inequality Database (WID) allow us to track the evolution of income inequality and redistribution over time. For reasons of data availability and simplicity, our descriptive analysis covers the period from 1995 to 2019 and is restricted to twelve countries: the United States, Australia, and the UK (commonly characterized as liberal market economies or liberal welfare states); the four Nordic countries (Denmark, Finland, Norway, and Sweden); and five continental European countries (Belgium, France, Germany, the Netherlands, and Switzerland). The European countries in this sample commonly serve as explicit or implicit comparative reference points in the literature that explores the politics of inequality in the United States. These countries are more egalitarian than the United States and they are often assumed to have done more than the United States to counteract rising inequality.

LIS and EU-SILC provide survey-based measures of household income that allow us to compute various measures of the distribution of household income before and after taxes and transfers as well as the redistributive effects of taxes and transfers. Combining information from labor-force surveys with administrative tax data, the WID adjusts for the fact that people at the very top of the income distribution are underrepresented in surveys. WID data represent an advance on LIS/EU-SILC data in that they provide a more accurate picture of top-end inequality. At the same time, the WID only provides measures of pretax income and disposable personal income, with public pensions and unemployment benefits included in pretax income, and does not readily enable us to distinguish between economically active and retired individuals.[3] As a

[3] The most obvious reason for focusing on the working-age population is to make cross-national comparison more straightforward. In countries that provide generous public pensions, people have limited incentive to save for their retirement and elderly households typically earn very little market income. Including retirees in our measures in these countries would make redistribution

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result, measures of redistribution based on WID data are effectively restricted to redistribution through taxes and cash transfers other than public pensions and unemployment benefits.[4]

Rather than choosing one or the other data source, we take advantage of the strengths of each by looking at top-10-percent income shares for the population as a whole based on WID data alongside Gini coefficients for the working-age population based on LIS/EU-SILC data.[5] Following conventional practice, we measure redistribution among working-age households as the percentage change between the Gini coefficient for market income and the Gini coefficient for disposable income, or, in other words, the percentage reduction of Gini coefficient brought about by taxes and government transfers. Based on WID data, we also report on redistribution as the percentage reduction in the top-10-percent income share of total (personal) income brought about by taxes and targeted social assistance.

Figure 1.1 provides an overview of what happened to overall inequality of disposable income, measured by the Gini coefficient, and top-end inequality of disposable income, measured by the share of the richest 10 percent, between 1995 and the late 2010s. Both panels show that disposable income inequality has risen in recent decades; taken together, they indicate that rising income inequality cannot be attributed to rising top-income shares alone. Averaging across countries, the Gini coefficient for working-age disposable income increased by 10.6 percent while the top-10-percent share increased by 7.2 percent. It is also interesting to note that Gini coefficients rose sharply in all the Nordic countries and that the United States does not stand out as having a particularly inegalitarian trajectory. Disposable income inequality among working-age households increased more in Germany and the Nordic countries than it did in the United States over this period. Of course, we are measuring changes in inequality relative to their

appear to be very high relative to countries with less generous pension systems. From a dynamic perspective, changes in the market income of elderly households also reflect changes in public pension provisions as much as (or more than) market dynamics, rendering the question of how tax-transfer systems respond to market income inequality much less tractable.

[4] WID data pertain to the income of individuals, with survey-based household income split equally among adults in the household. Note that the WID also includes measures of the national income distribution consistent with national accounts, distributing government spending on health as a lump sum to all individuals and spending on education proportional to income. The national income data series also attributes undistributed corporate profits to individuals. See Caranza, Morgan, and Nolan (2022) for further discussion of the differences between LIS/EU-SILC and WID data.

[5] Working-age households are defined as those headed by someone under sixty-five years old. The estimates of Gini coefficients for the working-age population are based on LIS or EU-SILC data for years when one or the other are available and the average of the two when both are available (the two data series are closely correlated). Due to lack of data on personal income, our estimates of top-10-percent income shares for the United States are based on national income (see footnote 4).

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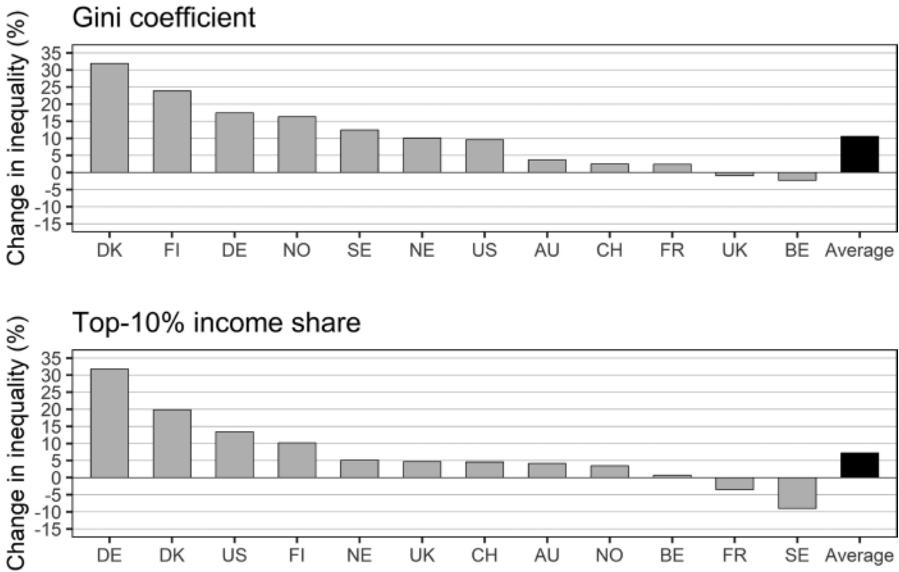

FIGURE 1.1 Income inequality growth, 1995–2018/2019
Note: Bars plot the percentage change in disposable income Gini coefficients and top-10-percent income shares between 1995 and 2018 (Gini coefficients) or 2019 (top-10-percent shares).
Sources: EU-SILC, LIS, and WID.

starting levels, and inequality was much higher in the United States than in the Nordic countries in the mid-1990s. The Nordic countries remain less unequal than the United States, but they have to some extent converged on the United States in this respect.

Most observers suppose that the trends displayed in Figure 1.1 result entirely from rising market inequality and then ask why governments have not responded. But as Tables 1.1–1.4 show, this misses two important elements of the story: the role of policy changes to tax and transfer systems in reducing redistribution, and the differences in these trends before and after the financial crisis.

Table 1.1 shows how inequality and redistribution among working-age households changed from 1995 to 2007.[6] For each country, the columns show initial levels of inequality (measured by the Gini coefficient), percentage changes in inequality, and absolute changes in the redistributive effect of taxes and transfers over this precrisis period. The key observation that emerges from this table is that disposable income inequality increased more than market

[6] We use 2007 as a cutoff because this was the peak year for top-10-percent income shares in the majority of the countries included in our analysis.

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TABLE 1.1 *Inequality and redistribution among working-age households, 1995–2007*

	Starting levels		Change (%)		
Country	Market income	Disposable income	Market income	Disposable income	Change in redistributive effect
Finland	0.434	0.222	−5.5	+19.4	**−13.5**
Germany	0.391	0.252	+10.7	+17.5	**−3.9**
Denmark	0.378	0.210	+0.3	+13.3	**−7.2**
Netherlands	0.402	0.248	+3.0	+9.3	**−3.8**
Norway	0.351	0.233	+7.7	+7.3	+0.2
Australia	0.417	0.294	+1.9	+7.1	**−3.6**
Switzerland	0.336	0.278	+1.5	+4.0	**−2.0**
United States	0.437	0.345	+1.4	+3.8	**−1.9**
Sweden	0.428	0.241	−14.3	+3.7	**−11.8**
France	0.424	0.290	+0.2	+2.1	**−1.3**
Belgium	0.401	0.262	+3.2	−0.4	+2.3
UK	0.467	0.324	−5.6	−1.9	**−2.7**
Average	0.406	0.267	+0.1	+7.1	**−4.1**

Notes: Values indicate the starting levels and changes in market and disposable income inequality measured as the Gini coefficients for working-age households. Bolded values represent regressive changes to redistributive policy.
Sources: EU-SILC and LIS.

income inequality in ten out of twelve countries. This pattern represents a regressive turn in redistributive policy. Market income inequality actually fell in three countries over this period. In two of these (Sweden and Finland), disposable income inequality nonetheless increased significantly and in a third (the UK), disposable income inequality declined by only 1.9 percent, while market income inequality declined by 5.6 percent. Belgium stands out as the only country in which the tax-transfer system clearly became more redistributive between 1995 and 2007.

Table 1.2 repeats the exercise for top-10-percent income shares. Here we observe a universal trend of increasing market income inequality, albeit with a very wide range of cross-national variation (from Belgium at 2.5 percent to Germany at a whopping 31.8 percent). In France and Sweden, increases in tax progressivity and targeted social assistance effectively cancelled out the impact of rising market income inequality on disposable income inequality measured this way. In five other countries (Australia, Denmark, Germany, Norway, and the United States), redistribution also increased, but not enough to offset the effects of rising market inequality. In the remaining five countries (Belgium, Finland, the Netherlands, Switzerland, and the UK), changes in redistribution reinforced the rise of

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TABLE 1.2 *Top-10-percent income shares and redistribution, 1995–2007*

	Starting levels		Change (%)		
Country	Market income	Disposable income	Market income	Disposable income	Change in redistributive effect
Germany	28.0	24.4	+31.8	+23.4	+5.6
Norway	27.5	22.6	+22.9	+15.9	+4.7
UK	34.5	27.7	+12.5	+14.8	**–1.7**
Switzerland	29.8	28.1	+12.8	+13.9	**–0.9**
Netherlands	27.6	23.4	+12.3	+13.3	**–0.7**
Finland	29.9	24.6	+10.7	+12.1	**–1.1**
Belgium	32.5	23.9	+2.5	+10.4	**–6.4**
United States	39.9	34.4	+10.3	+7.9	+1.9
Denmark	28.5	25.1	+7.7	+4.4	+2.3
Australia	28.2	23.9	+11.7	+1.3	+7.9
Sweden	31.5	27.8	+4.8	+0.4	+3.7
France	32.0	28.6	+4.8	0.0	+3.0
Average	30.8	26.5	+12.2	+9.8	+1.8

Notes: Values indicate the starting levels and changes in market and disposable income inequality measured as the top-10-percent income share. Bolded values represent regressive changes to redistributive policy.
Source: WID.

top-10-percent income shares. Regardless of whether we look at Gini coefficients or top-income shares, governments across these countries either failed to respond to market inequality or adopted policies that reduced redistribution.

Tables 1.3 and 1.4 show that these trends changed markedly in the wake of the financial crisis. Averaging across countries, market income inequality among working-age households increased more from 2007 to 2018 than it had from 1995 to 2007. But disposable income inequality among working-age households increased much less in this postcrisis period. Confronted with rising market income inequality, measured by the Gini coefficient, tax-transfer systems in this period became less redistributive in Denmark, Finland, Norway, Sweden, and the United States. In other countries (Germany, the Netherlands, and the UK), market inequality declined but tax-transfer systems also became less redistributive. Finally, progressive turns of redistributive policy offset rising market income inequality in France, Switzerland, and Belgium and reinforced declining market inequality in Australia. In the postcrisis period, inequality measured by Gini coefficients has been rising less sharply, and some governments do seem to have compensated for market forces.

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TABLE 1.3 *Inequality and redistribution among working-age households, 2007–2018*

	Starting levels		Change (%)		
Country	Market income	Disposable income	Market income	Disposable income	Change in redistributive effect
Denmark	0.433	0.296	+7.1	+16.4	**–5.4**
Norway	0.378	0.250	+3.2	+8.4	**–3.2**
Sweden	0.367	0.250	+2.7	+8.4	**–3.8**
United States	0.443	0.358	+5.0	+5.6	**–0.5**
Finland	0.410	0.265	+2.4	+3.8	**–0.8**
UK	0.441	0.318	–0.7	+0.9	**–1.2**
Netherlands	0.414	0.271	–4.1	+0.7	**–3.3**
France	0.425	0.296	+2.1	+0.3	+1.2
Germany	0.433	0.296	–5.3	0.0	**–3.8**
Switzerland	0.341	0.289	+3.5	–1.4	+4.0
Belgium	0.414	0.261	+0.5	–1.9	+1.5
Australia	0.425	0.315	–1.7	–3.2	+1.2
Average	0.410	0.292	+1.3	+3.2	**–1.2**

Notes: Values indicate the starting levels and changes in market and disposable income inequality measured as the Gini coefficients for working-age households. Bolded values represent regressive changes to redistributive policy.
Sources: EU-SILC and LIS.

In all these countries, top-10-percent shares of market income fell sharply during the financial crisis. As shown in Table 1.4, they were still lower at the end of the 2010s than they had been in 2007 in most countries. Measured by their impact on top-10-percent shares, taxes and targeted social assistance have become more redistributive in Belgium, Sweden, Finland, the Netherlands, and the UK, while they have become less redistributive in Denmark, France, Germany, and the United States, and have remained essentially unchanged in Australia, Norway, and Switzerland since 2007. Measured in this way, it becomes less clear that we can characterize the postcrisis era as a period of rising inequality, although some governments have continued to reduce the redistributive effects of taxes and targeted social assistance.

Tables 1.1–1.4 display a lot of cross-national variation as well as differences between the precrisis period and the postcrisis period. As such, they call into question the conventional notion that market forces favor the rich while democratic politics favor low- and middle-income citizens (an idea encapsulated by the title of Esping-Andersen's 1985 book, *Politics against Markets*). Measured before taxes and income transfers, top-income shares indeed rose sharply in most countries in the precrisis period, but the same is

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TABLE 1.4 *Top-10-percent income shares and redistribution, 2007–2019*

	Starting levels		Change (%)		
Country	Market income	Disposable income	Market income	Disposable income	Change in redistributive effect
Denmark	30.7	26.2	+8.1	+14.9	**–5.3**
Germany	36.9	30.1	+1.6	+8.3	**–5.4**
United States	44.0	37.1	+3.9	+5.1	**–1.0**
Australia	29.9	24.6	+3.5	+2.9	+0.5
Finland	33.1	28.7	0.0	–1.7	+1.5
France	34.1	28.6	–5.0	–3.5	**–1.3**
Netherlands	31.0	26.5	–5.2	–7.2	+1.8
Switzerland	33.6	32.0	–8.3	–8.1	**–0.2**
Belgium	33.3	29.7	–0.9	–8.8	+7.1
UK	38.8	31.8	–7.7	–8.8	+0.9
Sweden	33.0	27.9	–7.6	–10.0	+2.3
Norway	33.8	26.2	–10.6	–10.7	0.0
Average	34.5	29.1	–2.4	–2.3	+0.1

Notes: Values indicate the starting levels and changes in market and disposable income inequality measured as the top-10-percent income share. Bolded values represent regressive changes to redistributive policy.
Source: WID.

not true for overall income inequality among working-age households. In the years since the financial crisis, even these market top-income shares have not risen consistently.[7]

We can get a sense of political dynamics by treating each row in Tables 1.1–1.4 as a separate observation and looking at the redistributive effects of government policy. This yields twenty-one cases – a majority – in which changes to the distributive effects of taxes and transfers contributed to rising disposable income inequality and another six cases in which reductions in market income inequality did not fully pass through as reductions in disposable income inequality.[8] By contrast, we only observe thirteen cases in which increases

[7] Market forces are of course also embedded in politically created institutions, including collective-bargaining systems, employment regulation, and minimum wage legislation, and they respond to public policies. Piketty and Saez (2014) argue persuasively that reductions in top marginal tax rates in the 1990s boosted top-income shares by stimulating demand for corporate compensation.

[8] It is important to keep in mind that changes in the redistributive effects of tax and transfers are not necessarily the results of policy changes pertaining to the progressivity of taxes or the generosity of welfare benefits. For instance, many studies show that unemployment insurance has a strong redistributive effect for the simple reason that low-income households are more exposed to unemployment than high-income households (e.g., Pontusson and Weisstanner 2018). In all countries,

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