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ARE INEQUALITY AND DEMOCRACY INVERSELY CORRELATED?

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Abstract

The word "democracy" means "the rule of people". Following the etymology of the word, it would be assumed that democracy strives to achieve, to quote the British philosopher Jeremy Bentham, "the greatest happiness for the greatest number". Although happiness is not necessarily measured by affluence and wealth, the latter facilitates the material aspect of the former. It would be therefore incompatible to see democracy in societies in which wealth is focused in a small number of hands. One could set the following hypothesis: Democracy and inequality in income and wealth are inversely correlated. More democratic societies will have less inequality and vice-versa, less democratic societies will have bigger differences in a distribution of income and wealth.

Keywords: Democracy, Inequality, Hypothesis, National sovereignty, Hyper-globalization

INTRODUCTION

The word "democracy" means "the rule of people". Following the etymology of the word, it would be assumed that democracy strives to achieve, to quote the British philosopher Jeremy Bentham, "the greatest happiness for the greatest number". Although happiness is not necessarily measured by affluence and wealth, the latter facilitates the material aspect of the former. It would be therefore incompatible to see democracy in societies in which wealth is focused in a small number of hands. One could set the following hypothesis: Democracy and inequality in income and wealth are inversely correlated. More democratic societies will have less inequality and vice-versa, less democratic societies will have bigger differences in a distribution of income and wealth.

But hold on! Could not one say that this hypothesis is invalid on the very first sight? Could not one say that it is clear that the hypothesis is inaccurate without longer analysis? It is true that Nazi Germany substantially increased inequality compared to the Weimar Republic. But the communist countries in Eastern Europe drastically reduced inequality while abolishing a parliamentary democracy at the same time. If the Balkan democracies in the interwar period could be described as weak and fragile, this was not the case with Czechoslovakia, which had a well-developed and advanced democracy. And it was Czechoslovakia which reduced inequality most, with the Gini coefficient falling to 0.18. From these examples, one could set quite the opposite hypothesis: inequality and democracy are directly correlated. More democracy, higher inequality and vice-versa, less democracy less inequality. But again, we need to stop. Cuba, China and the North Korea, three socialist and undemocratic countries, have the Gini coefficient 0.41, 0.49 and 0.60+ respectively, while, for example three democratic countries, the Netherlands, the Czech Republic and Slovenia have the Gini coefficient 0.25 each. Apparently, with the countries which abolished parliamentary democracy, we are dealing with hysteresis.

This is why we will focus our analysis on countries which retained parliamentary democracy, i.e., freedom of association, freedom of speech and free multiparty elections. We will slightly modify the previous hypothesis; the level of inequality and the level of democracy are inversely correlated. A higher level of inequality is accompanied with a lower level of democracy and vice-versa, a lower level of inequality is accompanied with a higher level of democracy. We emphasize correlation, not causation.

The first part is dedicated to the analysis of the level of inequality and the level of democracy in the age of Keynesianism. The second part researches the level of inequality and the level of democracy in the age of neo-liberalism. The third part discusses the political trilemma, incompatibility to achieve at the same time three desirable goals; national sovereignty, democracy and hyper-globalization. The article ends with some recommendations as how to reconcile globalization and national democracy.

1. DEMOCRACY IN THE AGE OF KEYNESIANISM

After WWII, the world was ideologically divided. This division was most pronounced in Europe. Following the Yalta agreement between Churchill and Stalin, Europe was split into two parts: the communist East, and the predominantly capitalist West. In Eastern Europe communists abolished parliamentary democracy and replaced it with "people's democracy", which is a tautology. Some communist countries such as Czechoslovakia, Poland and East Germany and Hungary retained a multi-party system, but without free elections. Communist parties had a monopoly of power and held the most important political positions in their hands. Members of other parties were represented in a parliament. Sometimes their members might have been given a less important ministerial post in a government. But in the absence of free elections and with a widespread censorship, they were not different in the level of repression from the other communist countries which were declared one-party states.

In the contrast, the Western countries had a multi-party system, with free elections and a high level of political and personal freedom. Therefore, it is not surprise that most people identified capitalism with democracy, However, it would be wrong to equate capitalism with democracy. The history of capitalism shows that it started its existence neither as a democratic nor as a liberal system. It took capitalism centuries of political strives, civil wars and revolutions to establish what is nowadays known as a universal franchise. Even in the interwar period, when capitalism was a well-established system, parliamentary democracy collapsed in most countries. (Mahmutefendic 2018).

Even after WWII, capitalism and democracy were decoupled in some countries. Capitalism functioned without democracy in Spain under Franco, Portugal under Salazar, Chile under Pinochet and Kongo under Mobutu Divorce between capitalism and democracy was very often linked to an increase in inequality. (Milanovic 2018).
But in the Western world, democracy flourished after the WWII. Exceptions were Spain until 1975, Portugal until 1975 and Greece from 1967 until 1974 when military junta was in power. But eventually these countries rejected dictatorship and embraced democracy.

There were a host of political, social, legal and economic factors which contributed to huge advances in democracy:

1. ***Universal franchise***. A right to vote was restricted for centuries. Up until XX century only wealthy male property owners were allowed to participate in politics. At the time of the Revolution, France had a population of 23 million, out of which only 80,000 had a right to vote. In Italy, in voting for the unification of the country in 1861, only 2% of adults participated in the process. Wealth census was gradually removed as a criterion for voting. Between the two wars some countries allowed women to vote. But it was only after WWII that female participation in politics was endorsed in most of countries, with Switzerland being the last country to open this possibility to women in the Western Europe in 1971. Universal franchise allowed all adults to cast their vote in election and to choose political representatives who will best represent their interests.

2. ***Internal democratization and registration of the political parties***. In the interwar period, political parties were centralized and bureaucratized with strong hierarchy. There was no practical difference between officially democratic parties and communist parties. After the WWII political parties were formally democratised. In many Western European countries, inner democratisation of political parties was regulated in constitutions and laws which dealt with political parties' registration.

The main questions on which inner democracy in political parties depends are:

a) Relationship between party membership and party leadership;
b) Relationship between lower and higher organs within political parties;
c) Method of election of party leaders and functionaries;
d) Way of functioning of organs of political parties;
e) Method of adopting statute, programme and other party documents

Inner party democracy is regulated in statutes of political parties.

Political parties emerged with the Industrial Revolution and the advent of capitalism. Although they have been the most powerful political subjects, their activities had not been legally regulated for almost two centuries. Only after WWII did constitutions enter articles which set rules and principles for functioning of political parties. This was further developed to the level of special laws which regulate activities of political parties in more detail. The first Western European countries to legalise political parties after WWII were Italy, France and West Germany. Legalisation of political parties went in accordance with democratic rules set in constitution and corresponding laws. (Mahmutefendic 2019 Tuzla).

Democratisation went hand in hand with a sharp reduction in inequality in income and wealth. A reduction in inequality started after the WWI and was caused by "malign factors", predominantly the war, but also epidemics and natural disasters. After the WWII "benign" factors prevailed in reduction of inequality (Milanovic 2018).

1. **Unprecedented economic prosperity**. After WWII, the world economy went through unprecedented prosperity. Three golden, or three glorious decades of the world economy, also known as an upswing of the fourth Kondratieff, witnessed a growth of GDP at an average annual rate of 5.6% and a growth of world trade at an even higher rate of 7.3%. As a result of this, GDP per capita and the living standard quadrupled in the Western European countries. This spectacular economic performance owes its debt to a great extent to a Keynesian revolution in economic theory and policy.

Benign forces are lacking in societies with a stagnant mean income or low growth rates. "It is only in growing economies that forces of rising education, greater political participation, and an aging population demanding social protection impart downward pressure on income inequality. In other words, it is not accidental that societies with higher (and growing) income are also societies that have a higher level of education and greater political rights and have gone through the demographic transition. Among the benign forces, I also list low-skill -biased technological change" (Milanovic 2018).

High growth rates enabled those with no property to earn high incomes and to turn their savings into real and financial assets. This contributed to a decrease in differences in distribution of wealth. (Piketty 2015).

2. **Welfare state**. After WWII a welfare state replaced a night-watchman state, which was dominant in the XIX century and the beginning of the XX century. The nightwatchman or a minimalist state financed law and order, i.e., police, army and judiciary and accounted for about 10% of GDP. In contrast, the welfare state accounts for 40-50% of GDP. In addition to traditional items, it finances education, health, social insurance, pensions, social housing etc. These items were considered basic human rights, with the exception of medical insurance in the USA. (Stiglitz 2019). The welfare state provided a decent standard of living for a vast majority of citizens, and all but eradicated absolute poverty in developed countries.

3. **Progressive taxation and transfers**. Income tax is a relatively recent category. For example, it was introduced in the USA in 1913. It amounted to 1% and initially it faced a strong resistance. But after WWI, income tax became the most important source of government revenue in developed countries with its very strong redistributive function. For example, without taxes and transfers, the 10% richest in the UK would appropriate 21 times higher income than 10% poorest. After taxes and transfers, even when the top tax rate was firstly reduced from 83% to 60% and later to 40%, this ratio falls to 4.8:1. (Mahmutefendic 2018). In Scandinavian countries a redistributive function is even more pronounced. The market income Gini coefficient is 0.44 in Sweden, 0.47 in Norway and 0.48 in Finland. After taxes and transfers a disposable income Gini coefficient falls to 0.25, 0.26 and 0.28 respectively. (Milanovic 2018).

4. **Nationalisation of private companies**. Western countries experienced profound changes in socio-economic structure after the WWII. Many companies in banking, telecommunications, public services, transport and heavy industry and mining were nationalised. The public sector grew in size so that in some countries it provided almost 50% of all jobs. (Mahmutefendic 2018). In nationalised industries, a system of pay scales was established, guaranteeing much less differences in salaries compared to private companies. In addition, public corporations offered more security to their employees because they were less exposed to market vagaries compared to companies in the private sector.

5. **Strength of trade unions**. Emboldened by uninterrupted prosperity and low rate of unemployment trade unions got in strength and confidence. In collaboration with left-wing parties, which increased their appeal to the electorate, trade unions managed to influence legislation which was in favour of the working class. In tripartite collective negotiations, trade unions succeeded in obtaining many previously unknown rights for workers. These include paid holidays, paid sick leave and maternity leave, employers' contribution to pension schemes etc. Also, trade unions pushed through wage schedules, which compressed differences in income between managers and skilled workers on one side and workers with lower skills on the other side. In addition, trade unions pushed for an increase in minimum wages which exceeded an increase in average wages. For example, minimum wages in France increased by 92% from 1968 to 1983 while average wages rose by only 53%. As a result, the ratio between 10% highest salaries and 10% lowest salaries decreased from 4.2 in 1968 to 3.1 in 1983. (Piketty 2015).

6. **Existence of socialist/ communist countries**. The communist take-over in East Europe after the WWII contributed to the Great Levelling in Western countries. Being aware of the catastrophic consequences of excesses of capitalism in the interwar period, the Western countries adopted many admixtures of socialism, whose aim among other things was to prove their superiority in delivering prosperity to all compared to the Eastern European countries.

A synergy of the aforementioned factors secured prosperity to all parts of society, but the incomes of those at the bottom grew faster than those at the top. As a result, a strong middle class was created, a bulwark of democracy and a buffer zone against political excesses from the far right and the far left. (Stiglitz 2019).

The following indicators show a magnitude of the “Great Levelling“ in decades after WWII.
The capital-labour ratio fell from 1950 until 1975 from 34.9 to 30.9 in the USA, from 37.5 to 29.8 in France and from 33.2 to 28.2 in Germany. (Piketty 2015). The share of the 10% richest in the USA dropped from 40% of primary income to under 30% of a disposable income. A Gini coefficient in the USA fell from 0.50 to 0.35 in the USA from the Great Depression until 1979. In the UK a fall in Gini coefficient was even more pronounced; from 0.60 to 0.35. In Italy and Spain, the Gini coefficient was 0.50 in the beginning of the 1950. It fell by 20 points by 1985. (Milanovic 2018).

The first signs that prosperity was approaching its end appeared in 1971, when the USA abolished the convertibility of the dollar into gold. Two years later, a system of floating exchange rates replaced a system of fixed exchange rates, which struck a final nail in the coffin of the Bretton Woods international monetary system. In 1974 a group of the OPEC countries quadrupled the price of oil, spinning the world economy into a stagflation, a combination of stagnation and inflation. The world economy entered a particular phase of a long cycle, which combined a low growth and a high inflation. (Goldstein 1988). At that time, it was thought that stagflation had been an unprecedented event, since it contradicted economic theory. Keynesianism proved powerless in tackling stagflation. Expansionary fiscal and monetary policy did not work because of the breakdown of the Philips curve. This created a vacuum, exploited by big corporations and conservative circles in the USA and the Great Britain, who through Reaganism and Thatcherism conducted a neo-liberal counter-revolution by the end of the 1970's and the beginning of the 1980's.

2.DEMOCRACY IN THE AGE OF NEOLIBERALISM

The neoliberal onslaught started in 1979 with Margaret Thatcher becoming the British Prime Minister and in 1980 when Ronald Reagan became the American president. Ever since Thatcherism and Reaganism became a synonym for policies which wiped out many achievements of the post-war period. The policies whose outcome could be succinctly expressed as of the 1%, by the 1%, and for the 1% (Stiglitz 2019) were facilitated by a galore of factors.

1. **Globalisation**. Globalisation is not a new phenomenon. From a historical perspective it would be accurate to deduce that the world entered a new phase of globalisation in the 1980s. An earlier phase of globalisation occurred between 1870 and 1914. During that period the world economy was even more integrated than today. The basis for that integration was provided by the gold standard, whose guarantor was the Great Britain and its currency the pound, because of high surpluses in the balance of payments. In addition, the world, as today, but in a lesser degree, was unified with new transport means and new means of communication (telephone and telegraph). (Mahmutefendic 2014) What makes difference between this phase of globalisation and the current one is that they occurred in different phases of the Kuznetz cycle. The previous phase of globalisation had happened in the second phase of the first Kuznetz cycle, when inequality was high and stabilising, and even started declining in some countries such as the Great Britain, because of creation of the class of labour aristocracy. The current phase of globalisation started at the beginning of the second Kuznetz cycle, when low inequality began sharply to rise, a good deal because of increased mobility, not only of capital, but also the most qualified labour and a sudden increase in demand for this type of labour. (Bourguignon 2015).

2. **Technology.** The current phase of globalisation coincides with the Second Industrial Revolution, and according to some authors with the end of the Third and the beginning of the Fourth Industrial Revolution (Schwab 2017). Computerisation, digitalisation, robotics, artificial intelligence, biotechnology and nanotechnology profoundly changed all systems - economic, social, political, cultural, legal - and radically changed the way of life. Obvious winners of these changes have been consumers. The technological revolution(s) “have made possible new products and services that increase at virtually no cost the efficiency of our personal lives as consumers. Ordering a cab, finding a flight, buying a product, making a payment, listening to music or watching a film – any of these tasks can now be done remotely. The benefits of technology for all of us who consume are incontrovertible. The internet, the smartphone and the thousands of apps are making our lives easier, and – on the whole – more productive. A simple device such as a tablet, which we use for reading, browsing and communicating, possesses the equivalent processing power of 5,000 desktop computers from 30 years ago, while the cost of storing information is approaching zero (storing 1GB costs an average of less than $0.03 today, compared with more than $10,000, 20 years”. (Schwab 2017)

More ambiguous outcomes have been created by challenges related to work and production. Most developed countries experienced a significant decline in the share of labour as a percentage of GDP. Half of this drop is due to the fall in the relative prices of capital goods, driven by the progress of innovation, which made it attractive to companies to substitute capital for labour. As a result, the great winners of this technological revolution(s) are the providers of intellectual and physical capital, namely innovators, the investors and shareholders, which explains the rising gap in returns on capital and return on labour. (Schwab 2017).

New technologies have also stirred up the relationship between different types of labour. They widened income disparities. The increase in inequality happened in part because the technologies strongly rewarded more highly skilled labour. The structure of demand and derived demand for jobs moved towards services, which in turn were staffed by less qualified and worse-paid job. On the other hand, some service sector jobs, as in finance, telecommunications, management and marketing, were extremely highly paid. This widened wage gaps, and ultimately income distribution. (Milanovic 2018)

Inequality was additionally increased by the fact that highly-skilled highly-paid workers derived part of their income from capital, if nothing else because of the possibility to turn their savings into real and financial assets. On the other hand, low-skilled workers got disillusioned by fast technological changes, convinced that their real income may not increase and might even fall over their lifetime and that their children may not have a better life than theirs, i.e., that instead of material progress they will experience material regress. (Schwab 2017).

3. Liberalisation, deregulation and privatisation. Classical economic theory argues that a free trade will increase production and efficiency and bring benefits to all economic agents. Free trade proponents admit that some people might be worse-off in the short run, but that in the long run everybody will be better off. This statement is not corroborated by the facts. Stompler-Samuelson theory suggests that some groups will suffer long-term losses because of significant dislocations of resources. These groups include unskilled workers and those who are internationally immobile. Opening a country to a free trade will cause two effects; the gain effect and the redistribution effect. Although the gain effect is indisputable it can be swamped by the redistribution effect. This is particularly the case when tariffs are already low. The law of diminishing returns works in a way that the lower the starting point of tariffs, the higher the redistribution effect compared to the gains effect will be. For example, in the United States, at the level of tariffs of 40% the redistribution-to-efficiency -gains ratio is 6. At the level of tariffs of 5% this ratio amounts to 50. It might happen that before trade liberalisation two persons acquired $25 each. After trade liberalisation, the total welfare increased from $50 to $51, but person A will acquire $51 and person B will acquire nothing (the winner takes it all). (Rodrik 2012).

Liberalisation was accompanied by privatisation. The aim of privatisation was to increase efficiency and competitiveness since it was assumed that private companies perform better than public corporations. In certain cases, privatisation increased efficiency and consumer surplus and improved the quality of service. This was particularly pronounced in telecommunication industry in the UK. In some cases, privatisation even reduced monopoly rents that benefitted the wealthiest. (Bourguignon 2017). However, privatisation of public corporations often led to a profound restructuring of their activity, the number of people they employed, and their geographic locations, which had profound effects on particular social groups and regions. (Bourguignon 2017).

Unleashing market forces also required deregulation. This process was particularly conspicuous in financial and labour market. Deregulation of financial markets made the allocation of available funds more competitive between lenders and facilitated the access of financially constrained agents to credit. This improved the efficiency of the economy as a whole and contributed to the development of sectors and businesses that were initially deprived of access to credit. However, financial liberalisation has had other effects that have been clearly inegalitarian. Competition in the financial sector is restricted by the fact that it is highly oligopolistic. The existence of substantial rents and the nature of the financial sector's activities have made possible the very high incomes of certain operators and executive officers. This was more pronounced in the USA, where a CEO's income is 300-700 times higher than an average salary.

Deregulation in the labour market had the aim to make it more flexible. Of twenty OECD countries, fourteen have relaxed these regulations over the last quarter century. The Anglo-Saxon countries are not among the reformers, since labour markets in these countries have been much less restrictive than elsewhere, while France has been the only country where law protection for employees strengthen.

Labour market deregulation included relaxation of protection of employment, lowering redundancy payments and replacement of fixed-term and permanent contracts with temporary and part-time contracts. In addition, collective bargaining has been reduced and replaced by individual bargaining, social contributions of employers have been reduced, leading to much less security for many workers. This has made more jobs precarious and has given the upper hand to the employers.

4. Trade unions. John Kenneth Galbraith noticed that strong trade unions require strong employers. Trade unions were very strong in developed countries in the decades following WWII. Their membership was mostly concentrated in the public sector and manufacturing industry. Trade unions managed to negotiate good deals with employers, securing good pay and permanent employment.

After 1980, the power of trade unions weakened almost everywhere. This might be explained by the following factors:

- Change in economic circumstances, which strengthened the bargaining power of employers and weakened the bargaining power of employees.

- Widespread privatisation, which destroyed some of the trade unions' strongholds.
- Declining significance of the manufacturing sector and rising importance of the service sector, the latter being more fragmented. Also, the service sector employs some highly qualified individuals, who possess unique skills and talents, and who prefer individual to collective bargaining.

As a result of these changes, trade union membership rapidly declined. (Mahmutefendic 2019).

A decline was most pronounced in the private sector while this decline was less in education and health service in the public sector.

Trade union density in the two corporatist countries, the USA and the UK, decreased from 14% in 1999 to 11% in 2013, and from 30% in 1999 to 26% in 2013 respectively. A decline in trade union density was recorded even in the two countries of "welfare capitalism", Austria and Germany, where trade union density fell in the same period from 38% to 28% and from 25% to 18% respectively. The unweighted average share of unionised labour among employees in all OECD countries went down from 21% in 1999 to 17% about a decade and half later. (Milanovic 2018)

5. Taxation. From the perspective of distribution, the most important reforms were the changes in taxation, particularly change in composition of tax revenue. A shift occurred from income tax, whose rates were cut, to indirect taxes, whose rates increased. This increased regressivity of the tax systems. The argument for this was that the marginal tax rates on the highest incomes were practically confiscatory and were discouraging entrepreneurship and investment and encouraging tax evasion and tax avoidance. Lower tax rates were intended to restore these incentives and reduce tax evasion, while maintaining tax revenue at the same level or even increasing it. This stance has a theoretical backing in the "Laffer Curve", which has never been empirically confirmed. The highest marginal tax rate was reduced from 70% to 40% in the USA during the Reagan administration. In the UK during the reign of Margaret Thatcher, the highest marginal tax rate was reduced from 83% to 60% and later to 40%. At the same time VAT increased from 6% to 20%. Several other countries, such as Germany and France, applied the same reforms - albeit less radical. Even traditionally one of the most egalitarian countries in the world, Sweden, reduced the highest marginal tax rate from 70% to 45% and increased indirect tax rates in order to offset tax revenue losses. As a result of these changes, inequality rose substantially. (Bourguignon 2017).

6. Monopolies, monopsonies and rent. In mid-twentieth-century capitalism, corporations with market power shared their monopoly rents with their unionized workers. In twenty-first-century capitalism, not only that there is more market power on average, but there is less sharing of the rent. (Stiglitz 2019). Robert Solow explained that a declining labour share in developed countries is due to a renegotiation of rents in favour of capital owners. Solow analyses an economy of imperfect competition where value added is distributed between labour and capital according to their marginal products plus a rent, which is the object of negotiation between the two. There are different types of rent such as monopoly rents, patent rents, rents arising from barriers to entry etc. The relative share of rent going to labour and capital at the level of each company, sector and entire economy depends on the relative bargaining power of capital and labour. The current era of globalization has witnessed an increase in global population by two-thirds from 1980 and joining of world market by China and the former communist countries. This growth in supply of labour, according to Solow, has weakened labour's position worldwide and allowed capital owners to appropriate most of the rent for themselves. (Milanovic 2018).

Another Nobel prize winner, Joseph Stiglitz, observed that the wealth-to-income ratio increased by more than the capital-income ratio. He also noticed that both share of labour and share of capital in GDP decreased. Stiglitz found explanation for this in the fact that a share of rent in GDP increased. (Stiglitz 2019).

This means that the Cobb-Douglas function, which is the starting point in the Solow growth model, should be rewritten into the following form:

$$\mathbf{Y = AL^{\alpha}K^{\beta}R^{\Upsilon}},$$

Where Y stands for income, A for total factor productivity, L for labour, K for capital, R for rent, α for share of labour in GDP, β for share of capital in GDP and Υ for share of rents in GDP

If α and β are falling, this means that Υ is increasing.

An additional burden to workers is a monopsony power. Monopsony refers to a situation where there is a single buyer in a market, or a single employer in the labour market. In such a labour market structure workers are put in an unfavourable position. The firm can easily find a replacement worker, while a fired worker cannot find another job without a considerable effort. Jobs might be available in another city, requiring an individual to move, often with a family. Disruption is costly, not only financially. Fired workers are burdened with mortgage and other long-term payments related to various credits and loans. In a nutshell, there is a huge asymmetry of market power in favour of the employer. (Stiglitz 2019).

7. Welfare state. The welfare state came under attack, mainly, but not entirely, because of globalisation through cheaper imports and outsourcing. This attack acquires different forms such as cuts in national health service, cuts in public education, increased fees for government services, cuts in unemployment benefits and stricter conditions for obtaining them, a higher retirement age and flexible labour market, which is very often a euphemism for giving employers more freedom in dismissing workers. The victims of a weakening of the welfare state have been the working and the middle class. The working class was a major recipient of unemployment benefits and social assistance. The middle class was a major contributor and at the same time the major beneficiary of the welfare state through free or subsidized health care and education, pensions and a safety net in the case of unemployment and sickness. (Milanovic 2018).

8. Collapse of communism. After WWII, in addition to the strength of trade unions and the political power of left-wing parties, military threat of the Soviet Union curbed policies which favour the rich by constraining the power of capital. Social democratic taming of capitalism ended with the Fall of the Berlin Wall. With communism out of the picture and social democracy cornered a neo-liberal doctrine did not have a real contender. This gave rich capital owners the upper hand in a class struggle with the working class.

Combination of these factors caused a sharp rise in inequality of distribution of income and wealth. There is a galore of evidence to corroborate this statement. Here are some:

Market Gini coefficient increased from 1970 to 2010 in the USA from 42 to 50, while Gini coefficient of disposable income (after adding social transfers and deducting income tax) increased from 36 to 41 in the same period. (Milanovic 2018).

The following table shows a change in a share of capital and labour in value added in three major countries:

Year	United States		France		United Kingdom	
	Capital	*Labour*	*Capital*	*Labour*	*Capital*	*Labour*
1970	30.9	69.1	33.6	66.4	32.4	67.6
1975	30.9	69.1	29.7	70.3	28.3	71.7
1980	33.9	66.1	28.3	71.7	29.2	70.8
1985	34.0	66.0	32.0	68.0	32.2	67.8
1990	33.8	66.2	37.6	62.4	28.2	71.8
1995	33.8	66.5	39.7	60.3	31.5	68.5

Capital and Labour shares of value added in the United States, France, and the United Kingdom from 1970 to 1995
SOURCE: Thomas Piketty:" The Economics of Inequality", Harvard University Press, 2015, p41

Relatively stable capital-labour ratio in the United Kingdom can be explained by the fact that in this period, unlike many other countries, it had created new jobs, which increased total wage bill. The United Kingdom was the country with the largest increase in the Gini coefficient in this period, which can be explained by a widening gap in income from labour.

The following table shows a rise in the Gini coefficient in selected countries:

Period	Canada	France	Germany	Italy	Japan	UK	USA	Sweden	Denmark	Finland
Mid-80's	29	28	25	31	30	31	33	20	22	21
Mid-90's	28	26	27	35	32	33	36	21	21	22
2007-08	35	29	29	34	33	34	38	26	25	26
2010-11	34	31	29	34	34	34	39	27	25	27

The increase in inequality in selected OECD countries measured by the Gini coefficient of disposable income per adult equivalent, 1985-2010.
SOURCE: Francois Bourguignon: "The Globalization of Inequality", Princeton University Press, 2015, p51

The magnitude of inequality in income and wealth can be revealed from the following data. The United States has a very small elite, appropriating ever increasing share of GDP and national wealth, and a large and increasing bottom with almost no resources. 40% of Americans do not have $400 savings to help them in the case of calamity, whether it is a sickness or a minor financial problem. The three richest Americans - Jeff Bezos, Bill Gates and Warren Buffet - are worth more than the bottom half of the US population combined, testimony to how much wealth there is at the top and how little there is at the bottom. (Stiglitz 2019).

Over 20% of adults cannot afford the cost of medical care. One-sixth of Americans have no savings at all, and 58% have savings less than $1,000. At the same time the average CEO earns more than 300 times that of the average compensation of their workers, compared to 20 times in 1965 and 20 times in Norway. (Stiglitz 2019).

Inequality was boosted by the fact that the combination of high labour and capital incomes are received by the same individuals and household. This has been directly related to the greater influence of the rich on the political process, which meant bending rules so that they are favourable to themselves. The median voter hypothesis states that in a more unequal environment, voters will cast their vote for politicians who promise to increase the tax rate and to enhance redistribution of income from rich to poor. In new environments this is becoming more difficult, at least as far as taxing capital is concerned, because of higher capital mobility. In addition to this, even if a country would be closed, the rich would still be politically empowered to a much greater extent than the middle class and the poor. The rich dictate the political agenda, finance candidates who will protect their interests, and make sure that the laws passed are in their favour, and if not that they are violated. In other words, the principle "one person, one vote" is increasingly turning into "one dollar, one vote". In the USA, senators are five times more likely to respond to interests of the rich than to the interests of the middle class. Not only that the middle class has been hollowed out, but the same applies to democracy. (Milanovic 2018)

It is not by chance that since Aristotle (the golden mean), and more recently after Alexis de Tocqueville, the middle class has been viewed as a bulwark against nondemocratic forms of government. One of the reasons why the Industrial Revolution started in the Great Britain was that it had lower inequality and stronger middle class compared to pre-revolutionary France.

The rising inequality has been undermining the middle class in Western societies. The middle class is nowadays less numerous and economically weaker than it was forty years ago. In the United States, where this tendency has been most pronounced, the share of the middle class (disposable income 25% below and 25% above the median income) decreased from 33% in 1979 to 27% in 2010. At the same time, the average income of the middle class dropped from 80% of the overall income in 1979 to 77% in 2010. This has induced a sharp drop in economic power of the middle class. In 1979, the middle class accounted for 26% of total income, in 2010 only for 21%. The process has not been confined to the USA. Most of the OECD countries recorded the same changes. The difference is that initial position of the middle class was stronger in the European countries and that the fall in its economic power was less dramatic. (Milanovic 2018)

With the power of the middle class, dwindling financial support from rich individuals and companies becomes indispensable for political success. While the political system has not changed its form; it is remaining formally democratic and pluralistic with freedom of speech and freedom of association guaranteed, the system is becoming increasingly plutocratic. It seems that politics is increasingly resembling XIX century political environment, which Karl Marx described as a "dictatorship of propertied class" and government as "the committee for managing the common affairs of the bourgeoisie", albeit bourgeoisie had a different meaning. (Milanovic 2018)
In such a situation the march towards plutocracy is cleared. Elected politicians almost solely represent the interests of the rich. In the USA, the Supreme Court decision to treat corporations as individuals has paved the way, legally and formally, to ever increasing influence of money on political decision-making.

It is in the interest of the rich to promote globalization and suppress democracy. The suppression of democracy uses a two-prong strategy; 1. Suppressing the vote of the poor and 2. Creating a "false consciousness" among the lower middle class and the poor.

In the United States 80% of the rich and 40% of the poor vote. This is a paradox since under normal conditions the poor should be more interested to participate in the election process. A reason for much lower involvement of the poor could be found in a lower educational level, lower political consciousness and resignation with the increasingly farcical and redundant right to vote. In addition, there are policies deliberately implemented by the rich to disenfranchise the poor. They include voting on the working day, early closing of the polling stations and gerrymandering, whose aim is to redefine electoral districts in order to dilute the vote of the poor and minorities. Also, in the United States, felons and incarcerated are deprived of the right to vote. In the United States, the number of those amounts to 2% of adults - one third of them being African Americans. (Milanovic 2018). This disenfranchises a significant proportion of the US population from political participation.

The other strategy is a use of "false consciousness", which was a Mark's definition of ideology. It would be expected that the poor voted for left-wing parties, which pursue redistributive policies. However, economic interest is not the only criterion in division between the right and the left. One criterion of distinction between the left and the right is a system of values. The left is for progress, freedom, equality and internationalism, while the right is for tradition, family and religious values, nationalism etc. (Mahmutefendic 2019). The system of values can prevail over economic interest. This is why the rich, who control the media, instigate sensitive issues such as a terrorist threat, abortion, the same sex marriages etc, to open debate on topics which are unrelated to economic interest. After the Great Recession, the British media chose to scapegoat minorities and disabled, labelling them spongers and wasters of tax-payers money. In some cases, this provoked even physical attacks on disabled. Some poor then decided to cast their votes for the Conservative Party in order to eradicate "sponging" or acting against their economic interest. A class hatred towards the rich was successfully diverted towards ethnic hatred, xenophobia and hatred towards disabled.

New technologies, one of the major driving forces of increased inequality, has been a serious threat to democracy. They were used by Russia to interfere in elections in order to undermine confidence in Western democracy. The new technologies can be used for manipulation in order to foster certain views and compromise the others. Those with more money can be more successful in influencing the results of the elections. Thus, the new technologies opened the avenue for power and money to undermine democracy. (Stiglitz 2019).

These trends have been most pronounced in the United States. In other developed countries the process was much less pronounced. There is a clear causality chain: higher inequality, greater power of money and greater threat to democracy and vice-versa, lower inequality, lower power of money and lower threat to democracy.

3. THE POLITICAL TRILEMMA

Democratic deficit is deeply ingrained in the structure of the current world system. There are three desirable goals which countries want to achieve: national sovereignty, globalization and democracy. The problem is that these aims are mutually exclusive. Countries can achieve only two of the three goals at the expense of the third one.

Therefore, countries can choose between the following three options. It can push globalization further and give up either the nation state or democratic politics. If it wants to maintain a current level of democracy and even enhance it, it has to choose between the nation state and full international integration. And if it wants to maintain national sovereignty, it has to choose between deepening democracy and deepening globalization.

Therefore, it would be possible to combine globalization and democracy, but at the expense of national sovereignty. In other words, the nation state should surrender a good deal of its independence and accept the creation of a global political community. Such a project would require global rulemaking by democracy, supported by accountability mechanisms that go far beyond what the world has at present. Democratic global governance at this moment looks utopian. There are too many differences among nation states - historical, economic, political, cultural, religious and linguistic - to be accommodated within a single political entity. The great diversity that characterizes the current world renders hyper-globalisation incompatible with democracy. (Rodrik 2012)

One could imagine a hyper-globalization with a fully integrated world economy in which all transaction costs have been eliminated and national borders do not interfere with the exchange of goods, services, or capital. In such an environment, nation states can exist if they focus only on economic globalisation and if they strive to become attractive to international investors and traders. Domestic regulations and tax policies would be subdued to international standards, or set in a way that they do not impede international economic integration. The only services provided by governments would be those that reinforce the smooth functioning of international goods and financial markets. (Rodrik 2012)

Such a nation state would be a sort of internationalized night-watchman, or minimalist state. Tom Friedman coined such an arrangement by the term “Golden Straitjacket”. In such a world, governments pursue policies which would please goods and financial markets. While earning market confidence, they would attract trade and capital inflows. Those policies would assume a form of restrictive monetary and fiscal policy. Those policies include tight money, small government, low taxes, flexible labour markets, privatization, deregulation, liberalization of all markets and openness of an economy. This state of affairs resembles the gold standard, which functioned smoothly from 1870 until 1914. Strict monetary rules took a precedence over domestic economic and social obligations.

From this we can draw a clear conclusion that national democracy and deep globalisation are incompatible. Democratic politics casts a long shadow on financial markets and makes it impossible for a nation to integrate deeply with the world economy. The world learned this lesson in the 1930’s when countries, starting with Great Britain in 1931, were forced to get off gold. Keynes has called gold “the barbaric metal”, and ascribed it a minimal role in the post-war the Bretton Woods international monetary regime. (Rodrik 2012)

A core feature of the world economy is the clash between globalisation and domestic social arrangements. Here are some examples which show how globalisation infringes on national democracy.

Labour standards. Every developed country has a host of detailed regulations that cover employment practices. These regulations determine who can work, the minimum wage, the maximum hours of work, the nature of working conditions, job specification, job security etc. Workers have the right to form trade unions to represent their interests and set the rules for collective bargaining, which regulate pay, benefits and working conditions in general.

Globalisation opens a door for violation of these regulations. International trade enables outsourcing jobs to less developed countries, where these regulations are loose or non-existent. The subject of outsourcing can be not only manual, clerical and administrative jobs, but also highly skilled jobs, facilitated by new technologies and online work. Globalisation makes all the regulations in developed countries meaningless and irrelevant.

Corporate tax competition. The international mobility of multinational companies and capital also narrows a freedom of countries to set their preferable tax structure. This mobility puts downward pressure on corporate rates and shifts the tax burden from capital to labour, which is internationally less mobile. There is evidence that corporate taxes have been reduced since 1980. The average for the OECD countries, excluding the United States, has fallen from around 50% in 1981 to 30% in 2009. In the United States the statutory tax on capital has been reduced from 50% to 39% over the same period. As a result of capital mobility, countries are becoming less independent in setting corporate tax rates. Empirical evidence shows that the elasticity of domestic corporate rates to a change in corporate tax rates in other countries is 0.7. This means that a 1% decrease in corporate tax rate in other countries will lead to a fall in domestic corporate tax rate by 0.7%. This is a direct outcome of removal of capital controls, which started at the beginning of the 1980s. In this way, "tax competition" becomes harmful to national economies, since it reduces their ability to use in full domestic fiscal policy. The recent proposal by the American president Joseph Biden to introduce international corporation tax is an attempt to address this problem.

Health and safety standards. It would be logical to assume that individual countries had the right to set their own health and safety standards. However, this would lead to a significant divergence across countries. The World Trade Organization recognises the right of individual countries to set their own rules, provided that they are based on "scientific principles".

However, as the hormone beef case has shown, a decision as whether something is based on scientific principles is left to the WTO judges. The European Union had a ban on beef reared on certain growth hormones, which was not discriminatory since it applied to imported and domestic beef equally. The WTO judges ruled that the European Union's invocation of the precautionary principle did not satisfy the criterion of "scientific evidence". If the EU, with its sophisticated logistics failed to convince the WTO, one can just imagine the problems that developing countries face. This amounts to the essential question whether democracy is allowed to determine its own rules. As in this case, the trouble emerges when there is a clash between international tribunals and domestic courts on substantive matters. In this case, trade rules clearly took a precedence over democratic decision making within the European Union. (Rodrik 2012).

Industrial policies in developing countries. Globalisation imposed the most significant external constraint on industrial policies in developing countries. Under the GATT arrangements tariffs on trade in industrial products were considerably reduced, but countries were free to design their own industrial policies. Japan, the Four Tigers and the Latin American countries used subsidies, export subsidies, import-substitution, tax reliefs, tax breaks, government procurements etc. The measures enabled these countries to achieve high growth in several decades after the WWII. Also, active government policies boosted staggering Chinese growth over a period of several decades. Nowadays, the WTO deems these policies illegal.

The WTO's agreement on Intellectual Property Rights (TRIPS) is a serious impediment on the use of more advanced technologies in developing countries. Copying foreign technology has long been one of the most important drivers of economic catch-up. TRIPS restricts access to essential medicines, and has adverse effects on public health. Its detrimental effects on technological capabilities in developing countries are undoubted.

In such a situation, developing countries must use remaining industrial strategies and circumvent restrictions imposed by the WTO that promote new industries. However, with significantly narrowed room for manoeuvre, governments in developing world constantly ask themselves whether applied policies are WTO-legal. (Rodrik 2012)
Theoretically countries can preserve national sovereignty and democracy by de-globalising their economies. Raising tariffs and reintroducing exchange controls would lead to a full-blown protectionism. Protectionism is nowadays considered a blasphemous word, due to bad experiences in the interwar period. Trump's attempts to bring manufacturing jobs back to the USA by introducing 25% tariffs on a wide range of goods imported from China and the same tariff rate on imports of cars from Canada were widely ridiculed (Stiglitz 2019).

An alternative way to deal with the political trilemma could be to preserve national sovereignty and democracy not by ditching globalization, but by moderating and restructuring it. A "shallow globalization", under the GATT regime in 1960s and 1970s is instructive, albeit needs adjustment to changed circumstances. One of proposals for altering the nature of globalization would be to moderate globalization in trade and finance and enhance it in labour flows. (Rodrik 2012).

1. **Reforming the International Trade Regime**. A shallow globalization under the GATT regime in the 1960s and 1970s reduced tariffs on industrial products from 40% to 4%. There remained some pockets of high tariffs such as tariffs on sugar and dairy products within the CAP in the EU (Mahmutefendic 2020), but international trade is in general free. Further reduction in tariffs would set in motion the law of diminishing returns since detrimental redistribution effect would by far outweigh positive gain effect. According to some calculations further liberalisation of international trade would contribute to world GDP only by 0.1% (Rodrik 2012).

In a situation in which the world economy is open the focus of multilateral negotiations should shift to accommodate broader social goals. They need to take account of domestic social programmes and regulations, social contracts and pursue locally tailored growth policies. At the same time, this shift in multilateral negotiations does not abolish free trade, but it enhances and broaden it.

At the moment there is an opt-out clause in the WTO regulations. However, it relates only to the cases in which competitiveness and financial profitability are endangered. This clause should be extended to situations in which WTO rules violate domestic labour and environmental standards and impede implementation of domestic industrial and developmental policies. (Rodrik 2012).

2. **Regulating Global Finance**. Financial liberalisation, which started in the 1980s, was trumpeted as the pillar of world-wide prosperity. However, it has produced disastrous results, which culminated in the credit crunch as an introduction into the Great Recession. The subprime mortgage meltdown has exposed the inadequacies of the prevailing approach to regulation, both nationally and internationally. This has induced measures, whose aim is to improve soundness and robustness of financial regulation. They include tighter capital-adequacy standards, restrictions on leverage, caps on executive pay, rules that facilitate bank closures, broader disclosure requirements, greater regulatory oversight, and limits on bank size. (Rodrik 2012)

The problem with implementation of these measures is that they differ considerably between countries. With some important exceptions, continental European countries tend to favour a more stringent approach, while the Americans and the British prefer a more liberal approach. For example, in 2009, the European Commission, supported by Socialist parties, proposed extensive regulations on hedge funds and private equity firms that would restrict debt levels, impose capital requirements, require strict disclosure, and cap the pay of managers. These measures which would also apply to American firms operating in Europe unleashed a lot of effort in lobbying by Americans, in other to water them down.

In addition to this, the French and Germans, joined this time by the British, have pushed for a global tax on cross-border financial transactions. The proposal resembles the Tobin tax. This would be tax on short-term capital (hot money), which is destabilising, but not long-term capital, which contributes to economic development. The Americans again rebuffed the proposal.

The solution to this problem should resemble the one applied to consumer safety. When a financial firm does business in an economy of another country, it has to apply to financial regulation of that country, regardless of where it is based. That means it has to hold the same level of capital reserves as domestic firms, face the same disclosure requirements, and abide by the same trading rules.

A new global financial order must be constructed on the back of minimal set of international guidelines and with limited international coordination. The new arrangements should be a modified and improved IMF with increased resources and a larger input of developing countries. Financial transparency should increase through enhanced consultation and information exchange between national regulators. Financial safe heavens, that export financial instability, should be put under control. In addition, a small global tax on financial transactions, not higher than 0.1% would generate tens of billions of dollars to finance negative effects of global warming or health pandemics. However, the responsibility for regulating leverage, capital requirements, setting capital standards, and supervising financial markets more broadly should be a prerogative of national authorities. A shift from international to national regulations would soften technocratic domination and enhance democratic accountability to national parliaments. (Rodrik 2012)

3. **Liberalisation of Global Labour Flows**. The main characteristic of the world economy is an excess in trade and financial globalisation, and a deficit in labour globalisation. Today, the global labour regime looks like the international trade regime in the 1950s. It is full of high barriers that prevent a free flow of labour across different countries. The world could reap substantial benefits if labour flows were liberalised in the same way international trade was liberalised under the GATT regime. Liberalisation of labour flows would bring substantial benefits for rich and poor countries, much greater than further liberalisation in trade and finance. Even a minor liberalisation of the restrictions on the use of foreign workers, which developed countries impose, would produce a large positive impact on global incomes.

One of the reforms would look like this. Rich nations would introduce temporary work visa schemes that would expand their total labour force by not more than 3%. Under the scheme, skilled and unskilled workers from developing countries would join the workforce in developed countries for a period of five years. As the original migrants return home, a new wave of workers from the same countries would replace them. Such a system would produce an estimated gain of $360 billion annually for the world economy, a sum considerably greater compared to removal of all remaining tariffs and subsidies. The bulk of this increase would accrue to developing countries, but the rich countries would also be better off. This estimation does not take into account accumulation of know-how, skills, networks and savings by those workers and their use in native countries. In order to guarantee that workers would return home after five years, a portion of workers' earnings could be kept in block accounts until they are repatriated. Migrant workers would have a disincentive to prolong their stay, since this would incur significant financial losses. An enforced saving scheme would have the additional benefit for developing countries in terms of enhanced financial resources, which would increase the standard of living and could also be used for investment. (Rodrik 2012)

CONCLUSION

This work analyses the relationship between inequality and democracy. A hypothesis is set that inequality and democracy are inversely correlated. Higher inequality is accompanied by less democracy, and lower inequality is accompanied by more democracy – although here, we have established correlation and not necessarily causality.

A close inspection can prove that this hypothesis cannot be confirmed with the examples of countries which abolished parliamentary democracy. Nazi Germany substantially increased inequality compared to the Weimar Republic. This would confirm our hypothesis. But examples of the communist countries of Eastern Europe would discard the hypothesis. These countries substantially decreased inequality and abolished parliamentary democracy. Using these examples, one could set the opposite correlation; Inequality and democracy are directly correlated. But again, examples of the three remaining officially socialist and democratic countries do not fit this correlation. They have conspicuously higher inequality compared to most democratic countries.

Apparently, analysis must be confined to countries which did not abolish parliamentary democracy, but retained freedom of association, free speech and free multiparty elections. Our hypothesis should be slightly modified; The level of inequality and the level of democracy are inversely correlated. Higher level of democracy is accompanied with a lower level of inequlity and vice-versa.

In the age of Keynesianism, which lasted from 1945 until 1980, democracy thrived. Two political factors gave a boost to enhancement of democracy, introduction of universal franchise and internal democratization of political parties. This period was also characterized by a substantial decrease in inequality. A host of economic and legal factors contributed to a great levelling such as unprecedented economic prosperity, nationalisation of many private companies, a great involvement of government in economy, introduction of a welfare state and strong trade unions. The age of Keynesianism, therefore, confirms the hypothesis.

In the age of neoliberalism, inequality increased in almost all countries. This was due to a legion of factors, globalization and new technologies being the most important ones. This period is also marked with a democratic deficit. This was due to an increased power of money in politics, a control of media by big companies and a pressure on judiciary system and other democratic institutions by big capital. This period also confirms the hypothesis; inequality and democracy were inversely correlated.

This period is characterised by the political trilemma. Countries want to achieve three desirable goals; national sovereignty, democracy and globalization. However, it is possible to achieve only two out of the three goals. Nowadays, countries have national sovereignty and globalisation, but increasingly at the expense of democracy. One of the solutions of the political trilemma would be to modify and restructure globalisation. The main characteristic of globalisation is an excess of trade and financial globalisation and a deficit of globalisation of labour. By enhancing the latter and decreasing the former, countries would reap benefits of an altered globalisation. At the same time, they would preserve national sovereignty and democracy.

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