

Chapter 4

Theory of Persistent Income Inequality: A Study for EU Member States

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ABSTRACT

Psychology stipulates justice is one of the most powerful feelings of human beings. Societies strengthen as overall justice increases. People are seeking justice in many areas. A more fair income distribution has always been desired in almost every society since the beginning of civilizations. In recent times, European countries are known to be the most fair societies, at least within their boundaries. So, taking into account these facts, what can be said about income inequality levels for EU-15? This chapter tries to find an empirical answer for this question. There is also a solution for income inequality.

INTRODUCTION

There is one thing, everyone has to accept, that inequality is a fact of the life. It is a fact that people are born under unequal conditions; some is taller, some is richer, some is orphan, some in developed country, some into war, some in 9 months, some in 7 months etc. Yet inequality is not a bad thing in every aspect of the life. For instance helping a poorer person is a scene nicer than the one as if the two of them were financially equal (in a positive way). Even the society depends on the inequalities people have. Because inequalities make people dependent to each other and that dependency forms the basis of humanitarian values like cooperation, contribution, compassion, self-sacrifice etc. But there is one important thing to be mentioned. Inequalities can be split into two as natural and artificial. Natural means coming from the birth and cannot be changed. Artificial means caused by people and can be changed. So irritating

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inequalities are the artificial ones. Not all the artificial inequalities are disturbing but almost all disturbing inequalities are artificial. So income inequality is a kind of artificial inequality and it is disturbing.

Income inequality has been one of the general problems of capitalism from beginning of industrial revolution till now. But never has it reached such a huge level after World War II, specifically in developing countries. Taking look at the statistics, income inequality has increased by 11 percent between the period of 1990-2010, in developing countries. However even developed economies have not tried to manage a solution for this inequality problem until very recently and still they have not found a satisfying solution (United Nations, 2013).

Income inequality has many side-effects on human health. Researchers has found out that in countries which has similar income per capita, the higher income inequality a country has, the worse the health statistics are. More relevantly, there is lots of proof study claiming that the less income inequality a country has, the better economic performance is. Especially performances of East Asian economies after 1950s are a crystal clear example (compared to developed countries) at this point (Chang, 2014).

Income inequality has many drawbacks for an economy. For instance as the inequality rises, potential entrepreneurs of the economy become desperate due to the lack of capital. As capital is accumulated in the hands of few people, investment will slow down, innovation will ease off. This situation will threaten the economic improvement and social welfare in the long run. Widening the gap between social layers, society loses its unity, its solidarity and its harmony and turns into a fruitless tree. Economic dynamics (valid for other areas too) are based on social cohesion and once lost, it is not easy to regain (United Nations, 2013).

Criticizing income inequality should not mean supporting an absolute equality. Absolute equality is just a utopia for real world, but only an ultimate goal for some romantics. In past time, some socialist or communist countries had tried to realize that dream in a pitiful way (Chang, 2014). In fact income equality looks like body temperature. For instance it is dangerous for a body if temperature goes too high or deepens down too low. At both extreme a body cannot continue living. The best for a body temperature is to stay in an interval. Similarly for a country perfect income inequality is to stay between some values depending on the conditions of a country

Economists have been supporting the idea that liberalization (globalization) is the only solution for poverty and inequality. However general trend tells the story in an opposite way. As liberalization extended over the world, income inequality and poverty got increased. It can be argued that this failure does not belong to liberalization but to the executors who did not succeed in the application. But whatever the reason is, the result is clear that liberalization did not bring a more equal world (Smith, 2003).

What are the reasons of inequality is not an easy question to answer. Kuznets' inverted U hypothesis (1955) is still need to proved. In short U hypothesis tells that when a country is in the early stages of development, income inequality rises and as the country continues to grow and after some top point, income inequality begins decreasing. However this hypothesis has not been supported enough with empirical researches. So Kuznets' hypothesis had temporarily been valid for some chosen countries (Bräulke, 1983). Here it is important to mention that an economy cannot be independent from government policies. So it is not realistic talking about an isolated economy from all political, social etc. counter-relationships (United Nations, 2013).

There are some popular explanations for macro and micro level inequalities. Jared Diamond, the author of the *Guns, Germs and Steel* (1999), dedicated his life to find a reasonable answer to the question of "Why some countries are rich and some are poor?" or "Why some countries are developed and some are not?" He had researched the world history according to geographical conditions and found some

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