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THE POLITICAL ECONOMY OF INEQUALITY: EXAMINING INCOME DISTRIBUTION, EMPLOYMENT AND THE ROLE OF GOVERNMENT POLICY IN SHAPING ECONOMIC OPPORTUNITIES

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Abstract

Economic inequality is still an important issue due to the existence of economic disparities in terms of incomes and employment opportunities. The current paper analyzes the factors determining these inequalities and focusing on the impact of government policy on income distribution and employment opportunities. More specifically, the paper analyses how fiscal policy, labor market institutions, social protection, public investments, and other actions of government affect income and employment opportunities. The paper also explains why certain policies tend to reduce existing inequalities while others result in the lack of access to decent jobs, education, income, and production for certain population groups. Furthermore, the political and institutional determinants of policy-making aimed at tackling inequalities are analyzed. Thus, the paper treats inequality not as the outcome of market processes but the result of public policies as well. This paper contributes to the literature on political economy in terms of government policy and institutions' importance in creating wider access to employment, better income distribution, and more economic opportunities.

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INTRODUCTION

Increasing economic inequality is one of the focal points of today's political economy. Inequalities in household income, jobs, access to education, access to productive assets, and to economic insecurity affect people's living conditions, but also the economy and political systems as a whole. While in market economies some degree of inequality is built in as people are not the same in terms of skills, occupations, assets and economic decisions, if inequality becomes too great and is persistent it can limit social mobility and exclude disadvantaged groups from full participation in economic activity [1–3]. Similarly, the normative, institutional and global aspects of distribution and opportunity are highlighted in fundamental accounts [23–24,29–30]. Income inequality matters especially because income influences the capacity of the household to meet basic needs, to invest in education and skills, build assets, deal with economic shocks, and take advantage of economic opportunities. Wages and employment, returns to capital and the structure of economic activity are key determinants of the distribution of market income. However, tax policy and social transfers and publicly provided services also influence disposable income. Thus, observed inequality is a function not only of market forces, but also of public policy [1,4]. Another important pathway linking structures and inequalities relates to employment. Labour income is the main source of economic resources for most households. The inequalities in access to jobs, wages, working time, job security, formal jobs and social protection, consequently, directly manifest as inequalities in economic welfare. Labour market inequalities can be particularly entrenched when people face restrictions on their ability to gain skills and build savings, which in turn restricts their future earning power due to either unemployment or informal employment [5–6]. The political-economy approach builds upon this in two ways: why do governments pursue specific distributive policies, and why do the same economic challenges beget different policy responses in different countries? The distributional effects of government decisions on taxation, social spending, minimum wages, collective bargaining, education, health, infrastructure, labour regulation etc. are important. These choices, in turn, are shaped by institutions, political incentives, interest groups, administrative capacity and the distribution of political power [7-9]. It is thus a bidirectional relationship. Economic institutions and markets create outcomes of income and employment, political institutions shape the government's reaction to those outcomes and government policy, in turn, shapes the outcome of resources and opportunities. Inequality can have an impact on the nature of political participation and influence, impacting policy decisions in the future. This article investigates these linkages from a political-economic perspective. It focuses on five policy areas: fiscal policy, labour-market institutions, social protection, public investment and institutional capacity. The authors propose to not only consider redistribution as a transfer of income after market outcomes have taken place, but also as an income distribution effect of government policies that affect income opportunities prior to their creation.

Conceptualising Economic Inequality

Economic inequality is multi-dimensional. It is usually measured in terms of income inequality, although there are also differences in wealth, job security, education, health, access to productive assets and public services. Long-run OECD and World Bank evaluations also see inequality as a multi-dimensional problem, with opportunity and access to the productive resources [20–22,25] being considered as dimensions. Market income is the income received by the individual from the market, which can be distinguished from disposable income. Market income is the income from employment, self-employment and capital before taxes and transfers are received by or paid from government. The disposable income is the income that is available after making direct taxes and transfers. The difference between the distributions of market and disposable income therefore provides an indication of the

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redistributive effect of fiscal institutions [4,10]. Income inequality can be depicted using the Lorenz curve and Gini coefficient. A more unequal distribution results in a Lorenz curve that is further from the line of perfect equality; the Gini coefficient is a numerical summary of the degree of inequality. These measures are useful for comparing distributions but do not provide insight into the political, institutional or economic processes that lead to inequality. The political-economy approach thus transcends measurement and focuses on the processes by which distributions are created. These mechanisms involve allocation of jobs, wages, ownership of capital, tax structures, etc., public expenditure and public services. The main parameters of inequality, their key determinants and the areas of state action are summarised in Table 1.

Table 1. Major Dimensions and Sources of Economic Inequality

Dimension	Major determinants	Potential government response
Income inequality	Wages, employment, capital income, taxation	Progressive taxation and transfers
Employment inequality	Job availability, skills, discrimination, economic structure	Employment policy and labour regulation
Wealth inequality	Asset ownership, inheritance, savings	Property/inheritance taxation and asset-building policies
Educational inequality	Household income, geography, school quality	Public education investment
Health inequality	Income and access to services	Public healthcare
Opportunity inequality	Family background, institutions and access to resources	Education, social protection and inclusive institutions

Theoretical Foundation

3.1 Market-Based Explanation of Inequality

The conventional economic theories link income inequalities to productivity inequality, education inequality, skills inequality, experience inequality, and capital ownership inequality. Human-capital theory, for instance, holds that education and skills investment is a crucial factor in the determination of the returns an individual earns [11]. Technological change can affect this relationship by boosting the demand for some skills and declining the demand for others. Globalisation can also have an impact on income distribution, by influencing the location and composition of production, and by affecting the bargaining positions of workers and firms. The explanations are important, but incomplete because markets are regulated by legal and institutional structures. Institutional allocations are made in the areas of wage determination, working conditions, property rights, taxation and social insurance. Political economy is thus a study of the interaction between market generated inequalities and government and institutions.

3.2 Political-Economy Approaches

Theories of political-economy focus on the fact that distributional outcomes impact on political preferences. The preferences for taxation, public expenditure and redistribution vary between individuals and groups due to their differing economic roles [7]. A popular argument is that political competition in a democracy creates pressure for redistribution when the income of the median voter is below average income [7]. But redistributive outcomes in practice are far less uniform, implying that voting cannot account for redistribution. Policy can be shaped by political participation, institutional design, lobbying, attitudes, and administrative capacity and

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economic concentration. Institutions also decide who's preferences are heard and who's not. Acemoglu and Robinson propose that political and economic institutions affect both economic incentives and distribution of resources and political power [8]. In this view, inequality is tightly linked with the process of institutional development. More recent scholarship in political economy also challenges this idea that democracy or state capacity guarantees more egalitarian results. Distributional effects of institutions have been shown to be dependent on the interaction between political competition, administrative capacity, economic openness and financial development [31]. Other studies indicate that the politics of redistribution in democratic countries is not a simple function of the median-voter; the organization of interests, the preferences of key groups in the electorate and the structure of the state influence which interests are ultimately satisfied [32].

Income Distribution and Economic Opportunity

Income distribution has much more impact on who consumes what than on it. Household income impacts access to education, housing, healthcare, transportation, technology and financial services. If these resources increase future productivity and employment opportunities, then current inequalities can lead to future inequalities. This brings a significant difference between inequality of outcome and inequality of opportunity. Outcome inequality is related to differences in income, wealth or consumption. Opportunity inequality relates to inequalities that stem from circumstances which people may not have had a choice about, such as family background, location, gender, inherited wealth and access to public services. Government policy may have an impact on either dimension. Taxes and cash transfers mostly affect the gap between disposable-income, whereas education, healthcare, infrastructure and labour-market policies affect the gap before market incomes are created. The difference is key because the income earned can be redistributed afterward to alleviate the intensity of such disparities in access to skills, jobs and productive resources. Effective inequality policy must entail re-distribution, and also include policies that increase economic opportunity.

Employment as a Central Mechanism of Inequality

The political economy of inequality becomes much more complicated when the labour income is a key input of the livelihoods of households. Job security and employment opportunities, skill accumulation, eligibility for social insurance, retirement security, and current income are all related to employment. But the number of jobs does not constitute employment. The quality and productivity of work is also a key aspect. High inequality can be accompanied by large numbers of people working and reporting high employment if they are working in low-paid, insecure, or informal jobs. Informality, working poverty, and the unequal opportunities in the labour market remain salient issues in international labour-market analysis [5–6]. There are several links between employment and inequalities. The first effect of unemployment is a decrease in the labour income of the family. Unemployment can also deplete skills and future employment prospects. Second, there is significant variation in the wages of even working employees. Wage distributions are influenced by education, occupation, industry, and bargaining power, as well as labour-market institutions. Thirdly, in some cases, informal work may limit access to employment protection, social insurance and stable income. Fourth, the barriers to the labour market can systematically exclude certain demographic or socioeconomic groups. This would mean the policy goal should not just be about creating jobs, but also productive, decent jobs that offer a stable income and possibilities for progression. Underemployment, precarious working conditions, stagnation and technological change also contribute to the current inequalities of the labour-market. Often workers have a formal job but are short of pay, lack a career path or limited access to training. Blundell believes that

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tax credits and wage floors can help to sustain low incomes, but are not enough if less-educated workers are clustered at the bottom of low-quality jobs that offer little advancement in wages [33]. There is yet another distributional channel in the form of technological change. Even minor productivity increases can result in the loss of jobs from repetitive tasks, and a change in wage rates, due to automation. Acemoglu and Restrepo show that the wage structure in the United States has changed significantly as a result of task displacement due to automation, highlighting the importance of skills policy, institutions for retraining and institutions for labour-market adjustments for distribution [34]. Simultaneously, automation harms do not occur in the same way across firms and/or economies, and policies should not assume that technological change is necessarily inequality-aggravating [35]. This is because of labour force participation. Factors that prevent someone from entering or staying in paid work can also lead to an ongoing lack of income, and access to formal employment, networks, skills and childcare can affect disadvantage. Employment policy should thus focus not only on headline unemployment rates, but also on participation, hours, job quality and job progress.

Fiscal Policy and Redistribution

One of the most direct tools at the government's disposal for impacting on income distribution is the fiscal policy instrument [1,4]. Public spending can impact both current income and availability of services, while taxes impact what households have left after paying taxes. Comparative and incidence-based work also shows that the redistributive effects of fiscal intervention are contingent on the size, composition, and targeting of the intervention [14-19, 27-28].

6.1 Progressive Taxation

A progressive tax has a higher tax rate on a higher level of income than on a lower level of income. Personal income taxation can thus help to minimize differences in disposable income. The distributive impact is not only a function of the statutory rates, but also of the overall design of the tax system. Effective incidence is influenced by exemptions, deductions, tax avoidance, and administrative enforcement as well as by the relative use of income, consumption, property and capital taxes. Consumption taxes may be relatively high for low-income households if they spend a bigger share of their income on consumption. Therefore, governments need to think of the overall tax mix and not the individual taxes, because of this distributional aspect [12].

6.2 Government Transfers

Cash transfers, unemployment benefits, pensions, child benefits and targeted social assistance can contribute to an increase in household disposable income, and offer some protection against economic shocks. Tax and transfers have been shown to make a significant difference to the distribution of disposable income in OECD countries, although the redistributive impact of taxes and transfers differs between countries and over time [4,10]. Transfers also act as insurance. Even families that were previously well off can lose significant income when a member of the family becomes unemployed, sick, disabled or elderly. Social insurance can thus fulfil both a redistributive and an income stabilising function.

6.3 Composition Matters

Fiscal measures are not only measured by the dollars spent or collected by governments. It is important to understand the composition, progressivity and targeting of policies. When public services are financed with progressive revenue systems and social protection are well-designed, fiscal policy can be an effective tool to lessen inequality. Regressive taxes, however, can have a counter-productive effect on distributional goals if there are poorly targeted subsidies.

Table 2 summarizes the major fiscal instruments covered above and indicates the ways in which they could impact distribution.

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Table 2. Fiscal Instruments and Their Distributional Channels

Fiscal instrument	Main channel	Possible distributional effect
Progressive income taxation	Reduces disposable income differences	Lower inequality
Property taxation	Taxes asset ownership	Can reduce wealth concentration
Cash transfers	Supports low-income households	Lower poverty and inequality
Unemployment insurance	Replaces lost earnings	Income stabilisation
Education spending	Builds human capital	Greater long-run opportunity
Health spending	Reduces unequal access to healthcare	Greater economic security
Consumption taxes	Taxes expenditure	May be regressive without compensation

The significance of design is being reinforced by recent studies. Tax policies within developing countries can be beneficial for the inequality of disposable incomes, but the results depend on the state of macroeconomics and the strength of the government [36]. Assessments of redistribution can be biased based on measures used for taxation, transfer payments, in-kind transfers, and various income concepts [37].

Labour-Market Institutions and Inequality

Labour market institutions define the ways in which economic performance affects income and employment. Thus, minimum wages, collective bargaining, employment protection, unemployment benefits, and other regulations affect labor income distribution.

7.1 Minimum-Wage Policy

Minimum wages determine a wage floor for the covered workers and increase wages of poorly paid workers when correctly designed and effectively implemented. The overall impact of minimum wages depends on the structure of labour market, coverage, implementation, productivity, and the relation between the statutory minimum and prevailing wages.

The policy debate, in turn, pays attention to potential impacts on employment when minimum wages are determined well above productivity or market-clearing levels in some circumstances. Consequently, the distributive evaluation of minimum wage policy should take into account wages, employment, implementation and firm behaviour, and not the wage rate alone.

The latest evidence shows the contextual nature of such trade-offs. Minimum wage increases at national level have been increasing wages at the bottom with minimal measured job losses in some countries [38]. On the other hand, the analysis of minimum wage impact conducted for several Latin American countries indicates that the wage-compressing effects were more pronounced in the periods of strong labour demand, and vice versa [39]. In economies with substantial informal sector, formal wage regulations might change movements between formal and informal jobs and result in unintended distributional effects [40].

7.2 Collective bargaining

Collective bargaining could affect the development of wage inequality by increasing workers' bargaining position and coordination in wage setting. Broad bargaining coverage could lead to institutions reducing wage inequalities and setting a minimum standard for employment.

The reduction of workers' bargaining power, on the other hand, could exacerbate the separation of productivity improvement from wage improvement where workers lack the ability to bargain on their own behalf over the distribution of gains.

Spillovers are also important in this context. Fortin, Lemieux and Lloyd find that minimum

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wages and trade unions affect the wage distribution beyond their direct coverage, suggesting that the weakness or strength of labor institutions has wider distributive effects than coverage-based statistics indicate [41]. Cross-country evidence has also demonstrated the connection between collective bargaining coverage and functional income distribution in promoting inclusive growth strategies [42].

7.3 Informality

The issue of informality poses an especially challenging problem for developing countries. The workers who are not in the formal sector of employment are not necessarily covered by minimum wages, unemployment insurance, pension provisions or occupational safety regulations.

A policy strategy based on formal workers could potentially marginalize large chunks of the labor market from any redistribution.

Social Protection and Economic Security

Social protection programs alleviate vulnerability through shielding families from the risk of income losses resulting from unemployment, illness, disability, ageing and other such shocks. Social protection programs can involve contributions-based social insurance, non-contributions-based assistance, pensions, unemployment benefits, and family support schemes.

Social protection performs three key distributive roles. First, social protection redistributes resources to economically vulnerable households. Second, social protection stabilizes consumption during income shocks. Third, social protection can safeguard opportunities. Absent social protection, a household that suffers from an income shock may take children out of schooling, sell productive assets, and cut health expenditures. Such measures will transform transitory economic adversity into lasting disadvantage.

How it is designed makes all the difference. Targeted social-protection systems are efficient in channeling scarce public funds to poor households but tend to exclude potential beneficiaries through misallocation errors. Universal social-protection programs offer broad coverage but are costly. Therefore, governments must weigh coverage, targeting, capacity and affordability.

Equitable use of social-protection resources is as crucial as their availability. According to cross-country studies of low-and-middle income economies, a better allocation of social-protection spending is related to higher poverty reduction and inequality reduction [43]. However, countries with lower per-capita incomes spend less of their income on social protection programs due to many institutional constraints [44].

Public Investment and Equality of Opportunity

9.1 Education

The importance of education stems from its impact on productivity, job mobility, and earnings. If the quality of education is highly correlated with the income level of the household, then inequality may reproduce itself across generations.

Public investment reduces the effectiveness of this channel if high-quality education becomes available regardless of income. The effect on inequality depends not only on the enrolment rate but also on the quality of the school and its geographic proximity, and progress through the educational ladder.

Studies of inequality of educational opportunity reveal that family and social background still influence educational outcomes even in rich European countries [45]. It further justifies considering the effects of public education not only in terms of average education levels but also as a way of reducing inequality.

9.2 Healthcare

Poor health lowers labour force participation, productivity, and household savings. Inequalities in access to health care could be one of the sources of economic inequality.

Public health care could be seen as an in-kind transfer at the same time as a source of improved productive ability. The importance of public

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health care goes beyond welfare issues since healthy workers participate in labour markets better than others.

9.3 Infrastructure

Infrastructure including transportation, electricity, water and internet access affects access to market, education, and labour markets. Insufficient infrastructure creates spatial inequalities by isolating communities from productive opportunities.

Public investment thus has two roles – to improve aggregate productivity and access to means of participation in economic activity.

Political Institutions and Policy-Making

Policies which affect inequality are inherently political, as they produce both winners and losers and thus constitute redistribution.

Economic classes may be unequal in terms of the capacity to influence public policy. Wealthy people and economic organisations might enjoy greater capacity for lobbying, participation in political processes or shaping public opinion. Poorer segments of the society may have poorer organization and participation in political life.

Thus, we might observe the cycle of feedback: economic inequality – inequality in political influence – policies adopted – economic inequality of the next period.

If political influence is concentrated, then policies will serve as the means to maintain the economic advantages of certain classes via favourable tax laws, barriers to competition, different access to public goods. Inclusive political institutions are likely to enhance representation and provide more accountability in the supply of public goods.

Government efficiency is also crucial. While the government might introduce policies such as progressive taxation, labour standards or social transfers, it may fail to implement them due to poor governance, lack of information or low capacity for enforcement.

The capacity of the state should therefore be taken into account as an intrinsic part of distributive policies rather than an external question for them.

10.1 Political Power, Elite Influence and Policy Capture

Political power is unequally distributed since economic power allows to transform economic capacity into organizational, access to decision-makers, influence on campaigns and agendas. It does not mean that all policies reflect the preferences of elites, but formally equal political rights may coexist with unequal practical influence. Interest groups can affect tax breaks, subsidies, regulation and public expenditure, and the concentrated benefits tend to lead to better organization than diffuse costs.

Interaction between interest group influence and public expenditure is especially relevant for the study of inequality. Recent literature describes the interdependent dynamic process, where public expenditure, interest groups and income inequality affect each other, and the inequality-reducing effect of government expenditure is attenuated when policies are influenced by the interest groups [46]. Policy capture thus involves not only the level of expenditure, but its composition and implementation.

10.2 Democratic Accountability, Political Incentives and State Capacity

Democratic accountability might encourage governments to act upon their distributive preferences, but electoral competition does not imply equal responsiveness. Turnout, information, party organization, veto points and financing structure might influence what preferences become policy. As such, redistribution is the product of political coalitions and institutional incentives, as much as it is of economic necessities [32].

State capacity determines the conversion of policy promises into actual results. Effective taxation needs information and enforcement; labor market regulation needs inspection; social protection needs administration; and public investment needs capable procurement and implementation. The recent cross-national evidence on the effect of political institutions and state capacity on inequality highlights that there is no simple

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relationship, but a conditional one [31]. It is the key political-economy message: administrative capacity matters, but the distributional direction in which it is used is ultimately determined politically. Evidence from comparative governance of today reinforces the importance of administrative capacity and institutions [26].

An Integrated Conceptual Framework

The core of this paper can be encapsulated in an integrated framework: Political and Institutional Conditions → Government Policy Choices (Fiscal Policy, Labor-Market Policy, Social Protection and Public Investment) → Economic Opportunities (Education, Skills, Health, Employment Opportunities and Resources) → Labor-Market Outcomes (Employment, Wages, Job Quality, Formality and Labor Income) → Income Distribution and Economic Security → Political Participation and Policy Preferences in the Future → feedback to Political and Institutional Conditions.

The feedback loop is implied in this conceptual framework, rather than a simple linear process. Institutions determine policies; policies determine economic opportunities; economic opportunities determine employment and incomes; and finally, distribution influences political participation and institutions.

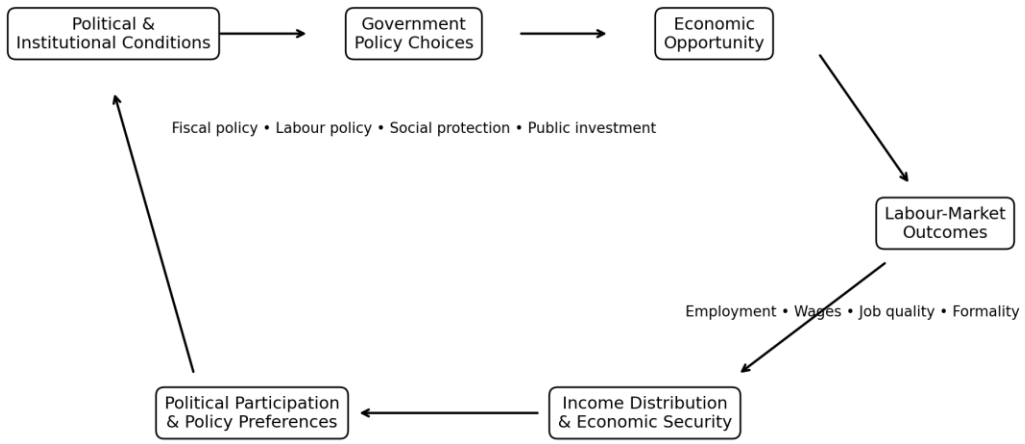


Figure 1. The Political Economy Framework of Inequality and Economic Opportunity

The feedback mechanism for the suggested framework is illustrated by Figure 1, where political and institutional environment influences policy decisions, while distribution results influence political participation and policy preferences.

Table 3 operationalizes the framework by listing the channels through which the immediate effects translate into distribution results.

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Table 3. The Political Economy Channels

Policy/institution	Immediate effect	Intermediate mechanism	Distributional outcome
Progressive taxation	Changes disposable income	Redistribution	Reduced post-tax inequality
Social protection	Income support	Greater household security	Reduced vulnerability
Education	Human-capital formation	Better employment prospects	Greater opportunity
Healthcare	Better health	Higher productive capacity	Greater opportunity/security
Labour institutions	Wage and employment regulation	Bargaining and job quality	Changes labour-income distribution
Infrastructure	Improved market access	Higher participation/productivity	Broader economic opportunity
Institutional capacity	Better implementation	Increased policy effectiveness	More effective redistribution

11.1 Developed and Developing Economies: Differences in Institutions

The mechanisms of the framework function differently at different levels of development. Developed countries usually have wide tax bases, well-developed social-insurance system and higher level of administrative capacity, which allows the process of redistribution to be mostly based on direct taxation and transfers. Inequality discussions in developed economies are concentrated around the topic of wage dispersion, technology changes, labor market polarization, housing, wealth concentration and efficiency of already existing welfare institutions.

Developing economies are characterized by narrower tax bases, high level of informality, weak enforcement and lower degree of social-protection coverage. Wide informality will limit the effect of payroll social-insurance and wage regulations, while administrative limitations will complicate the use of progressive direct taxation. This does not mean that the redistribution mechanism becomes obsolete; it means that the policy combination used will be different, giving a prominent role to universal public services, administrative development and integration of informal workers into the system of social-protection.

The recently gathered information on tax reforms in emerging and developing economies shows that fiscal policies can help to improve income distribution, but it is important to understand that there is a strong dependency of such policies on economic circumstances and country's political and administrative system [36]. Likewise, there is a lot of evidence about the effectiveness of labor regulations in Latin America, showing how such policies can have different outcomes depending on the level of enforcement, labor market demands and mobility from formal to informal economy [39–40].

Why Some Government Policies Do Not Promote Equality

Government intervention does not guarantee more equality. There can be poorly designed interventions which bring more advantages for wealthy families or do not reach disadvantaged populations.

One reason can be policy capture where organised interests have an excessive impact on the policy-making process. This way tax breaks, subsidies or special regulations may go to those who already have a lot of money.

Another factor is insufficient government capacity. Governments can have problems in

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identifying who needs help, collecting progressive taxes, implementing labour market regulations and providing services continuously.

Another issue can be the fragmented nature of social-protection system which does not cover informal workers and other disadvantaged populations.

Also, there can be geographic and social inequalities in public spending. Increased total expenditure in education and healthcare does not mean increased equality as better quality services may be still provided only in richer communities.

Finally, the last problem is the inconsistent nature of policies. The development of human capital, infrastructure and institutions requires long-term policies. Short political cycles may incentivise governments to pursue immediately visible policies.

12.1 Policy Trade-offs and Unintended Consequences

A proper critical assessment should separate the intended goal of any policy from its actual implementation. Progressive taxes could lower disposable-income inequality; however, too high marginal effective rates, small tax bases, or insufficient enforcement could prompt avoidance, behavioural distortion, or loss of revenue. Consumption taxes could generate stable revenue; however, they could also place disproportional burden on poor people unless they include exemptions, transfers, or publicly provided goods. Therefore, tax reform requires compromise between equity, efficiency, simplicity, and enforcement issues [36–37].

The same applies to the minimum wage policies: their impact on wages of poor people depends on labour market conditions, level of compliance, degree of coverage, and extent of informal employment [38–40]. Transfers can alleviate poverty problems but they could also be inefficient because of exclusion errors, poor targeting, or adverse work incentives caused by bad design of the withdrawal rules. Subsidies could also insulate poor people from price fluctuations but could be costly for the budget or favour better-off households. Regulatory policy could improve the working conditions but could lead to avoidance and informalisation because of the lack of proper enforcement.

This does not mean that such interventions are unproductive. It means only that distributional policies must be assessed together. The criterion for evaluation of the policy is an overall efficiency of the tax-transfer-labour-market-public investment framework.

Efficiency, Growth, and Redistribution

An enduring controversy revolves around the idea that equality of income must come at the cost of economic efficiency. The reality is far more complicated.

Improperly constructed taxes could diminish the incentive to invest and work, as well as inefficient spending by the government, which wastes economic resources without helping redistribution. But policies to enhance education, healthcare, infrastructure, and economic stability may increase productive potential and opportunities at the same time [13].

Inequality itself may create economic inefficiencies if people with high abilities cannot get access to education and financial services due to their social standing. In this case, the policy of increased opportunities may lead to greater efficiency and equity.

The real issue, then, is not about the choice governments have to make between growth and equality, but what kinds of taxes, spending, labor regulations, and investments are likely to increase equality without damaging incentives.

Discussion

It is clear from the above that inequality should not be viewed as solely determined by market processes. The role of markets is to determine wages, employment, and income from assets, but the operation of markets occurs within an institutional and political context.

Government plays a role in shaping distribution through predistribution policies which influence market results through education, institutions,

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infrastructure, and the availability of productive resources. Government also acts on redistribution by changing after-tax income through taxes and transfers. Government acts on social insurance to insulate households from shocks, and on investment for mobility.

Employment links all of these dimensions. A strategy for inclusive growth must take into account not only employment creation but also productivity, wages, security, and accessibility of these jobs.

Fiscal policy is vital because the tax system and expenditures change households' resources directly. There is international experience to show that tax-and-transfer systems have the potential to significantly decrease market-income inequality, although depending on their design [1,4,10].

This discussion also highlights the importance of politics in inequality policy. Technical effectiveness is meaningless when redistribution is poorly implemented, political capture is extensive, and disadvantaged groups do not have access to the political process.

Three questions are important in assessing inequality policy: Who gets economic opportunities before they earn any income? How are incomes created through the market divided up? What is the capacity of government to modify and protect this distribution?

14.1 Synthesis of the Political-Economy Argument

In light of this review, it would appear that income distribution is better explained by interacting market, institutional and political mechanisms than a simple distributive process. Labour markets create incomes, but wage-setting institutions, technologies and employment structures determine the extent to which productivity translates into income [34,41-42]. Fiscal systems redistribute resources in terms of disposable income, while public goods and social protection systems have an impact on both the security and ability to participate in economic activity [36,43].

The key conclusion of the political economy approach is that the same policy instrument may have different results due to differences in institutions. The capacities of the state, political competition, interest groups and informal structures influence the effects of policies [31-32,40,46]. This is the reason why the comparison of tax rates, welfare benefits and minimum wages may be misleading.

Moreover, the political economy of income distribution suggests that redistribution and predistribution should not be seen as alternatives. Tax and transfer policies can compensate for the results of the market, but education, labour institutions, infrastructure and the availability of productive resources determine pre-distribution. Therefore, sustainable reduction of inequality is possible if governments combine the two approaches – income support and policies that improve employment quality, mobility and opportunities.

14.2 Contribution to the Literature

This article contributes to the literature in three interrelated respects. First, the article attempts to integrate income distribution, employment, fiscal policy, labour market institutions, social protection and public investment into one political economy framework instead of analyzing each of them separately as different reasons for inequality. Second, employment plays a crucial role in the transmission mechanism from economic opportunities to household income, along with the quality of jobs, informality, participation, technological change and bargaining institutions, in addition to employment levels. Third, political feedback effects are included in the analysis because inequality may have an impact on political participation and organized pressure that influences the design and implementation of future distributional policy.

Policy Implications

15.1 Design Fiscal Systems to be Progressive and Efficient

Tax systems should collect sufficient revenues and allocate tax burdens based on the economic

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capacity of households. Progressive personal taxation, effective property taxation, and improved tax administration can enhance redistributive capacity. Tax expenditures and exemptions should be periodically reviewed since misdirected provisions can lower tax collections while disproportionately benefiting high-income people.

15.2 Prioritise Quality Jobs

In designing jobs programmes, policy should emphasize quality as well as quantity of employment. Skills training, infrastructure development, access to finance, and support to productive firms can help raise labour demand.

15.3 Extend Coverage of Social-Protection Systems

Social protection should progressively extend coverage to workers and households who fall outside traditional contributory schemes in countries characterized by large informal sectors.

15.4 Invest in Quality Education

Quality education is especially important for disadvantaged communities. Educational inequality at an early age can create cumulative inequality in working lives.

15.5 Expand Health-Care Access

Access to health care lowers vulnerability and allows productive engagement. Public health-care provision is thus a two-pronged strategy that involves both social policy and economic investment.

15.6 Address Geographic Inequality

Public infrastructure provision should ensure that disadvantaged communities are connected to labour markets and economic opportunities. Infrastructure provision has assumed increasing importance in the form of transport and digital networks in connecting to employment and educational opportunities.

15.7 Support Labour-Market Institutions

Minimum wage, collective bargaining system, and labour standards should be adjusted to the national labour market and effective enforcement.

15.8 Institutional Capacity Building

Redistributive policy is contingent on tax administration, labour inspection, social registries, public financial management, and monitoring. Reform of institutions is thus crucial for distributional reform.

15.9 Incorporation of Distributional Analysis in Policymaking

Large-scale fiscal and economic policy reforms should be analyzed for impact on different income groups and not just their macroeconomic implications.

Conclusion

Income inequality arises as a result of the complex interaction between markets, labor relations, institutions, and government policies. Inequality in market income appears due to income differences, employment, assets, and human capital, but it is governmental decisions that determine to what extent these inequalities will be reinforced, mitigated or transformed.

Government fiscal policies can lead to income redistribution through taxation and transfers, labor market institutions shape the wage structure and employment opportunities, social protection decreases the households' vulnerability, and investments into education, health care, and infrastructure can create more economic opportunities. These policies show that inequality cannot be discussed without taking into consideration the institutional environment where economic activity takes place.

On the other hand, the success of government policies to reduce inequality largely depends on political and institutional factors. Policies aimed at reducing inequality will be less efficient in case of low administrative capacity, inefficient targeting of benefits, poor regulation of labor relations and

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excessive influence of special interest groups on governmental decisions.

Thus, the efforts to mitigate the problems associated with income inequality should not only include policies for redistribution after the income has been created but also the increase in the distribution of economic opportunities such as access to education, employment, health care, infrastructure and economic resources.

Finally, the politics of inequality implies not only the distribution of resources but also the political and institutional environment where the distribution takes place. Sustained improvement in economic opportunities requires effective public policies, productive employment, inclusive institutions and enough state capacity to implement policies consistently.

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