ORIGINAL PAPER

DOI: 10.26794/2587-5671-2020-24-6-174-186
UDC 336.02;338.2(045)
JEL D30, D31, D33, D41, D63, J31

Analysis of the Causes of Long-Term Changes in Economic Inequality in the Global Economy

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ABSTRACT

The author examines long-term changes in economic inequality in the global economy. **The aim** of the article is to update, analyze and systematize the long-term causes of changes in economic inequality in the global economy and identify its country specifics. The author used the **methods** of analysis and synthesis, systematization, classification and categorization of information from various scientific and statistical sources and databases. To illustrate the trends in economic inequality, the author applied the indicator of the share of national income among different groups of the population. The study revealed the cyclical nature of economic inequality in accordance with Kondratieff innovation waves lasting 50–60 years. Based on the data analysis of economic inequality for the period 1900–2018, the author **concluded** that technological progress is the priority factor in changing economic inequality. Together with the country specifics of the financial mechanism for redistributing income and wealth and various regimes of international cooperation and trade, it affects the changes in cross-country and domestic economic inequality. Understanding the nature of changes in inequality will allow for effective long-term strategies for economic development and the corresponding state regulation policy in the context of faster digitalization and robotization of the global economy.

Keywords: economic inequality; poverty; economic growth; Kondratieff innovation cycle; economic cycles; taxes; government regulation

For citation: **Dorofeev M.L. Analysis of the causes of long-term changes in economic inequality in the global economy. *Finance: Theory and Practice.* 2020;24(6):174-186. (In Russ.). DOI: 10.26794/2587-5671-2020-24-6-174-186**

INTRODUCTION

Inequality is among the greatest challenges of modernity. This is confirmed not only by numerous scientific studies, but also by obvious multiple aspects of this problem in the current UN sustainable development goals until 2030.[1] Over the past few years, the problem of inequality has often stepped forward and became leading in the international economic agenda in any economic conditions.[2]

Most scientists think that inequality really exists, which is confirmed by various data (*Fig. 1*). They also believe that with the current global financial system, economic inequality is increasing, which is a threat to the world community in the long term.

However, some scientists believe that the problem of growing global inequality is exaggerated and requires more thorough research [1]. Possible inaccuracies in assessing the dynamics of economic inequality may be caused by insufficient quality data, since this information is collected differently for various groups of the population in terms of income. Moreover, there is still a problem of identifying the ultimate beneficiary of depository and brokerage accounts [2].

According to modern macroeconomic goals, many scientific works seek to solve economic inequality in the context of economic growth and poverty. Poverty reduction is possible by accelerating economic growth, which, however, can accelerate the growth of inequality if redistributing of income and wealth in the country is ineffective [3].

Economic growth, growing income inequality and overproduction, which creates environmental problems for the Earth and risks to sustainable development, are the prime interest for the scientific community [4]. These issues are difficult to solve due to the fact that the available tools and methods will slow down economic growth, which is totally unacceptable for its main beneficiaries, since it will become a challenge to the stability of the global financial system.

Analysis of the causes of long-term changes in economic inequality in the global economy aims to develop a comprehensive view of state regulation of economic inequality, reassess the analysis of the causes of long-term changes in economic inequality in the global economy and prioritize the importance of various factors that influence economic inequality. The practical importance of systematization, analysis and clarification of the reasons for developing economic inequality is to allow state regulation bodies to better understand this problem and to apply science-based approaches in building optimal socio-economic and financial policies.

R.I. Kapelyushnikov [1] assumes that the risks of primitivization of the problem of growing economic inequality are quite high and we should examine the reasons for its change more carefully. The author provides a critical analysis of various points of view on the causes of rising economic inequality and shows their weaknesses, emphasizing the relevance and the need to continue research on this issue. In this regard, a new look at this problem that considers the long-term factors of changes in economic inequality, as well as the importance of considering its cyclical nature of development are relevant.

MATERIALS AND METHODS OF RESEARCH

Economic inequality refers to the differences in indicators of economic well-being between individuals or groups of individuals. The most common classification in the scientific literature is cross-country and domestic economic inequality. To illustrate trends in economic inequality, we applied the indicator of the share of national income among various groups of population. Trends in the share of national income of 1% of the richest people in the coun-

[1] UN. 17 Goals to Transform Our World. 2020. URL: https://www.un.org/sustainabledevelopment/sustainable-development-goals/ (accessed on 20.07.2020).

[2] WEF. Challenges and Opportunities in the Post-COVID-19 World. 2020. URL: http://www3.weforum.org/docs/WEF_Challenges_and_Opportunities_Post_COVID_19.pdf (accessed on 20.07.2020).

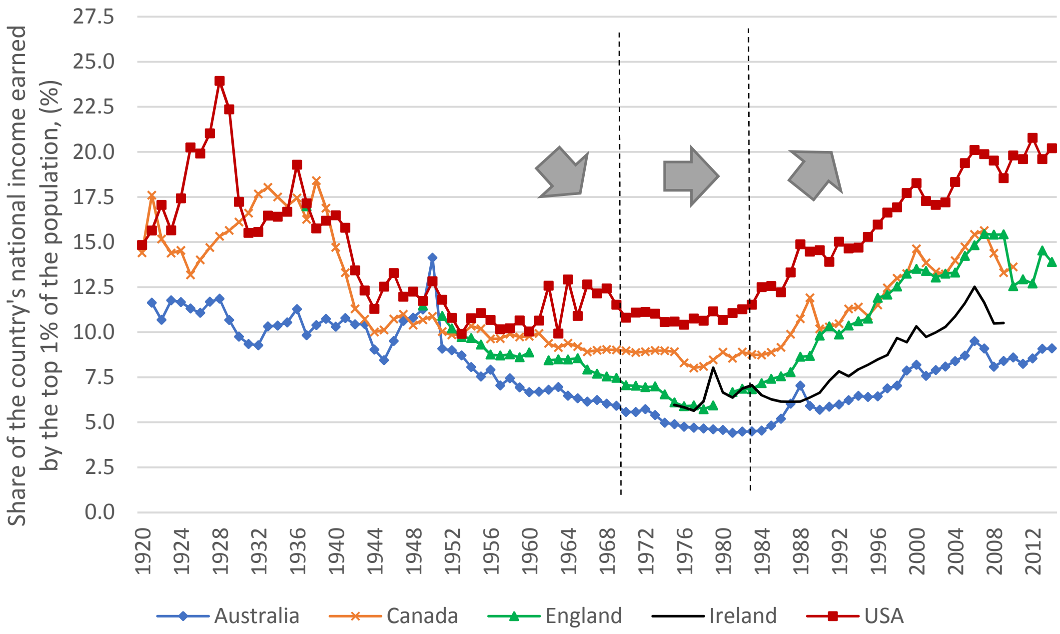

Fig. 1. **Trends in the share of income of the top 1% of the population by share in national income in different countries***

Source: compiled by the author based on World inequality report 2018.

* To illustrate this, we have marked the generally accepted trends in inequality, highlighting the period from the 1970s to the 1980s as reversal and the beginning of the growth of economic inequality in the world. Note that the graph clearly shows how the process of decreasing inequality slows down first in the United States, and then in other countries. In fact, in the United States, the reversal of inequality took place in the 1950s–1960s. In other countries, it happened later, closer to 1978.

try over a long period of time clearly shows how economic inequality is changing.

To identify the causes and factors affecting long-term trends in economic inequality, we used the methods of analysis and synthesis, systematization, classification and categorization of information from various scientific and statistical sources and databases.

The major source of information for the research base is the World Inequality Database.[3]

LITERATURE REVIEW

R. I. Kapelyushnikov [1, p. 10] classifies the drivers of changes in inequality into general and specific. Common reasons of global nature that have a large-scale impact on the standard of living, include the following:

1. Fundamental changes in the political regime, manifested in the revitalization of socialism, which resulted in a number of relevant reforms for a more equitable distribution of income in society.

2. Heterogeneous technological progress and production rates of the corresponding highly skilled labor force.

Particular causes and drivers of changes in economic inequality include:

1. Weakening of trade unions, traced in a significant loss of their ability to defend workers' rights.

2. Globalization of the global economy.

3. Fast development of financial markets and the "financialization" hypothesis.

4. Labor migration.

A lot of foreign research is devoted to inequality. In the fundamental work on inequality, S. Kuznets [5] explored the hypothesis that inequality changes nonlinearly during the economic growth cycle, increases fast at the initial stage of GDP growth and decreases at its later stages. Thus, the inequality change

[3] World Inequality Database. URL: https://wid.world/summary-table/ (accessed on 10.06.2020).

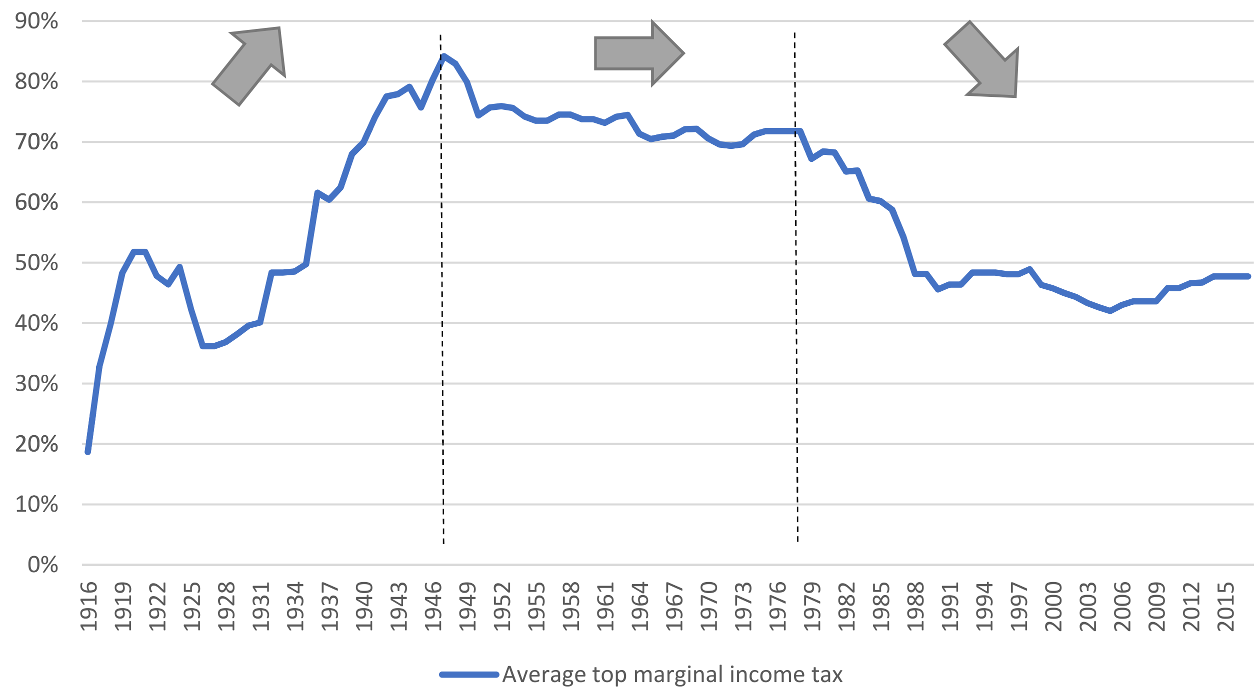

Fig. 2. **Marginal income tax and wealth tax of the top 1% of the population, averaged for the group of rich countries (USA, England, Germany, France, Japan) for the period 1916–2017**

Source: compiled by the author based on [2].

cycle can be divided into two stages relative to economic growth. S. Kuznets presented the economic inequality development at different stages of economic growth as a U-shaped function.

The most comprehensive and fundamental foreign works include the periodic World Inequality Report 2018 [2] and the work by P. Tridico [6]. The conclusions in these works differ, since both works note the complexity and multifactorial nature of changing economic inequality.

The World Inequality Report 2018 describes the dynamics of economic inequality in a number of developed and developing countries over more than 100 years. In this context, it shows two distinct periods of development of the global economy, lasting about 50–60 years.

The first period lasts from about 1910–1920 to 1970–1980. During this time, most countries experienced a steady decline in inequality. The period was characterized by powerful political, economic and social shocks that influenced the dynamics of inequality in almost all these countries. The reasons for the change in trends in economic inequality were world wars and financial crises, which led to a significant deterioration of production factors.

To finance the two world wars, the tax burden was sharply increased in many countries, especially on the wealthy strata of the population (*Fig. 2*).

After the two world wars, tax rates on the income of the richest strata of the population and on the bottom 90% of the population started to converge. For the poor and middle strata of the population, the tax burden during this period grew with a delay. Super high tax rates for the wealthy began to decline immediately after World War II.

We will supplement the idea of capital market regulation with a monetary policy factor, which has not been considered as detailed as the issues of income and inheritance taxation.

- After the outbreak of World War I, interest rates of the central banks of developed countries (USA, England, etc.) were reduced to historical lows (about 2%) as a measure to tackle crises and great uncertainty in the global economy.

- After World War II, acceleration of inflation began, which led to a sharp increase in interest rates of central banks [7]. At the time of reaching the peak tax rates on income and inheritance for the richest strata of the population, interest rates were at the minimum values.
- After uncertainty reduction in the world and exhaustion of the need to finance military spending, the tax burden on the rich peaked and stopped growing, but inflation and interest rates started rising. In the period from 1939–1945 to 1970–1980, interest rates in the world grew almost seven times, reaching about 14% (in the United States and England). Then inflation stopped growing and allowed for easing of interest rate and monetary policy of central banks.

The second period (from the 1970s — 1980s to the present) is associated with totally opposite shocks, characterized by state regulation of inequality turning towards liberalization and supporting the idea of accelerating economic growth. During this period, the policy of strict control of capital turnover broke up, asymmetric practices for motivating top managers were introduced, as well as tax cuts for the rich and the equalization of the average tax burden on all groups of the population. The global economy focused on the concept of value maximization, which is still fundamental in the theory of corporate finance [8].

Note that economic growth has affected the development of countries in different ways. The main reason for the unequal changes in inequality was differences in adjusting the financial mechanism in different countries for redistributing national income, associated with the specifics of the political system and the terms of the social contract.

We will support this explanation with the conclusions interesting in this context [9]. Cross-country differences in a country's social mentality largely determine the rigidity of its state economic policy adjustment. The authors argue that the United States, following the spirit of the free market and equal opportunity, believe that if a person is poor, it is his/her fault. The European mentality sticks to the idea that a poor person is most likely unlucky and needs help, since the whole society as a whole will benefit from this. In richer and more developed countries, inequality is comparatively lower, since as wealth accumulates, society becomes more tolerant and changes its attitude towards the poor, pursuing appropriate policies of social support and equalizing economic inequality.

We should also mention the more rare country features of economic inequality growth specific for some developing countries. For instance, South Africa is among the countries with the greatest economic inequality.

For a long time, the main driver of economic inequality in South Africa was class inequality (apartheid), abolished in 1994. The aftershocks of apartheid appear in the fact that today 10% of the country's population, including predominantly white people, earns more than 60% of the total national income of Africa and receives income comparable to that of the European Union [2]. Accordingly, the bottom 90% of the South African population by income earns quite little and lives in extremely poor conditions.

The fairest income distribution in the USSR was the period of de-Stalinization of the economy after 1958, when massive investments in infrastructure and education took place. However, after the 1970s-1980s, it is not quite right to assess economic inequality in the USSR only by monetary indicators. In the context of a significant commodity deficit and a number of economic difficulties in the 1980s [10], non-monetary economic inequality boomed in the USSR. It consisted in unequal access to scarce goods and services for the political elite, the richest people and the rest of the population. According to the World Inequality Report 2018, the standard of living of the top 1% of the

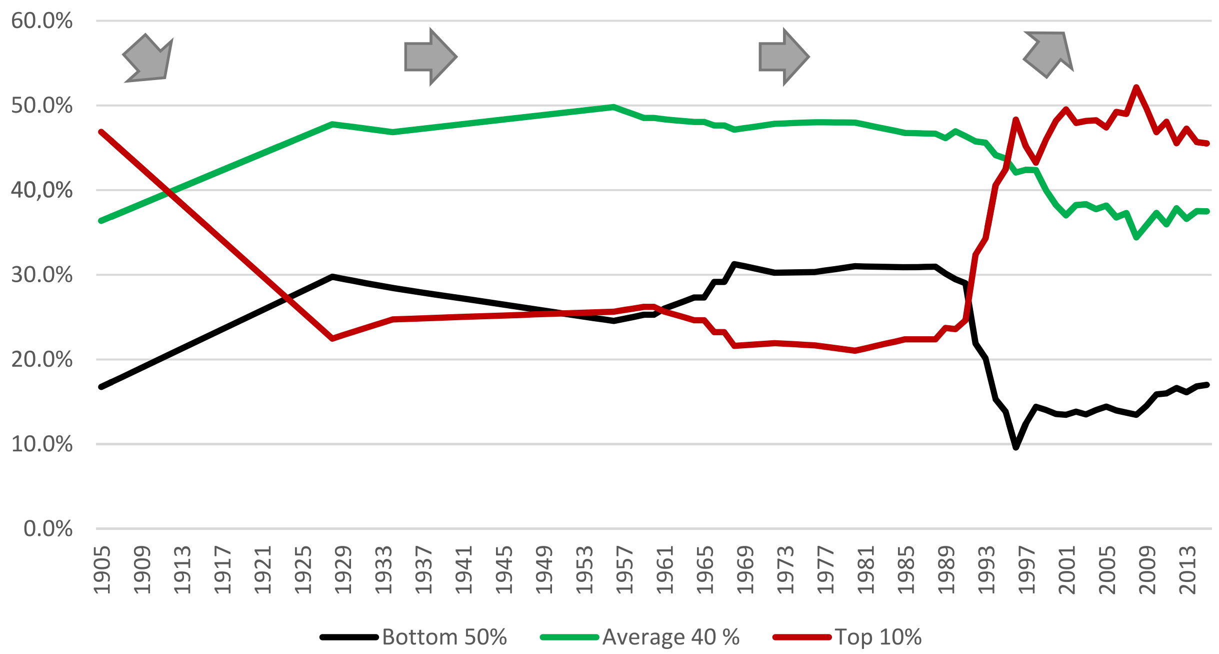

Fig. 3. **Inequality in Russia in the share of the rich (top 10%), middle class (average 40%) and the poor (bottom 50%) in the distribution of national income of the country. The period from 1905 to 2016**

Source: compiled by the author based on [2].

population in the USSR was 4–5 times higher than their annual income [2].

After the collapse of the USSR in 1991, the shock therapy policy and a series of economic reforms, there was a sharp increase in wealth of the top 10% of the population in terms of income. Due to unequal opportunities of the super-rich and the poor non-monetary factors of economic inequality were converted into monetary ones, which is still discussed in the context of the introduction of countervailing taxes on unfair privatization [11]. The current inequality in Russia is comparable to that of tsarist Russia before the February Revolution of 1905 [12] (*Fig. 3*).

The Middle East region, along with South Africa, is a territory with a very high level of inequality, its country specifics and the reasons for its formation. According to the World Inequality Report 2018, labor migrants played a significant role in the income stratification [2].

The share of foreign workers in the labor force of the Gulf group countries (UAE, Kuwait and Qatar) in the period 1990–2016 grew to almost 80%. For a long time, working conditions for labor migrants in this region were incomparably worse than for the indigenous population. The adjustment of the national income distribution system in these countries was and remains asymmetric in favor of the indigenous population. As a result of this country specifics, indigenous citizens have many economic benefits, while labor migrants do not. There is a special term to characterize labor relations in these countries — the kafala system, which is an analogue of labor slavery [13].

RESULTS AND DISCUSSION

The analysis of the World Inequality Report (2018) allowed for a key conclusion that long-term changes in inequality are affected by a combination of political, economic and social shocks leading to changes in public attitudes, expectations and behavior of investors, as well as responses and corresponding reforms of regulators, which generally changes adjusting the financial mechanism for redistributing national income and wealth and leads changing long-term trends in economic inequality.

By adjusting the financial mechanism, we understand a system of methods, tools, levers, information and legal systems that affect the processes of financial redistribution in the economy. Changes in adjusting the financial mechanism for redistributing national income and wealth affect the growth rate of income and wealth of various groups of the population and, in our opinion, are the main long-term factor in changing trends in economic inequality.

The most important elements of the financial mechanism affecting the dynamics of economic inequality are:

1. Fiscal adjustments of the economy, such as marginal tax rates on income, wealth and inheritance of various groups of the population.

2. Interest rates of central banks and monetary policy parameters that determine the cost of borrowing, exchange rates, inflation, real incomes, propensity to save households [14] and prices in the financial market.

3. Tariffs, terms of international trade, the rigidity of anti-offshore regulation and cross-country cooperation to control the practice of tax avoidance.

4. The share of government spending on social security and transfers for social support of the population as a percentage of total spending is a very important factor and leverage for influencing the lower strata of the population in terms of wealth. Expenditures on education and health play a great role, since the potential of human capital depends on their size in the early development.

To illustrate the change in adjusting the financial redistribution mechanism, we will consider the economic inequality reduction in the world in the period 1910–1970. The first half of this period showed a progressive increase in the tax burden on the rich to finance military spending. World War II was followed by a tightening of monetary policy in response to a strong global inflation increase. Readjusting the financial redistribution mechanism in the form of a tightening of economic policy primarily affected the growth rates of the wealthiest strata of the population, since most of their wealth and income was generated in rental income, income from investments in financial markets and from shares in business. During the same period many countries carried out important social reforms to support the poor, and started large-scale investments in social spending (education, health care, etc.), which, in turn, accelerated the welfare growth rate of the lower strata of the population in terms of income and wealth [15]. All these factors led to a significant adjustment of redistributing labor and capital incomes of various groups of the population, as well as to the inequality decline up to the 1970s — 1980s.

The changes took place differently for various countries, since their socio-economic models differ and determine the domestic specifics of adjusting the financial mechanism for redistributing income and wealth [6, p. 78]. The impact of this factor on developing the political structure and the conditions of the social contract is great. For instance, differences in values and attitudes towards the poor in the United States and Europe lead to different adjustments of the financial mechanism for redistributing and supporting the lower income groups and are important non-economic reasons that cause differences in economic inequality in these countries [9]. However, the country specifics did not significantly affect the trend of inequality in the long-term. For the countries opposite in their approach to progressive taxation of income, wealth and inheritance, inequality is still changing, as evidenced by the data of the World Inequality Report (2018).

We now come back to the cyclical nature of economic inequality as the most complex reason for describing the dynamics of this phenomenon. Considering the available data on economic inequality for the period 1900–2018, we conclude that the development of economic inequality in the long term occurs within long-term cycles similar in duration to Kondratieff innovation waves. To prove this

Table 1

Approximate dates and characteristics of economic inequality cycles (1400 — present)

Key events at the beginning of the inequality cycle	Beginning	Cross-country inequality	Domestic inequality	Reason for change	International trade regime	End	Total duration, years
1. Venetian trade and conquests, financial sector development in Florence, Spain, Republic of Genoa	1400	↑	↓	New technologies, transport, large ships	Protectionism	1600	200
2. Peace of Westphalia	1600	↑	↓	New technologies, transport, large ships	Protectionism	1750	150
3. Thirty Years' War / industrial revolution	1750	↓	↑	Differentiation of labor resources by income due to the emergence of new professions	Development of international trade and globalization	1900	150
4. 1890 financial crisis / two world wars	1900	↑	↓	New technologies	Protectionism	1970	70
5. 1970 oil shock / boom in financial markets	1970	↓	↑	Differentiation of labor resources by income due to the emergence of new professions	Development of international trade and globalization	2050	80
Maximum						200	200
Median						150	150
Mean						130	130
Minimum						70	70

Source: compiled by the author based on [7, p. 29–32].

hypothesis empirically we need representative data over a longer period, which we do not have.

In this regard, one should consider the study by P. Tridico concerning the cycles in inequality dynamics. The author suggests [6, p. 27–29] that inequality should be classified into two types: (1) global cross-country economic inequality and (2) domestic economic inequality.

Global inequality is taking off following technological reforms that create new complex and long value chains around a key geographic area (country). This leads to capital

Table 2

Duration of Kondratieff innovative cycles (1771 — present)

Innovation cycles	Beginning	Initiation and implementation of technology		Peak formation	Aging of the technology		End	Total duration, years
		Phase 1	Phase 2		Phase 3	Phase 4		
1. Industrial revolution	1771	10	12	2	14	16	1829	58
2. Steam engines and railways	1829	11	8	2	7	16	1873	44
3. Metallurgy, electricity and heavy industry	1875	9	9	2	12	10	1918	43
4. Oil, automobiles and mass production	1908	12	9	4	26	14	1974	66
5. Information and telecommunication technologies	1971	16	14	2	12	15	2020-2037*	50-60
Maximum		16	14	4	26	16		66
Median		11	9	2	12	15		51
Mean		12	10	2	14	14		53
Minimum		9	8	2	7	10		43

Source: compiled by the author based on [17].

flows and differences in economic growth rates between countries. During this process, the leading country and its main competitor are far away from the catching-up countries in economic development, the national income of the leading countries is growing at a higher rate, which ultimately leads to an increase in cross-country inequality.

During this period, domestic economic inequality goes in antiphase and decreases, while international trade and cooperation are going through a period of protectionism. For a certain time, the leading country maintains high growth rates. However, over time, other countries catch up with it, and the corresponding cyclical changes occur. They and reduce cross-country and increase domestic economic inequality (*Table 1*).

Domestic inequality tends to grow after technological shifts in the exploitation of human capital, labor resources, skills and competencies in the country. Better educated and skilled citizens gain advantages in the domestic labor market, which leads to an increase in income polarization within the country. Domestic inequality grows naturally due to the fact that the leading country exhausts opportunities for growth within the country, expands into foreign markets, intensifies international trade, opens markets, and relaxes for production factor movements and other processes of globalization.

The analyses of the materials presented in [6] and in *Table 1* raises questions about the data sources. First, the author indicates round dates, which speaks of a superficial assessment of the cycle durations. Second, in [6] has no references to the original sources.[4] Third, the author's concept of changes in inequality, a leitmotif in P. Tridico's book, is presented as a working hypothesis, according to which economic inequality has been changed in five or six stages since the 1970s to the present time. *Table 1* presents only the last stage, which is considered and analyzed in sufficient detail.

Based on the World Inequality Report 2018 and the work by P. Tridico [2, 6], we believe that Kondratieff innovation waves are the best description of cyclical processes in economic inequality.[5] At the same time, the theory of dividing economic inequality into cross-country and domestic and the description of the logic of cyclical changes proposed by P. Tridico complement it well to form a conceptual description of the cyclical development of economic inequality.

Table 2 shows the dates of the key stages of Kondratieff innovation cycles, grouped into four phases (not considering the formation period of the peak of innovative development): (1) introduction of technology, (2) rapid development of innovations, (3) formation of bubbles and slowdown in growth, (4) stagnation of technology and formation of prerequisites and conditions for changing to a new innovative technological order.

According to *Table 2*, the average duration of an innovation development cycle is about 53 years. Comparing these data with the materials of the World Inequality Report 2018 confirms the hypothesis of a cyclical change in economic inequality with cycles lasting 50–60 years for the period from 1900 to the present.

CONCLUSIONS AND RECOMMENDATIONS

To summarize, we can explain the reasons for the change in trends in the economic inequality dynamics as follows.

The review of scientific discussions on the causes and drivers of the economic inequality dynamics has led us to conclude that this is a complex and multifactorial process. Therefore, individual reasons and drivers do not allow for its sufficient justification and characterization.

Long-term changes in inequality are affected by a combination of political, economic and social shocks. They lead to changes in public attitudes, expectations and behavior of investors, as well as the response and corresponding reforms of regulators, which generally changes adjusting the financial economic mechanism and national income redistribution, and leads to a turning point of the long-term trend in inequality.

By adjusting the financial mechanism of the economy and redistributing national income, we understand the parameters of economic policy (tax and monetary components), as well as other conditions (priorities of government spending) that affect the rate of change in income and wealth of various groups of the population.

Among the other reasons, one can distinguish primary (various external and internal shocks) and secondary (reactive actions of regulators to reconfigure the financial mechanism for redistributing income and wealth between groups of the population).

Based on the analyzed data on the long-term dynamics of inequality and the theories of cyclicality, we developed a hypothesis about the cyclical nature of this process. According to the available data, the dynamics of inequality for 120 years can be best described by Kon-

[4] A footnote below the table confirms that the table is compiled by the author and does not specify the sources of data on economic inequality.

[5] To test this hypothesis empirically, a reliable information for a period of 500–600 years is required, that we, unfortunately, do not have. Therefore, we took the databases on inequality for the past 100–120 years.

dratieff innovation cycles. This theory is well complemented by the concept of the cyclical development of cross-country and domestic inequality, proposed by P. Tridico, with the corresponding changes in international cooperation and globalization of the global economy.

Considering this conclusion, one can also prioritize the list of factors affecting the change in economic inequality. Based on the idea of cyclical innovation development, we assume that the main driver of changes in economic inequality is innovation and technological progress.

Heavy regulations of cross-country inequality can have negative affect on the technology development and slow down the development of humanity. Thus, to address the main problems of economic inequality that today concern society, regulators should focus primarily on domestic economic inequality. To do this, it is necessary to work with adjusting and increasing the efficiency of the financial mechanism for redistributing income and wealth within the country, which is complicated by the country socio-economic specifics.

A reasonable supplement to the above is the strengthening of cross-country cooperation to tackle the shadow economy, impersonal accounts and offshores. This will enable countries to better address the problem of domestic economic inequality, as far as their mentality and socio-economic structure let them do this.

Works [18–23] reveal the idea of developing the institution of global regulation, increasing control over the blind spots of the global financial system that allow transnational corporations and super-wealthy individuals to significantly optimize and legally avoid taxes. We suppose that this area of scientific knowledge has not yet been sufficiently developed in scientific works on economic inequality and requires further research using economic, mathematical and econometric research methods.

The key directions for developing a global strategy for sustainable development of the global economy, considering the specifics of economic inequality, are the ideas described in Part V of the World Inequality Report 2018 [2]:

(1) development and adjustment of progressive taxation of income, wealth and inheritance;

(2) creating a global financial register of assets to control the reallocation of property rights, tackle offshore and more effectively address the problem of tax avoidance;

(3) creating a balanced global regulatory body to tackle global (cross-country) inequality;

(4) review of the priorities of the state allocation policy and greater investment in education and educational technologies, as well as in medicine and biotechnology, including those based on public-private partnership.

These ideas can be supplemented by the idea (5) of developing the market and instruments of green bonds, creating a special section to tackle cross-country economic inequality, creating a global fund to tackle cross-country inequality, allowing for a coordinated global countercyclical financial policy at all stages of the economic growth cycle of the global economy.

Most scientists believe that since the 1970s the level of economic inequality has reached very high values and, with the current settings of the global economy, economic inequality will be growing.

Long-term changes in inequality are affected by a combination of political, economic and social shocks leading to changes in public attitudes, expectations and behavior of investors, as well as responses and corresponding reforms of regulators, which generally changes adjusting the financial mechanism for redistributing national income and wealth and leads changing long-term trends in economic inequality.

The reason for the increase in domestic inequality since the 1970s is ineffective and insufficient government regulation of the financial mechanism for redistributing national income within countries. In our opinion, this problem could be solved by readjusting the parameters of state economic policy. However, cross-country competition, open markets, insufficient cooperation in the joint regulation of inequality problems create certain obstacles, since the blind spots of the international financial system for regulators still remain an unresolved problem.

Another important conclusion is the idea of the cyclical development of economic inequality. We suppose, it supplements the theory of Kondratieff innovation cycles very well.

In general, tackling economic inequality is a difficult task that may require all countries to cooperate more closely and search for new approaches to developing and agreeing on a global strategy for the sustainable development of the global economy.

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The article was submitted on 10.08.2020; revised on 24.08.2020 and accepted for publication on 12.09.2020.
The author read and approved the final version of the manuscript.