 CHAPTER 7

Inequality and Social Disorder

According to the epsilon, omega, and sigma models presented so far, production and distribution in capitalist societies are endogenously determined. Income inequality is thus an outcome of the economic process. An implicit assumption of these models was that the degree of inequality was always socially tolerable. Therefore, once static general equilibrium was reached, production and distribution could be repeated period after period under the same rules of the economic game, that is, the general equilibrium implied social order.

This prediction is however inconsistent with the most distinctive features of the workings of capitalism. Workers go on strike; people expropriate assets or incomes of others by force; cities are insecure places to live in; democracy is interrupted by dictatorship; and so on. Governments spend significant resources in protecting private property and individual security through police, courts, and jails. People also make significant expenditures to protect their property directly, which gives rise to the development of the security industry. These are reflections of social disorder.

Social disorder will be defined here as the behavior of people directed to break the rules of the institutional context. What are the factors that lie behind the observed social disorder? General equilibrium with excess labor supply is a trait of capitalism, as shown in previous chapters. Is general equilibrium with social disorder another trait of capitalism?

This chapter presents, first, a theory that intends to explain the role of inequality in the generation of social disorder in the three types of capitalist societies; second, it also presents a theory of government behavior toward inequality. Then both theories are integrated into new general equilibrium
models of the epsilon, omega, and sigma theories. The empirical predictions of these models are derived and then confronted against facts.

**Limited Tolerance for Inequality**

In order to understand the origin of social disorder, a general theory will be presented in this section. We may call it the *theory of limited tolerance for inequality*. The following alpha proposition is then proposed:

\[ \alpha(C). \ (1) \text{Limited tolerance for inequality: In capitalist societies, which are unequal societies, individuals have a sense of justice or fairness with respect to economic inequality, which sets thresholds of tolerance for inequality. Whenever inequality reaches levels beyond their tolerance thresholds, individuals will react and seek measures (legal or illegal) to restore inequality to the tolerable range.} \]

The symbol “C” after alpha indicates that this theory is “general,” in the sense that it is intended to be valid in the three capitalist societies that have been studied, namely, epsilon, omega, and sigma. Indeed, limited tolerance for inequality is included as an assumption of their alpha propositions, which will now be developed.

As mentioned before, capitalism is an unequal society; moreover, in this society, people act motivated by self-interest. In this context, people will also seek social status, which may then be treated as a good. The individual’s relative position in society in terms of real income is thus a very important objective. Inequality becomes an essential factor of human behavior, as the proposed theory says. Individuals will seek not to be left behind; a fall in real income will not be tolerated. Individuals will seek to earn higher incomes in order to gain social status or maintain it and “keep up with the Joneses.” If general equilibrium with equal incomes for all was attained, people would hardly seek higher incomes, nor would they worry about being left behind. However, in an unequal society, people act motivated to seek higher relative incomes.

The theory of limited tolerance for inequality assumes the existence of a threshold level of tolerance for inequality. Whenever inequality reaches values that go beyond the threshold, individuals will start considering inequality to be unjust or unfair. In addition, the theory assumes that people do not just contemplate injustice, but react, do something, protest, and seek to resist what they consider to be unfair distribution, or else retaliate with illegal actions. The social conflict of income distribution becomes important in society because of the existence of the tolerance threshold; if such a