General Assembly 69th Session
Second Committee General Debate – Keynote Address

"High and Rising Inequality: Causes and Consequences"

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Tuesday, 7 October 2014, 10:00 am
United Nations Secretariat, Conference Room 2

Welcome

Good Morning –
Your Excellency, Ambassador Cardi, Chair of the Second Committee;
Excellencies;
Assistant Secretary General Mr. Thomas Gass;
Distinguished Delegates;
Ladies and Gentlemen:

It is a tremendous honor, and a pleasure, to have the opportunity to speak to you today – especially on the topic of inequality.

In the last approximately three years, an extraordinary development has unfolded. Concerns about inequality have attracted unprecedented attention – in the United States and in many other countries. This attention has permeated multiple spheres, from social science research, to journalism, to local electoral politics. This past fall, the voters of New York City elected a mayor whose remarkable campaign rested squarely on a promise to reduce inequality in this great city.

A confluence of factors sparked and intensified this international conversation about high and rising inequality. In many countries, the Global Financial Crisis, the Great Recession, and the ongoing recovery, cast light on disparities between financial sectors and labor markets. The Occupy movements that cropped up in many countries captured worldwide attention; scholars have contributed fresh accounts of inequality's origins, nature, and effects; journalists and activists have produced vivid stories and innovative visualizations – and new data have been created and analyzed.

My plan for this morning is to share with you a portrait of inequality across a range of countries and to present highlights from what has been learned about inequality in recent years.

Let me begin by offering a roadmap to the remarks that I will make this morning.

Roadmap

First, *I will introduce LIS*, the data archive that I direct and that provides the foundation for my own work on inequality and that of many other researchers. That will help to set the context for what follows.

Second, I will paint a brief cross-national portrait of *levels* and recent *trends* in inequality.

Third, I will comment on what social scientists have concluded in recent years about the dominant *causes* of high and rising inequality in several of the world's major economies.

As part of that discussion, I will turn our attention, briefly, to one particular question: What has been the effect on income inequality of *women's* increasing levels of economic activity?

Fourth, I will highlight current thinking about the *consequences* of inequality.

Finally, I'll come full circle and will return to some concerns about *strengthening data capacity*.

By way of a brief preview:

As all of *you in this room* surely know, the General Assembly's *Open Working Group on Sustainable Development Goals* recently issued its proposal for a set of future development goals known as the Sustainable Development Goals, or "the SDGs". One of these goals – Goal # 10 – is to "Reduce inequality within and among countries", with a more specific target set for the year 2030.

Earlier this month, I had the privilege of attending a meeting of new *UN Independent Expert Advisory Group on the Data Revolution for Sustainable Development.* Throughout that morning, several representatives from civil society spoke, and one idea was heard again and again – and that is that "high quality information drives sustainable development". So I will close with some thoughts about building the data capacity that could *help* to achieve the goal of inequality reduction, and the SDGs more generally.

Introduction to LIS

I'd like to start by taking about *five* minutes to introduce LIS – a widely-used and rapidly growing resource for research on inequality, and the source of many of the findings that I will present in the next half hour.

LIS – formerly known as the *Luxembourg Income Study* – is a cross-national data archive located in Luxembourg, with a satellite office here in New York City, at the Graduate Center of the City University of New York. LIS' core mission is to enable cross-national comparative research on socio-economic outcomes – *including inequality* – and on the institutional factors that shape those outcomes.

To achieve that, we acquire and harmonize datasets – mostly based on household surveys – and we make these harmonized data available to scholars and analysts around the world. In recent years, we have grown rapidly and we now have in-house datasets from nearly 50 countries, and – for over half of those – we have time-series data going back for two or three decades.

At LIS, our main “value added” is that we provide access to harmonized *micro*-data, that is, data at the level of households and the persons within those households. Access to *micro*-data enables fine-grained research on the *distributions* that underlie the national-level information about income that is more widely available.

I am gratified to note that LIS has provided data, and analyses, to some of the many United Nations agencies that are engaged in monitoring inequality levels and trends. We have provided that input through a variety of collaborative arrangements with – for example – UNDP, UNICEF, UN-Women, and the UN Research Institute for Social Development (UNRISD).

Before I present an empirical snapshot, I want to take a few more moments to characterize – and explain – the scope of the countries included in the LIS archive.

LIS began 30 years ago as a consortium of seven rich countries – and we grew from there. For our first two decades we included, almost exclusively, rich countries; our coverage tended to mirror that of the *Organization for Economic Cooperation and Development* (the OECD). Nearly ten years ago, we launched a new strategy: we decided to expand, specifically by bringing in datasets from middle-income countries.

As you all know, the major supranational institutions classify the countries of the world into four groups according to income level: high-, upper-middle, lower-middle, and low. At LIS, we first focused our expansion on upper-middle-income countries, because we knew that datasets from these countries (and the institutions that those data reflect) would be most similar to those from the high-income countries with which we had worked for many years.

I am happy to report that LIS now includes, as I noted, nearly 50 countries. About one third of those are middle-income countries, overwhelmingly upper-middle. The countries in LIS now include approximately 62% of the world’s population and about 85% of world GDP.

That said, we lack data from many countries – from many of *your* countries. Ideally, the LIS archive would include one or more datasets from *every* country in the world. However, until now, we have not brought in datasets from every high- and middle-income country, and we have no datasets from low-income countries. Why is that?

- For starters, income – LIS’ core indicator of wellbeing since its founding – is understood to be a less meaningful indicator in poorer countries. In low-income countries, analysts often rely on consumption as the core measure of household or individual well-being. Harmonizing or blending income data (our specialty) with consumption data raises daunting theoretical and technical challenges that remain largely unsolved;

- In addition, data from many countries are simply not available to us. Unfortunately, data producers in some countries choose not to participate in LIS, often due to national legal or administrative restrictions that they understand to be insurmountable;

- Last, our capacity to build a truly worldwide repository of comparable micro-data is further limited by resource constraints. Resource constraints limit our work (especially the number of datasets that we can harmonize each year), and they limit the work of other cross-national data projects, including those in organizations much larger than ours. And – perhaps most of all – they limit the work done within the national statistical institutes that produce the data that we aspire to gather, harmonize, and make available. Sadly, data producers in a number of countries have declined to join our consortium, explaining that they simply lack the staff capacity to document their data and package it for external users.

Of course, what all of this means is that my own expertise – and that of the 1000s of researchers who use the LIS data – is focused on inequality within high- and middle-income countries, mostly upper-middle.

All of that said, I hope that the "story" that I will tell today – about inequality in affluent countries – has implications outside of that subset of the world. As lower-income economies continue to develop and grow, it may be instructive to look towards inequality outcomes and dynamics in higher-income countries, in search of transnational lessons – lessons that are both positive *and* cautionary.

Levels and recent trends in inequality across higher-income countries

Let me turn our attention now to some "facts and figures". I am going to show you four figures that highlight inequality patterns and trends in recent years. The first three are from LIS; the fourth is from a new database known as *The World Top Incomes Database.* I will describe those data shortly.

It is very important to note that inequality encompasses an enormous array of conditions and outcomes. This morning, I am focusing on only <u>one</u> particular aspect of inequality: income inequality, specifically, the distribution of *income* across households – and my primary frame of reference is inequality *within* countries.

Figure 1

Income inequality varies across high- and upper-middle-income countries.
Gini coefficient, most recent time point, post-tax-post-transfer income
(data source: LIS Key Figures, 32 countries – 26 high-income, 6 upper-middle-income)

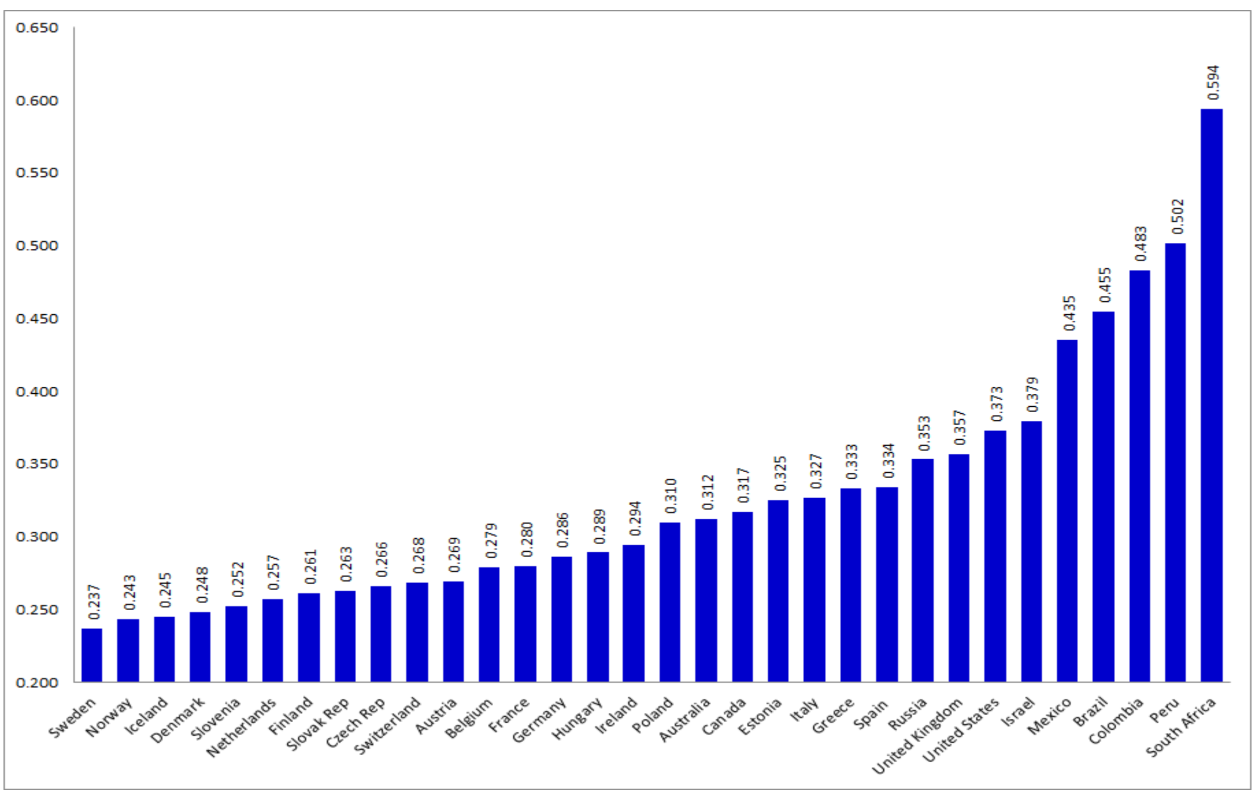

Figure 1, based on the LIS data, reports one well-known measure of inequality – the Gini coefficient – and it is based on data from 32 countries in the LIS archive; these are the countries for which we have data from recent years ready for analysis. This figure depicts within-country inequality across households; it is based on what is often called "post fisc" income; that is, essentially, the sum of income from the market and income from government, minus direct taxes paid.

The figure shows that income inequality varies dramatically across these countries, ranging from a low of .24 in Sweden to a high of .59 in South Africa.

Let me add that, according to Sir Tony Atkinson, the renowned inequality scholar, a difference in the Gini coefficient of about one point generally indicates a statistically significant difference; in general, a difference of about three points is substantively meaningful. Using these rules of thumb, the overall variation seen here is surely meaningful.

The figure also reveals some notable country clustering. The *four most <u>unequal</u>* countries include four middle-income countries – South Africa and three Latin American countries: Peru, Colombia, and Brazil. The *four most <u>equal</u> countries* are four Nordic countries – Sweden, Norway, Iceland, and Denmark.

Between the two extremes, we see the following:

- of the high-income countries, the two most unequal are two liberal market economies, the United Kingdom and (in the top position) the United States;

- just below these two English-speaking countries, we find Russia and a cluster of southern European countries;

- several continental European countries, including the large economies of Italy, Germany, and France, fall in the middle of this group; and

- the former state socialist countries reveal diverse outcomes.

Clearly, levels of income inequality vary sharply across countries, and, in this case, across countries at relatively similar levels of economic development. This suggests that national-level institutions matter, and they matter a lot.

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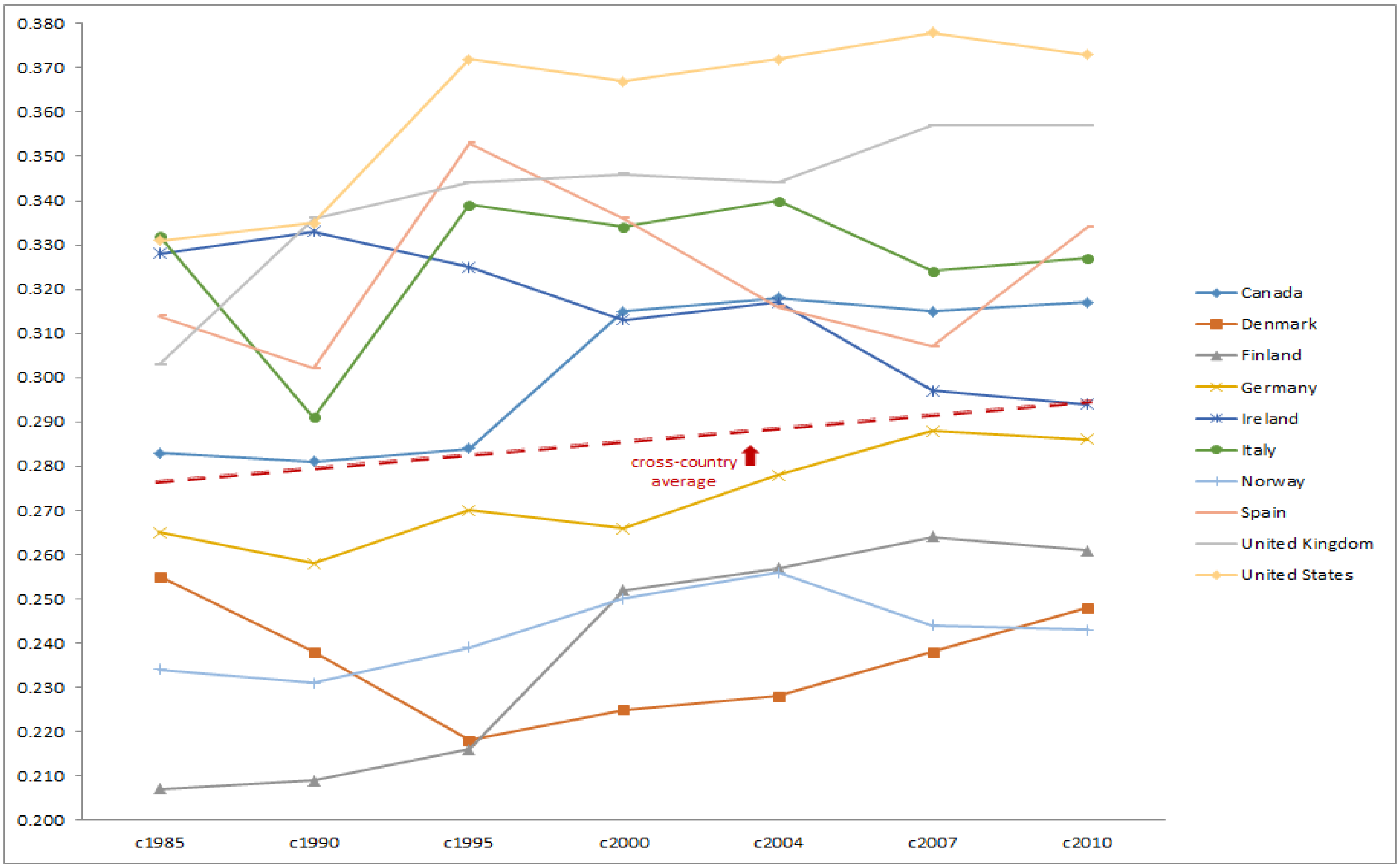
Figure 2 reports changes over time in this same indicator, the Gini coefficient based on "post tax and transfer" income – among ten of the countries included in the prior figure. I included in Figure 2 a set of countries for which we have data for 2010 and for the prior 25 years.

Here we see that inequality both rose and fell, within and across these cases – but the overall trend was *upward*. The cross-country average – based on these ten countries – reveals a rise of about two Gini points.

The OECD recently reported trends in inequality during this same time period – for approximately 30 affluent countries – and their results confirm ours. According to the OECD, inequality has risen in about two-thirds of OECD countries. (That is about 20 countries). They note that the increase averages about 2 points (exactly what we found among these ten countries). OECD analysts observe that the increase, among these countries, is perhaps not as dramatic as has been portrayed in the media but they add (and I concur) that it *is* both substantial and significant.

Figure 2

Income inequality has risen in many high-income countries.
Gini coefficient, approx. 1985-2010, post-tax-post-transfer income
(data source: LIS Key Figures, 10 countries)



What underlies these results? In most high-income countries – in which inequality has risen in recent decades – it has risen because rich households have done particularly well compared to middle-income and lower-income households. In other words, the top has risen – with the US being the extreme case. I will return to this in a moment.

You may note that, in a few cases – including the US and Germany – while the *overall* pattern is one of rising inequality, we see a decline in inequality between 2007 and 2010 – that is, during the heart of the recent downturn. That pattern is, in fact, not uncommon, because while the bottom falls during a downturn, often the top does as well – especially when income at the top is largely from capital. At LIS, we are eager to receive and process a wave of datasets from 2013, our next wave, as that will allow us to assess what recovery brings. In the US, recent findings from the Census Bureau indicate that inequality has risen again, after 2010, as the top (with a large share of income from capital) has recovered more quickly and more fully than the bottom (which is more reliant on the labor markets that are recovering notoriously slowly).

Unfortunately, at LIS, we cannot track change over time in our newly acquired middle-income country datasets – or at least not yet – because so far we have data from those countries only for the most recent time periods. However, we do know from the academic literature that inequality has been falling in at least one crucial corner of the world – that is Latin America.

Several scholars have studied inequality in Latin America and there is a clear consensus that inequality unambiguously declined in the 2000s. In a recent paper, Nora Lustig and her colleagues report that "… the Gini coefficient fell in 16 of the 17 countries where there are comparable data, and the change was statistically significant for all of them." Lustig and her colleagues find that the decline in inequality has two main roots – wage inequality declined, and government transfers became more progressive and more robust. Other scholars concur that declining inequality in Latin America is associated with growth in the income and spending power at the bottom, not from compression at the top. While inequality in most Latin American countries remains alarmingly high (as we saw in Figure 1), the recent declines in inequality, seen throughout the region, suggest potential lessons for policy-makers in other countries.

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In rich countries, we often hear that the rise in inequality signals a worrisome correlate – the so-called "hollowing out of the middle."

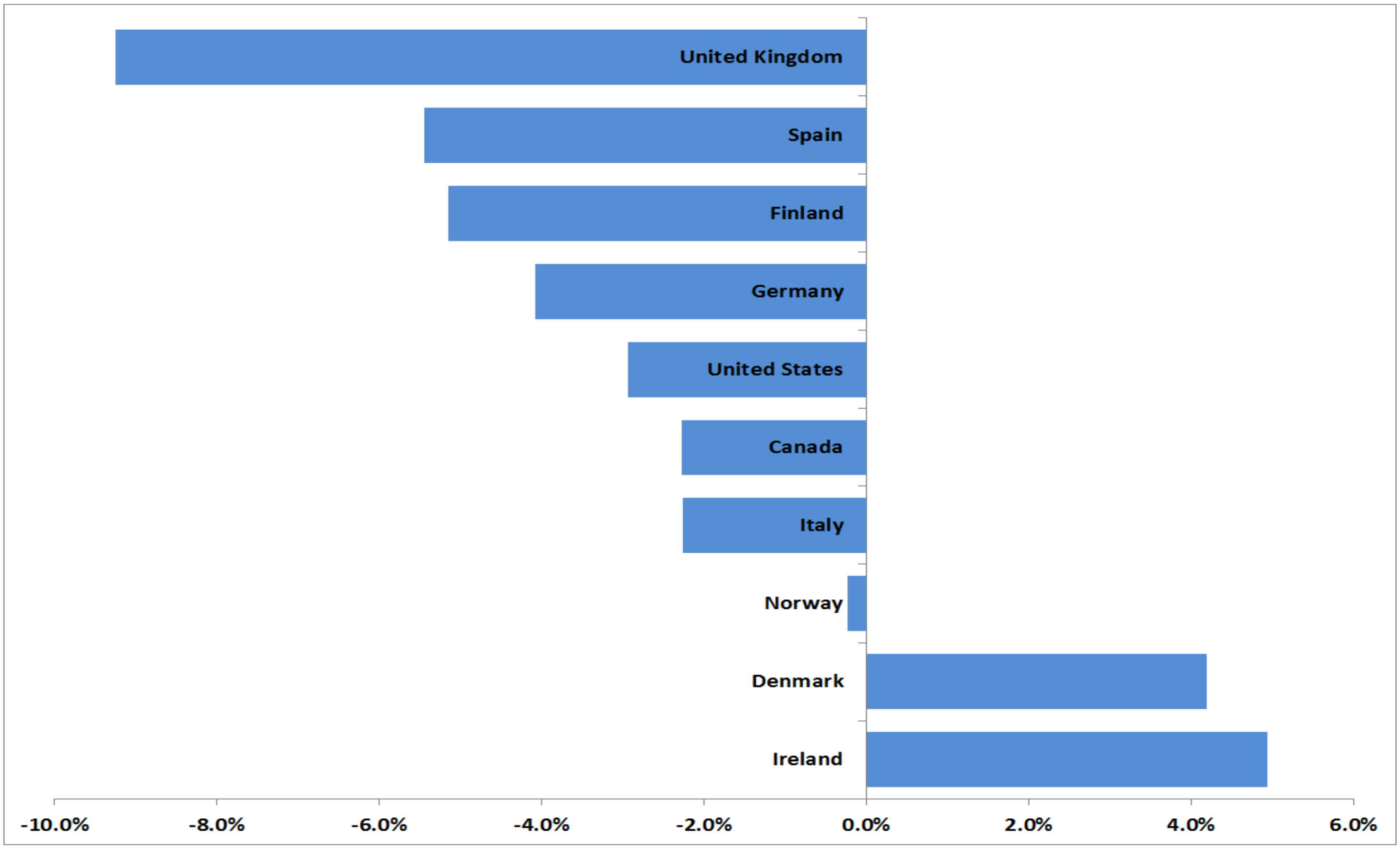
Figure 3, also based on the LIS data, reports change in the share of households whose income falls between half and twice the median. In this figure, we see that, indeed, among these ten high-income countries, the dominant pattern is one of a shrinking middle.

Although inequality scholarship has given relatively short shrift to the middle of the income distribution, there is – in fact – a large literature that concerns the importance of having a strong and stable middle class – and that literature addresses countries at all income levels. In their volume on fiscal policy and the middle class, the economists Antonio Estache and Danny Leipziger observed that "the economic success of the middle class is often seen as synonymous with welfare gains in societies in both developed and developing countries."

There is a growing consensus among inequality scholars that the hollowing out of the middle, in several high-income countries, signals problematic consequences that have yet to fully take shape. I will return to this.

Figure 3

The middle class has diminished in size in many high-income countries.
change in share between ½ and 2x median, approx. 1985-2010, post-tax-post-transfer income
(data source: LIS microdata, from Nathaniel Johnson and David Johnson, same 10 countries)



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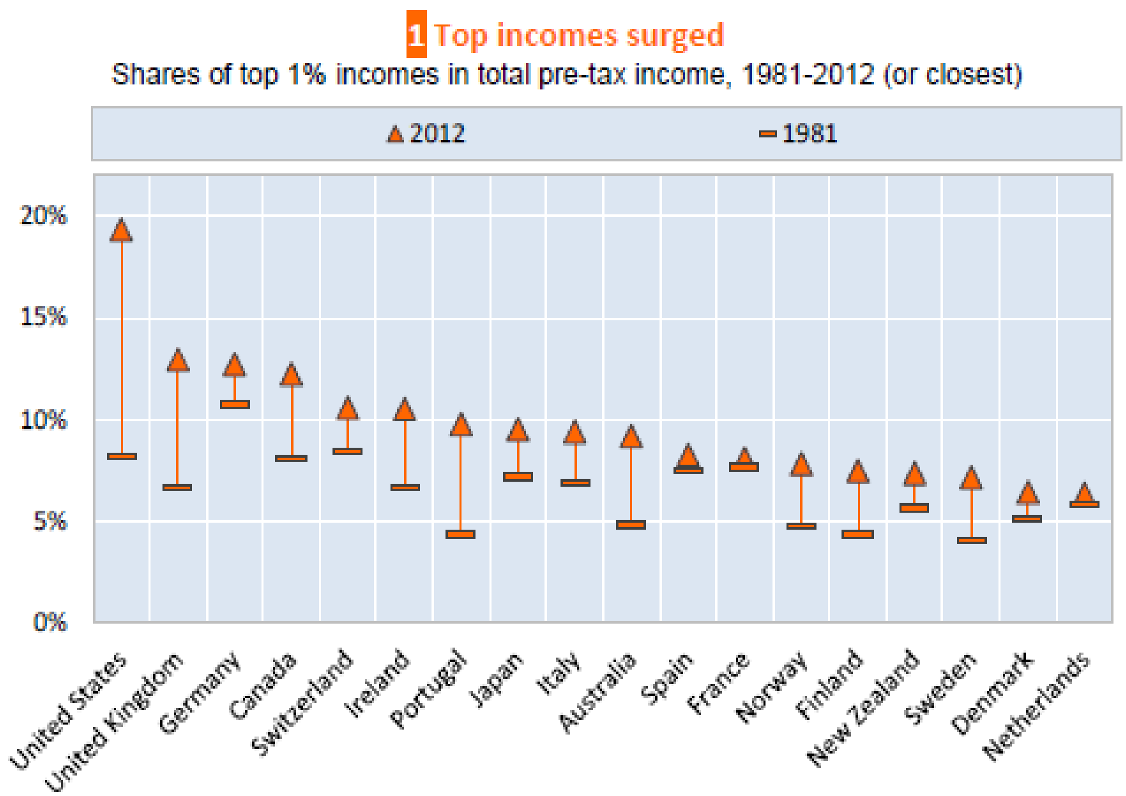
Finally, I want to turn your attention to inequality at very top.

Let me pause to note something – something that is well-known to inequality researchers but might be less well-known to some of you in the audience. Household surveys, the core ingredient of our work at LIS, tell us an immense amount about the whole of income distributions – with one exception: They are not well suited, for technical reasons, to looking at the very top. For research on the wealthiest of the wealthy, a different approach – a complementary one – has long been needed.

Fortunately, a group of scholars – including Tony Atkinson, Thomas Piketty, and Emmanuel Saez – recently filled this crucial hole with the launching of a new database, built from historical tax records. These new data – now known as the *World Top Incomes Database* – illuminate what survey data cannot – "the top of the top" – thus allowing us to peek at a part of the distribution that was, until now, largely behind a curtain. At LIS, we consider this excellent database to be a sibling of sorts – and, together, the two data sources, and the two approaches, allow us to study inequality more fully than either can do alone.

Figure 4 – compiled by OECD analysts – draws on the *World Top Incomes Database* to assess levels and trends in the income share held by the top one percent, in 18 high-income countries.

Figure 4
Top income shares have risen in many high-income countries.
top 1 percent, approx. 1981 to 2012, pre-tax income
(data source: World Top Incomes Database, from OECD)



As the OECD reports: "The share of the richest 1% in total *pre-tax* income has increased in most OECD countries in the past three decades, particularly in some English-speaking countries but also in some Nordic and Southern European countries.… This increase is the result of the top 1% capturing a disproportionate share of overall income growth over the past three decades… At the same time, tax reforms in almost all OECD countries reduced top personal income tax rates as well as rates of other taxes affecting the highest income earners. The crisis did put a temporary halt to these trends – but it did not undo the previous surge in top incomes. In some countries, top incomes had already largely recovered in 2010."

As I'm sure many of you know, Thomas Piketty reported these findings in his recent book, *Capital in the Twenty-First Century* – which became a surprising best seller. His work sparked an international exchange about how to halt this growth at the top of the top. Piketty advocates the development of a global wealth tax, an idea that sparked fairly wide consensus on two points: (1) such a tax *would* likely slow the run-away top; and (2) the political feasibility of such a proposal is extremely limited.

“Causes” of high and rising inequality

As I have noted, in most – at least 20 – high-income countries, inequality has been increasing over the course of the last 25-30 years. In the broadest of terms, let me lay out the main factors driving those increases, according to a developing research literature on this question.

It is crucial to note that many changes are happening at once. Some operate through market income, some through taxes and transfers, and some both. As my colleague Branko Milanovic often observes: with so many simultaneous factors at work, rising inequality in many countries is “over-determined.” It is equally important to note that the primary factors, and their effects, vary across countries:

In any case, these are the main factors that appear throughout the literature:

- One overarching factor is globalization itself, especially increasingly open trade, greater movement of capital, and the growth of outsourcing; each of these *may* have exerted upward pressure on inequality;

- In many countries, we have seen the growing importance of technical skills in determining market income, and that *may* contribute to rising inequality. As OECD analysts recently noted: “We have to acknowledge that better-educated, higher-earning workers have reaped higher gains while those with lower skills have been left behind”;

- Another widespread trend is what is often referred to as “financialization” – the rising importance of capital markets and institutions, and the rising share of capital in income, especially among the rich;

- A number of countries have seen major changes in the way that high earners are compensated, including the rise of paying executives with stock and stock options; Emmanuel Saez has noted that one key factor in the US case has been the *erosion of pay norms* that, in earlier periods, placed limits on executives’ compensation;

- Several countries have weakened protections for low-wage workers, leading to growing low-wage sectors and falling wages among the lowest earners; in some cases – notably the US – both union coverage and the real value of the minimum wage have fallen, contributing to declining earnings at the bottom of the earnings distribution;

- Some countries have experienced marked changes in household structure, especially the rise of one-adult households; and

- Last, but very much not least, some countries have weakened redistributive policies that lessen market-driven inequality. Another recent OECD report concluded: “In some countries – especially after the 1990s – the reduced redistributive capacity of tax-benefit systems was sometimes the main source of widening household-income gaps. In some countries – including the US – declining tax rates at the top increased inequality.”

Women's contribution

It is important to note that there are also countervailing forces at work in many high-income countries. One of those is women's rising attachment to the labor market. In nearly every high-income country, women's engagement in paid work has risen in the last three decades – especially in the form of increased labor force participation.

It is interesting that – in public discourse, especially in the United States – it is often said that women's rising employment is actually dis-equalizing vis-à-vis the distribution of household income. As the argument goes, because high-earning men are increasingly partnering with high-earning women, women's rising employment has the effect of blowing up the top of the household income distribution.

But, in fact, a growing body of empirical work – including recent two studies using the LIS data – finds the opposite: women's contributions to household income mitigate income inequality across households. That is because, in short, women's increased contributions have pulled up the bottom more than they have pushed up the top. Overall, women's rising employment has an equalizing effect.

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I think that it's fair to say that inequality scholars have a reasonably good understanding of the range of factors shaping inequality outcomes across affluent countries. *But* we know much less about each factor's relative contribution, and about the ways in which the effects of these factors cumulate and interact.

It is telling that Thomas Piketty – often described as the world's foremost scholar of inequality – recently said (about inequality): "We know a *little bit more* than we used to know, but we still know far too little."

So, clearly, much more research on the forces that shape inequality is needed, and fortunately, a great deal of work is now underway.

Potential consequences of high and rising inequality

Let me shift from causes to potential *consequences*.

With this massive surge in studies of inequality, and the factors that shape inequality, we are prompted to consider the fundamental question: Why do we care? Why does inequality matter?

Many argue that high levels of inequality raise fundamental concerns about equity and justice. From this normative perspective, extreme or increasing inequality is intrinsically unacceptable, especially against the backdrop of national affluence. The "haves" simply have too much … relative to the "have-nots".

But, a different set of concerns is currently capturing the attention of legions of scholars and political actors – in many countries. These concerns are mainly *instrumental* – meaning that we worry about inequality because of its effects. From this vantage point, inequality is problematic because it is correlated with – and, in some cases, causes – a range of undesirable consequences:

- First, some scholars emphasize that rising inequality may indicate declining income – and thus decreasing wellbeing – among those at the bottom of the income distribution. Thus, rising inequality might signal *rising poverty rates* or deepening poverty among the poor. Poverty, in turn, has demonstrably negative consequences for individuals, families, and communities. That claim is not controversial.

- Others argue that high or rising inequality may depress *economic mobility*, which is generally interpreted as a measure of openness and opportunity in an economy. A relatively new literature, much of it cross-national, finds that high levels of inequality thwart mobility. The Canadian economist Miles Corak presents extensive evidence indicating that countries with more inequality also experience less intergenerational mobility, a relationship that has been dubbed "The Great Gatsby Curve."

- Yet another group of economists argue that high levels of inequality harm *economic growth*. Joseph Stiglitz popularized this claim in his recent book *The Price of Inequality.* He argues, in short, that the mal-distribution of economic resources ultimately depresses aggregate demand (and thus hurts growth); the rich can only consume so much. While some economists have argued for years that inequality hurts growth, this conclusion is now taking hold more widely. A recent report from the International Monetary Fund addressed this link and concluded: "The Fund has recognized in recent years that one cannot separate issues of economic growth and stability on one hand, and equality on the other. Indeed, there is a strong case for considering inequality and an inability to sustain economic growth as two sides of the same coin."

  The question as to whether – and how – high levels of inequality depress growth is very much an open one. One recent study, using LIS data, underscored the complexity of this relationship – concluding that inequality in the upper end of the distribution may increases growth whereas inequality in the lower end may deter it. That finding suggests, perhaps not surprisingly, that the impact of inequality on growth depends on where in the distribution the inequality resides.

- Other instrumental arguments have received attention in popular debates about the adverse consequences of inequality. In their popular book, *The Spirit Level*, Richard Wilkinson and Kate Pickett argue that large income disparities – within a country – have harmful effects on a multitude of outcomes, including physical and mental health, infant mortality and life expectancy, crime and incarceration, and educational attainment. Research is ongoing on the association between income inequality and these diverse outcomes. Thus far, there is little consensus regarding the existence of these effects, or the nature of the underlying causal mechanisms. However, given the high-stakes nature of these claims, they certainly merit attention.

- Finally, many scholars – especially political scientists and sociologists – have concluded that excessive levels of inequality have harmful effects on *political processes*. In countries that operate as democracies, or aspire to, evidence is accumulating that increasing economic inequality is associated with increasing disparities in political influence. Focusing on the US case, the political scientist Larry Bartels found that Senators are more responsive to the views of the affluent than to those of the middle class; views held by the bottom third of the income distribution have no apparent effect on Senators' voting patterns.

Economists are increasingly concerned about this as well. Joseph Stiglitz argues that one of the main costs of inequality is that “our democracy is being put at peril”. Robert Reich goes further, arguing that “inequality undermines the trust, solidarity, and mutuality on which responsibilities of citizenship depend.”

In closing this discussion of the consequences of high and rising inequality in rich countries, I would say – much as I did about my review of its causes – we know a fair amount about the range of possible consequences, but much less about the conditions and interactions that set each of them in motion or determine their magnitude.

Much more research is needed on this crucial question.

Strengthening Data Capacity

As I mentioned earlier, the new Proposed Sustainable Development Goals (which I understand are still in negotiation) include the following:

Goal 10. Reduce inequality within and among countries

10.1 By 2030 progressively achieve and sustain income growth of the bottom 40% of the population at a rate higher than the national average

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An extensive, rich, international discussion is now underway about the process of defining – and the means of achieving – the Sustainable Development Goals.

Two themes are repeatedly echoed, in the discussions about the SDGs as a whole, and about the goal that concerns reducing inequality.

One theme – as noted by the UN Secretary-General Ban Ki-moon – is that “there is nothing inevitable about inequality”. Indeed, many forms of inequality are the products of *processes and institutions* that could be reversed and reformed. The challenge at hand is uncovering, designing, and activating the forces for change.

A second theme might be summed up in this quote from past Secretary-General Kofi Annan:

“Knowledge is power. Information is liberating.”

Indeed, data and other forms of information *can* drive progress. With regard to inequality, the more we understand about its causes, its characteristics – and also its consequences – the more we stand a prayer of a chance of effecting real change.

This idea – that activism is shored up by facts – was recently popularized by Bono, who coined the colorful term “the factivist”: the evidence-based activist, the activist whose work is shaped and powered by facts.

So, what is needed to build the data capacity to drive sustainable development in general, and inequality reduction more specifically?

First, we need:

- theoretical and technical advances that will enable us to more meaningfully define and compare inequality across countries at different levels of economic development and from diverse geographic regions.

Second, we need to produce more data, higher-quality data, and more fine-grained data on socio-economic wellbeing and standards of living.

We need:

- more disaggregated data, by ethnicity, race, geography, family structure, disability, gender, caste, and class – and other breakdowns;
- more standardization of data across countries and over time;
- more timely processing and releasing of data, so that we can learn and monitor "in real time";
- fewer legal and administrative restrictions on releasing data beyond their national borders.

Third, we need more resources and new strategies for enhancing existing resources.

We need:

- more resources for national statistical offices and other producers of national and subnational data;
- more resources for projects (such as LIS) that acquire and harmonize data across countries;
- more resources for making data and analyses available to political actors, policy-makers, and activists;
- more opportunities for volunteers to join the so-called "data revolution", a concept that is taking hold throughout the UN and beyond.

On this last point, LIS has been in talks recently with staff at UN-Volunteers; together, we're exploring strategies for deploying volunteers who might take multiple roles in creating, sharing, and interpreting data, and information in all forms.

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So, to close, achieving the goal of reducing inequality, within and among countries, is a daunting prospect.

As the United Nations as a whole, and the UN member states, forge ahead in service of that goal, I – and my colleagues at LIS – will do our best to produce and make available high-quality and timely information in support of your work. We look forward, with excitement and commitment, to being part of the *data revolution for sustainable development.*

Thank you.