OECD Centre for Opportunity and Equality

Evidence-based, policy-oriented research on inequalities

Inequality in the OECD Area:
Trends, causes, consequences and remedies

Workshop *Inequality By The Numbers*, June 5 – 10, 2017

CUNY The City University of New York

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OECD

Inequality – in the heart of international policy discourse and policy debate

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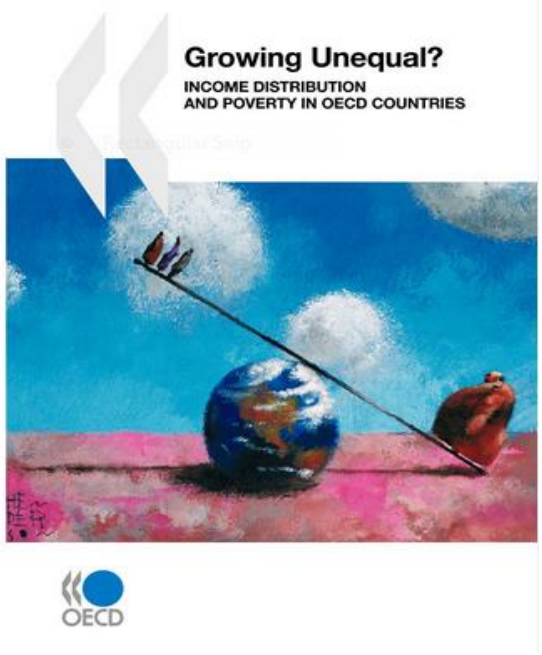
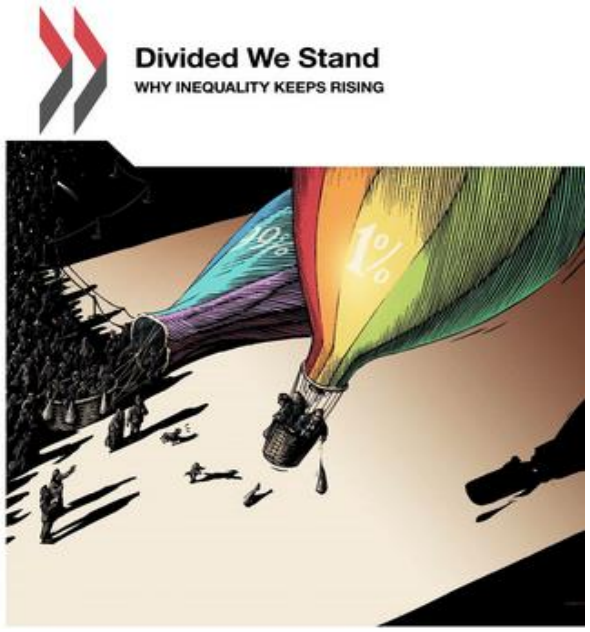
- "***Inequality*** *can no longer be treated as an afterthought. We need to focus the debate on* ***how the benefits of growth are distributed***" (A. Gurría, OECD)
- *"This is the first time that the World Bank Group has set a* ***target for income inequality***" (*Jim Yong Kim, World Bank*)
- "*Reducing excessive* ***inequality*** *is not just morally and politically correct, but it is* ***good economics***" (C. Lagarde, IMF)
- "*The crisis has added to the long-term trend of* ***rising inequalities***" (J-C. Juncker, EC)

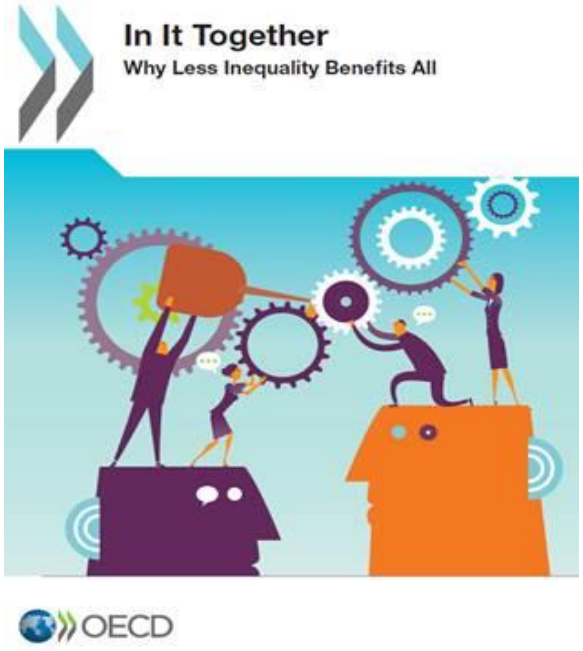
2008



2011



2015



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Income inequality in OECD countries: outline of the discussion

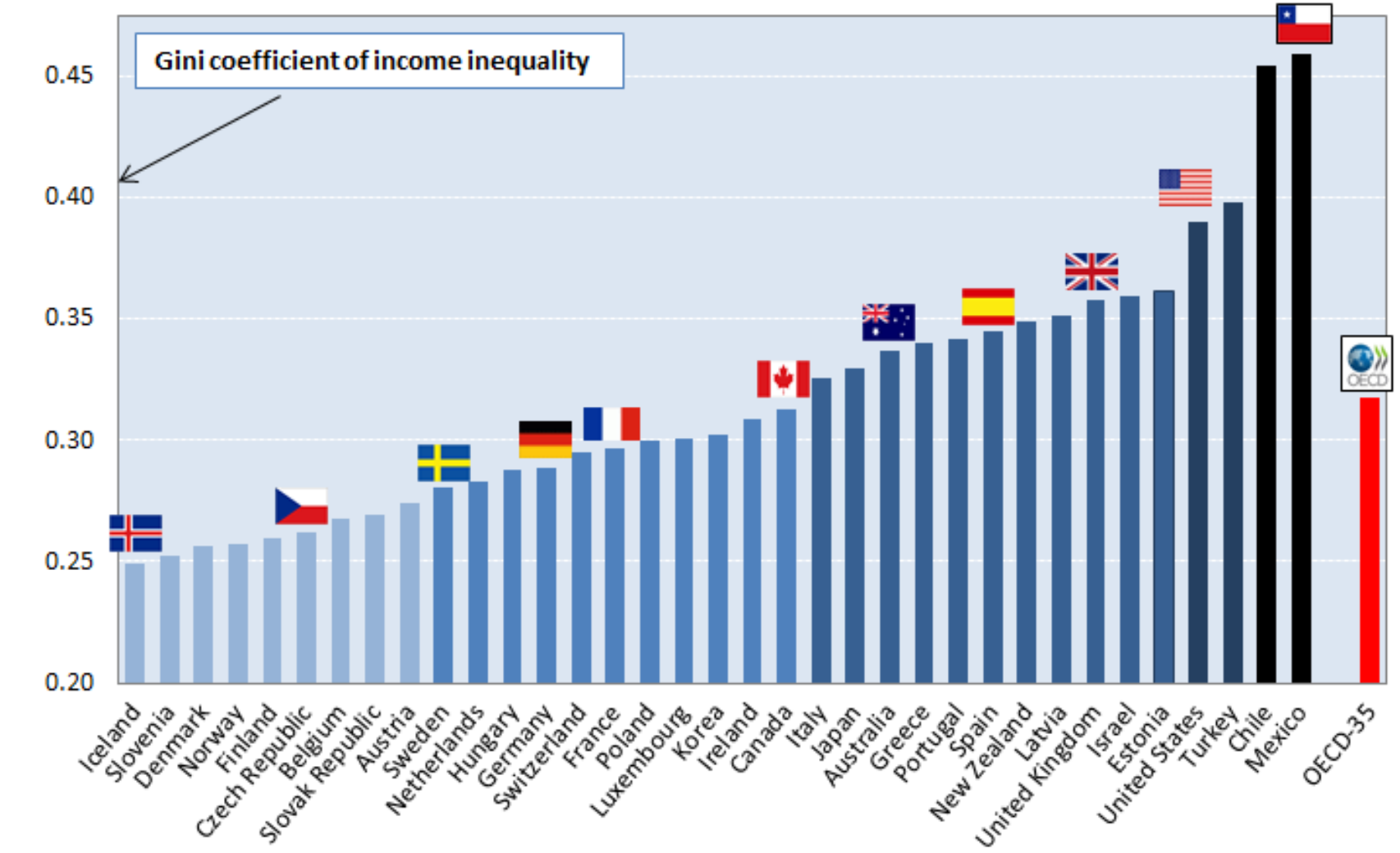
1. **TRENDS**: How do income inequality levels compare internationally and how have inequalities developed over the longer run? Was the crisis a game changer?

2. **CAUSES**: What are the major underlying forces behind increases in inequality?

3. **CONSEQUENCES:** Why do we have to care? What are the links between inequalities, opportunities and economic growth?

4. **REMEDIES**: Which policies are most promising to tackle high and increasing inequality?

Large country differences in levels of *income* inequality



Source: OECD Income Distribution Database (www.oecd.org/social/income-distribution-database.htm), as at 1-Jun-2017

Note: the Gini coefficient ranges from 0 (perfect equality) to 1 (perfect inequality). Income refers to cash disposable income adjusted for household size. Data refer to 2015 or latest year available.

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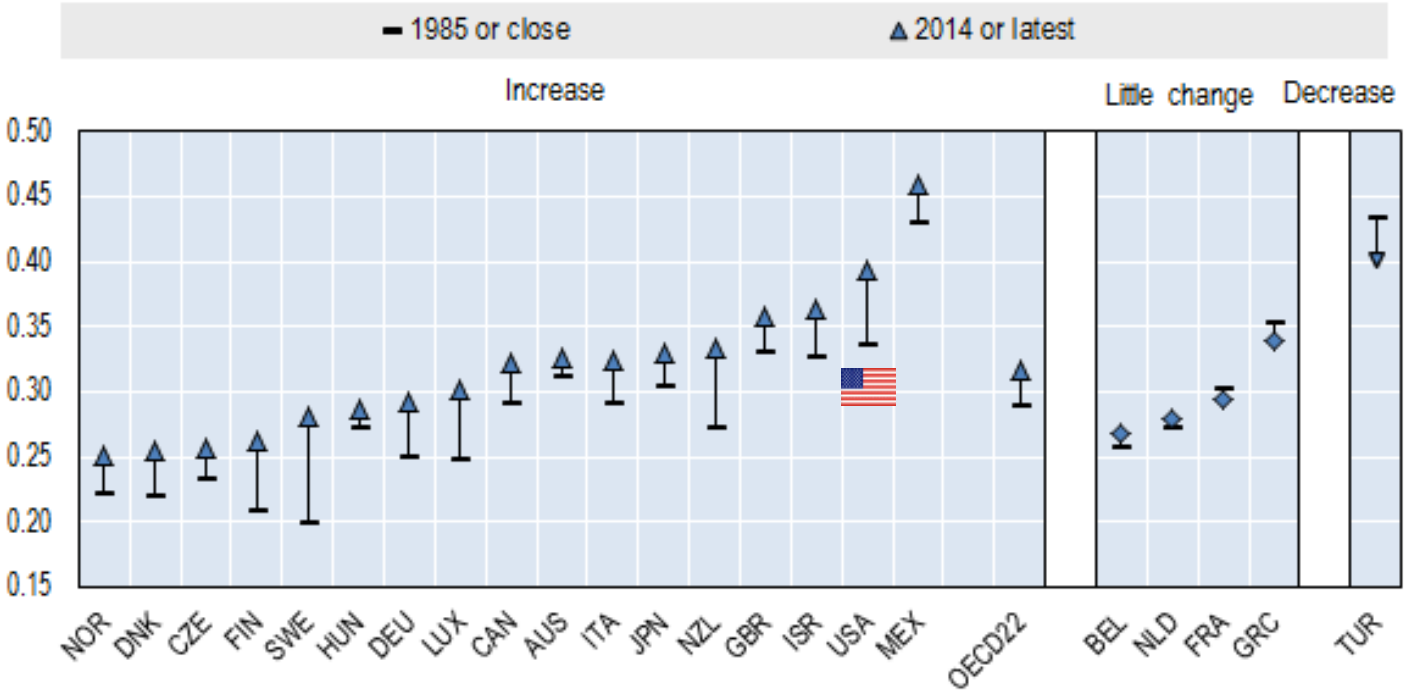
A long-term rise in *income* inequality

- The gap between rich and poor at its highest level since 30 years
- The richest 10% earn 9.5 times more than the poorest 10%
- This is up from a ratio of 7:1 (1980s); 8:1 (1990s); 9:1 (early 2000s)

Gini coefficients of income inequality, mid-1980s and 2014, or latest date available



Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm;
OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm

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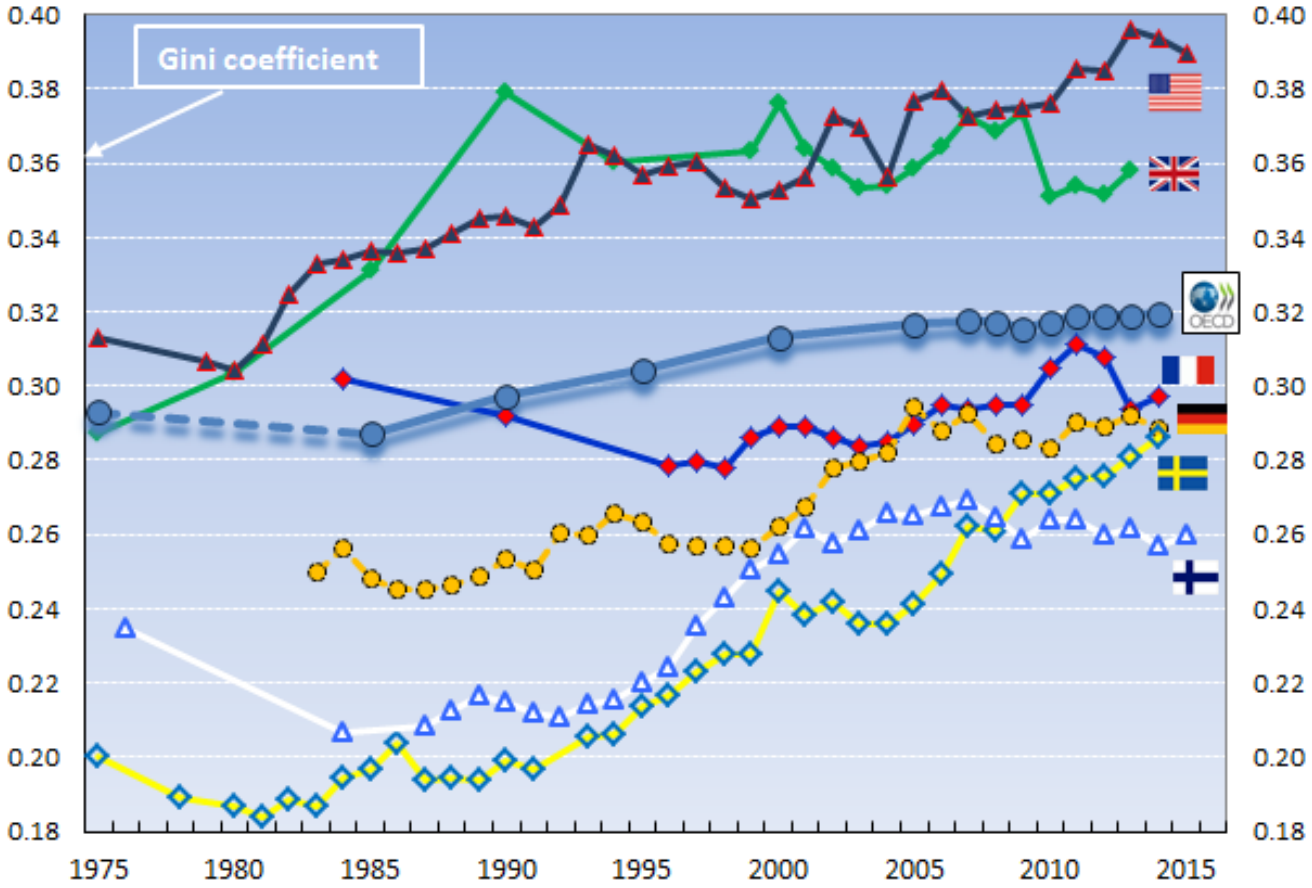
Rather than continuous long-term trends, "episodes" of inequality increases

Long-term trends in inequality of disposable income (Gini coefficient)



Source: OECD (2016), "Income inequality remains high in the face of weak recovery", http://www.oecd.org/social/OECD2016-Income-Inequality-Update.pdf OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm.
Note: Income refers to disposable income adjusted for household size.

In English-speaking countries, > 20% of long-term growth has been captured by the top 1%

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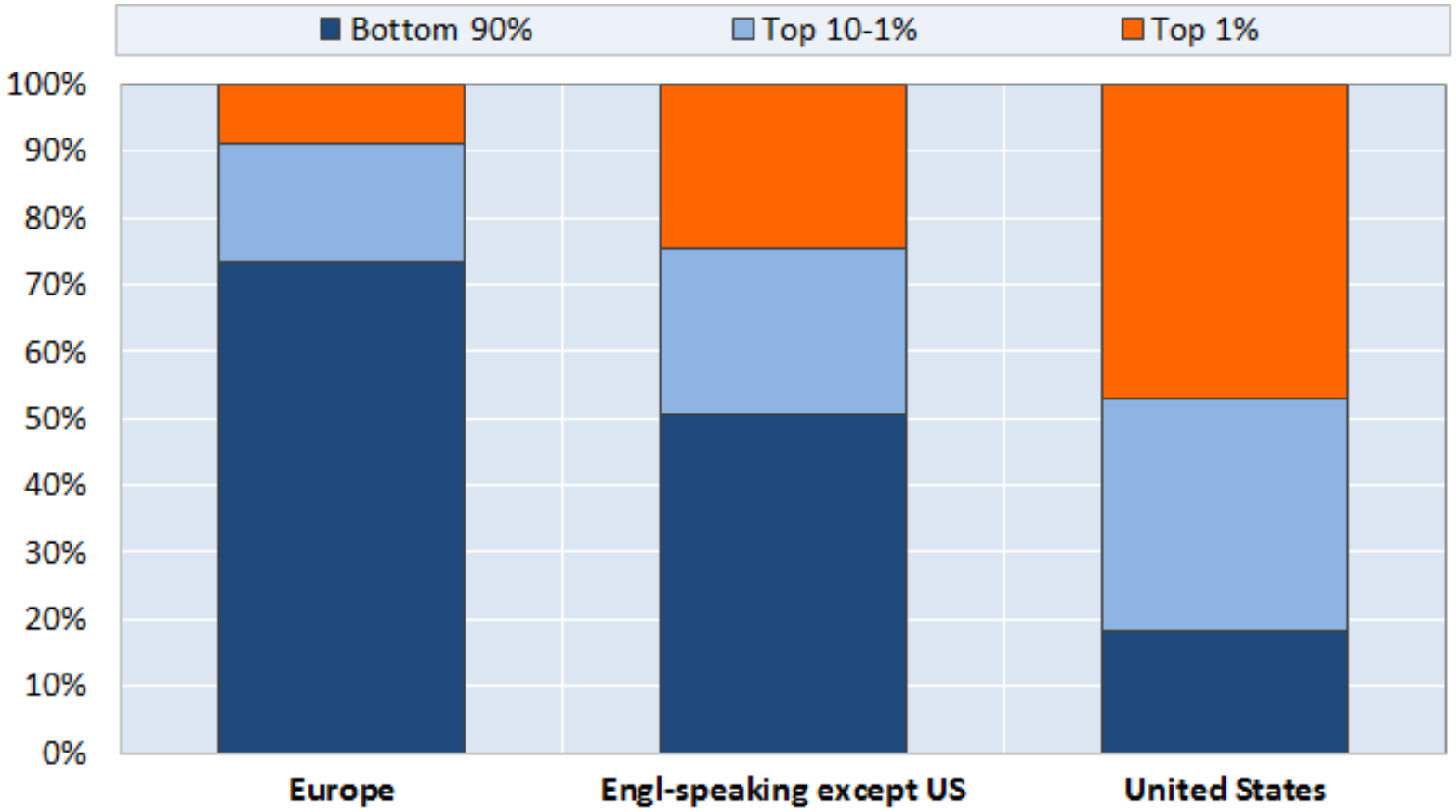
Share of income growth going to income groups from 1975 to 2007



Source: OECD 2014, *Focus on Top Incomes and Taxation in OECD Countries: Was the Crisis a Game Changer?* (http://www.oecd.org/els/soc/OECD2014-FocusOnTopIncomes.pdf), Based on World Top Income Database.
Note: Incomes refer to pre-tax incomes, excluding capital gains

Rise in income inequality is not only about the top

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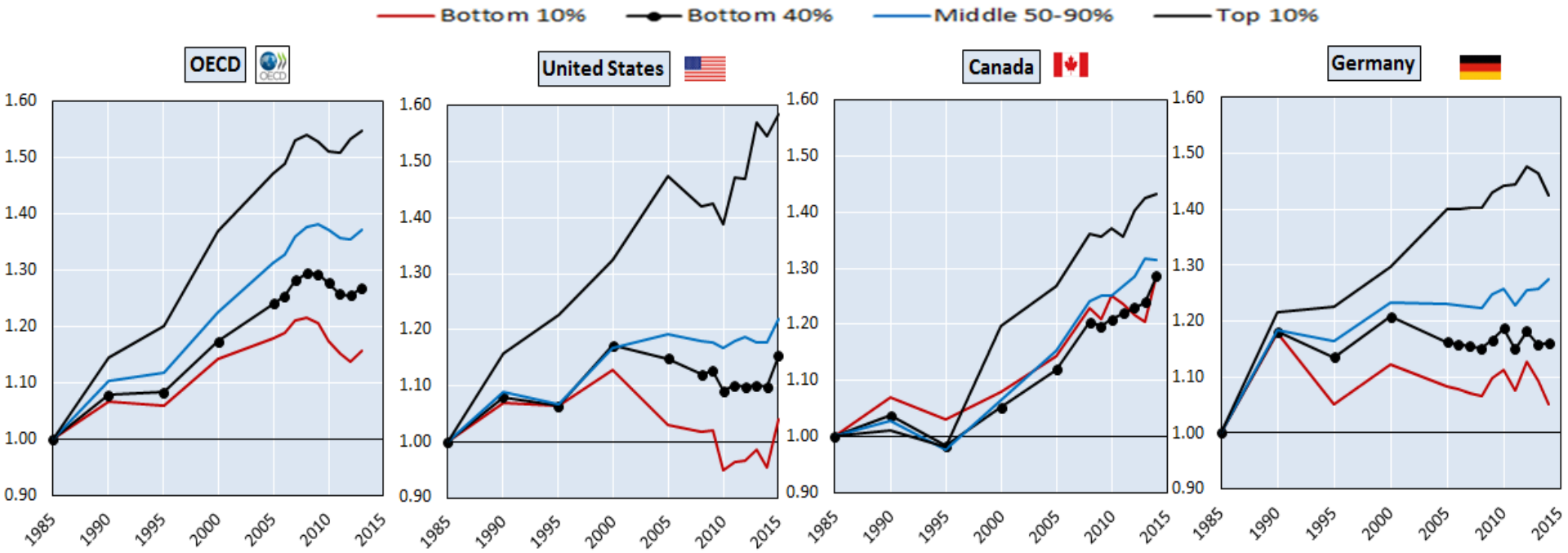
→ When looking at the long run, lower and lowest incomes were increasingly left behind

Trends in real household incomes at the bottom, the middle and the top, 1985 = 1



Source: OECD (2017), OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm. Preliminary data for 2014/15.

II. Multiple possible drivers of increasing income inequality

Globalisation

- Trade openness: largely reported insignificant
- Financial openness: insignificant or (sometimes) dis-equalising
- Inward FDI: inconclusive
- Outsourcing: inconclusive
- Technological change: dis-equalising (especially at the upper part of the distribution)

Labour institutions and regulations

- Unionization (coverage, density) and wage coordination: largely equalising, rarely insignificant
- EPL: equalising
- Minimum wages: (modestly) equalising
- UB replacement rate: equalising, rarely insignificant
- Tax wedge: inconclusive

Employment effects tend to off-set inequality effects, except for EPL

Political processes

- Inequality: the structure of it matters (via the position of the pivotal voter)
- Voter turnout: significant, equalising especially if low income voters are mobilized
- Partisanship: equalising for Left cabinet seats
- Indirect effects (via institution formation and redistribution): sizeable but direction is inconclusive

Inequality

Macro-economic structure

- Evidence on inequality/development relationship inconclusive, including for enlarged country sample
- Industry sector dualism : generally not confirmed but there may be issues of knowledge sector dualism and bias
- Unemployment: dis-equalising

Demographic and societal structure

- Education: largely reported equalising
- Assortative mating: dis-equalising
- Female employment: equalising
- Single headed households: dis-equalising
- Age composition: inconclusive
- Migration: inconclusive

Redistribution

- Tax/transfer systems: equalising, with great country variation
- Reduction in redistributive effectiveness: dis-equalising (since 1990s)
- Cash transfers generally have larger equalising impact than income taxes (except decomposition calculations)
- 2nd order effects (disincentives) off-set but do not outweigh 1st-order redistributive effects

Source: Förster and Toth (2015), in: *Handbook of Income Distribution* (eds. Atkinson/Bourguignon), chapter 19 (p.1804), Fig. "a qualitative summary of results for OECD countries reported in recent studies". EPL, employment protection legislation; FDI, foreign direct investment; UB, unemployment benefit.

What are the relative weights of inequality drivers?

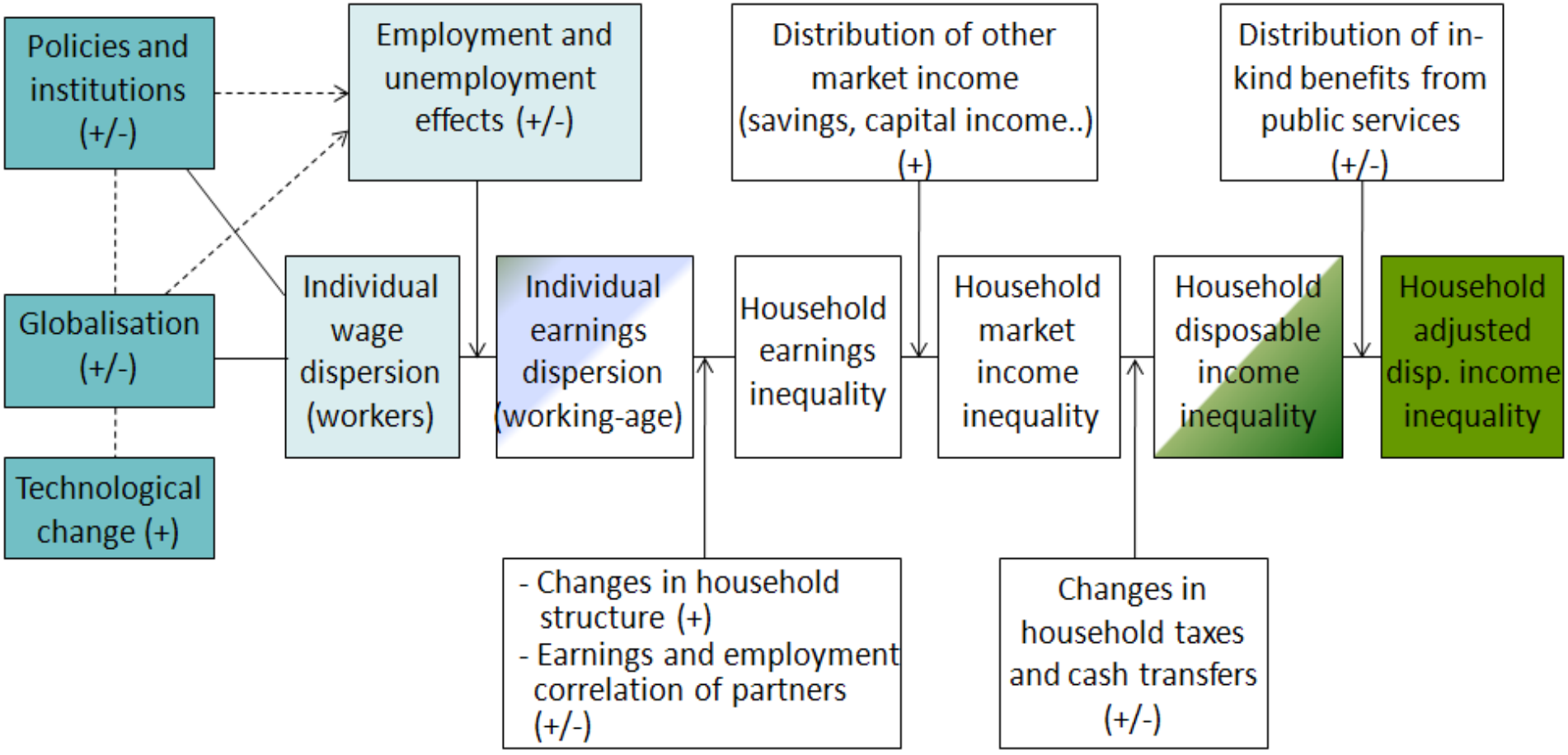
CAVEAT!

*"**Technological change** and **globalisation** are wrapped around each other, and trying to disentangle their individual effects is futile" .. " If, in addition, we regard **policy changes** as endogenous with respect to globalisation, it becomes very clear that all three elements .. are mutually dependent and **cannot be separated** in any meaningful sense"*

Branko Milanovic 2016, *Global Inequality*

→ looking at "smoking guns" : identifying the key drivers with a "step-wise" approach

At the quest of "smoking guns" – identifying the key drivers: a "step-wise" approach



Source: OECD (2011), *Divided We Stand – Why Inequality Keeps Rising*, chapter 1

OECD evidence on the main drivers of rising household income inequality

Main drivers

- Changes in employment patterns and working conditions
- Weaker redistribution via the tax/benefit system
- Skill-biased technological change

Indirect effects

- Globalisation (trade, FDI)

Ambiguous effects

- Changes in labour market regulations and institutions

Minor effects

- Changing household/family structures

Off-setting factors

- Increase in education
- Higher female employment participation

→ Both off-set part of the drive towards rising inequality

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Ad 1) New employment patterns contributed to inequality:

- Non-standard work arrangements increased:
  - Today, one third of jobs are “non-standard”, and 43% of working households include a non-standard worker
  - More than half of all jobs created since 1995 were non-standard jobs

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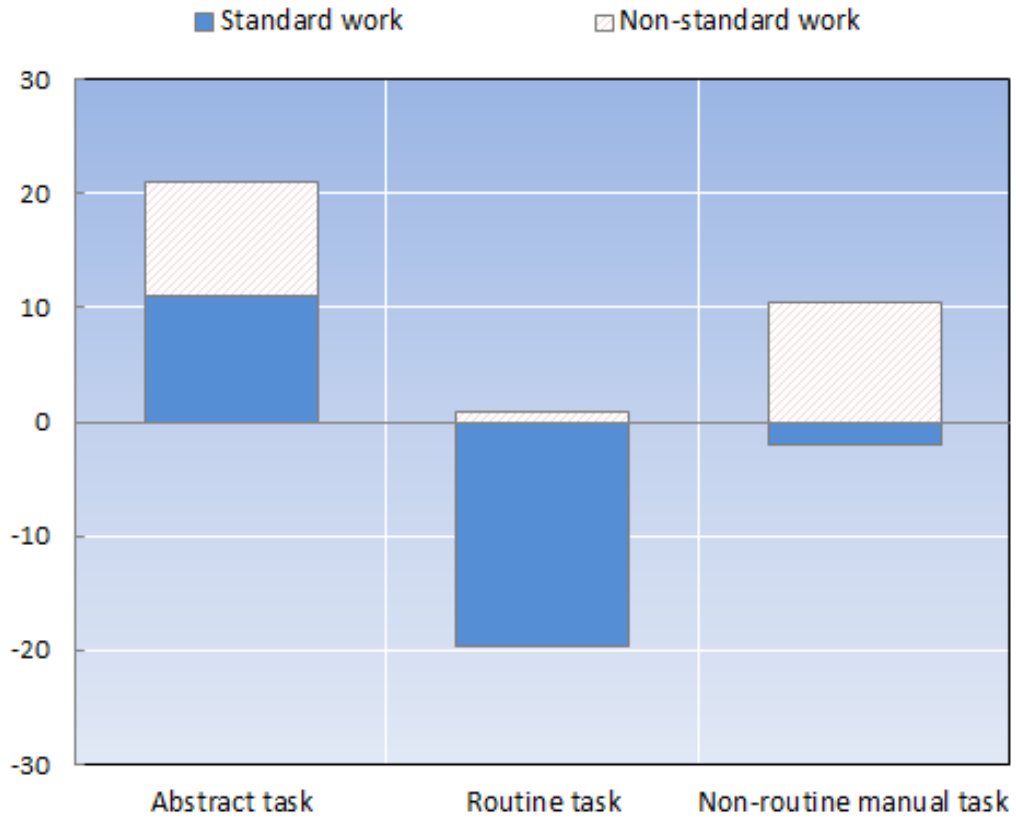
Non-standard work contributed to job polarisation into high- and low-skill jobs, away from routine jobs

Percentage change in employment shares by task category, 1995/98-latest available year



Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm Note: Abstract occupations (ISCO88: 12-34); Routine (ISCO88: 41-42, 52, 71-74, 81-82 and 93); Non-routine manual (ISCO88: 51 83 and 91). The overall sample restricted to workers aged 15-64, excluding employers as well as students working part-time.

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Ad 1) New employment patterns contributed to inequality:

- Non-standard work arrangements increased:
  - Today, one third of jobs are “non-standard”, and 43% of working households include a non-standard worker
  - > 50% of all jobs created since 1995 were non-standard jobs
- Those jobs provide less job quality:
  - hourly wages (-30% for temp work);
  - job security;
  - training;
  - job strain;
  - social protection (esp. “new self-employed”).

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The future of work requires a change to how we think about **social protection**

Benefit rules for the self-employed are different from those of standard workers, 2010

	Old age, disability	Health	Accidents	Unemployment	Family
Australia	No benefit	Different rules from standard workers	Optional enrolment	Different rules from standard workers	Same rules as the general scheme
Austria	Different rules from standard workers	Different rules from standard workers	Same rules as the general scheme	No benefit	Same rules as the general scheme
Canada	Same rules as the general scheme	Optional enrolment	No benefit	No benefit	Same rules as the general scheme
France	Different rules from standard workers	Different rules from standard workers	Different rules from standard workers	No benefit	Same rules as the general scheme
Germany	Different rules from standard workers	No benefit	No benefit	Optional enrolment	Same rules as the general scheme
Italy	Different rules from standard workers	Different rules from standard workers	Same rules as the general scheme	No benefit	Different rules from standard workers
Japan	Different rules from standard workers	Different rules from standard workers	No benefit	No benefit	Same rules as the general scheme
Korea	Same rules as the general scheme	Same rules as the general scheme	Optional enrolment	Optional enrolment	Same rules as the general scheme
Mexico	Optional enrolment	Optional enrolment	Optional enrolment	Same rules as the general scheme	No benefit
Portugal	Different rules from standard workers	Optional enrolment	Same rules as the general scheme	No benefit	Same rules as the general scheme
Turkey	Different rules from standard workers	Same rules as the general scheme	Different rules from standard workers	No benefit	Same rules as the general scheme
United Kingdom	Different rules from standard workers	Different rules from standard workers	No benefit	Different rules from standard workers	Same rules as the general scheme
United States	Different rules from standard workers	Same rules as the general scheme	No benefit	No benefit	Same rules as the general scheme
# Countries no benefits	**2**	**2**	**10**	**19**	**3**

	No benefit
	Optional enrolment
	Different rules from standard workers
	Same rules as the general scheme

Source: OECD (2015), *In It Together: Why Less Inequality Benefits All*, OECD Publishing, Paris.

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- Those jobs provide less job quality:
  - hourly wages (-30% for temp work);
  - job security;
  - training;
  - job strain;
  - social protection (esp. “new self-employed”).
- “Stepping-stone” effects do exist, but mostly for prime-age and older workers
- Poverty risks are high when ns workers live in households with other ns workers, or with non-employed people

Ad 2).Redistribution via taxes and benefits plays an important role in (almost) all OECD countries

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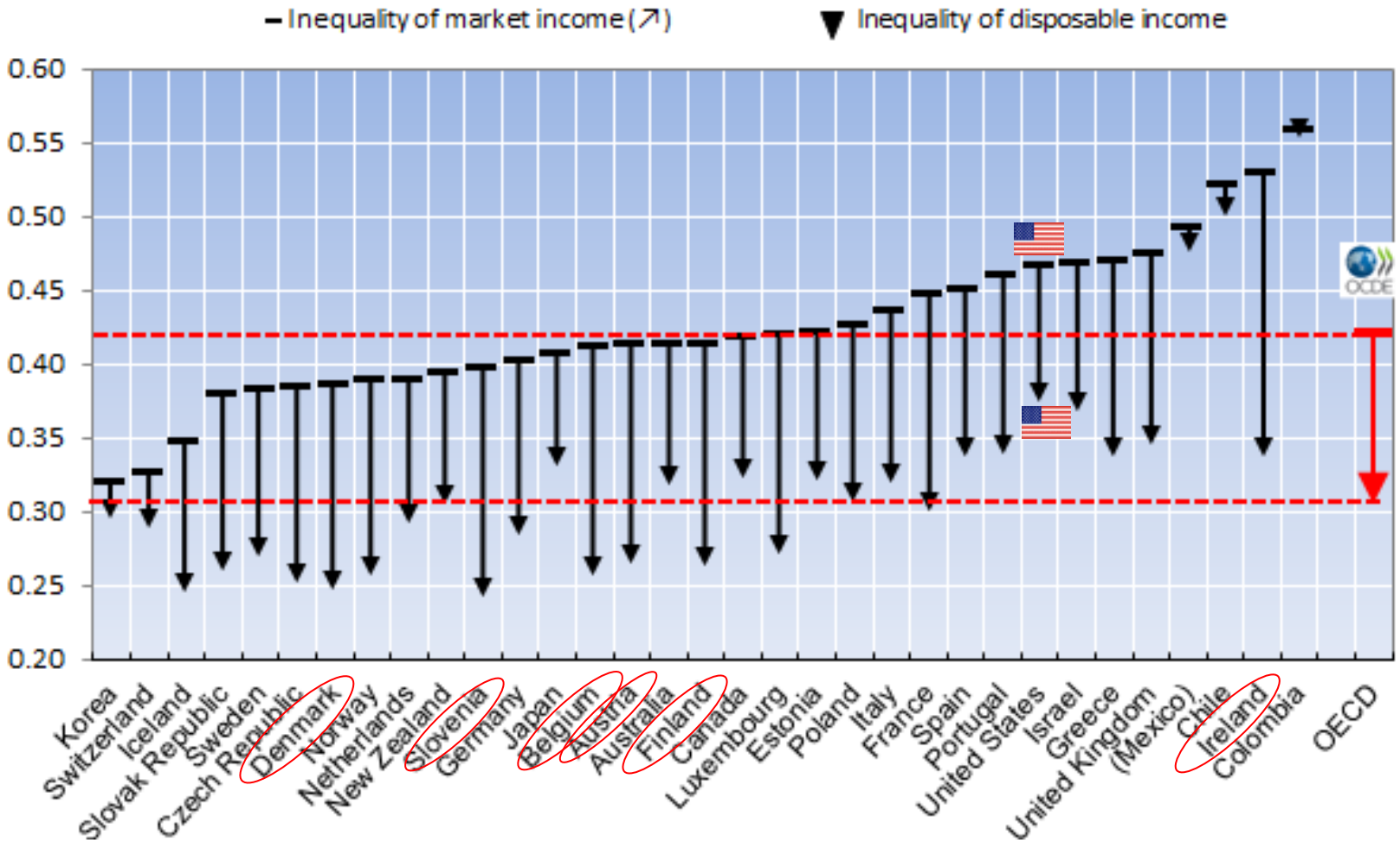
Inequality of (gross) market and disposable (net) income, working-age persons



Source: OECD Income Distribution Database www.oecd.org/social/income-distribution-database.htm. Note: Data refer to the **working-age population**.

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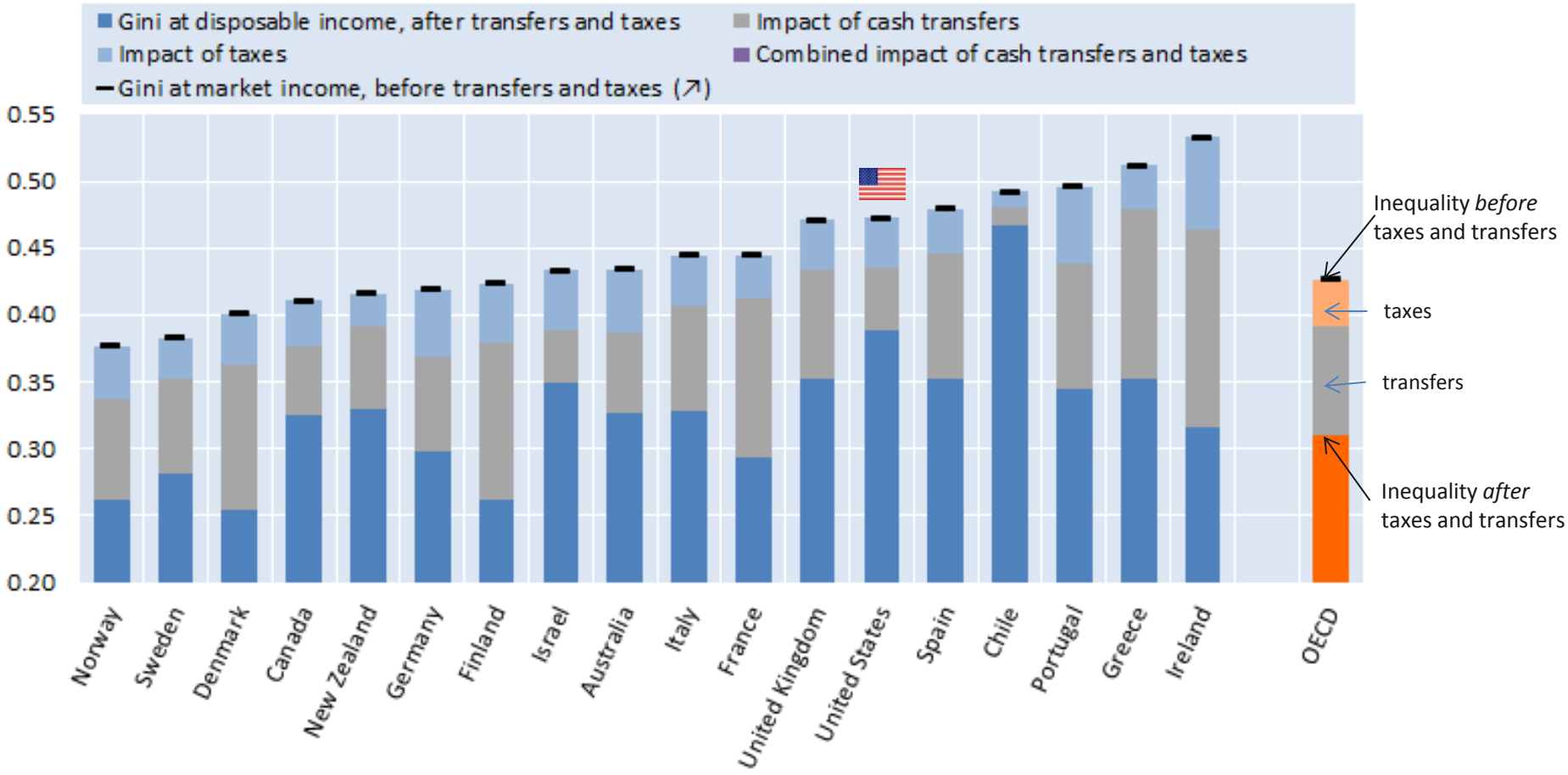
Among the two instruments, cash transfers play a more significant role in (almost) all countries

Respective redistributive effects of direct taxes and cash transfers



Source: OECD Income Distribution Database (www.oecd.org/social/income-distribution-database.htm, .
Note: **Data refer to the working-age population.**

…, but redistribution became weaker in most countries until the onset of the crisis

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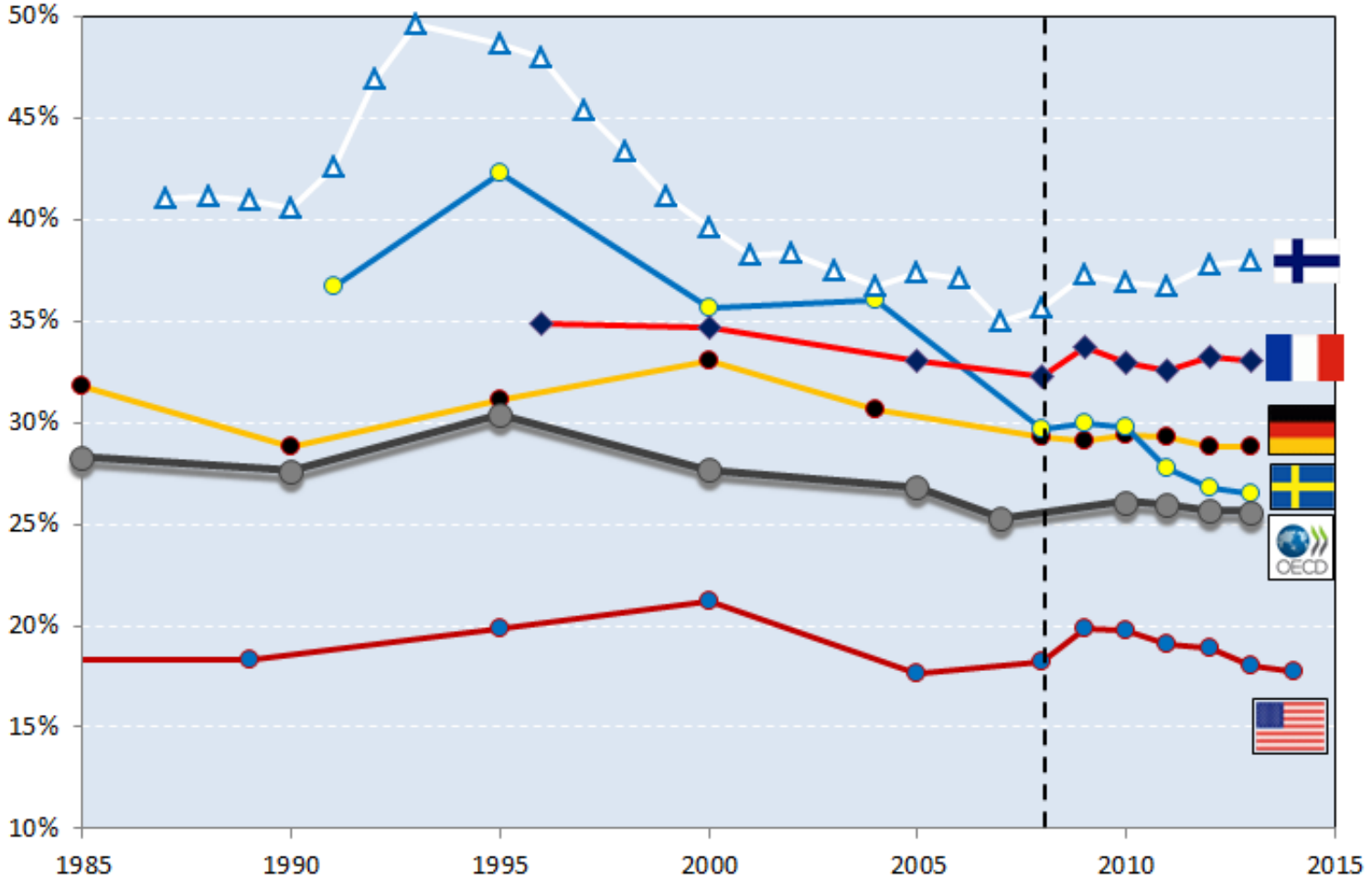
Trends in market income inequality reduction, working age population



Source: OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm

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Why have tax/benefit systems become less successful at reducing inequality?

The weaker redistribution via taxes and benefits was one of the culprits of higher income inequality prior to the crisis:

- Such changes in overall redistribution were mainly driven by benefits: taxes also played a role, but to a (much) lesser extent;
- Spending levels have been a more important driver of these changes than tighter targeting of benefits;
- Spending shifted towards "inactive" benefits, leading to reduced activity rates and higher market-income inequality;
- In some countries, in-kind benefits i.e. public services in health, education etc. became less redistributive, too.

Effects of tax and benefit policy changes on household incomes: two (or three?) different phases since the crisis

→ In many countries, households tended to gain from the policy changes implemented in 2008/09 and to lose from those in 2010/12. Effects since 2013 were less homogenous.

Simulated overall effect of tax-benefit measures, 10 OECD countries

	2008	2009	2010	2011	2012	2013	2007-2013
Estonia	+		-	-	-	+	+
France	-	+	-	-	-	+	+
Germany	-	+	+	-	+	+	+
Greece	+	+	-	- -	-	- -	- -
Iceland	-	-	-	-	-	+	- -
Ireland	+	-	-	- -	-	-	- -
Portugal	+	+	-	- -	-	- -	- -
Spain	+	+	-	-	-	-	-
United Kingdom	+	+	-	-	-	-	-
United States	+	+			-	-	+
OECD10	+	+	-	-	-	-	-

Source: OECD 2015, "In It Together", Note: + sign indicates a measure that has a positive effect on household income (i.e. a tax cut or benefit rise). – sign indicates a measure that has a negative effect on household income (i.e. a tax rise or benefit cut).

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III. Why do we have to care about high and rising inequalities?

- Social concerns
- Political concerns
- Ethical concerns
- Economic concerns

More and more people believe that equal opportunities and social mobility have declined over time

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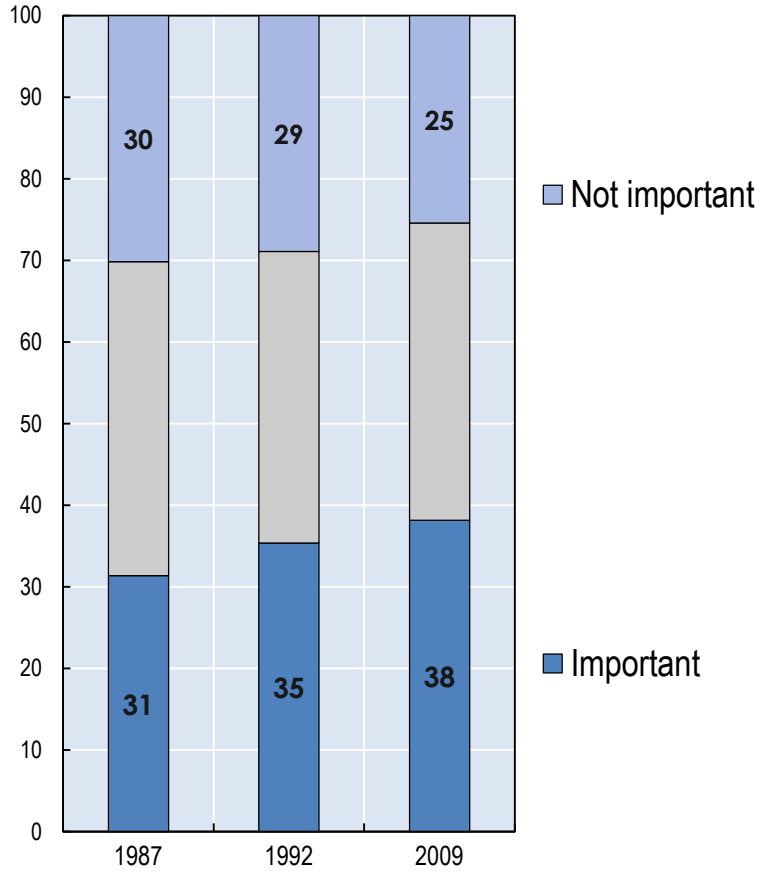
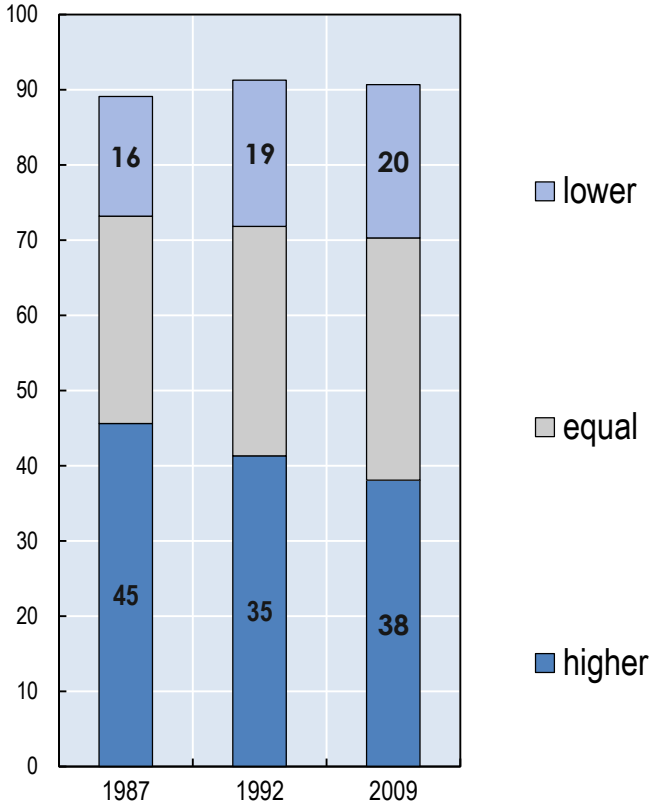
"How important is having well-educated parents to get ahead?"



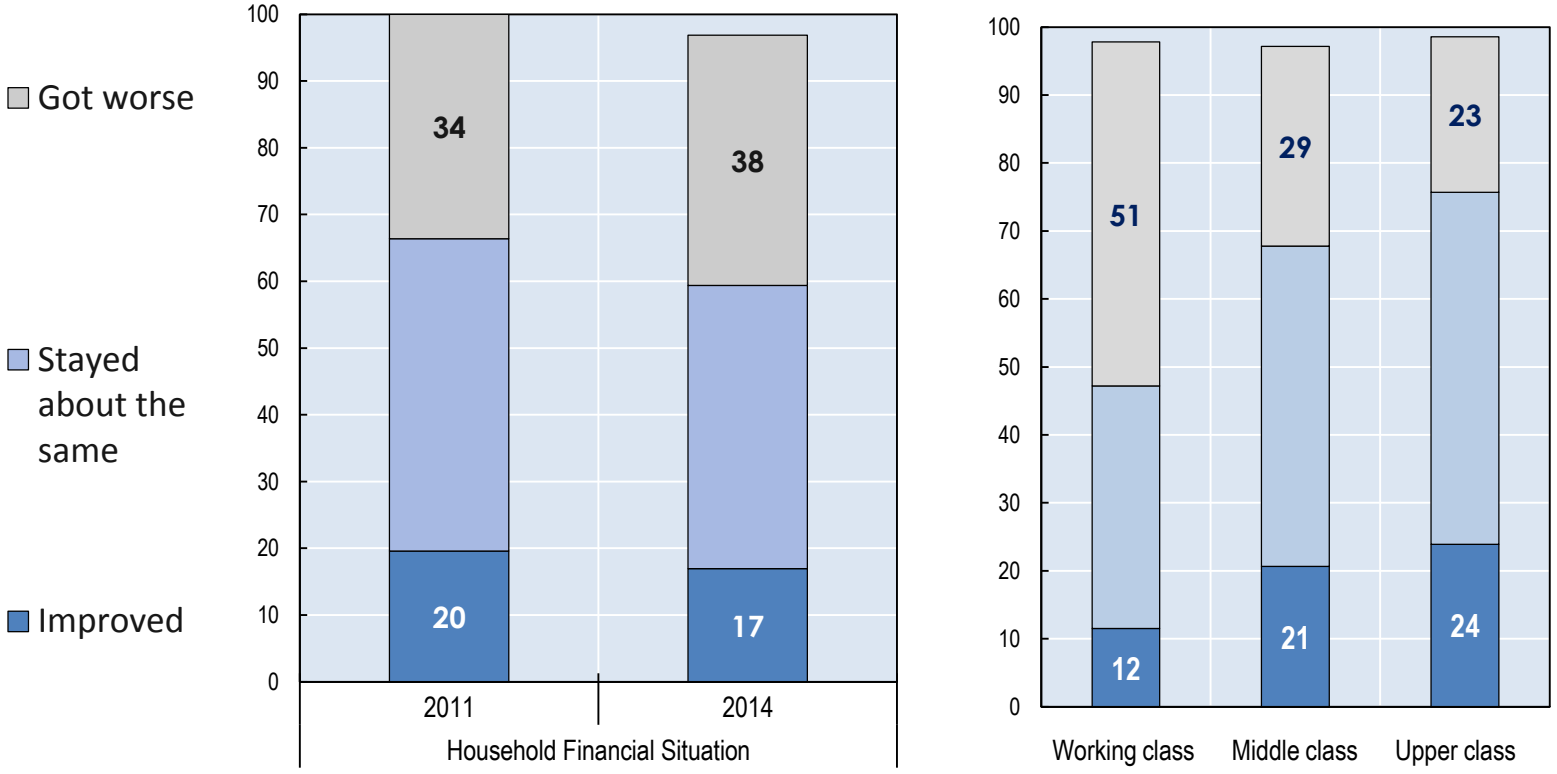
Level of status of respondent's job compared to the job of father



Source: OECD Secretariat estimates based on ISSP 1987 to 2009

More and more people say that their situation has got worse

Changes over past five years: household financial situation

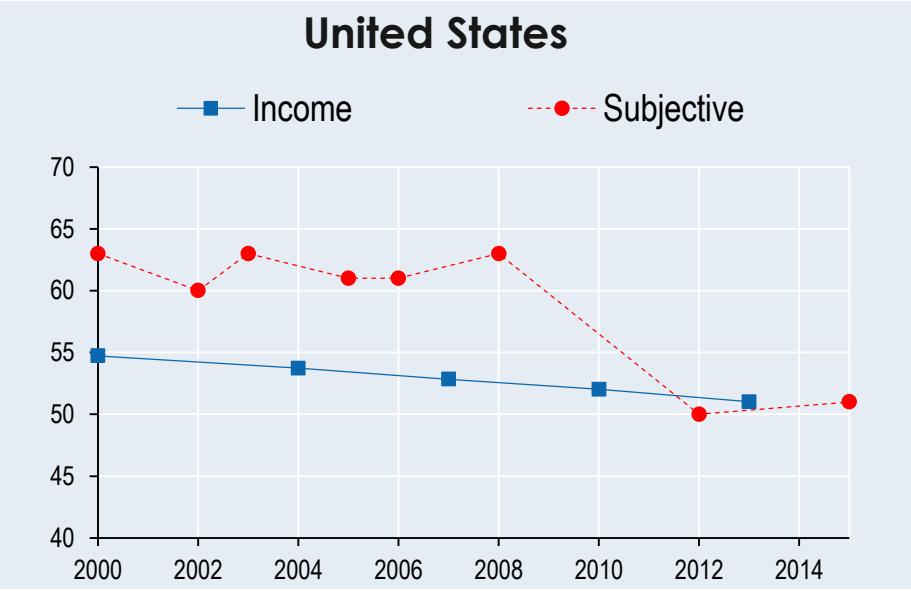


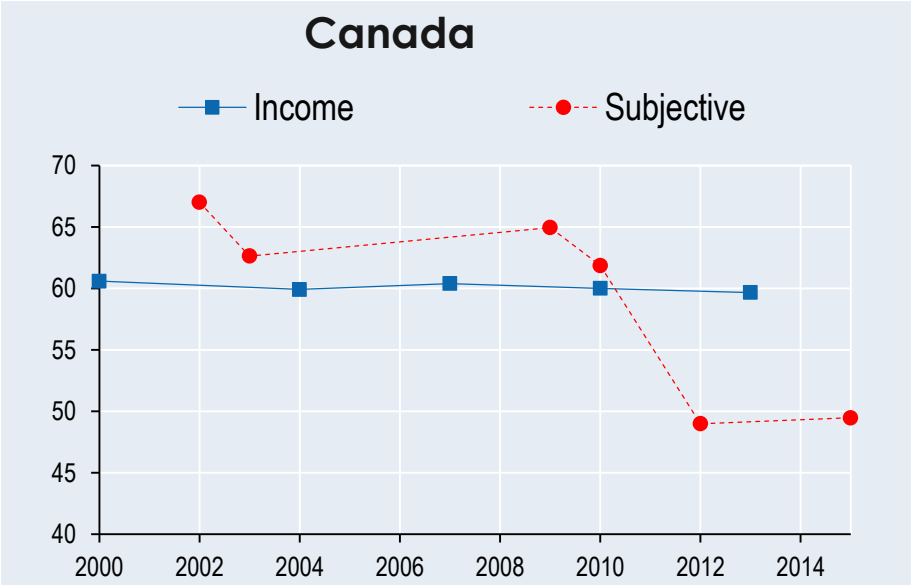
Source: OECD 2017 (forthcoming), Secretariat calculations based Eurobarometer Surveys

Middle class decline: perception or fact?

- Fewer people today think they belong to the middle class.
- Income data suggest a more moderate trend.

Share of population in the middle class (75-200% median)





Subjective: share of population who report belonging to the middle class
Income: share of population living in households with income between 75% and 200% median household disposable income.

Source: : OECD (2017, forthcoming), Secretariat calculations from EKOS and LIS data centre.

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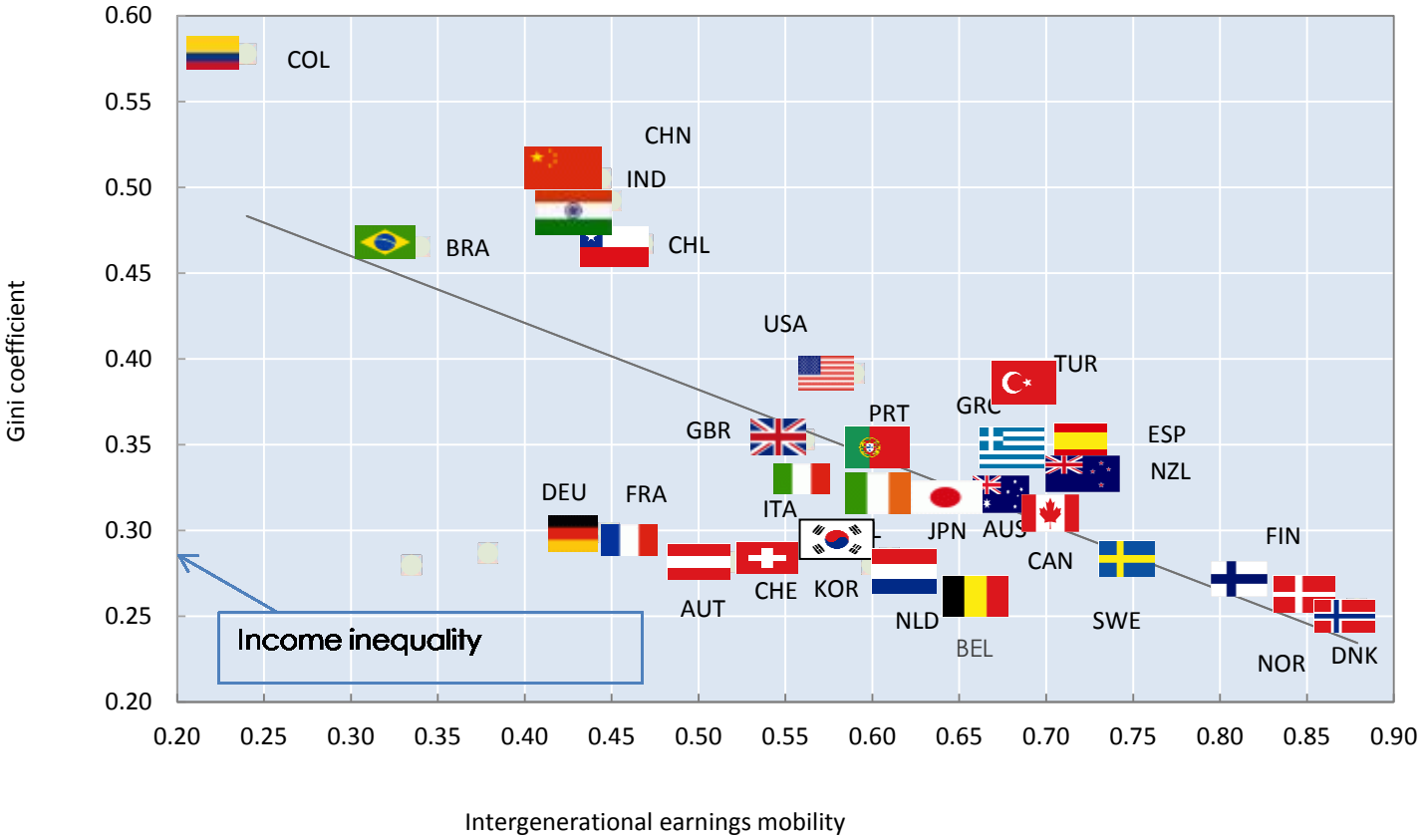
Mobility and inequality: higher inequality may fuel *lower* social mobility

Far from perfect social mobility
Children' earnings depends on parents' earnings

Earnings mobility is lower in high-inequality countries
But the association is weaker across European countries



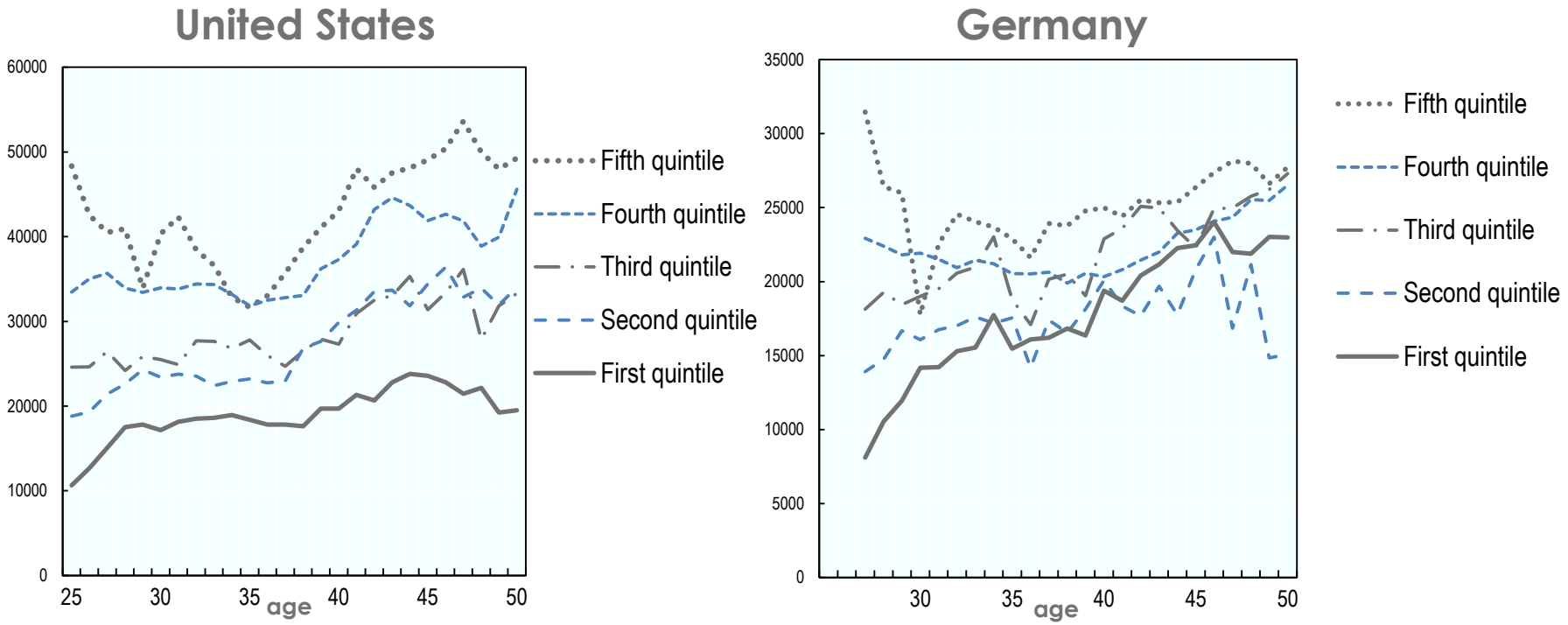
Source: OECD 2017, forthcoming). Note: Data refer to mid to late-2000s up to 2012. Intergenerational earnings mobility is proxied by the degree to which sons' earnings are correlated with that of their fathers. **Data are preliminary estimates**.

http://oe.cd/cope

Can intergenerational disadvantages be compensated by individual upward income trajectories?

- While individual income mobility concerns a large share of the population each year, it remains modest in the long run → "unequal mobility"
- Income mobility in terms of individual income trajectories is shaped by specific "trigger events" which can have long-run scarring effects
  → Labour market related events (job changes, unemployment) seem a more significant factor than family-related events (child birth, marriage)

Longer-run income trajectories, US and Germany



Note: disposable equlivalised income in 2010 USDollars and 2010 Euros. Source: OECD calculations based on CNEF (PSID and GSOEP). Preliminary data

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The economic rationale: (How) Does inequality affect economic growth?

Long standing, controversial debate:

- Inequality might **increase** growth by providing **incentives** to work, invest and take risks; or by increasing aggregate savings
- Inequality might **decrease** growth by inducing missed **opportunities** of investment by the poor (in particular, if they can not borrow money); or by favoring distortionary, anti-business policies.

OECD 2015 uses standardised data to examine

1. the strength and sign of the inequality-growth nexus
2. the link between inequality, social mobility and human capital accumulation

Inequality and growth: main findings from the recent OECD study

1. Higher income inequality is associated with *lower* subsequent economic growth in the long-term
   - Increasing income inequality by 1 Gini point tends to lower the growth rate of GDP per capita by ~0.12 %-points per year
2. This is driven by disparities at the lower end of the distribution, incl. lower middle classes, not just the poor
3. Redistribution through taxes and transfers does *not* necessarily lead to bad growth outcomes
4. Prominent mechanism: inequality narrows the set of investment opportunities of the poor. Hypothesis: inequality lowers social mobility and human capital stock

The role of inequality and family background for schooling outcomes

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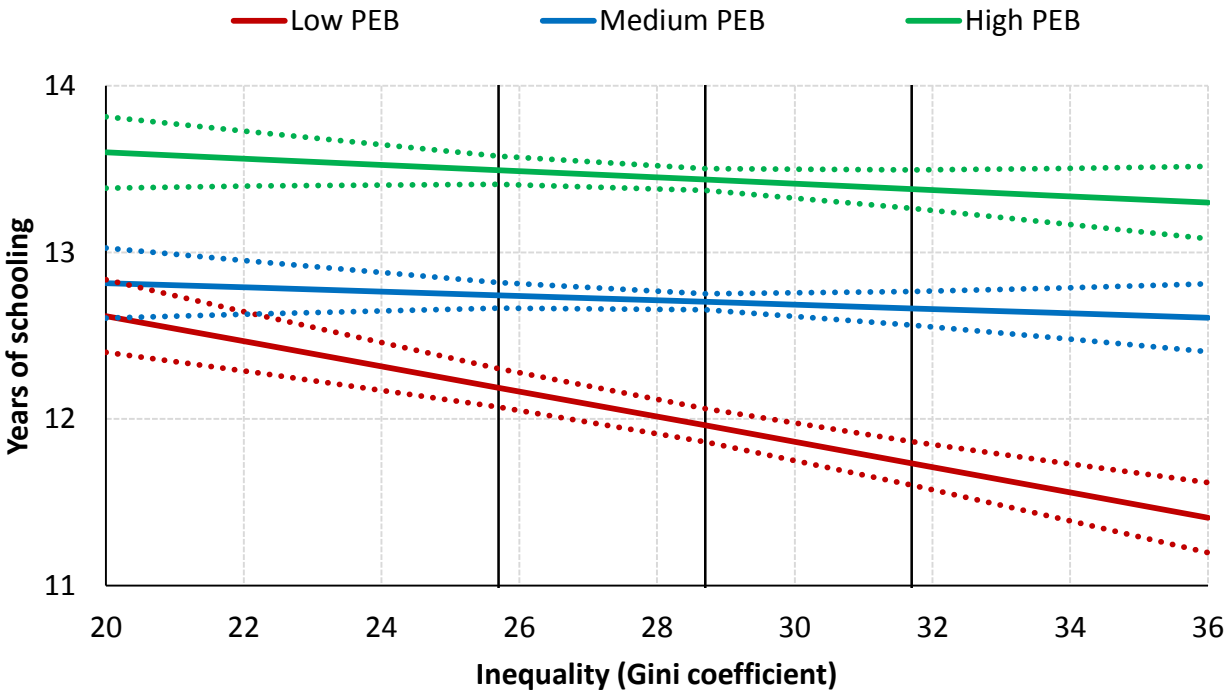
Inequality decreases average years of schooling, but mostly among individuals with low parental education

Average years of schooling by parental educational background (PEB) and inequality



Source: OECD (2015), "*In It Together*"

Higher inequality by ~5 Gini pts. (the current differential between the US and Australia) is associated with less average schooling of low PEB individuals by ~half a year

Note: Low PEB: neither parent has attained upper secondary education; Medium PEB: at least one parent has attained secondary and post-secondary, non-tertiary education; High PEB: at least one parent has attained tertiary education. The bars indicate 95% confidence intervals.

The role of inequality and family background for accessing tertiary education

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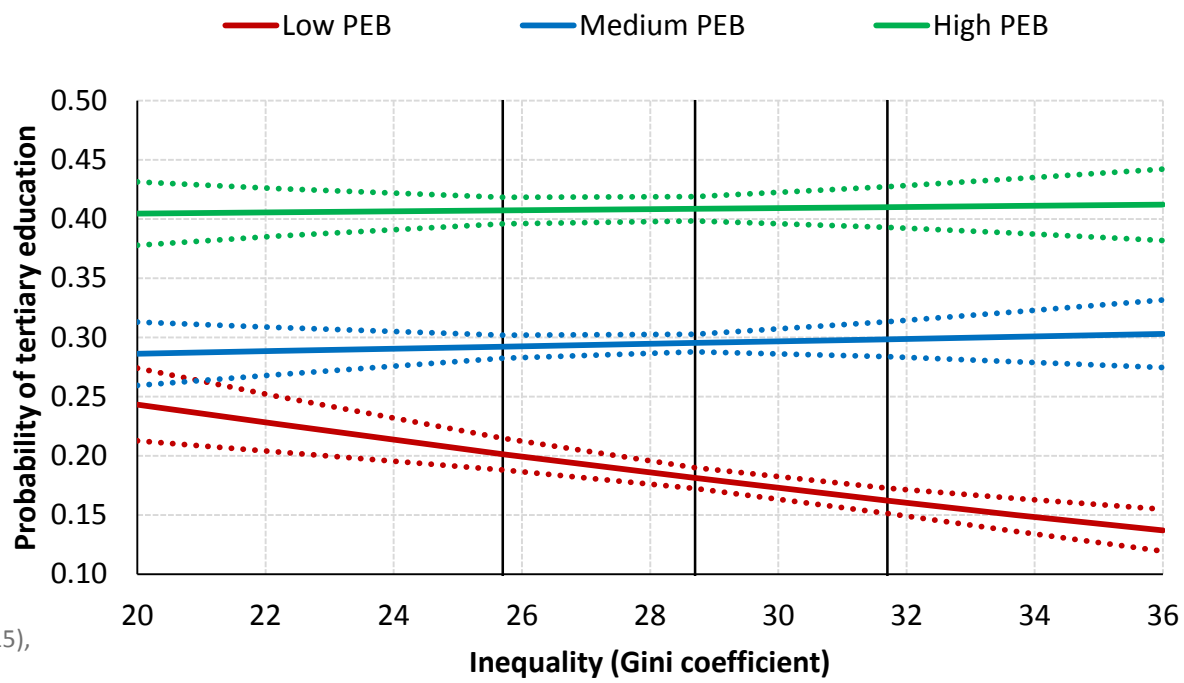
Inequality lowers the probability of tertiary education, but only among individuals with low parental education …

Probability of tertiary education by parental educational background (PEB) and inequality



Source: OECD (2015), "*In It Together*"

Higher inequality by ~10 Gini pts. (US – Germany difference) is associated with lower probability of tertiary education of low PEB individuals by ~6 percentage points

Note: Low PEB: neither parent has attained upper secondary education; Medium PEB: at least one parent has attained secondary and post-secondary, non-tertiary education; High PEB: at least one parent has attained tertiary education. The bars indicate 95% confidence intervals.

The role of inequality and family background for skill proficiency

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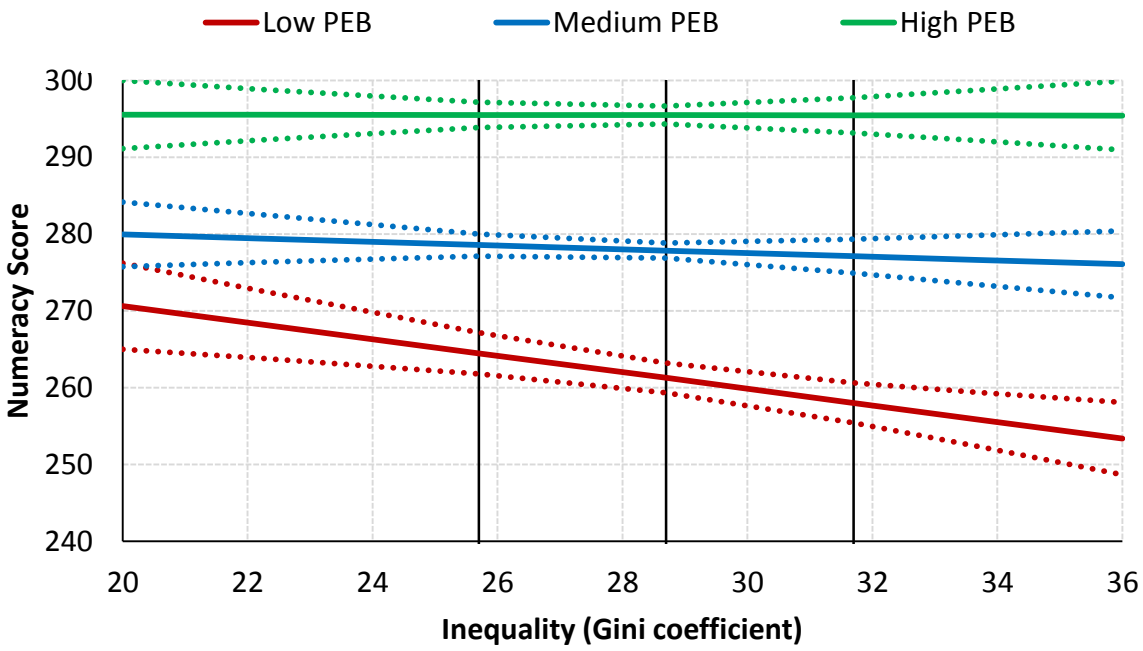
Inequality lowers (literacy and numeracy) skills, but only among individuals with low parental education

Average PIAAC numeracy score
by parental educational background (PEB) and inequality



Source: OECD (2015), *"In It Together"*

Increasing inequality by ~6 Gini pts. (the US – Japan differential) lowers Numeracy score by ~6 pts

Note: Low PEB: neither parent has attained upper secondary education; Medium PEB: at least one parent has attained secondary and post-secondary, non-tertiary education; High PEB: at least one parent has attained tertiary education. The bars indicate 95% confidence intervals.

IV. Designing policy packages to tackle high inequality and promote social cohesion

1. Foster **women's** participation in the labour market and economic life

2. Promote **employment** and **good-quality jobs**

3. Strengthen quality **education** and **skills** development

4. Improve the design of **tax and benefit** systems for a more efficient **redistribution**

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Some lessons for employment policies

- Given the heterogeneity of non-standard workers and their households, it seems less promising to target policies specifically at atypical workers but rather
  - Design policies that enhance the employability of vulnerable workers who are overrepresented in non-standard work arrangements (e.g. youth; single parents), and
  - Target dual-earner policies such as child care provision to vulnerable households

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Some lessons for education/skills policies

- Promoting access to education for the low-skilled
- Improving job-related training and education (on-the-job training) and access to formal education over their working lives
- Promoting access to other public services, such as high-quality childcare, or health
- Facilitating access to jobs (and career prospects) for under-represented groups (youth, older workers, women and migrants)

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Some lessons for tax and benefit reforms

- Abolishing/scaling back tax deductions and exemptions;
- Taxing fringe benefits, stock options etc. as ordinary income;
- Greater reliance on recurrent taxes on immovable property and reviewing other wealth taxes such as inheritance taxes;
- Harmonising capital and labour income taxation;
- Reducing avoidance opportunities and improving transparency and tax compliance, including efforts for automatic exchange of information between tax authorities, to minimise “treaty shopping” and tax optimisation;
- Ensuring counter-cyclicality of tax / benefits
- Focusing on activation benefits;
- Increasing benefit coverage and take-up.

So what about a universal Basic Income?

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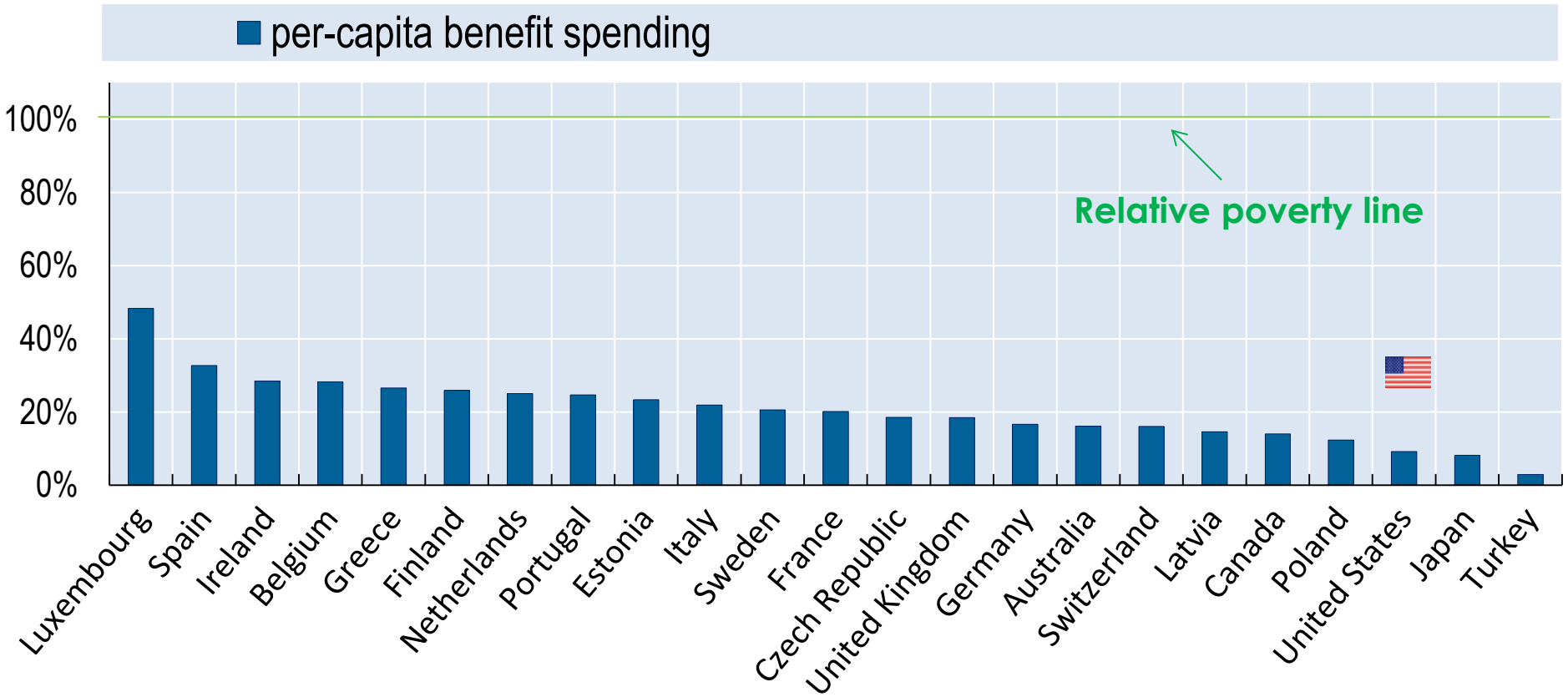
BI amount that would be equivalent to current spending on working-age benefits

2014, in % of poverty line



Notes: poverty threshold at 50% of median disposable income. Spending on "working-age" benefits includes expenditures on all public cash transfers minus old-age and survivors categories. Social assistance amounts exclude support for rented accommodation. *Sources:* OECD Social Expenditure (www.oecd.org/social/expenditure.htm) and Income Distribution (oe.cd/idd) databases, OECD tax-benefit models (www.oecd.org/social/benefits-and-wages.htm).

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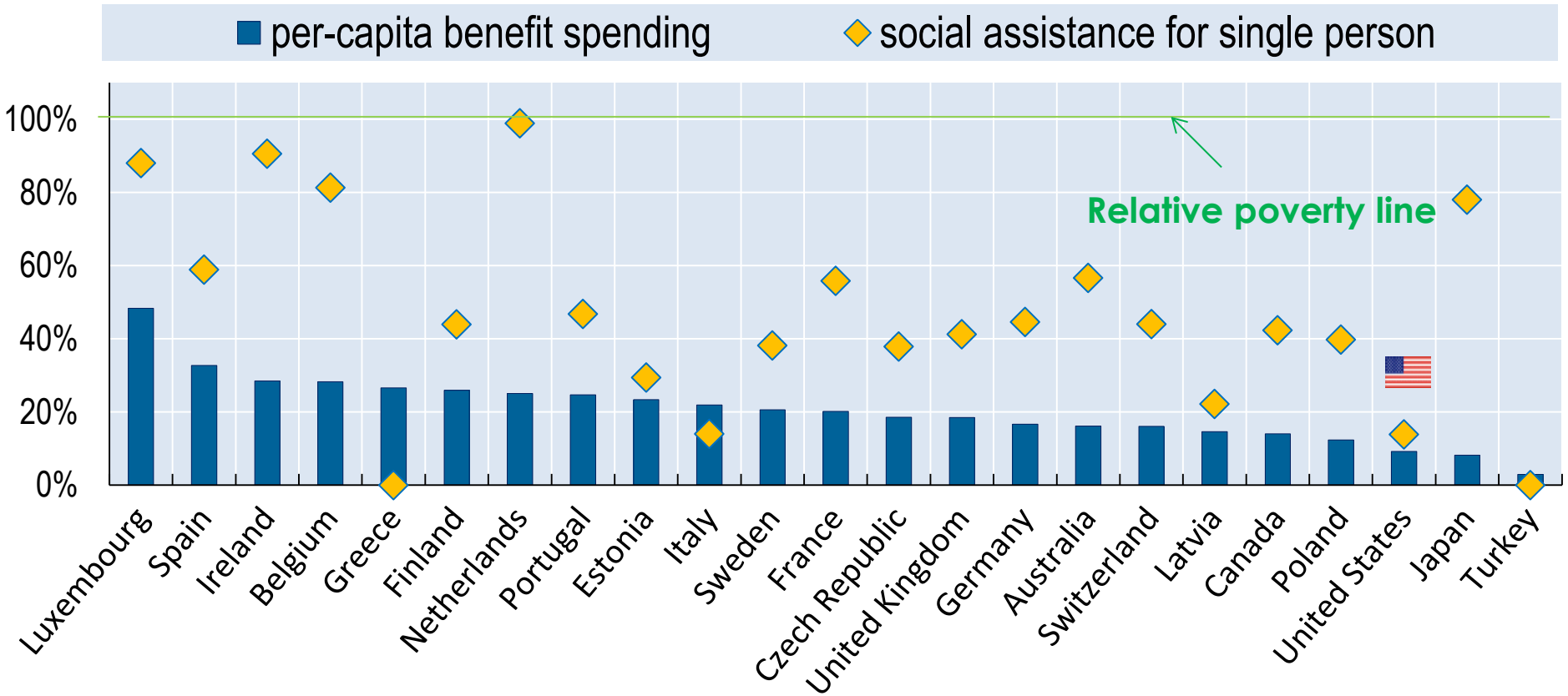
So what about a universal basic income?

BI amount that would be equivalent to current spending on working-age benefits

2014, in % of poverty line and current social assistance ammoints



Notes: poverty threshold at 50% of median disposable income. "non-elderly" benefits is total spending on public cash transfers minus old-age and survivors categories. Social assistance amounts exclude support for rented accommodation. *Sources:* OECD Social Expenditure (www.oecd.org/social/expenditure.htm) and Income Distribution (oe.cd/idd) databases, OECD tax-benefit models (www.oecd.org/social/benefits-and-wages.htm).

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Designing policy packages to tackle high inequality and promote social cohesion

1. Foster **women's** participation in the labour market, and economic life

2. Promote **employment** and **good-quality jobs**

3. Strengthen quality **education** and **skills** development

4. Improve the design of **tax and benefit** systems for a more efficient **redistribution**

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Thank you for your attention!

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www.oecd.org/social/inequality-and-poverty.htm

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