INCOME INEQUALITY AND REDISTRIBUTION IN THE OECD AREA: TRENDS AND DRIVING FORCES

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Questions addressed in recent OECD work (*Growing Unequal?*, *Divided We Stand*..)

1. **TRENDS**: How have inequalities **developed** over the longer run and during the Great Recession?

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

3. **REMEDIES**: Which **policies** are most promising to counter increases in inequality?
Large country differences in *levels* of income inequality

Data refer to 2011 or latest year available. Source: OECD Income Distribution Database (www.oecd.org/social/inequality.htm).

Note: the Gini coefficient ranges from 0 (perfect equality) to 1 (perfect inequality). Gaps between poorest and richest are the ratio of average income of the bottom 10% to average income of the top 10%. Income refers to cash disposable income adjusted for household size.
Trends in income inequality over the past three decades: the bottom line

- Income inequality increased in a large majority of OECD countries, including in traditionally more equal countries;
- Income inequality increased during both recession and boom periods and despite employment growth, up to the crisis;
- In many countries, income inequality increased especially at the top;
- OECD countries recorded a historically high level of inequality as they were shattered by the crisis in 2008;
- The welfare state has prevented income inequality going from bad to worse in the first years of the Great Recession..
- ..but as the jobs crisis persists and fiscal consolidation takes hold, there is a growing risk of further rising inequality
Income inequality before and since the Great Recession: the facts

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

At the upper end of the distribution, the shares of very high incomes surged in many countries.

Shares of top 1% incomes in total pre-tax income, 1980 – 2012 (or closest)

Source: OECD 2014, *Focus on Top Incomes and Taxation in OECD Countries: Was the Crisis a Game Changer?* Based on World Top Income Database.
Note: Incomes refer to pre-tax incomes, excluding capital gains, except Germany (which includes capital gains). Latest year refers to 2012 for the Netherlands, Sweden and the United States; 2011 for Norway and the United Kingdom; 2009 for Finland, France, Italy and Switzerland; 2007 for Germany; 2005 for Portugal; and 2010 for the remaining countries.
In some countries, 20% and more of long-term growth has been captured by the top 1%

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? Based on World Top Income Database. Note: Incomes refer to pre-tax income, excluding capital gains.
But the rise of income inequality is, not only, about the top of the distribution.

During the crisis, in many countries incomes of the poorest households fell behind in relative and, often, in absolute terms.

Annual percentage changes in household disposable income between 2007 and 2011.

Source: OECD 2014, *Rising Inequality: youth and poor fall further behind*. 
Middle class(es): a concept on slippery grounds (156 definitions!)

**Economic approaches:**
- Limiting the people’s space, F(y):
  - The middle 60% of the distribution (D3-D8);
  - The 5th to 9th decile (D5-D9) (Palma);
  - The 6th to 9th decile (D6-D9) (Piketty)
- Limiting the income space, y:
  - Between 75% and 125% of the median (Ravallion; Pressman)
  - Between 70% and 150%/200% of the median (Grabka/Frick; Peichl)

**Sociological approaches:**
- Control over resources and position in the division of labour
- Occupational structure: non manual employees, technicians, supervisors, self-employed (Goldthorpe). Size far less variable than with economic definitions (Atkinson/Brandolini)

**Subjective approaches:** A large majority of people classify themselves as being part of the “middle class”
A moderate decline in the size of middle incomes (mainly in the US)..

**Trends in income shares of the middle 60%**

**Trends in income shares of 5th to 9th decile**

.. but much more pronounced movements at the edges of the distribution

Trends in income shares of the bottom, middle and top income classes

Trends in inequality are not a good predictor of trends in \textit{absolute} incomes of middle-class households (Kenworthy)
OECD evidence on the main drivers of rising inequality in OECD countries

**No direct effect:**
- Globalisation (trade, FDI)

**Ambiguous effects:**
- Changes in regulations and institutions

**Lesser culprit:**
- Changing household/family structures

**Main culprits:**
- Skill-biased technological changes
- Changes in employment patterns and working conditions
- Weaker redistribution via the tax/benefit system

**Off-setting factor:**
- Increase in education levels off-set much of the drive towards rising inequality
Focus on redistribution: taxes and benefits play an important role in almost all OECD countries

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

Source: OECD 2013, Crisis squeezes incomes and puts pressure on inequality and poverty. Note: Data refer to the working-age population.
Among the two instruments, cash transfers play a more significant role in (almost) all countries.

Respective redistributive effects of direct taxes and cash transfers, 2011

Source: OECD 2014, preliminary data. Note: Data refer to the working-age population.
.. but redistribution became weaker in most countries until the onset of the crisis

Percentage reduction of income disparity through taxes and transfers, working-age persons

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.
Social transfers are more often part of consolidation plans than other areas of public spending.

Major programme measures in fiscal consolidation plans, by area of public spending: percent of countries participating

Reading note: 70% of countries have planned to cut welfare spending on working-age transfers in 2012.
Policy lessons from OECD work: both redistribution and inclusive employment policies matter

Three main policy avenues to tackle too-high inequality:

• Reforming tax and benefit systems:
  - Government transfers (cash and in-kind) have an important role to play to safeguard low-income households;
  - There is also scope for reviewing some tax provisions in light of increased “tax capacity" among top-income households;

• Boosting employment and career prospects (“more and better jobs") : Facilitate and encourage access to employment for under-represented groups and address labour market segmentation;

• Investing in human capital: Promote up-skilling of the workforce, better training and education for the low-skilled.
Thank you for your attention!


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