OECD Centre for Opportunity and Equality

Evidence-based, policy-oriented research on inequalities

Inequality in the OECD: trends, drivers and policy responses

Vienna, 20 October 2016

WIIW Seminar

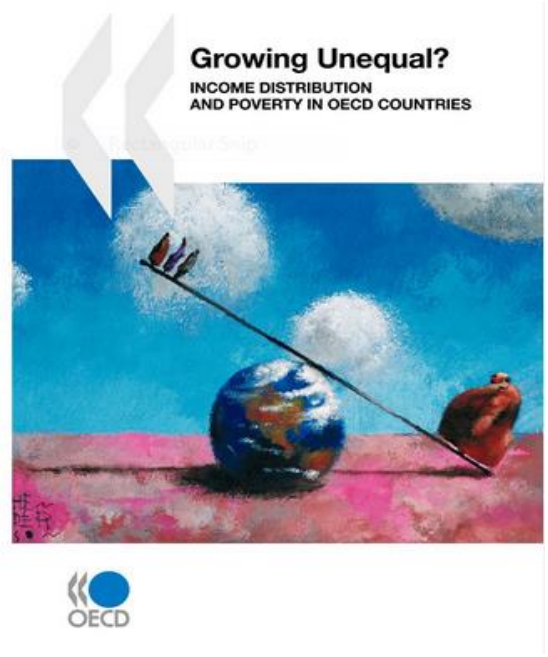
wiiw

Michael Förster
OECD, Social Policy Division

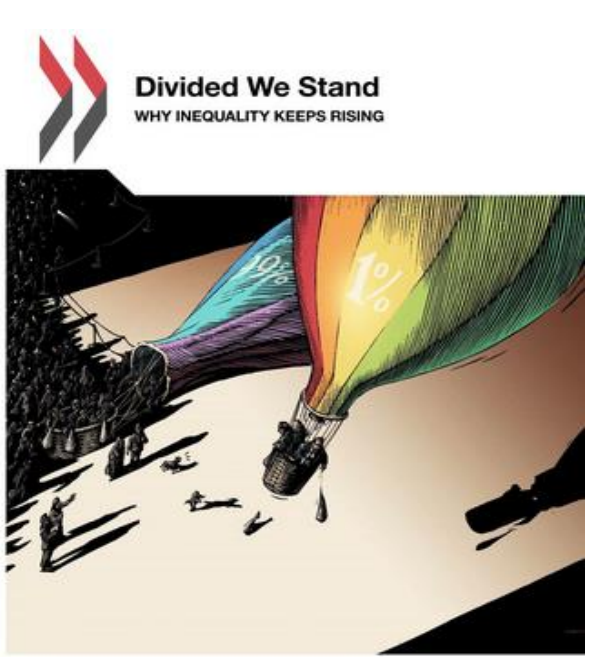
Inequality – in the heart of policy discourse and policy debate

- *"Rising income inequality is the **defining challenge of our times**"* (President Obama, US)
- *"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)
- *"Reducing excessive inequality is not just morally and politically correct, but it is **good economics**"* (C. Lagarde, IMF)

2008

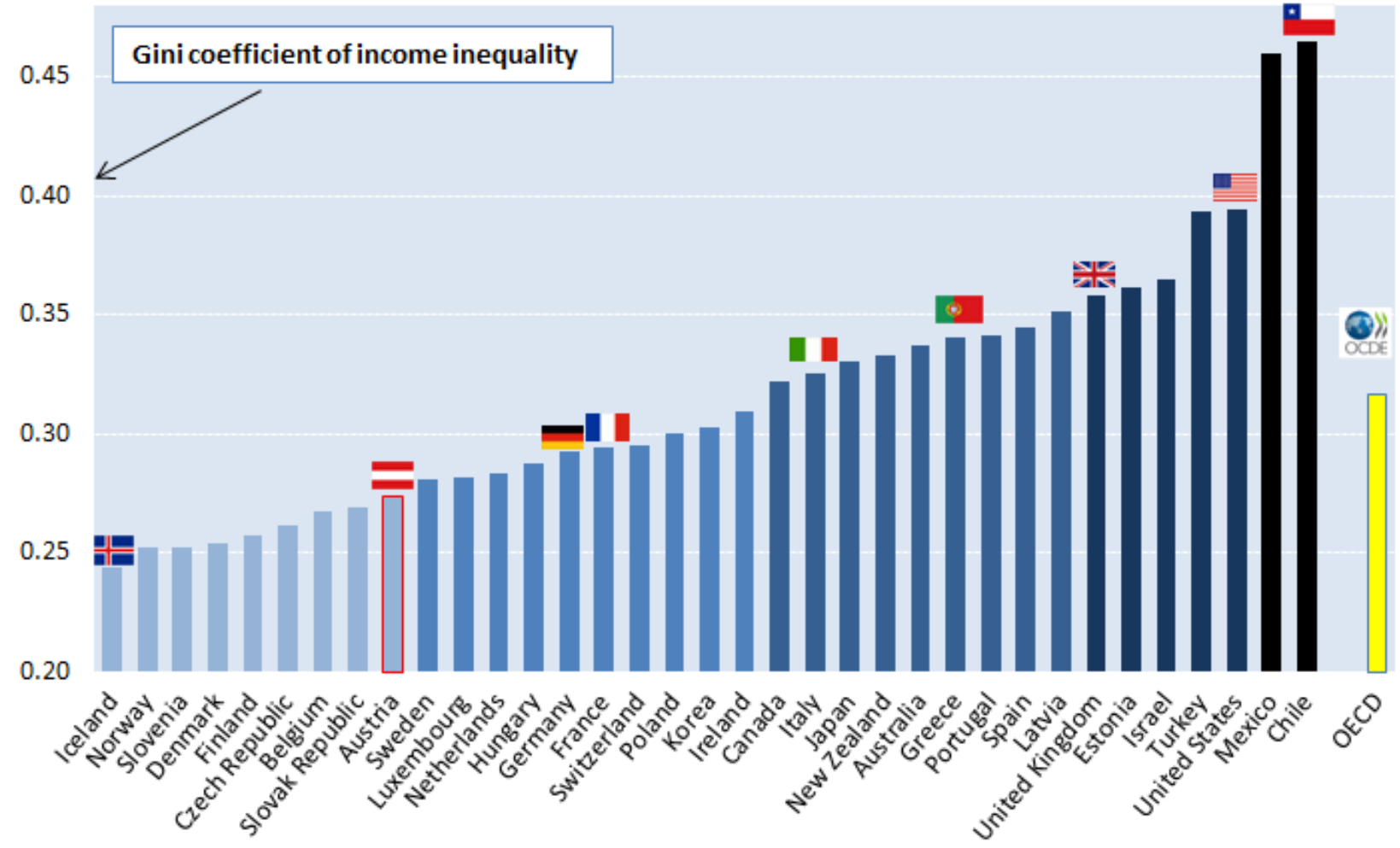


2011



2015

Large country differences in levels of *income* inequality



Source: OECD Income Distribution Database (www.oecd.org/social/income-distribution-database.htm)
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 2014 or latest year available.

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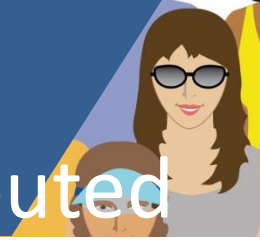
It is not just about income: *Wealth* is much more unequally distributed



Share of income and wealth going to different parts of the income and wealth distribution, respectively, around 2013

	OECD		USA		AUSTRIA	
	income	wealth	income	wealth	income	wealth
top 10%	25%	50%	29%	76%	22%	62%
next richest 50%	55%	47%	55%	24%	55%	37%
bottom 40%	20%	3%	16%	0%	23%	1%

Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm .
OECD wealth questionnaire and ECB-HFCS survey and OECD Income Distribution Database (www.oecd.org/social/inequality.htm
Note: Income refers to disposable household income, corrected for household size. Wealth refers to net household wealth.

Countries with high wealth concentration are not (always) those with high income concentration

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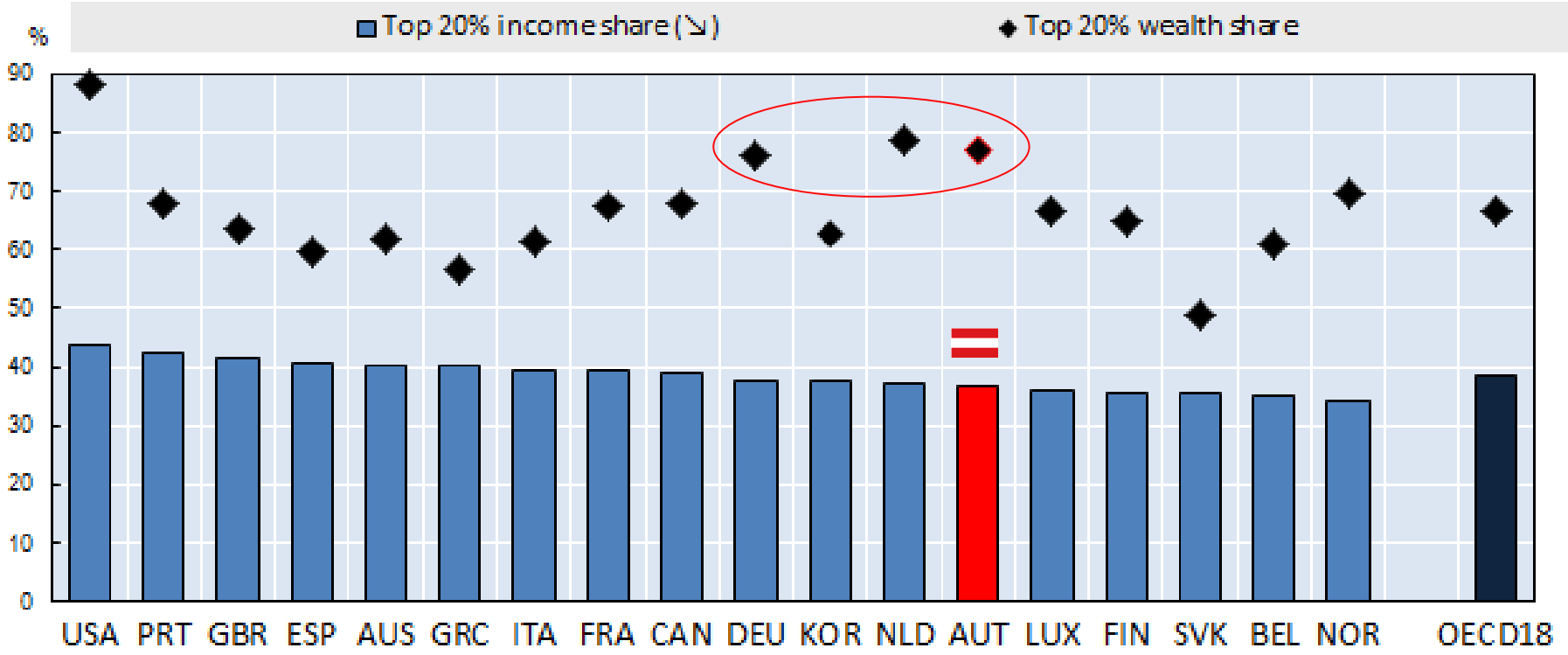
Share of top 20% of household disposable income and top 20% of household net wealth, 2013 or latest available year



Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm
OECD Wealth Distribution Database and OECD Income Distribution Database (www.oecd.org/social/income-distribution-database.htm).
Note: Income refers to disposable household income, corrected for household size. Wealth refers to net private household wealth. Data refer to the shares of the richest 10% of income earners (bars) and of the richest 10% of wealth holders (diamonds), respectively.

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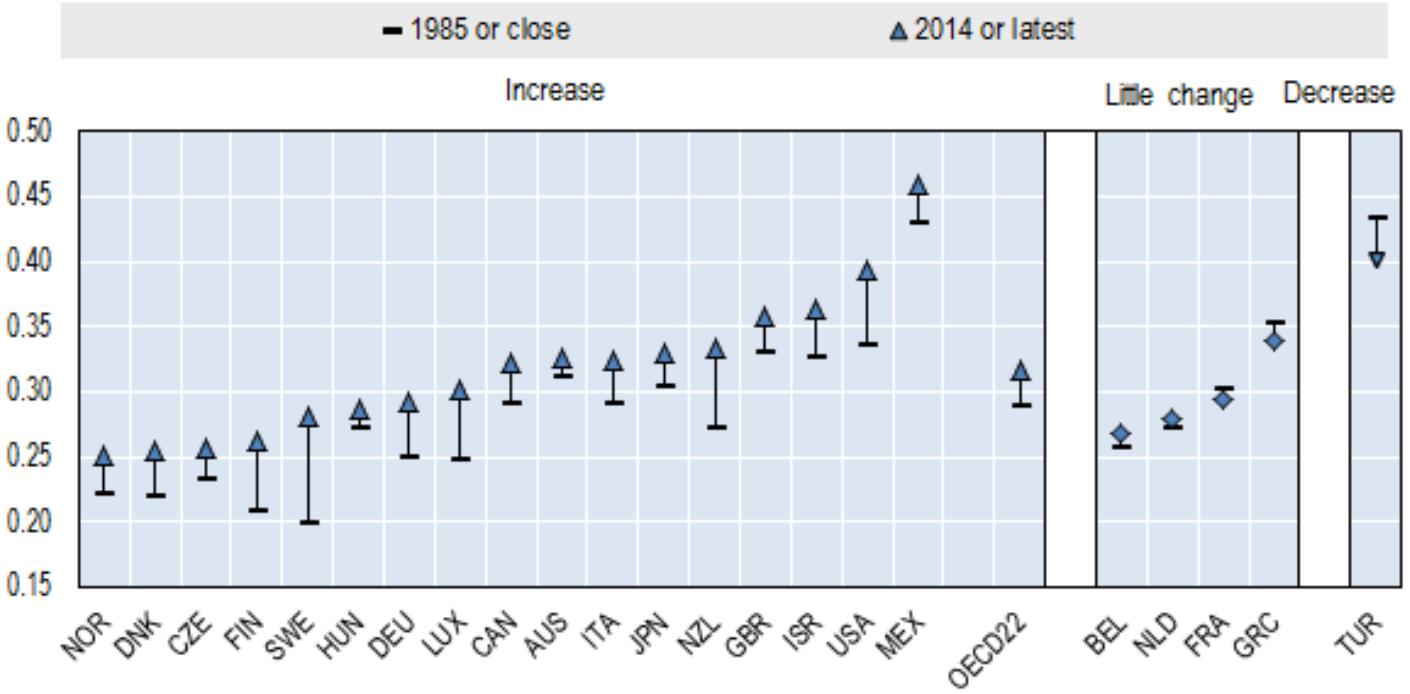
A long-term rise in *income* inequality

- The gap between rich and poor at its highest level since 30 years
- The richest 10% earn 9.4 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.

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

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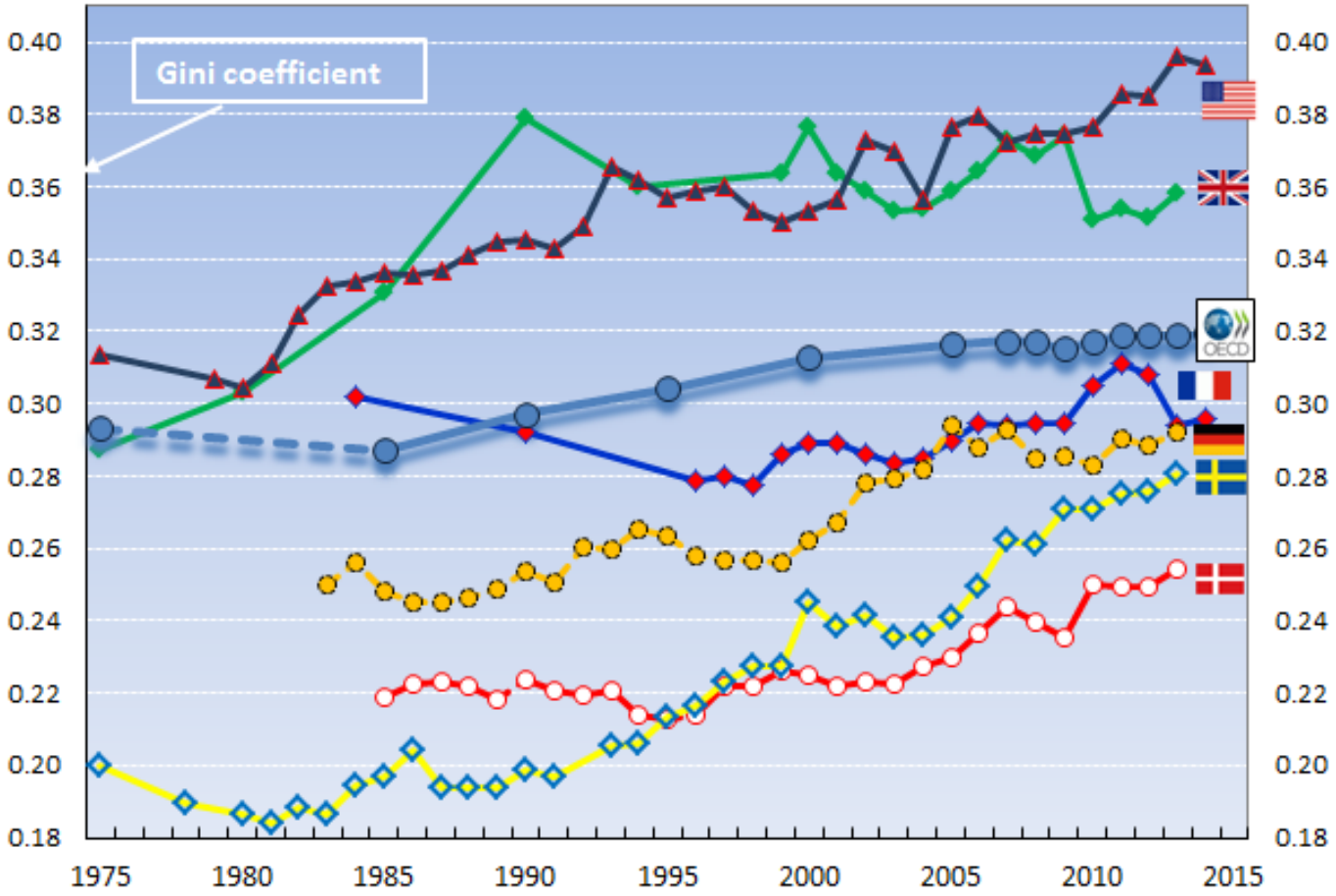
Long-term trends in inequality of disposable income (Gini coefficient)



Source: OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm.
Note: Income refers to disposable income adjusted for household size.

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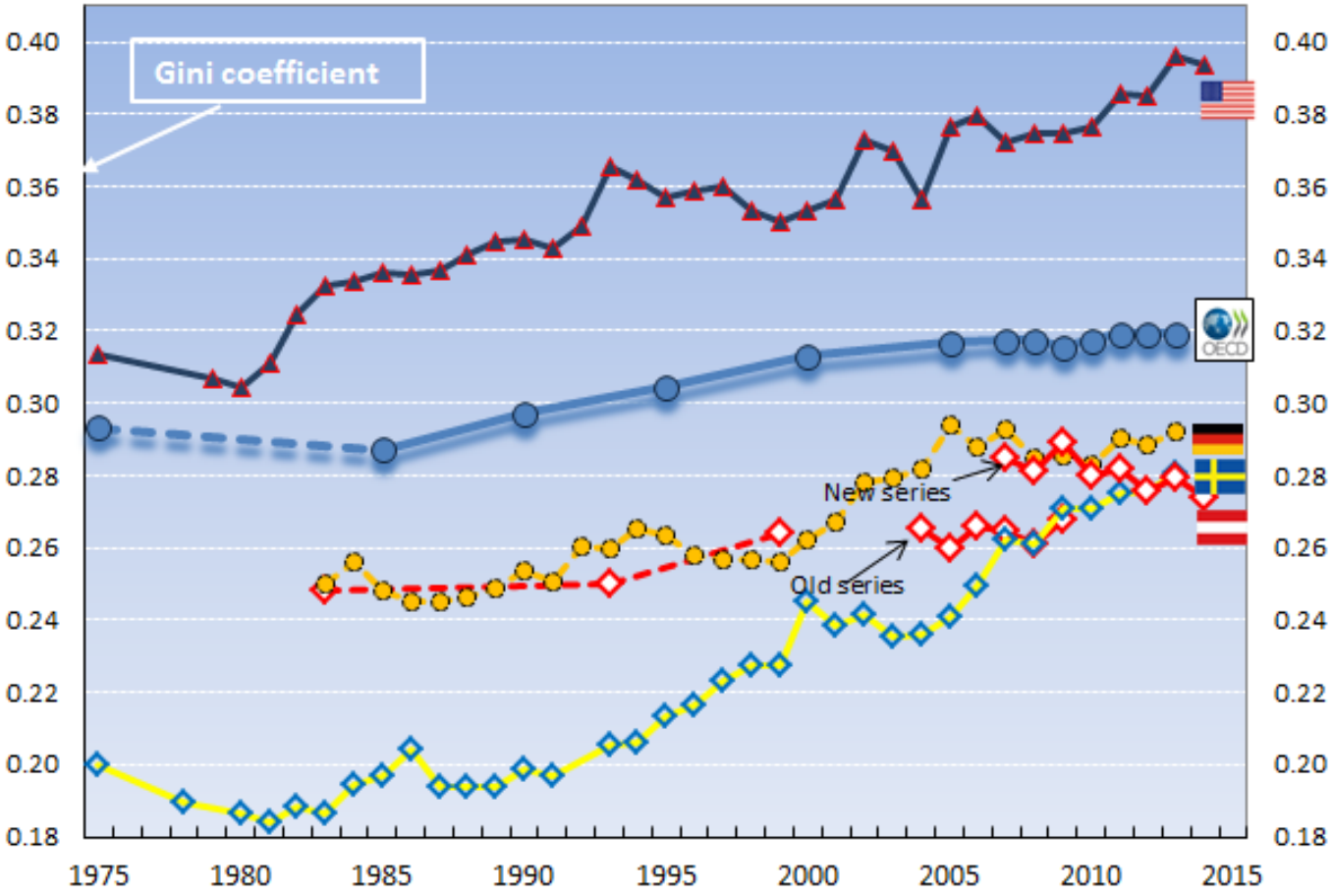

Source: OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm.
Note: Income refers to disposable income adjusted for household size.

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

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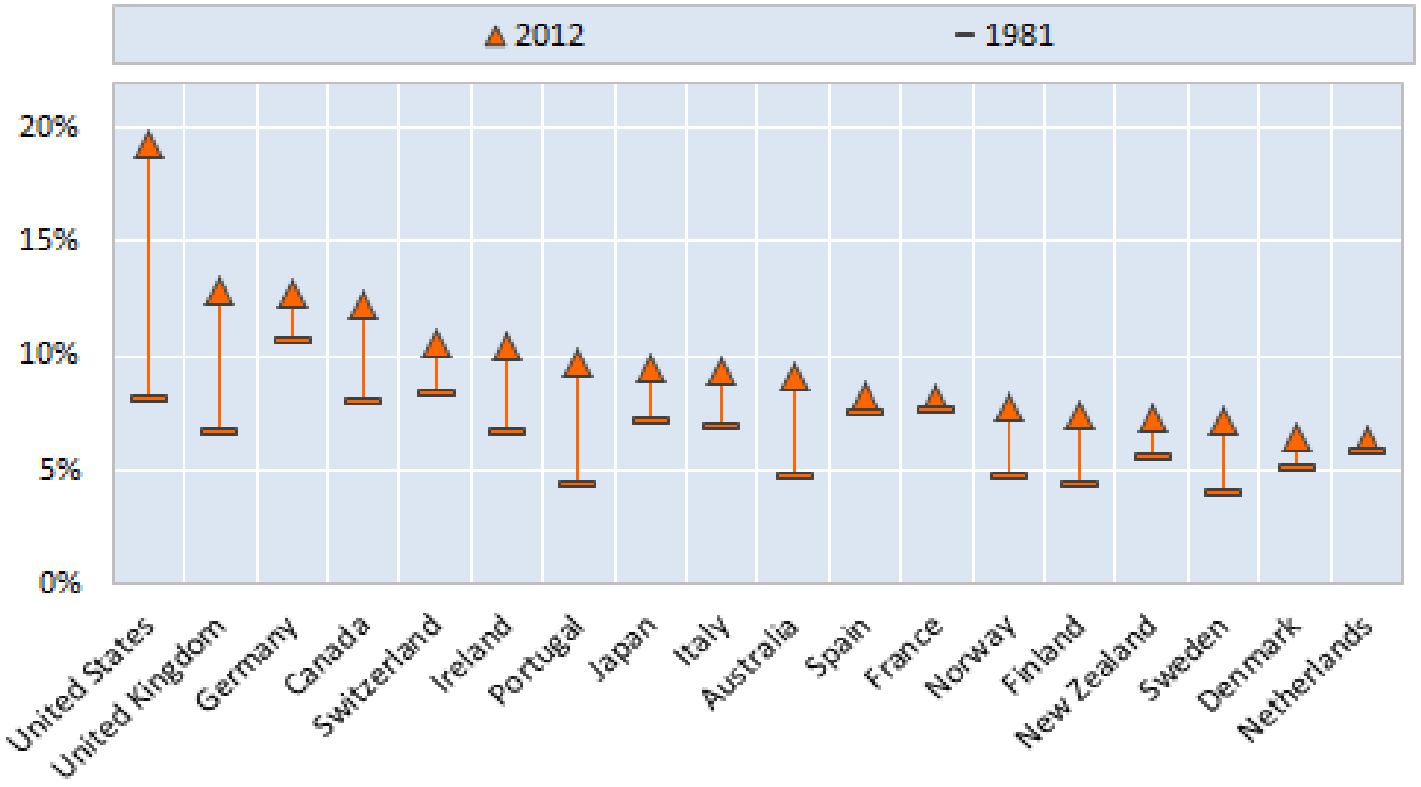
Shares of top 1% incomes in total *pre-tax* income, 1980 – 2012 (or closest)



Source: OECD 2014, *Focus on Top Incomes and Taxation in OECD Countries: Was the Crisis a Game Changer?* (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, 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 English-speaking countries, > 20% of long-term growth has been captured by the top 1%

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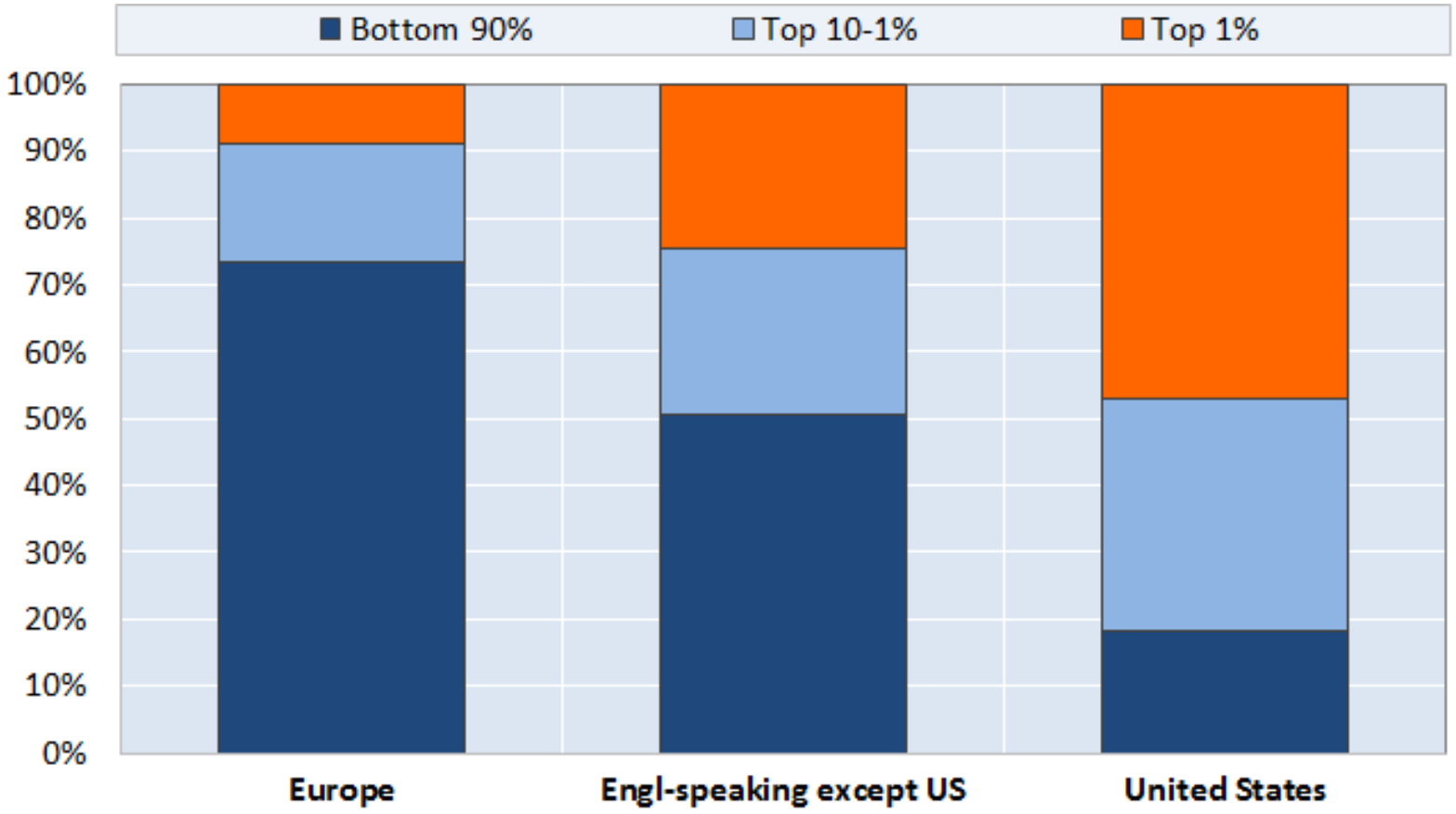
Share of income growth going to income groups from 1975 to 2007



Source: Förster and Heitzmann (2016, forthcoming), "Entwicklung von Spitzeneinkommen in OECD-Ländern", in: Dimmel et al. (eds.), Handbuch Reichtum, 2016 forthcoming. Based on World Top Income Database.
Note: Incomes refer to pre-tax incomes, excluding capital gains

But the rise of income inequality is, not only, about the top of the distribution

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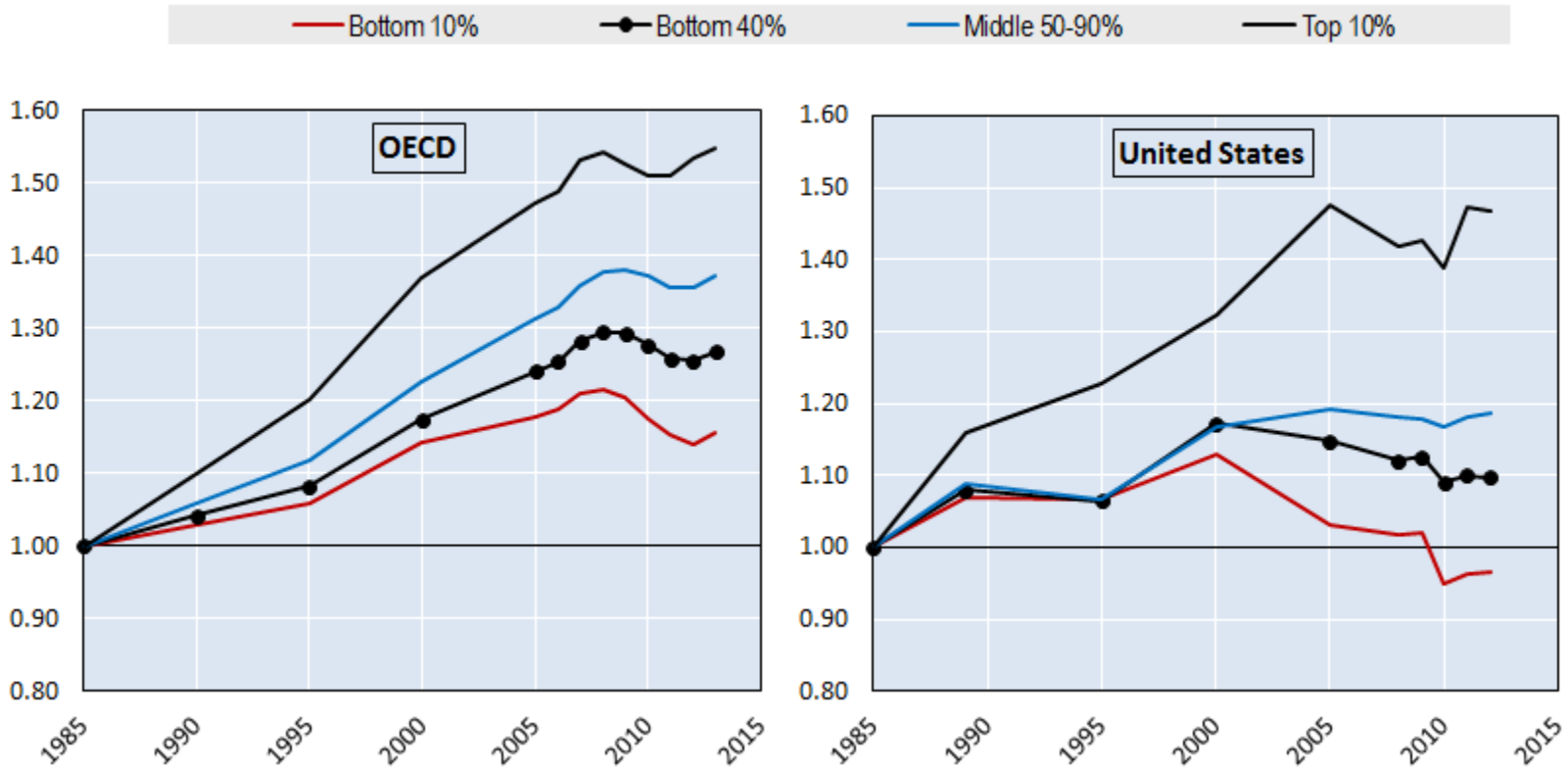
→ When looking at the long run, lower and lowest incomes were increasingly left behind

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



Source: OECD (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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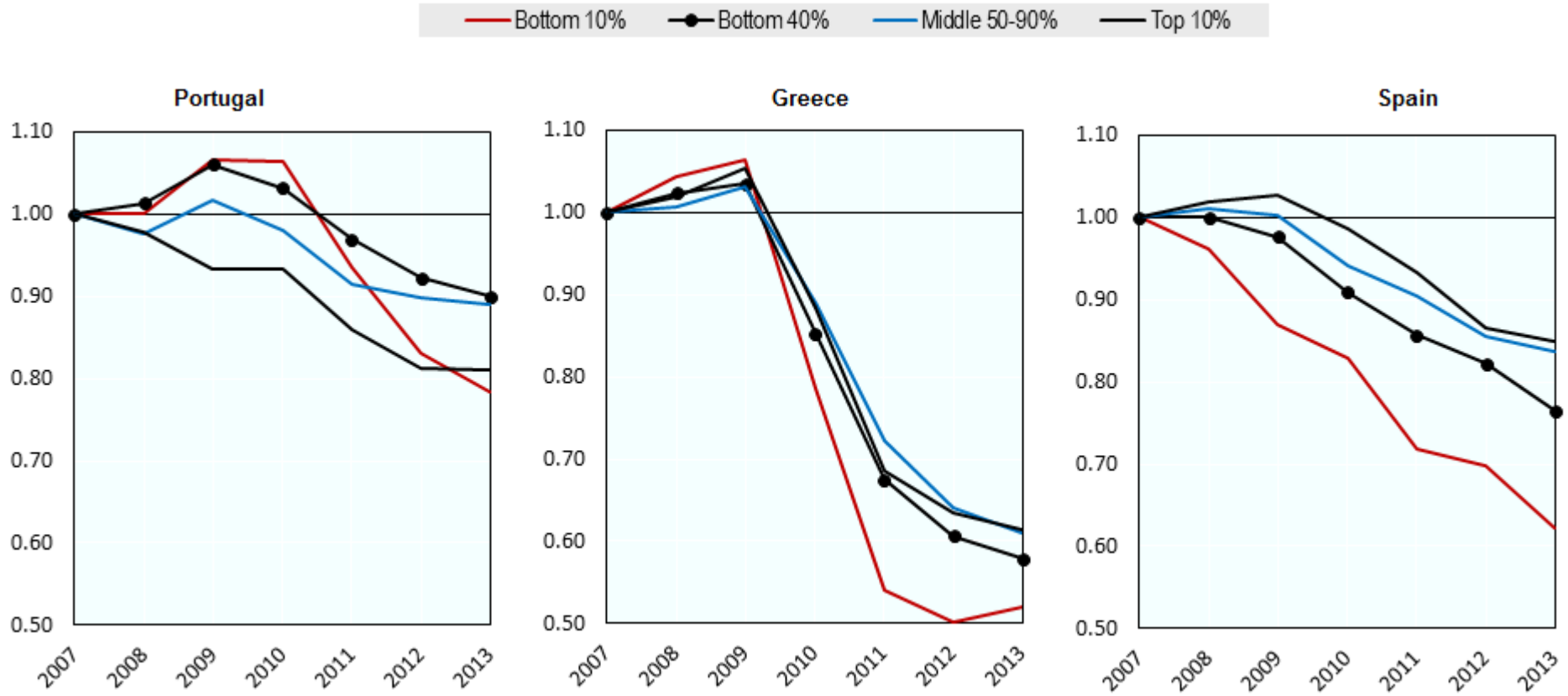
So was the crisis a game changer?

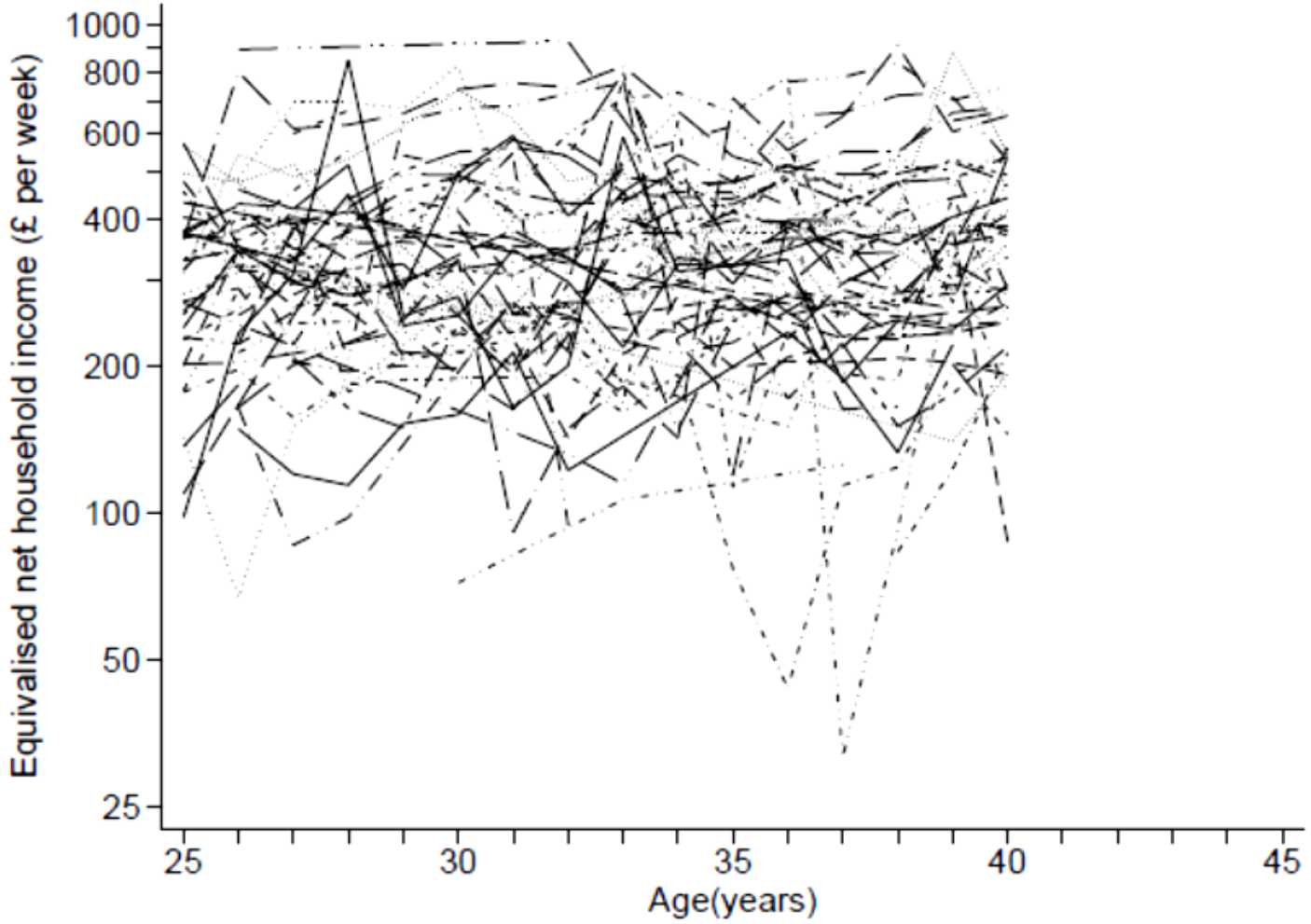
→ .. also during the crisis, in a majority of countries incomes of the poorest households fell behind, particularly in Southern Europe

Trends in real household incomes at the bottom, the middle and the top, 2007 = 1



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

Individual income changes over longer periods: Stephen Jenkins's "tangled spaghetti"



Source: Jenkins (2011), figure 7.2, based on BHPS

Different trends in income growth during the crisis and since the (weak) recovery

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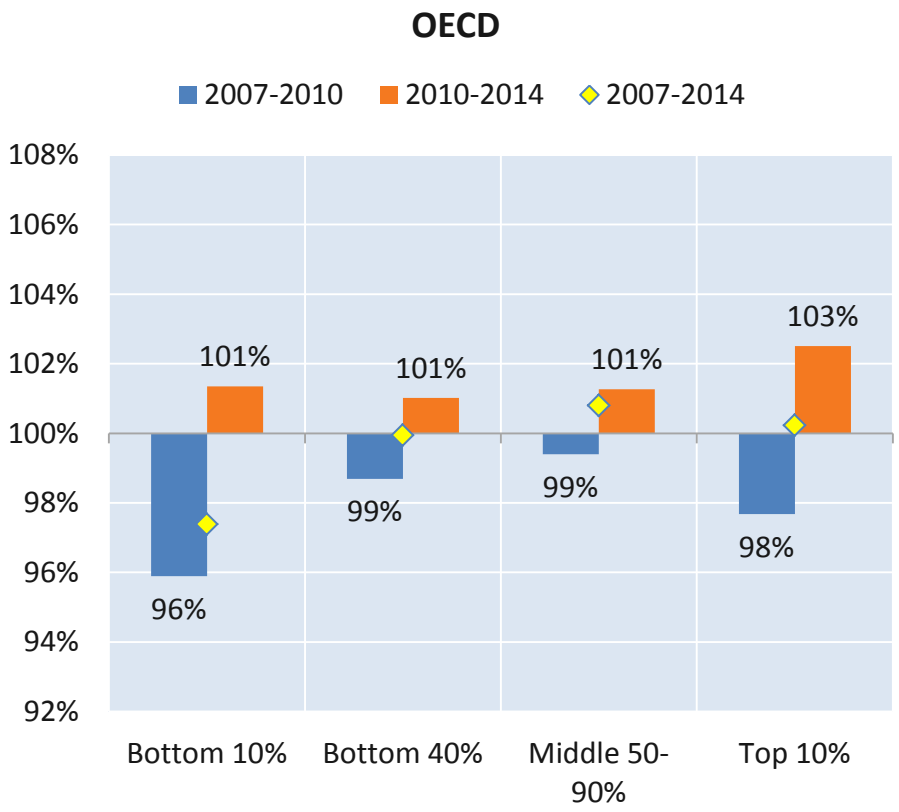
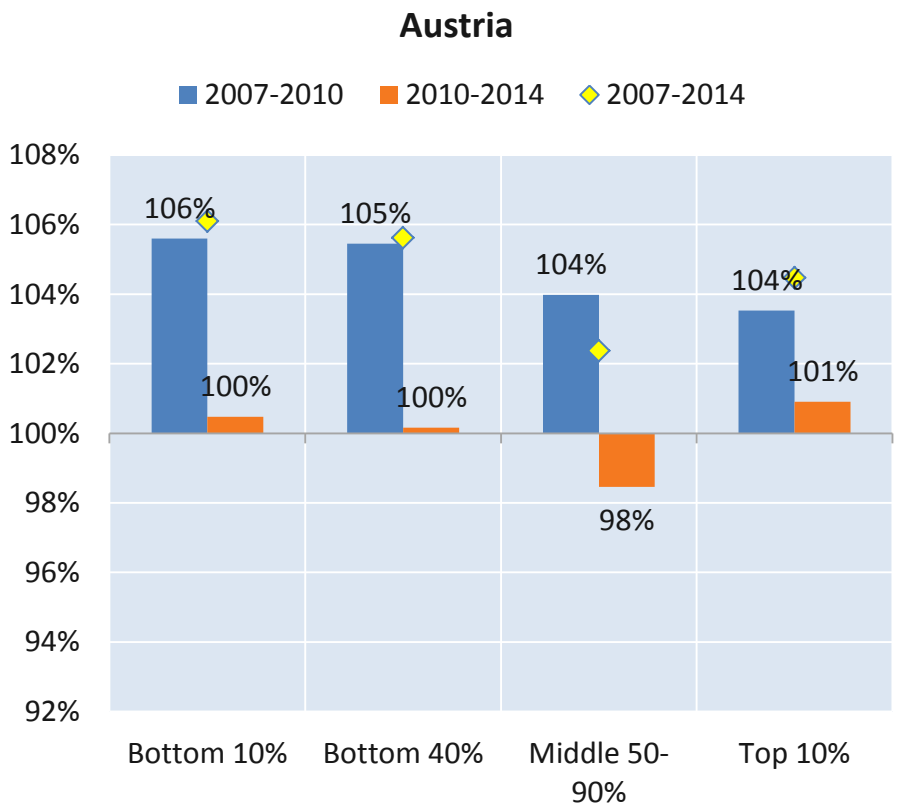
Average disposable income growth during the crisis and since the recovery





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

Multiple possible causes of increasing income inequality

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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

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

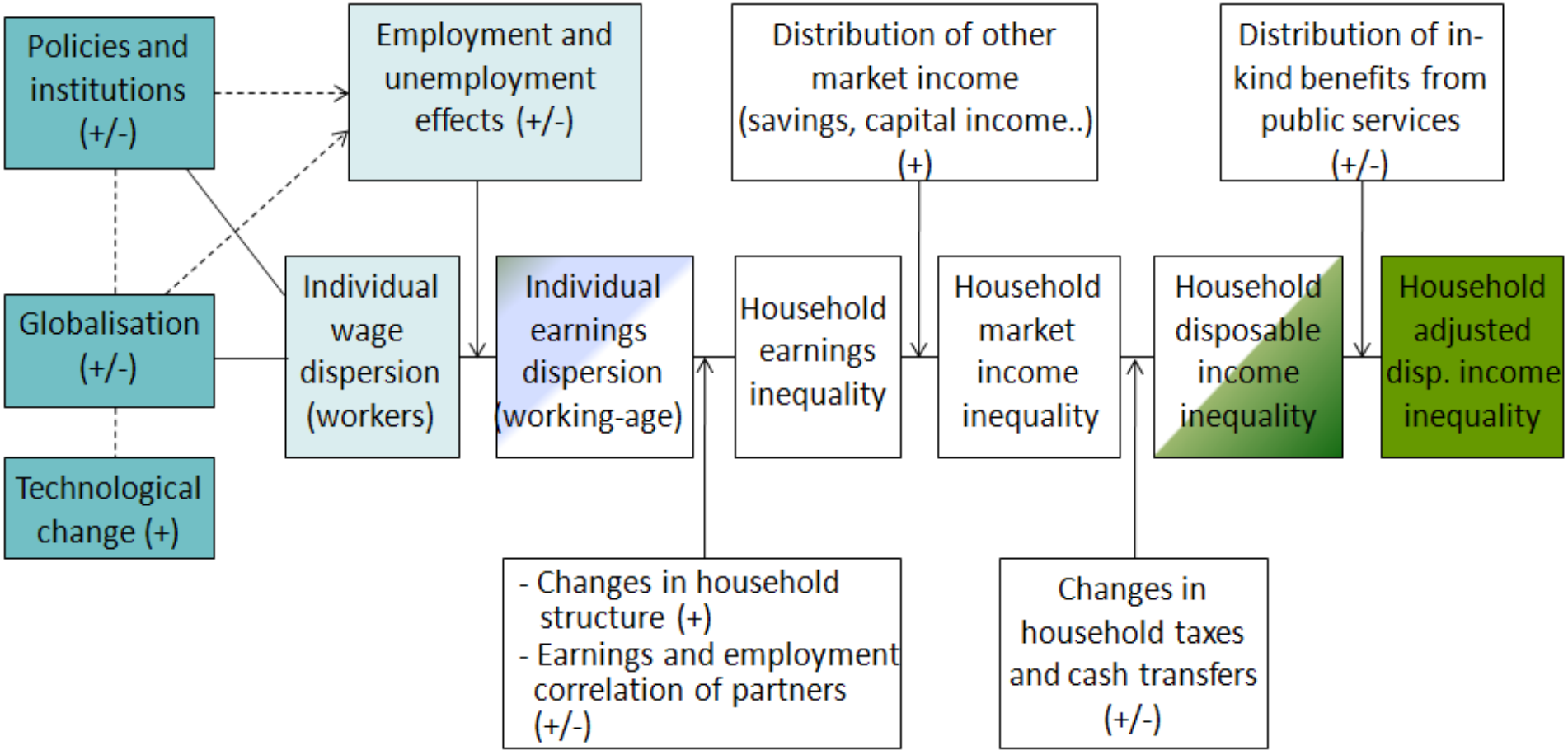
- Education: largely reported equalising
- Assortative mating: dis-equalising
- Female employment: equalising
- Single headed households: dis-equalising
- Age composition: inconclusive
- Migration: inconclusive

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), Handbook of Income Distribution, 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.

Identifying key drivers of income inequality: 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 culprits

- 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

Lesser culprit

- Changing household/family structures

Off-setting factors

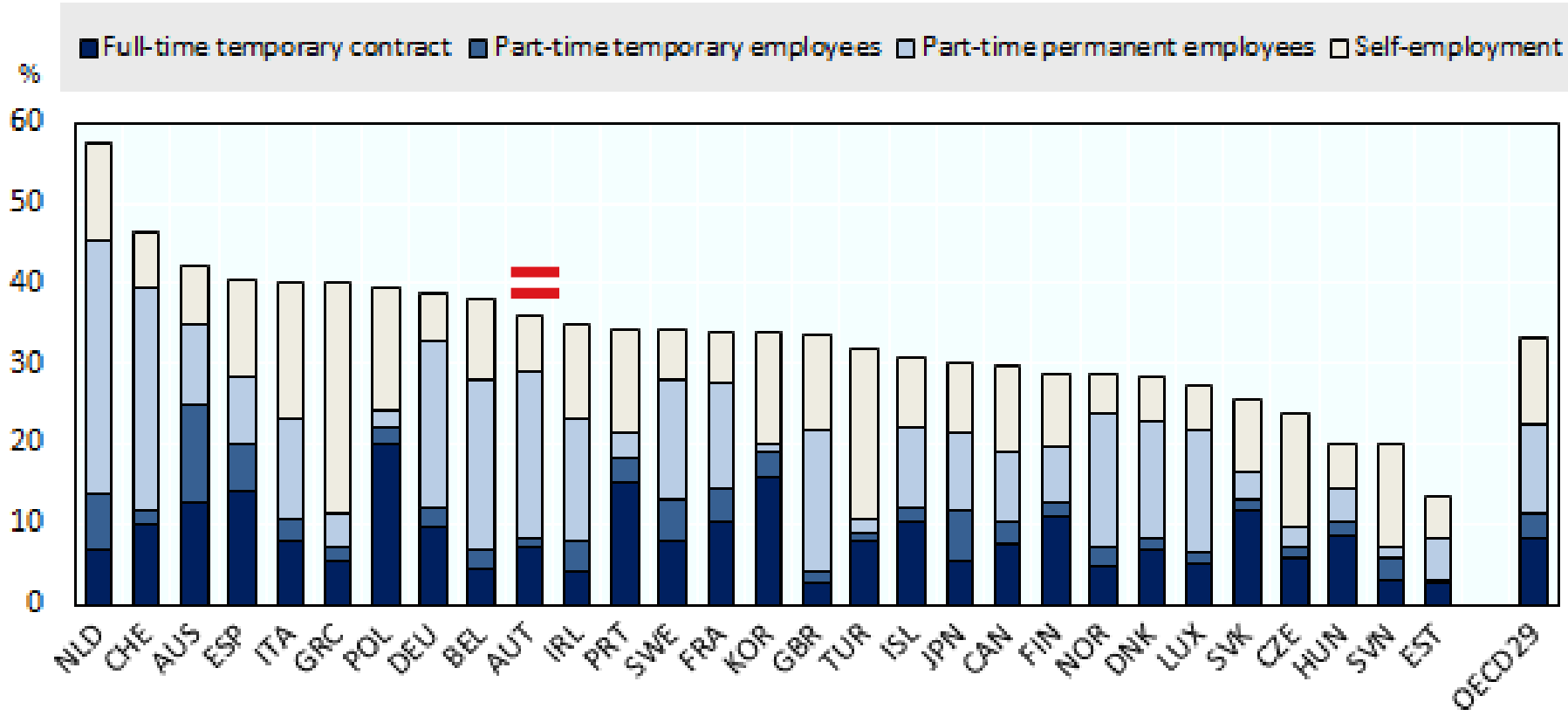
- Increase in education
- Higher female employment participation

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

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

Ad 1). New employment patterns and inequality

Share of non-standard employment in total employment, latest date available



Note: Sample restricted to paid and self-employed (own account) workers aged 15-64 years old, excluding employers, student workers and apprentices.
Source: OECD (2015) "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm.

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

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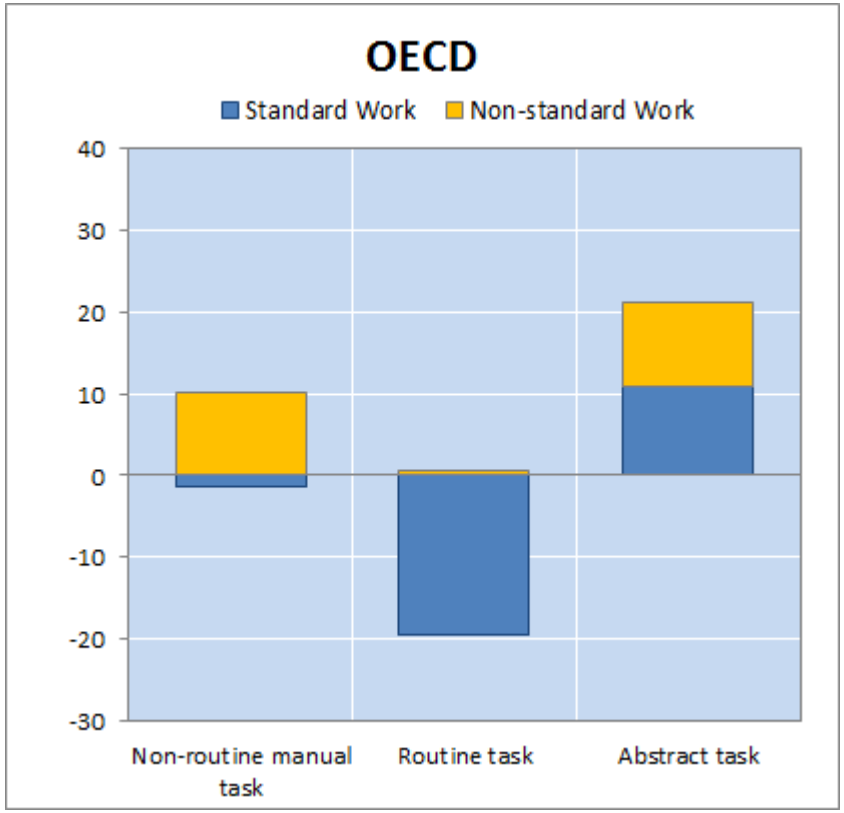
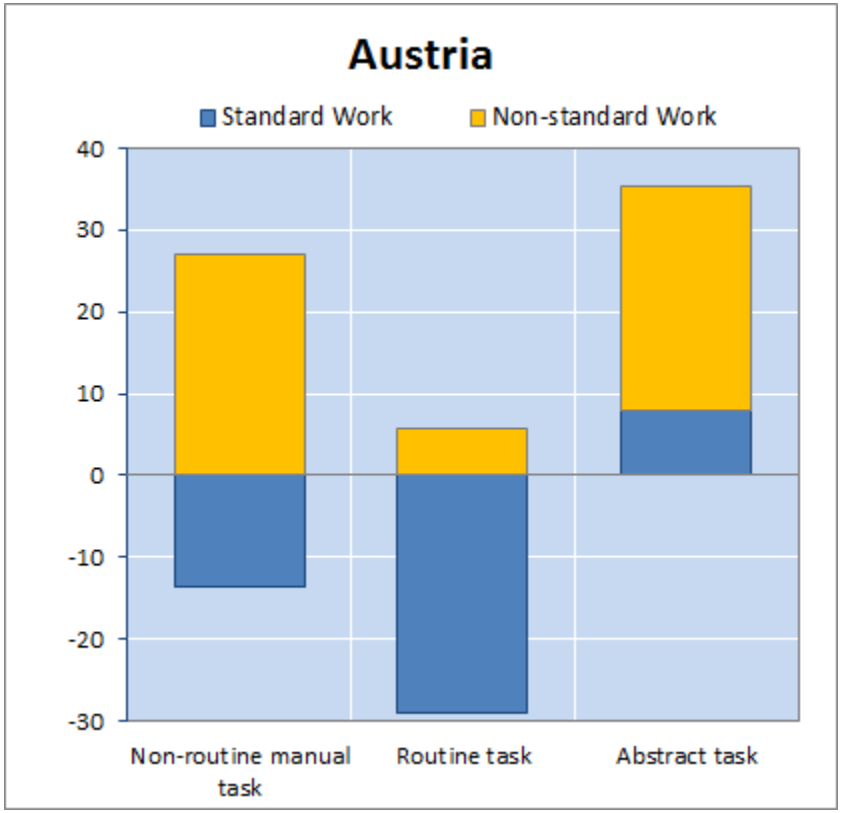
Percentage change in employment shares by task category, 1995/98-latest available year





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.

Is there a wage penalty for non-standard workers?

- Temporary workers have 30% lower hourly wages; they still face a wage penalty, about 12% controlling for observable characteristics, and 5-8% once unobservables are taken into account
  - The penalty is higher for younger workers
- Sticky floors: the earnings gap for non-standard workers is (much) higher at the bottom of the wage distribution

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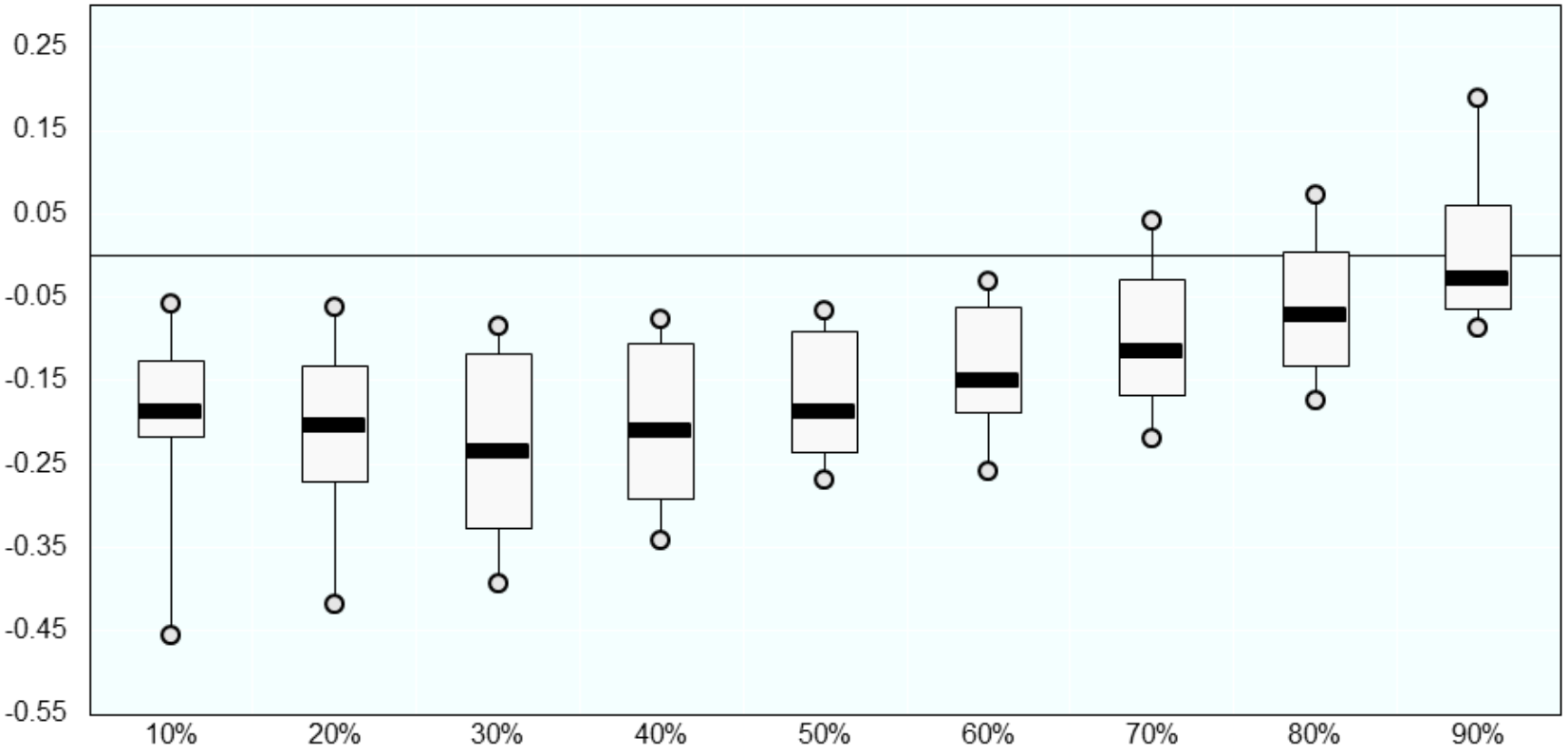
Sticky floors

Effect of non-standard work on (log) hourly wages by decile



Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm
Note: The box for each quantile represents the interval of the impact of NSW on log hourly wages ranging between 25% and 75% of values, with the black line representing the median impact. The circles represent the country with the highest and lowest impact on wage associated with NSW for each decile.

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Other measures of job quality also suggest that non-standard workers are worse off

- job insecurity is higher
- they provide less training
- and report a higher level of job strain
- And have less social protection (esp. “new SE”)

→ but do they improve labour market prospects, e.g. by a higher probability to move to a more stable job?

In most countries, temporary workers have a better chance to get a standard job than unemployed

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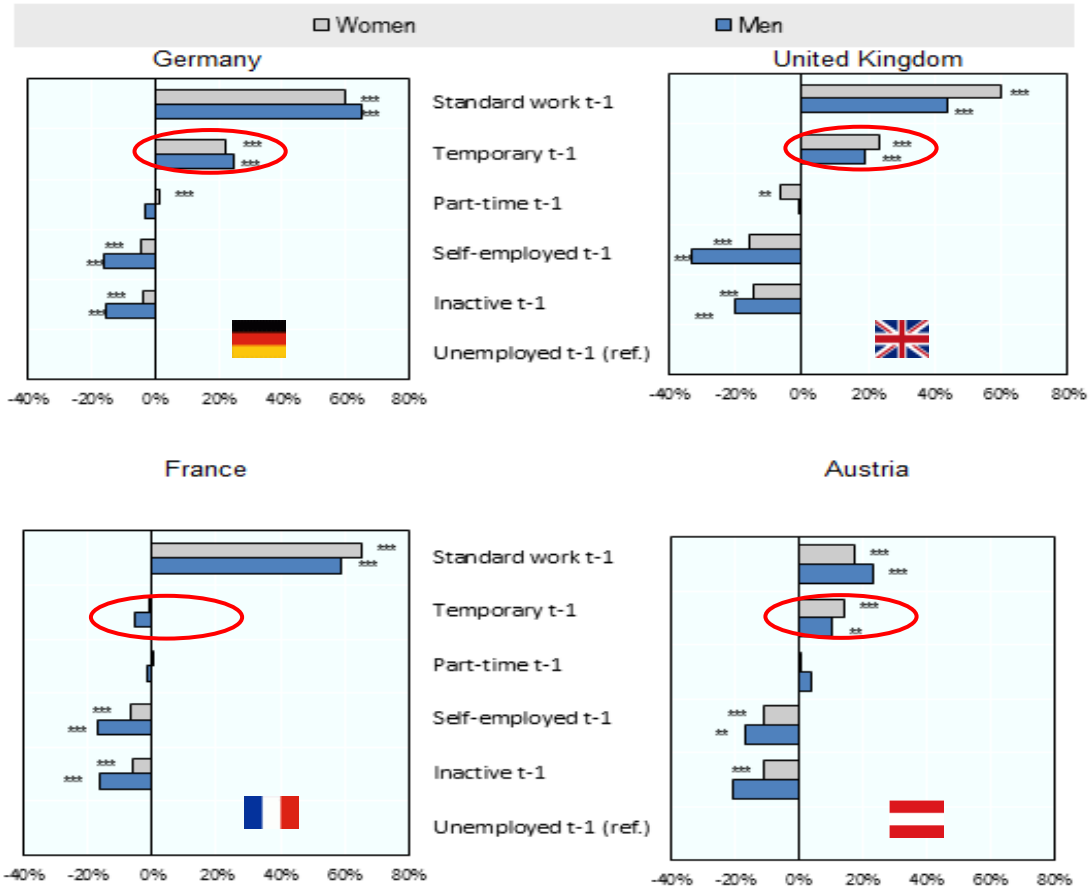
Influence of previous labour market status on the probability of having a standard employment



Source: OECD (2015), "*In It Together*", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm
Note: Marginal effects from lagged employment status on probability of standard employment based on random-effects dynamic probit, controlling for initial conditions. ***, **, *, denote 1%; 5%, and 10% significance, respectively.

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"Stepping stones or dead ends": how likely are non-standard workers to move into standard jobs?

- Controlling for characteristics and initial employment status, temporary workers are 12-13 points more likely than the unemployed to be in standard work after one year
- But only prime-age and older temporary workers exhibit higher transition probability into permanent jobs; a stepping-stone effect for young temporary workers (15-29) is generally not found
- In addition, transition rates remain low over a longer time span (less than 50% move to a permanent contract after 3 years)
- Temporary workers are at higher risk of both unemployment and inactivity than those with standard work in ¾ of countries

Low transition rates over a longer time span: less than half move to a permanent contract after 3 years

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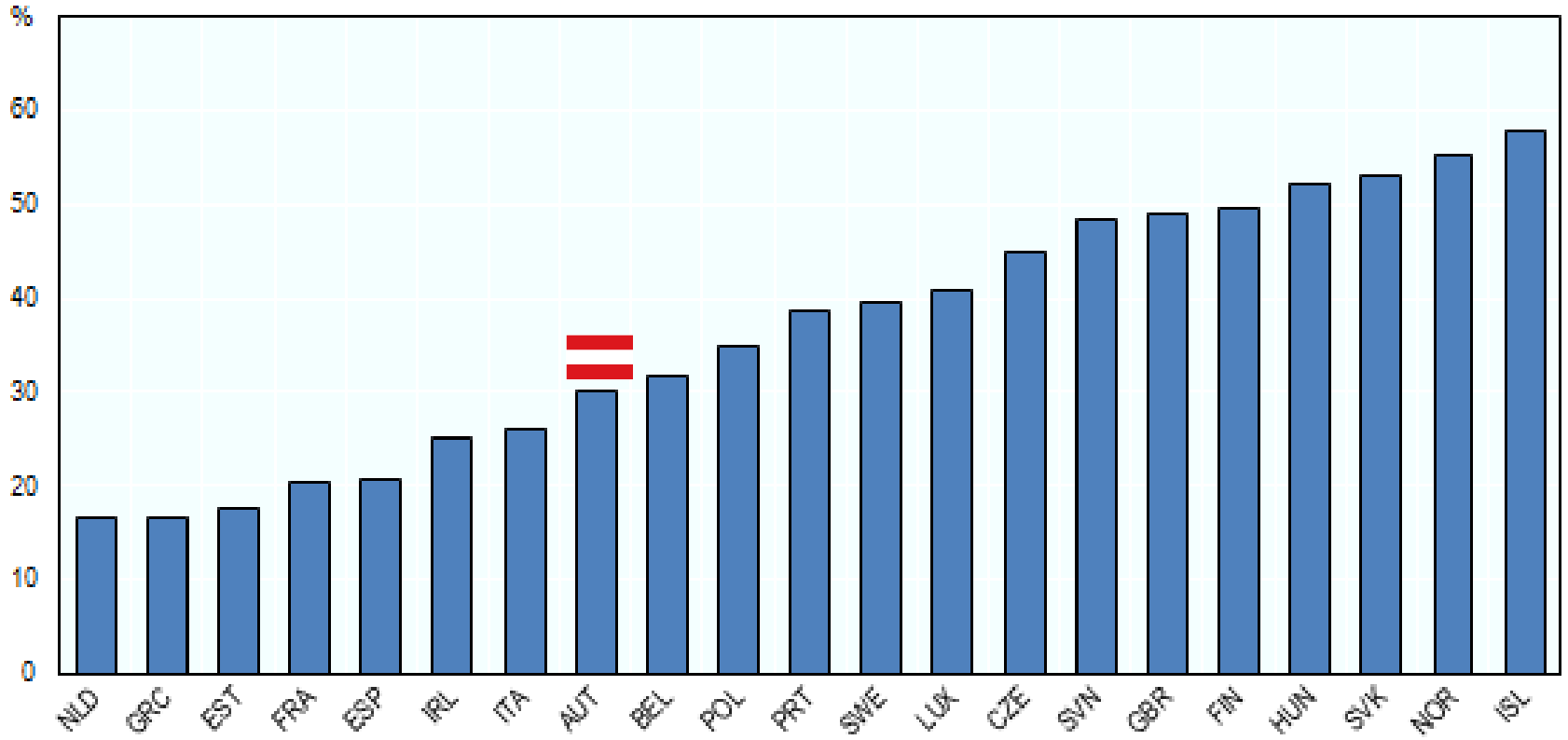
Percentage of temporary workers in 2008 who were employed as tull-time employees in 2011



Source: OECD Employment Outlook 2014

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Will more non-standard work lead to higher *income* inequality and poverty?

An increase in the share of non-standard workers (NSW) contributed to increased *individual earnings* dispersion, but the impact on *household income* depends on:

- "Demography": in which household do NSW live, and are they main or secondary earners
- "Earnings": what is the contribution from NSW earnings at the household level and how are they distributed
- "Incomes": what is the position of NSW workers in the overall income distribution and how do different work arrangements affect the risk of poverty

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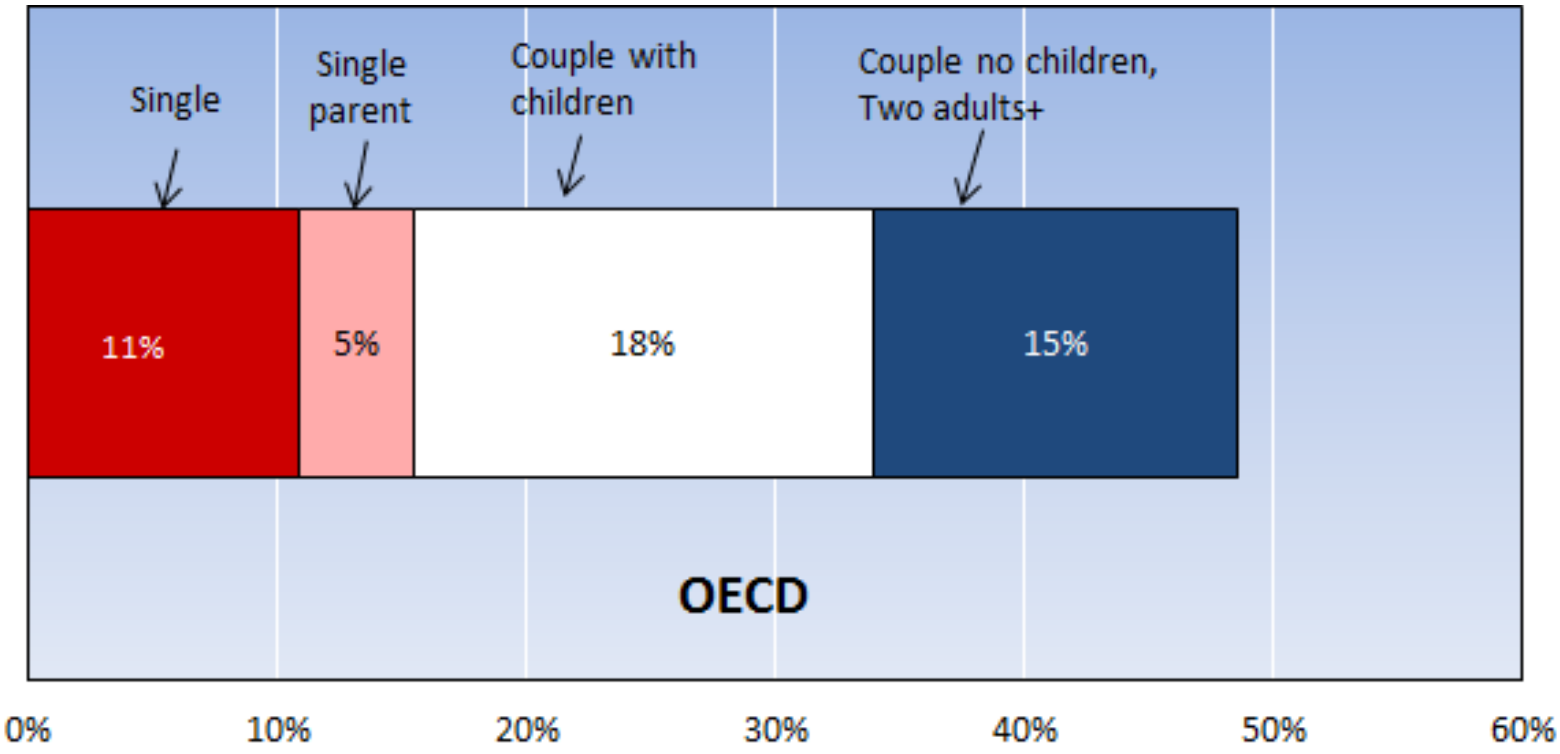
Half of all non-standard workers are the main breadwinners in their household

Share of non-standard workers who are main earners, by family type



Source: OECD (2015), *"In It Together – Why Less Inequality Benefits All"*

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

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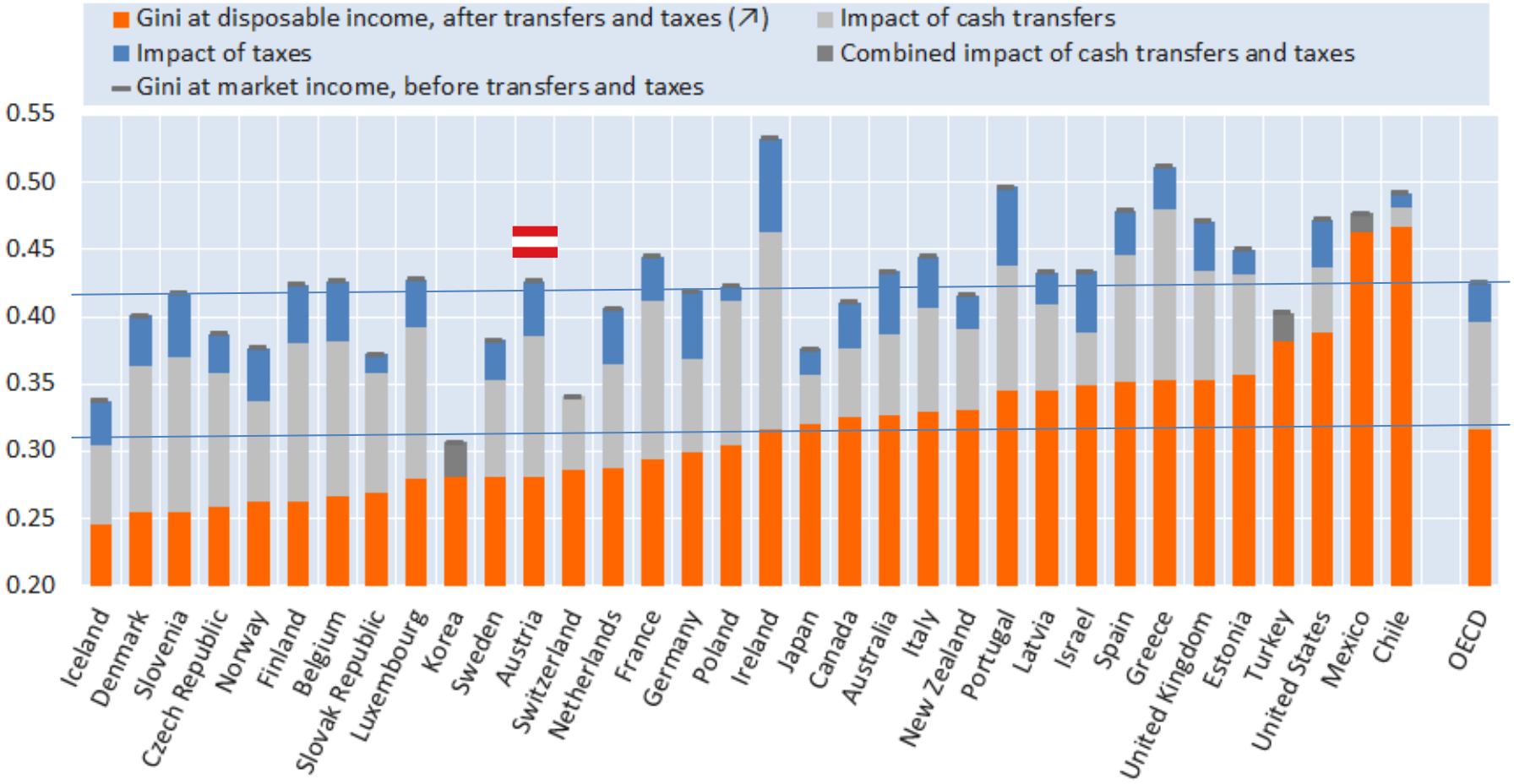
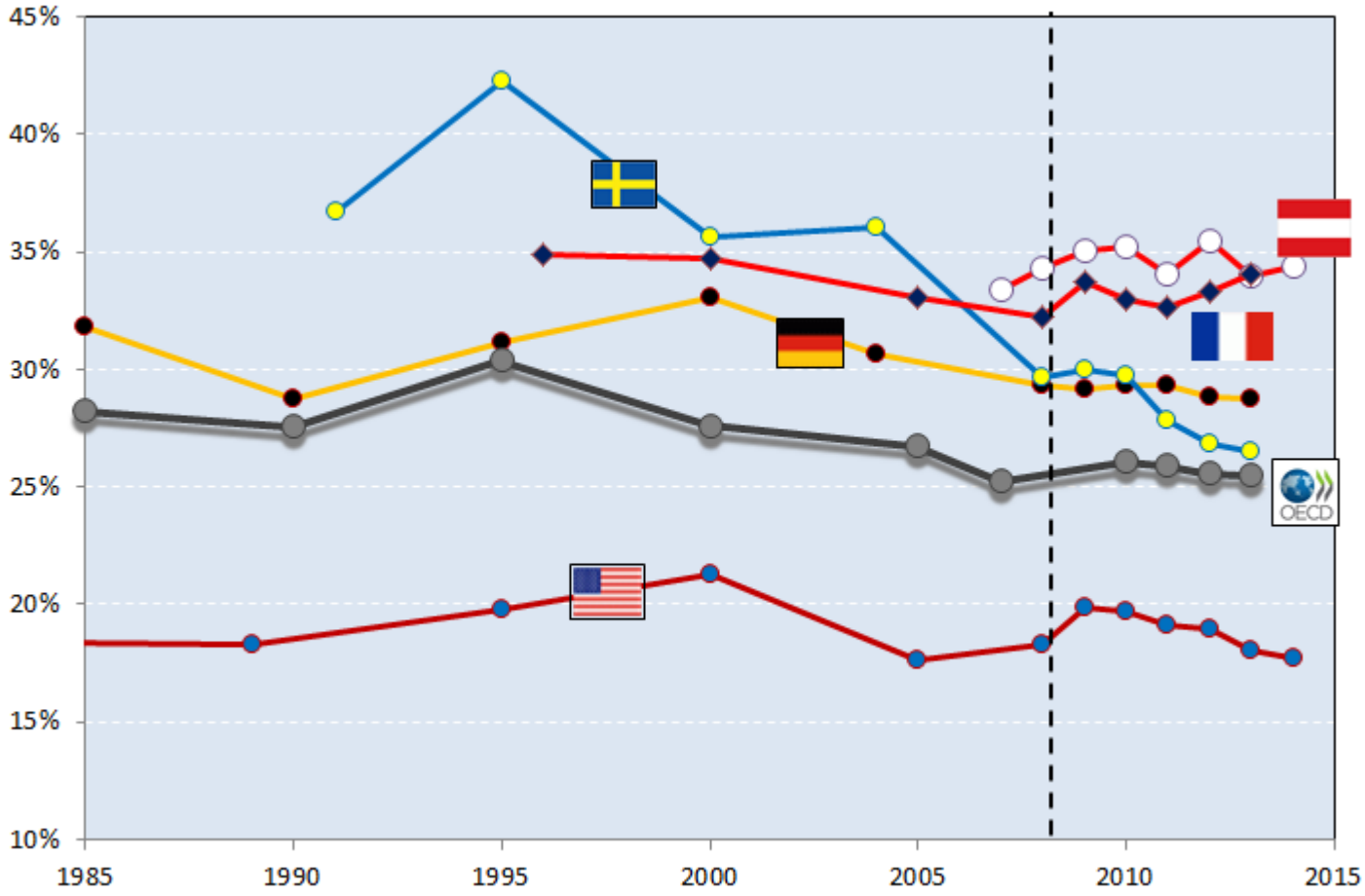
Gini coefficient of market income inequality and impact of taxes and transfers, working-age population, 2014 (or latest year)



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

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

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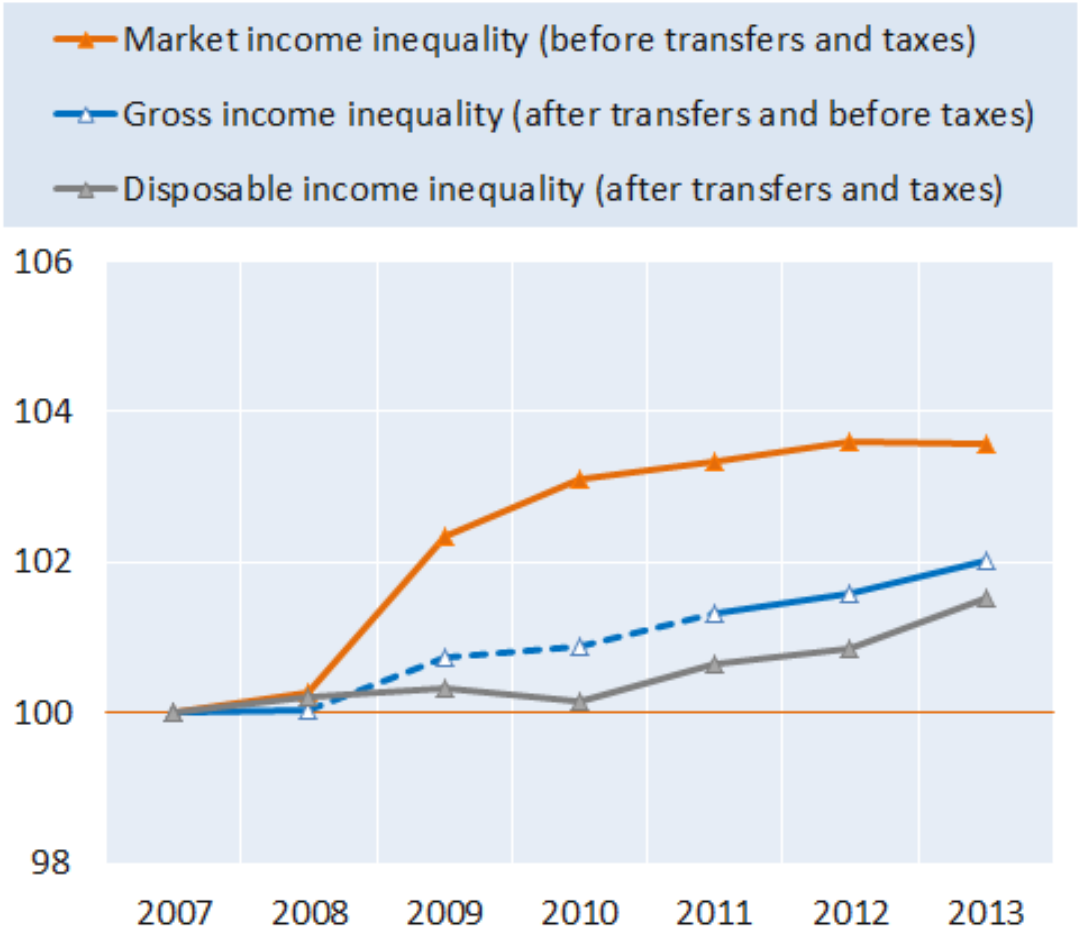
Why have tax/benefit systems become less successful at reducing inequality?

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.

Redistribution prevented the increase in disposable income inequality in the early years of the crisis

Inequality before and after redistribution, 2007=100, working age population, OECD average



Source: OECD (2016, forthcoming), *No light at the end of the tunnel? Economic recovery has not reduced inequality,* Policy note.

Taxes are back at their pre-crisis level while transfers stagnated and tend to decline

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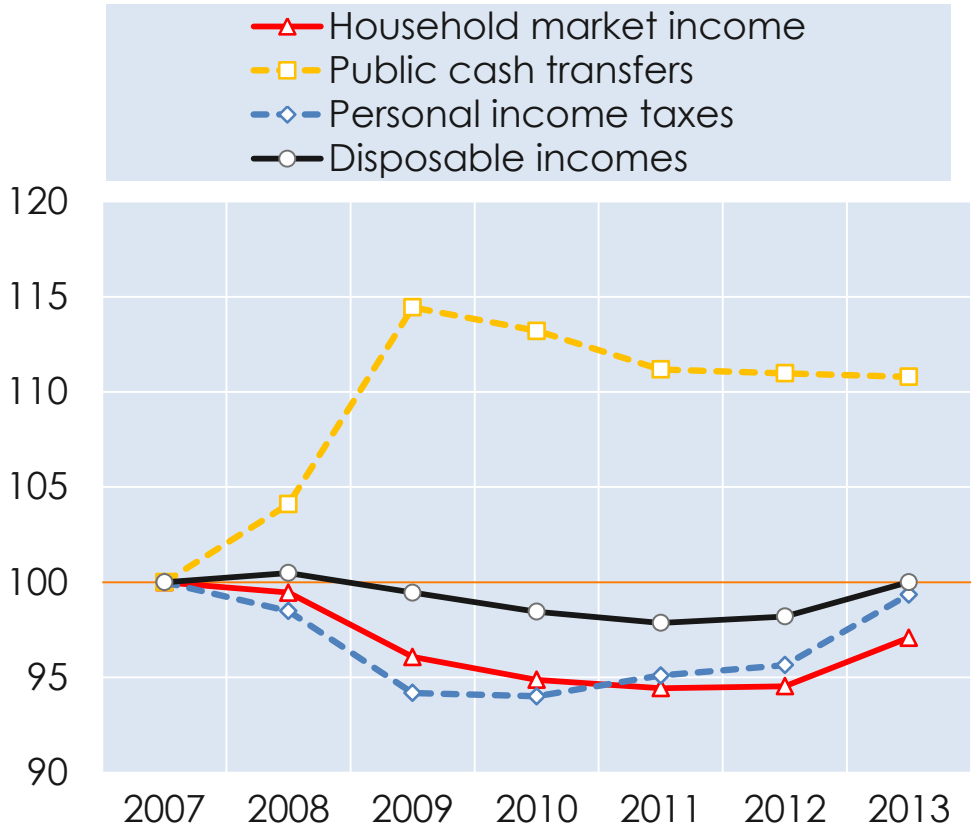
Change in levels of disposable and market incomes, public cash transfers and taxes

2007=100, working age population, OECD average



Source: OECD (2016, forthcoming), *No light at the end of the tunnel? Economic recovery has not reduced inequality,* Policy note.

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

→ In many countries, households tended to gain from the policy changes implemented in 2008/09 and to lose from those in 20010/12. Effects in 2013 were less homogenous.

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

	2008	2009	2010	2011	2012	2013	2007-2013
Estonia	+	0	-	-	-	+	+
France	-	+	-	-	-	+	+
Germany	-	+	+	-	+	+	+
Greece	+	+	-	- -	-	- -	- -
Iceland	-	-	-	-	-	+	- -
Ireland	+	-	-	- -	-	-	- -
Portugal	+	+	-	- -	-	- -	- -
Spain	+	+	-	-	-	-	-
United Kingdom	+	+	-	-	-	-	-
United States	+	+	0	0	-	-	+
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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Why do we care about high and rising inequalities?

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

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

Higher inequality hinders skills investment by the lower middle class and lowers social mobility

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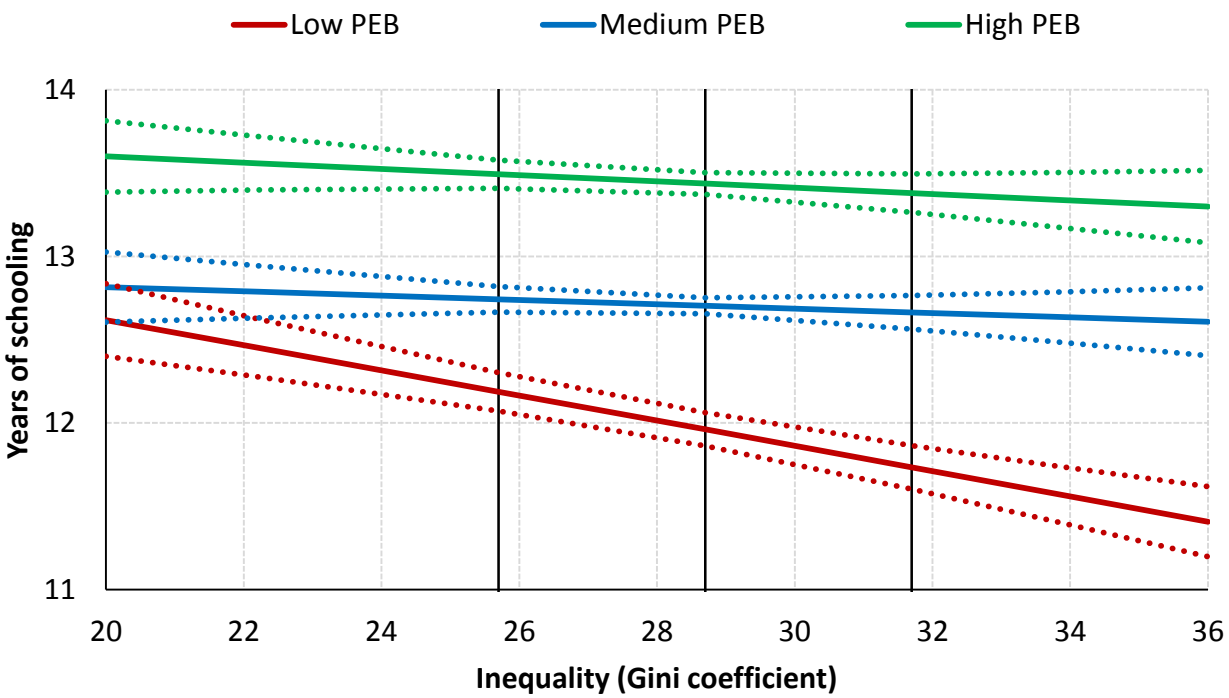
Inequality decreases average years of schooling, but mostly among individuals with low parental education

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



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

Increasing inequality by ~5-6 Gini pts. (the current differential between Austria and Italy) 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.

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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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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
- Design family friendly employment policies

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Some lessons for tax 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;
- Reviewing other wealth taxes such as inheritance taxes;
- Harmonising capital and labour income taxation;
- Increasing transparency and international cooperation on tax rules to minimise “treaty shopping” and tax optimisation;
- Reducing avoidance opportunities and thereby the elasticity of taxable income;
- Improving transparency and tax compliance, including efforts for automatic exchange of information between tax authorities.

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Thank you for your attention!

michael.forster@oecd.org

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

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