Rising inequality: features, causes, consequences and corrective policies

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Why has inequality come to the center of the public debate?

• Fast increase in inequality or lasting high inequality in key countries (e.g. US)
• The 'Great Gasby' bias: increasing mediacic attention to top incomes.
• The effect of 'austerity'
• "The social elevator does not work anymore"
• Presumption that inequality can 'easily' be corrected – through taxation or by changing the 'economic system'
• Hence the distrust towards the political establishment and the success of 'populist' discourse.

What's the state of play and what to do?
This lecture

• Is the perception that 'inequality is rising everywhere ' correct?
  – Differences across countries, periods and inequality concepts/measures
  – Differences between reality and perception
• The main causes of change in inequality
• The economic inefficiency of 'excessive' inequality
• Which corrective policies and constraints on them?
Outline

1. A tour d'horizon of the evolution of income inequality
2. The possible causes of changes in inequality
3. The economic cost of excessive inequality
4. How effective/efficient may be corrective policies
5. Conclusion
A summary of conclusions

1. Evidence: diversity of national situations, variability with respect to the concept/measure of inequality being used:
   - main common features: increasing GDP-share of capital income generating some unequalizing at the top of the income scale

2. Causes of changes. Multiplicity and heterogeneity of causes: there is more than globalization and technical change

3. Corrective policies: Addressing symptoms and/or causes
   - Need for international coordination
   - In many countries, progress can be made in some specific dimensions of inequality
1) A tour d'horizon of the evolution of inequality

a) Inequality of 'equivalized disposable income'
   - All people are imputed their household's disposable income per consumption unit

b) Other inequality concepts and sources:
   - Earnings, gross (market) income (top x %), wealth,
   - Non-monetary : inequality of opportunity
   - Horizontal inequality (gender, ethnicity, migrant status,..)

c) The functional distribution of income

Note: inequality fconsidered at national rather than global level
a) Inequality of 'equivalized disposable income'

- Mostly based on surveys and sometimes on administrative data
- In most OECD countries inequality is higher in the early 2010s than in 1985-1990, but *paths are different*
- Roughly true for emerging countries (BRICS) too
OECD Countries with rising inequality trends

Figure 1a. Inequality of equivalized household income, 1985-2012. Selected OECD countries with a rising inequality trend. (Gini coefficient)

Source: OECD
OECD Countries with one-step rise in inequality

Figure 1b. Inequality of equivalized household income, 1985-2012. Selected OECD countries with a one-step rise in inequality. (Gini coefficient)

Source: OECD
OECD countries with stable or falling inequality

Figure 1c. Inequality of equivalized household income, 1985-2012. Selected OECD countries with declining inequality. (Gini coefficient)

Source: OECD
Inequality in emerging countries (BRIICS)

Figure 1d. Inequality of equivalized household income, 1985-2012. BRIICS countries plus Colombia. (Gini coefficient)

Source: Povcalnet, World Bank
b) Other sources on inequality: top incomes

- Top income share in gross (market) income from tax data (WWID database: Alvaredo, Atkinson, Piketty, Saez, Zucman)
- Most OECD countries show trends which are often in contradiction with Gini coefficient on equivalized disposable income
Inequality measured by gross income share of top 1% (Tax data): OECD countries with rising trends

Figure 2a. Top 1% gross income share, 1985-2012. OECD countries with rising inequality trend

Source: WWID
Inequality measured by gross income share of top 1% (Tax data): Countries with stable trends
Top income and survey data

- Issue of reconciliation of tax data and household surveys:
  - Tax units vs households
  - Equivalizing
  - Missing people or missing income?

- Work in progress: rough linking of databases
  - Jenkins (2016) in UK: correction of Gini = + 7% at maximum (2008). Figure likely to be much smaller in continental European countries.
  - Correction probably small in countries where surveys are linked to administrative data
Other income inequality concepts and data sources

• Earnings

• Horizontal inequality

• Inequality of opportunity
c) The declining GDP-share of labor

Source: OECD
From the functional to the personal distribution of income

- Shift of GDP factor shares away from labor should imply more inequality
- Shift is more general than the G20:
  - Karabarbounis and Neiman (2013), Guerreiro (2012)
- Inequality increase may thus be under-estimated (or 'mis-estimated') in a number of countries
- Appropriately corrected by top incomes?
In summary

• Income inequality higher today than 25 years ago in a majority of countries (developed and emerging)
• Overall increase is probably under-estimated in a number of countries
• Inequality rise has *probably* been continuous in several countries, driven by the trend in the GDP-share of property income
• But the evolution of inequality remains heterogeneous across countries (even taking into account) top incomes
• Satisfactorily merging survey and tax income data is a research priority
• An important issue: evolution of the 'perceived' inequality
2) Causes of change in inequality

*Common vs. country autonomous unequalizing forces*

a) Globalization as an obvious common unequalizing force:
   - Trade in goods and services
     * Developed vs. emerging economies*
   - International mobility of capital and labor
   - Increasing capital share as a result of globalization (?)
   - Financiarisation

b) Technical progress as another common equalizing force:
   - Economies of scale (winner takes all)
   - Automation, artificial intelligence,.. seem to favor capital over labor
   - But aren't some aspects of technical change equalizing (information sharing correcting information asymmetries)
Causes of change ... (ct'd)

c) Autonomous sources of change:
   – Regressive reforms of redistribution systems (taxation)
   – Deregulation
   – Demographics (migration, household composition, assortative mating, ..)
   – Macro-economic shocks
   – Sectoral changes (developing countries, Kuznets mechanism)

Remarks:
   – Several 'autonomous' factors indirectly linked to 'globalization'
   – Some have been clearly dominant in several countries
   – What type of change matters most: common or autonomous?
3) The cost of 'excessive' inequality

a) Economic costs
- Depressive effect through the demand side
  - One of the causes of the Great Recession?
- Inefficiency of the inequality of opportunity
  - Unexploited economic potential
- Endogenous distortive redistribution
  - Taxation (Meltzer-Richard), violence (?)

b) Non-economic costs
- 'Populism' (but, is it inequality or other type of exclusion?)
- Self-reinforcing rise in inequality through intergenerational transmission - multiple equilibrium stories à la Acemoglu-Robinson

How much is too much inequality?
The ambiguity of reduced form cross-country/panel empirical work (OECD)
4) Corrective policies

Two key questions:

- Are we fighting against 'too high inequality' or 'rising inequality'?
- Should policies address symptoms (downstream) or causes (upstream) or both?

Clearly, if the issue is 'rising inequality', policies should address causes (and symptoms if they feed back on causes)
Corrective policies (ct'd)

a) **Downstream**

i. Progressive income taxation
   – Theory and empirical evidence on past reforms suggest that top marginal tax rates are below optimum
   – Uncertainty about the evolving mobility of the tax base due to globalization
   – Political economy factors
   – Recent progress in transparency (FATCA, AEOI, BEPS, ..) may give back some autonomy to national governments

ii. Cash transfers and social assistance
   – Insufficient in several countries but no strong external constraint

iii. Capital taxation
   – Same issues as for income taxation
Corrective policies (end)

b) **Upstream**

i. Equalizing opportunities (to reduce inequality or the transmission of inequality)
   - Equalizing educational achievement
   - Fighting segregation and discrimination
   - Inheritance taxation (same problem as income taxation)

ii. Regulation of key markets: finance, labor, patents and IPR, utilities, monopolies, ..

iii. More generally, identify *unequalizing market failures* and remedies

*Notes:*  
- This does not address the issue of a constantly changing context due to technical change and innovations
- Need for international coordination in a few cases (e.g. regulating finance)
Conclusion

• Inequality may be on a rising trend in a number of countries, not only the US, even though at slower speed
  – This needs to be confirmed and the cause (technical change?) better identified so as to design the adequate policies
• Otherwise, bringing inequality back to earlier lower levels often socially and economically desirable (... and desired!)
• Maintaining or improving the equality of opportunities and the 'social elevator' as a parallel and autonomous goal
• The importance of the growth context for the perception and the social sensitivity to inequality
• Inequality corrective policies call for international cooperation in several areas
Grazie mille per la vostra attenzione