

# Rising inequality: features, causes, consequences and corrective policies

François Bourguignon  
Paris School of Economics

Lecce, SIEP 2016

# 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 mediatic 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

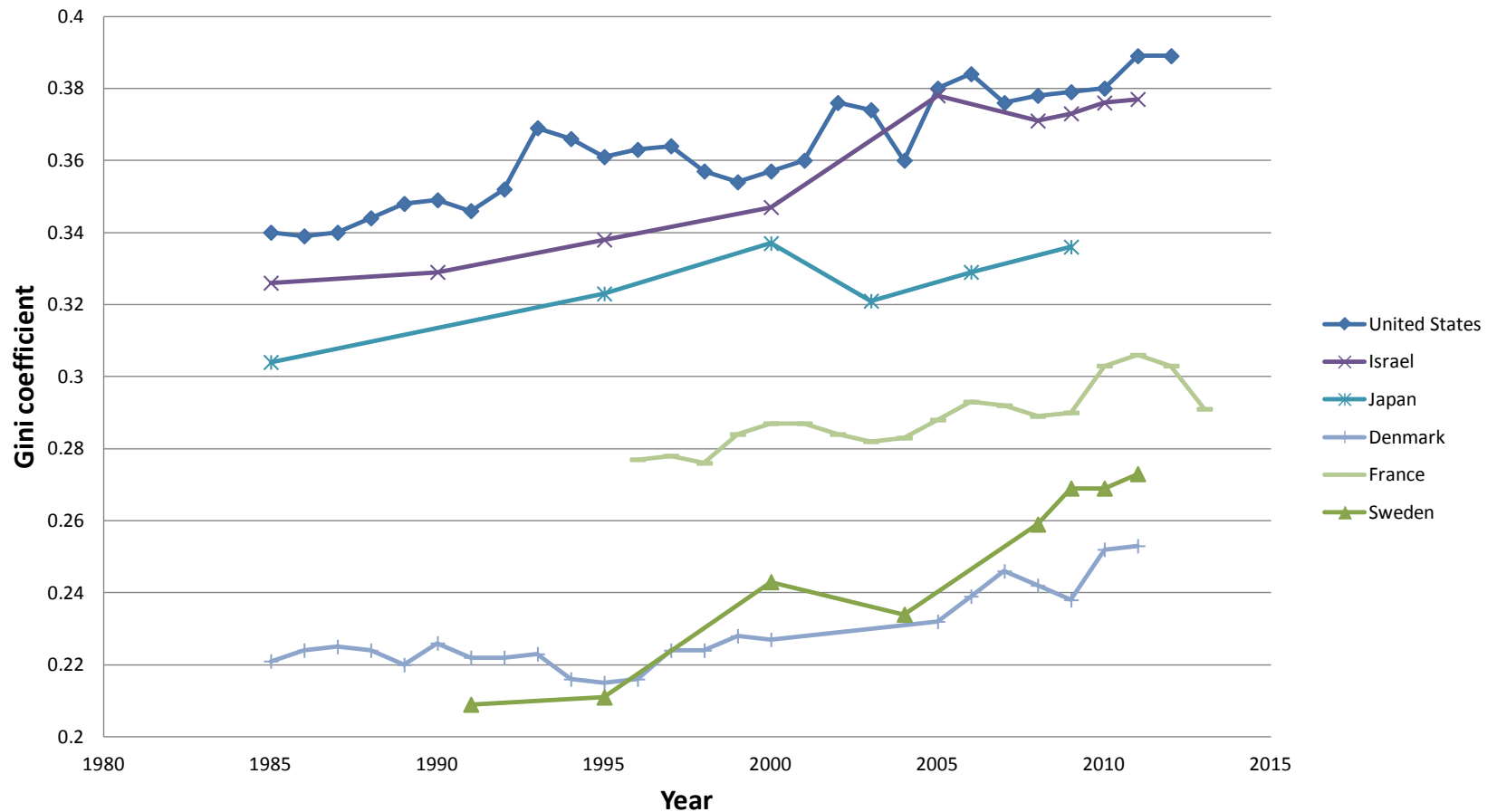
*Note : inequality fconsidered at national rather than global level*

## 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

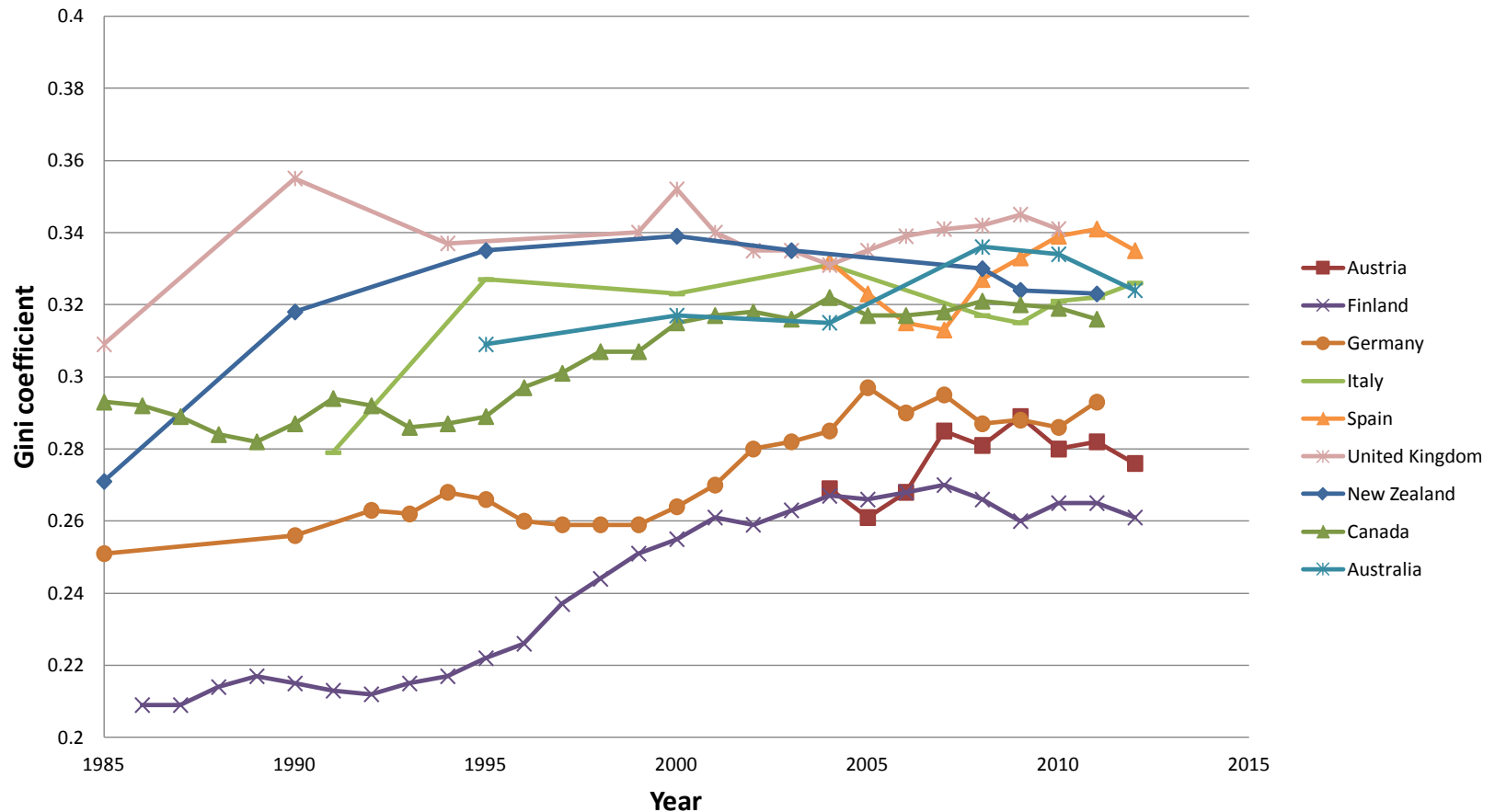
**Figure 1a. Inequality of equivalized household income, 1985-2012. Selected OECD countries with a rising inequality trend.**  
(Gini coefficient)





# OECD Countries with one-step rise in inequality

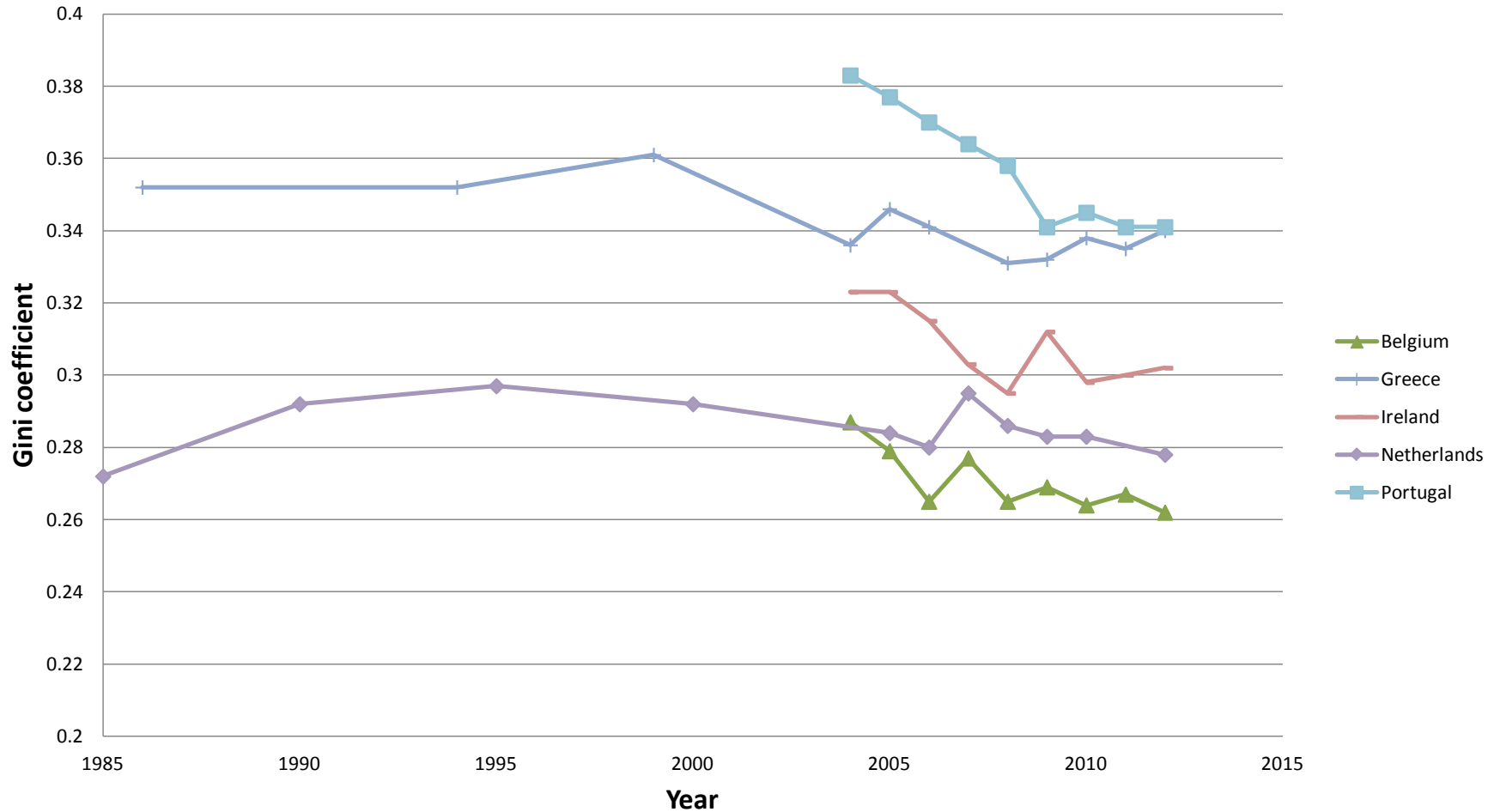
**Figure 1b. Inequality of equivalized household income, 1985-2012. Selected OECD countries with a one-step rise in inequality.  
(Gini coefficient)**



Source: OECD

# OECD countries with stable or falling inequality

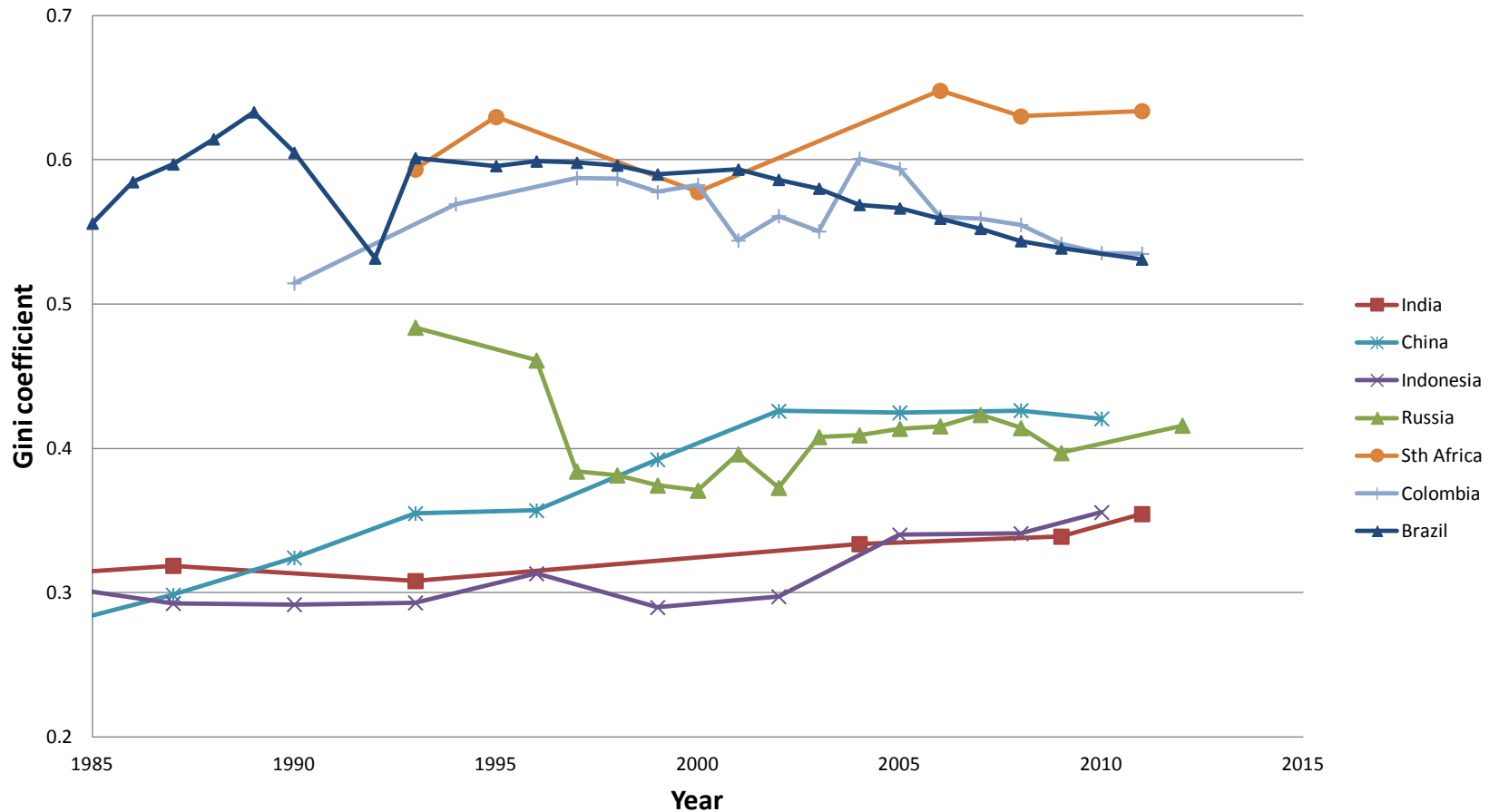
**Figure 1c. Inequality of equivalized household income, 1985-2012. Selected OECD countries with declining inequality.  
(Gini coefficient)**



Source: OECD

# Inequality in emerging countries (BRIICS)

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



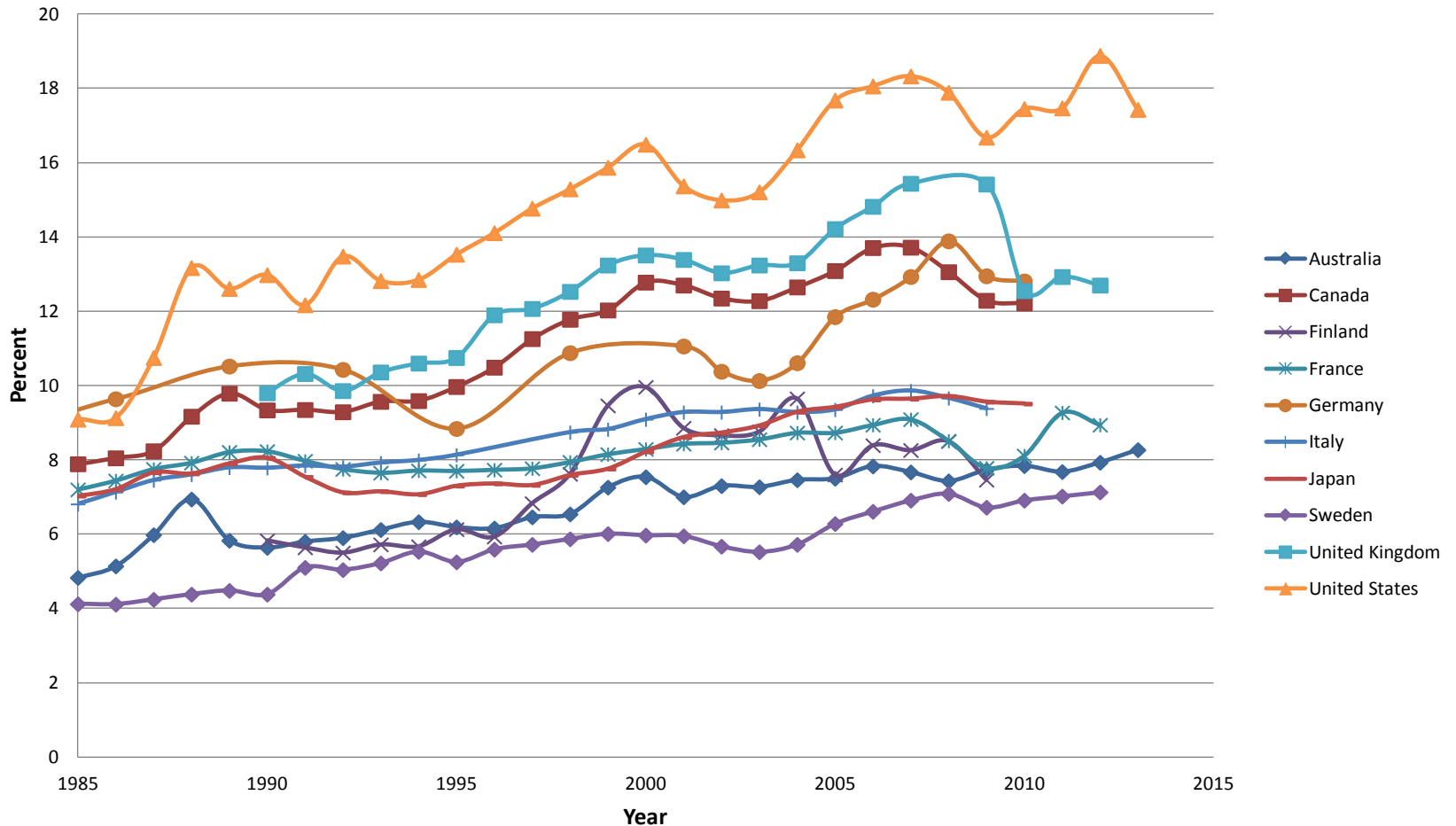
Source: Povcalnet, World Bank

## 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

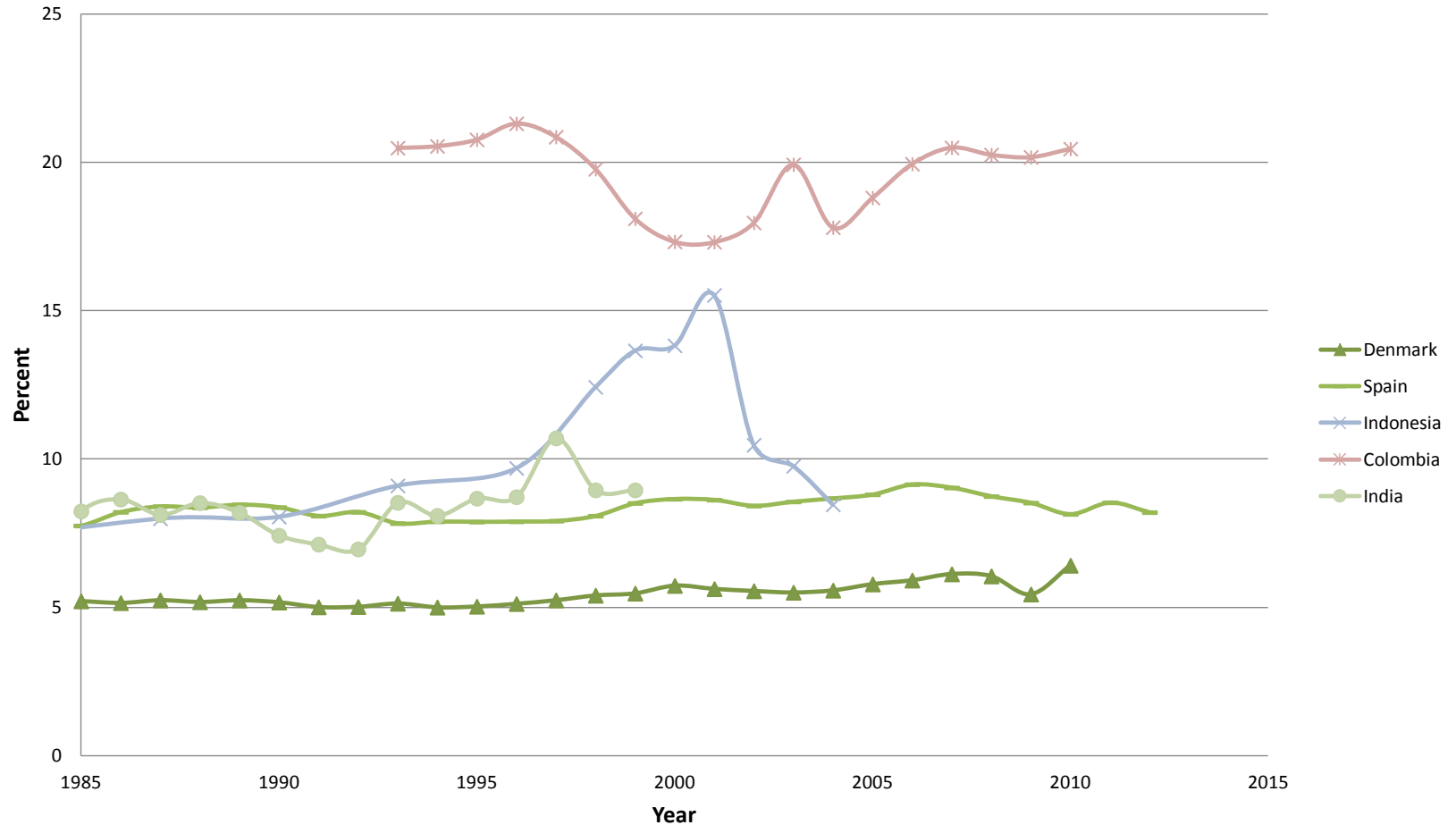
**Figure 2a. Top 1% gross income share, 1985-2012. OECD countries with rising inequality trend**



Source: WWID

# Inequality measured by gross income share of top 1% (Tax data): Countries with stable trends

**Figure 2b. Top 1% gross income share, 1985-2012. Selected OECD countries with stable inequality and selected emerging countries**



Source: WWID

# 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

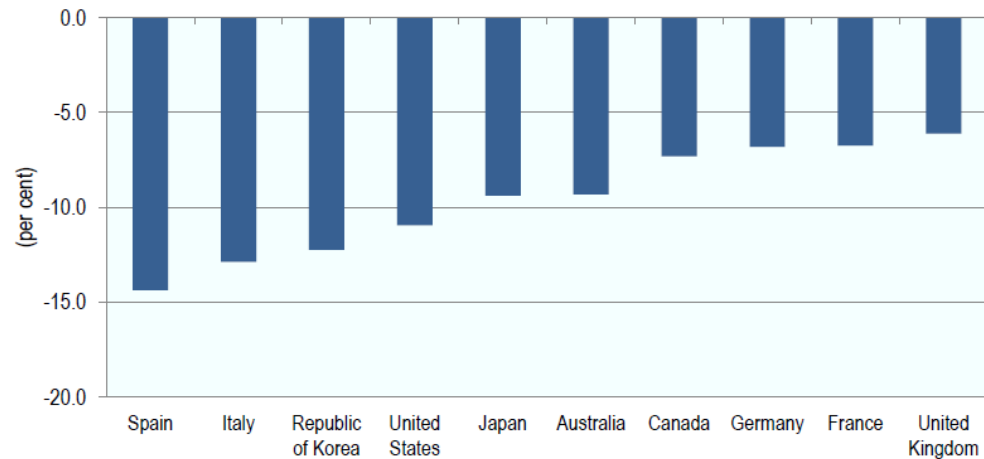
- Earnings
- Horizontal inequality
- Inequality of opportunity



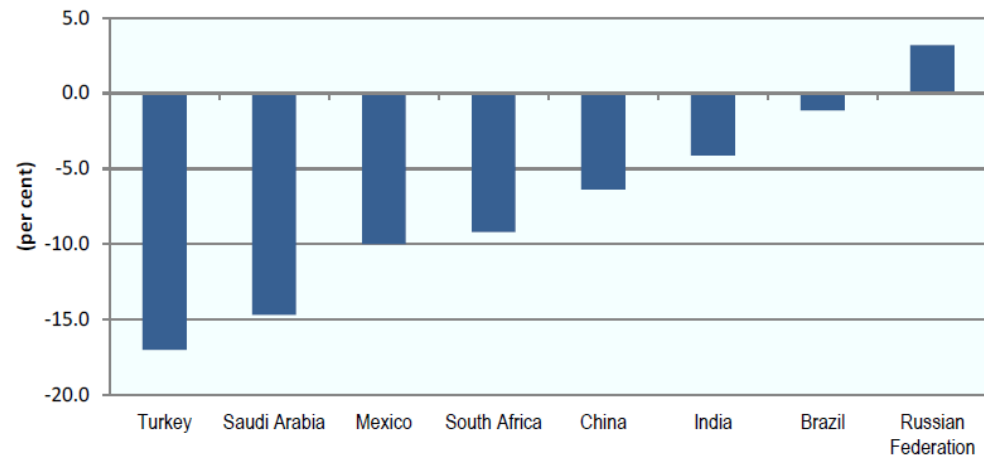
# c) The declining GDP-share of labor

**Figure 3. Changes in labour shares in G20 countries (plus Spain)**

**Panel A. Advanced economies 1970-2014**



**Panel B. Emerging economies 1995-2012**



# 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