INCOME INEQUALITY
The Gap between Rich and Poor

Keeley, B. (2015), Income Inequality: The Gap between Rich and Poor, OECD Insights, OECD Publishing, Paris

Income inequality has been rising in many wealthy countries in recent decades. In the 1980s, the average disposable income of the richest 10% in OECD countries was around seven times higher than that of the poorest 10%; today, it's around 9½ times higher.

In countries like India, China and Brazil, there has been the sharp fall in the number of people living in absolute poverty and the emergence of a new middle class. However, relative poverty is proving stubbornly resistant and inequality, too, is widening.

In Asia, income inequality has grown in a number of the region's economic powerhouses, including China, India and Indonesia; in China, it rose by about 1.6% a year in the two decades following 1990.

In the United States between 1975 and 2012, around 47% of total growth in pre-tax incomes went to the top 1%. The share was also high in a number of other (mostly) English-speaking countries: 37% in Canada and over 20% in Australia and the United Kingdom.

The average Gini value* across OECD countries is 31.5 points, although there is quite a lot of variation between countries. The societies with the lowest levels of inequality, Slovenia and some of the Nordics, score around 24 to 28 Gini points; the most unequal societies, such as Mexico and Chile, score around 45 points.

Inequality is particularly high in Chile, Israel, Mexico, Turkey and the United States, and particularly low in Denmark, Norway, the Slovak Republic and Slovenia.

Since the late 1990s, the engine of the world economy has moved from the traditionally wealthy OECD countries to developing and emerging economies – a phenomenon sometimes called "shifting wealth", leading to the emergence of a new middle class. China and India are the most famous examples.

About the Report: Understanding Inequality

High inequality slows economic growth and reduces social mobility. Striking variations in inter-country income inequality is reflected in two factors:

- Size of the gap between the highest and lowest salaries in a country
- Extent to which the state redistributes income through taxes and benefits.

Income inequality has also risen in developing economies, even during a period that has seen sharp falls in extreme poverty and the emergence of a new, albeit fragile, middle class.

Causes of Growing Income Gaps

Globalization, and in particular the impact of technology on the workforce.

Shifts in the workplace – more people are now working part-time and on temporary contracts and fewer are in unions. The state's role has evolved, too, with a general tendency towards less redistribution.

Performance pay, shifting pay expectations and changes in tax policy contribute towards rise of top incomes.

Why is inequality higher in some countries than in others?

Wage gap (or "wage dispersion") – The gap between the wages of high and low-income workers. Nordic countries (Denmark, Iceland, Norway, and Sweden) and Switzerland all have below-average inequality and below-average poverty. Unemployment is low and the wage range is relatively narrow – very high wages are relatively rare.

Role of the state - State takes income in the form of taxes and hands it back in the form of transfers. Nordic countries receive cash transfers from the state, and income taxes are strongly progressive.

Chile, Israel, Mexico, Portugal, Turkey and the United States, with relatively high income inequality, have a high wage gap and the state often provides less in the way of cash transfers.

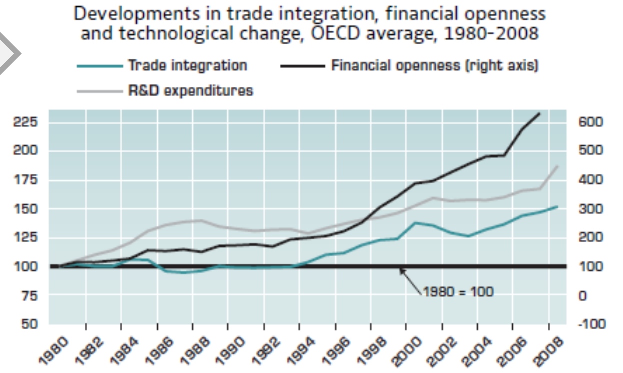
Key Findings:

- Compared to 1981, worldwide there are now around 650 million fewer people living in extreme poverty (less than $1.25 a day) – even though, over that same period, the global population rose by about 2 billion. But while absolute poverty has fallen in much of the developing world, relative poverty has not reduced.
- Countries that have made the biggest contributions to reducing poverty also have very high levels of inequality. One consequence of these trends is that most of the world's poorest people no longer live in the world's poorest countries.
- About three quarters of the world's 1.3 billion poorest people now live in what the World Bank classes as middle-income countries (MICs), most notably India.

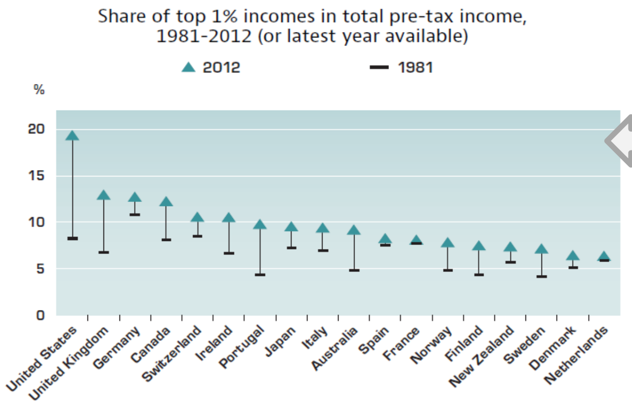
Why is Income Inequality Rising?

Globalization: Globalization can be a divisive issue, and polls suggest that in many parts of the world there's a perception that its benefits are not being enjoyed equally across societies. In many developed countries, there's also a perception that aspects of globalization, such as outsourcing by businesses, are costing jobs and driving down incomes.

Data: The pace of globalisation – represented here by rising trade, the opening of financial markets and technological progress – sped up in the mid-1990s.



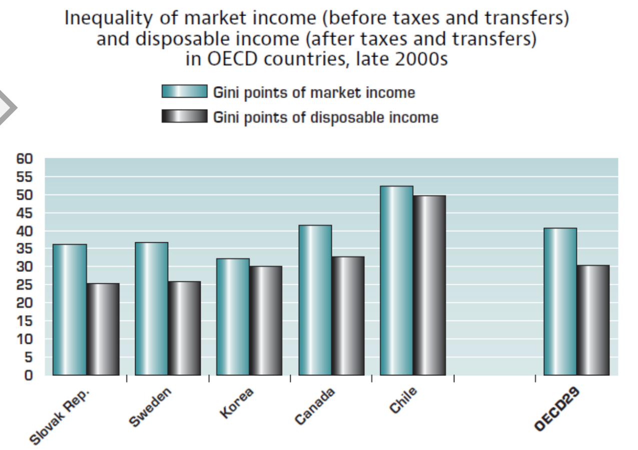
Data: Top earners have increased their share of total earnings in most OECD countries since the 1980s.



In the decade to 2007, real household income increased by an average of 1.2% a year in the United States. But when the top 1% of earners is excluded, that figure falls to 0.6%. In effect, the 1% took 58% of the gain in real incomes. So, what looked to be an overall improvement in the population's economic well-being actually benefited a much smaller group than the broad figures seem to suggest.

Taxes and Transfers: Up to the mid-1990s, taxes and transfers were tending to play a growing role in reducing inequality. But in the middle of that decade the pattern began to reverse. A key change seems to have come on the transfers' side, especially a decline in spending on unemployment benefits. Unemployment fell, so fewer people were claiming benefits, while rules for claiming benefits were tightened. Similarly, some of the impact of fall in taxes was cushioned by the fact that income taxes also became more progressive – if taxes fell on better-paid workers, they fell even more on lower-wage workers. On the other hand, very high earners ("the 1 %") seem to have bucked this trend towards increasingly progressive taxation, enjoying a very considerable fall in their tax burden.

Data: The taxes that workers pay to the state, and the transfers they receive, do much to narrow the earnings gap in OECD countries.



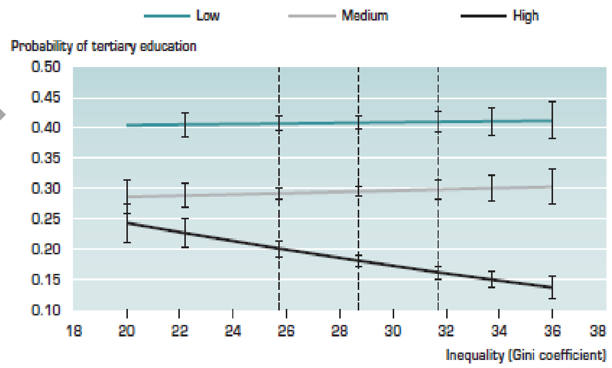
Is Inequality Good or Bad for Growth?

Inequality drives growth as it allows for entrepreneurs to enjoy the rewards of their risk-taking. Proponents of the second option – light tax and relatively little redistribution – support their case with two arguments. First, allowing people to accumulate wealth means they become sources of investment for the economy. Second, there may be a trade-off between inequality and economic efficiency – attempting to reduce inequality beyond a certain level may lead a society to use its economic resources less efficiently than it could do.
However, the idea that there is a trade-off between inequality and efficiency is increasingly criticized, and there is rising evidence that excessive inequality is bad for growth.

Numeracy Skills: As inequality rises, there is little change in the numeracy skills of people from well-off and middle-income backgrounds. However, there is a substantial decline among poorer people. This effect is visible not just in math skills. It can also be seen in the length of time people spend in education and employment – rising inequality has little impact on the numbers of people from better-off and middle-income families who graduate from university or on how they do in the job market. The same is not true for people from poorer backgrounds. As inequality rises, they become less likely to graduate from university and more likely to endure periods of unemployment.

Data: As inequality rises, numeracy skills of poorer people decline.

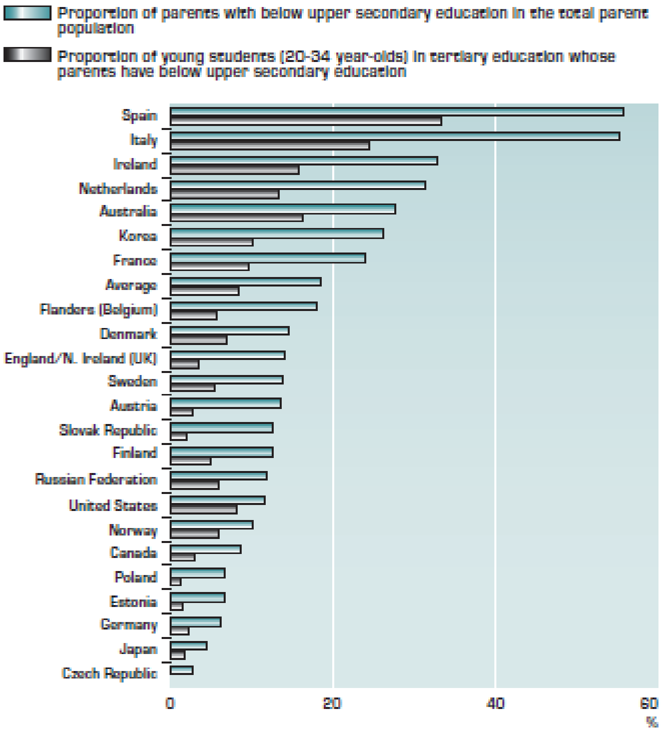
Average numeracy score by parental educational background (PEB)



Source: OECD (2015), *In It Together: Why Less Inequality Benefits All*, *http://dx.doi.org/10.1787/888933207742*.

Data: Young people whose parents didn't finish secondary education are themselves underrepresented in university-level education, indicating that inequalities in access to education persist from one generation to the next.

Participation in tertiary education of students whose parents have below upper secondary education (2012)



Source: OECD (2014), *OECD Education at a Glance 2014*, *http://dx.doi.org/10.1787/888933115654*.

Social Divisions in Classroom: Education systems, too, can reinforce social distinctions by offering a lower quality of education or a narrower range of options to children from disadvantaged families. For example, schools with large numbers of disadvantaged students tend to find it harder to attract qualified teachers, even though – or, perhaps, because – the challenges of teaching children from disadvantaged families may be greater. The impact of social background on students is clearly evident in results from PISA, which surveys the performance of 15-year-old students worldwide in more than 65 countries. Across OECD countries, students from better-off families are almost a year ahead on average in math compared to students from poorer families, according to PISA 2012.

Society: Inequality may hold people down: In PISA 2012, around 6% of disadvantaged students were "resilient" – in other words, they overcame social disadvantage to perform well in PISA. But in some countries, notably in East Asia, the proportion of resilient student was at least double this. These findings suggest that the right policies can do much to reduce the impact of social background in education.

Read the full report at the official website: http://dx.doi.org/10.1787/9789264246010-en