Income Inequality and Public Policy

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Outline

• Introduction: following Piketty!
• What has happened to income inequality in rich countries over past 30 years, and why?
• What has been the impact of the Crisis?
• Why should increasing inequality be addressed?
• What can public policy do?
Core Concern

• There is widespread concern that
  – income inequality increasing across OECD, driven inexorably by technological change and globalisation
  – accelerated by the Economic Crisis and its aftermath
  – higher/increasing income inequality produces
    • more family fragmentation and crime,
    • poorer health and greater health inequalities,
    • less social solidarity and cohesion,
    • reduced intergenerational mobility and greater inequality of opportunity
  – threatens democratic politics
  – and undermines future economic growth, prosperity
Capturing Income Inequality Trends

• Inequality in terms of household net income
  – Sum of labour earnings, investment and property income, cash transfers less income taxes and social insurance contributions, adjusted for household size
  – not consumption expenditure, wealth, ‘happiness’, or ‘capabilities’

• ‘Non-cash benefits’ from social expenditure not included

• Rely mostly on survey data – but top incomes estimated from tax data

• Income inequality measured in various ways –
  – Gini coefficient most widely used, range among industrialised countries c. 0.20-0.40
Income Inequality Trends

• OECD has assembled data from countries for 1985, 1990, 1995 .......

• Shows income inequality trending upwards from 1980s in many OECD countries
  – Up in 2/3rds OECD countries from mid-1980s to mid-2000s
  – “Moderate but significant” rise – [Growing Unequal, 2008]
  – Average Gini coefficient for working-age households across OECD up from 0.29 in 1980 to 0.316 by 2009

• Comparative micro-data on income inequality from Luxembourg Income Study, also in ‘waves’ rather than annually, shows similar though not identical picture
Inequality Trends in OECD

Trends in inequality of disposable income, working age
The ‘GINI’ Research Project

• FP7 project to capture and understand income inequality trends and their impacts
  – two books from Oxford University Press end-2013
• Studied 30 countries over 30 years 1980-2010
• Assembled, analysed annual data on income inequality, social and political outcomes, policies (also studied wealth, education)
Income Inequality Trends: Top Incomes

• Household surveys cannot capture incomes right at the top of the distribution
• Major advance in knowledge due to recent use of income tax administration data to study shares of top 1%, 0.1%
  – Atkinson, Piketty, Saez
• Data now available for wide range of countries in *World Top Incomes Database*
• ‘1%/99%’ distinction now in common use
• Estimates are for gross incomes, and not aligned with survey data for overall inequality
Top income shares. 1910-2012
Sources: The World Top Incomes Database. http://topincomes.g-mond.parisschoolofeconomics.eu/

- Top 1% income share (France)-Piketty (2001, 2007); Landais (2007)
- Top 1% income share (Germany)-Dell (2007)
- Top 1% income share (Ireland)-Nolan (2007)
- Top 1% income share (Netherlands)-Salverda & Atkinson (2007); Salverda (2007)
- Top 1% income share-married couples & single adults (United Kingdom)-Atkinson (2007)
- Top 1% income share-adults (United Kingdom)-Atkinson (2007)
- Top 1% income share (United States)-Piketty & Saez (2007)
Size of ‘Middle’ (75-150% of Median) Income Group Over Time, Selected OECD Countries
Derived from LIS and EU-SILC (CREDOC)
Income Shares of ‘Middle’ (Deciles 3-7) Over Time, Working Age Households, Selected OECD Countries
Derived from OECD Database
Factors Driving Inequality Trends

• Increasing inequality in market income among households is key
  – related to increased dispersion in individual earnings (75% of household income), and to technology, globalisation, and institutional change
  – income from self-employment and capital also contributes
  – other factors, incl. age and household structures contribute – e.g. more single person households
  – multiple earners concentrated towards top

• Reduced redistribution via tax/transfers also contributes
  • especially in latter half of period

• Special factors at work at top of distribution
  • changing remuneration practices for top executives incl. link to stock market, financial sector, changing norms?
The ‘Great Recession’ and Inequality

- Worst downturn since 1930s, but no ‘rule’ for inequality trend during recessions
- Jenkins, Brandolini, Micklewright and Nolan eds. (OUP, 2014) highlight
  - heterogeneity in impacts on GDP, employment
  - changes in income from capital vs labour
  - social transfers and taxes cushion initial impact on household disposable incomes via automatic stabilisers and delayed reaction, policy mixes adopted then vary across countries/over time
  - Some groups – notably elderly – protected relatively well
Change in Market and Disposable Income Inequality 2007-2011, OECD Countries

Market income inequality (↗)
Disposable income inequality
Striking Variation across Countries

• In extent and pacing of inequality increase
  – Little higher in 2008 than 1980 in certain countries (France, Belgium, Austria, Ireland, Mediterranean)
  – Very substantial increase in Nordic countries, more than in ‘liberal’ regime countries (better measurement?)
  – Increase in some countries was in discrete ‘episodes’
    • 1980s for UK
    • 1995-200 for Canada
    • 2000-05 for Germany
  – Transition countries had very different experiences
  – Crisis had very different effects in different countries
Striking Variation across Countries

• In patterns of increase in inequality
  • Almost all countries where inequality rose saw gains in share of top decile at expense of rest
  • But scale of that increase, and extent to which ‘upper middle’, lower middle or bottom lost out, varies

• In market income and role of redistribution
  • Market income inequality rose exceptionally rapidly in UK, whereas reduction in market income Gini by transfers + tax fell in Sweden from 45% to 39% and in Netherlands from 38% to 31%, rose in UK and was stable in USA

• In policy impacts more broadly
  • Significant policy ‘drivers’ of inequality - Hartz reforms in Germany, in-work versus non-working transfers in Sweden, UK labour market

• In relationship to evolution of real incomes
‘Middle’ (Deciles 3-7) Real Income Change Over Time, Working Age, Selected OECD Countries
Derived from OECD Database, Price Adjustment: CPI
Some Implications

• Data matters – divergences across sources significantly complicates understanding
• Forces driving increases in market income inequality have had widespread impact, but country-specific institutions, contexts and responses very important
• Direct redistribution policies via taxes and transfers still central to distributional outcomes
• Scope for policy to affect distribution of market income considerable and could be expanded
Why Address Rising Inequality?

• Can be motivated by normative views about what is ‘fair’
  – e.g. CEO should not earn 120 times pay of ‘ordinary worker’
• By concerns about its impact on poverty and exclusion
• By concerns about impact on social outcomes
  – family breakdown, crime, health
• By concerns about impact on political engagement, processes and democratic functioning
• By belief that it increases barriers to intergenerational mobility, so equality of opportunity more distant
• By concerns that it may undermine economic growth and prosperity
Inequality and Poverty

• Relative income poverty broadly associated with level of inequality
  • but poverty varies among countries with similar inequality
• Relationship between trends in income inequality and in relative income poverty looser, variable
  • nature of inequality increase key
• Poverty measured against ‘anchored’ income benchmarks more closely linked to trends in average/median income
• Differences in material deprivation across countries and over time also strongly related to average income, with income inequality having much modest role
Inequality and Social Outcomes

- Income inequality can explain little of dramatic change in family structures in recent decades
- Crime rates not strongly linked to inequality, but more unequal societies may be more punitive
- Levels of social solidarity and trust, and status anxiety, may be weakly related to inequality
- Health gradients/inequalities may increase with income inequality while population health improves
- Intergenerational mobility may be higher in lower-inequality countries, but no firm evidence that increasing inequality has generated lower mobility
Inequality and Politics

• Increasing inequality is associated with increase in preferences/demands for redistribution
• ‘Discontent’ with inequality rises as inequality rises, but only moderately because
  – extent of increasing inequality not fully recognised
  – some increase in acceptability of higher inequality
  – ‘salience’ of inequality may be less
• Higher inequality is associated with lower civic participation, lower turnout among poor
• Increasing income/wealth concentration => greater political influence for rich
Inequality and Equalising Opportunity

• Intergenerational mobility appears to be higher in lower-inequality countries, at least in terms of income

• but no firm evidence that increasing inequality has generated lower mobility as yet
  • Robust debate in UK, based on interpretation of cohort studies, between teams of economists who see decline in mobility and sociologists who do not
  • Conflicting studies for USA, with latest (Chetty et al., 2014) finding no evidence of changes in mobility comparing cohorts from 1970s, 1980s and 1990s
Inequality and Economic Growth

• Combined with stagnating real incomes, may have fuelled credit boom and Economic Crisis

• May be dampening recovery and contributing to ‘secular stagnation’ via reduced aggregate demand
  • Rich have lower marginal propensity to consume, middle and lower incomes dealing with debt overhang

• In longer term, could
  • contribute to boom-bust cycle and retard investment
  • impede education and skill upgrading and increase barriers to socio-economic mobility, reducing productive workforce

• Could also
  • entrench elite capture and rent-seeking
  • fuel demands for protection and stifle innovation
  • undermine institutions critical for sustained growth
Addressing Increasing Inequality

• Distributional role of social provision via health services, education etc. difficult to capture (esp. over time) but crucial

• Focusing on disposable income, potential policy levers include:
  – Strengthening direct redistribution
  – Influencing wage setting
  – Social Investment
  – Other
Policy Options: Strengthen Redistribution

• Via taxes
  – more progressive income tax (incl. SI) structures
  – reverse shift towards indirect taxes
  – treatment of income from capital and/or capital gains
  – increase capacity to tax corporate profits
  – increase property taxes (including gifts and inheritance)
  – target tax havens/improve international co-operation

• Via transfers
  – restructure/reinforce transfers to working families
  – Improve family/child benefits
  – strengthen safety-nets in terms of coverage and adequacy
Policy Options: Wage Setting

• Introduce/raise minimum wages
  – Germany now introducing MW, UK debating less cautious approach to setting level

• Encourage payment of ‘Living Wage’ – in private sector for companies that can afford it and in public sector

• Direct constraints on ‘top pay’ – bankers’ bonuses, CEO pay

• ‘Nudges’ to limit top pay via codes of conduct, public procurement requirements, promote move away from short-term link of remuneration to share price

• Collective bargaining institutions and practices
Policy Options: ‘Social Investment’

• Increase spending on/availability of/quality of early childhood education

• Improve (supports for)
  – completion of secondary level
  – proportion going on to tertiary level
  – proportion completing 3-4 year degrees
  – vocational education incl. apprenticeships

• Address multiple barriers facing disadvantaged throughout education

• Improve design and effectiveness of re-training/active labour market policies
Policy Options: Other

- Widen distribution of wealth/ income from capital
- Seek to influence sectoral and regional pattern of growth
- Seek to influence nature of technological change
- Seek to influence family structures
- Reduce influence of wealthy on political process by changes in funding etc.
- Influence migration
- Increase protection of industries/sectors/regions
Inequality and Public Discourse

- Assumption that growth will automatically ‘trickle down’ to disadvantaged, and that greater inequality promotes growth and social mobility, now dispelled
- In highlighting instrumental concerns about specific (potential) impacts of higher inequality, important not to lose sight of broader normative underpinnings
- Public policy has a range of levers available
- Job creation and education and upskilling have to play a major role but should be seen as representing elements in a much more encompassing strategy