On Dagum’s Decomposition of the Gini Coefficient

by

William Griffiths

Department of Economics
The University of Melbourne
Melbourne Victoria 3010
Australia.
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University of Melbourne

Abstract
To measure the contributions to inequality from population subgroups, the Gini coefficient is often decomposed into inequality within groups, inequality between groups and a residual term arising from the overlapping of income distributions from different groups. In this paper we show that two decompositions presented separately in the literature, a traditional decomposition and a decomposition suggested by Dagum (1997), are identical, a fact not previously acknowledged in the literature.

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Author information
William Griffiths
Department of Economics
University of Melbourne 3010
Vic., Australia
Email: wegrif@unimelb.edu.au
Ph: +613 8344 3622
Fx: +613 8344 6899

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1. Introduction

When using the Gini coefficient to measure inequality, it is frequently of interest to assess the contributions to inequality from within and between designated population subgroups. For example, in countries like India and China who have experienced recent rapid growth, it is common to examine inequality within and between rural and urban population subgroups. When studying the global distribution of income (see, for example, Milanovic 2002), the contributions of inequality within countries and between countries to overall global inequality are of interest. To measure inequality between and within populations subgroups, a number of authors have suggested ways to decompose the Gini coefficient into within and between components, and these components have been given various interpretations. Examples of articles that do so are Dagum (1997, 2008), Deutsch and Silber (2008), Lambert and Aronson (1993), Sastry and Kelkar (1994), van de Ven et al (2001), Silber (1989), Yitzhaki (1994) and Yitzhaki and Lerman (1991). This list is not exhaustive; details of earlier contributions can be found in the reference lists of these papers.

In this paper we focus on two decompositions of the Gini coefficient, one that we call the traditional decomposition (e.g., Silber 1989, Lambert and Aronson 1993) and a second that we call the Dagum decomposition (Dagum 1997). We show that these two decompositions are identical, a fact that seems to have been overlooked in the literature. More specifically, the traditional decomposition can be written as

\[ G = G_w + G_b + G_R \]  (1)

where \( G_w \) denotes within-group inequality, \( G_b \) denotes between-group inequality and \( G_R \) is a residual which is positive when some of the subpopulation income distributions overlap. More precise definitions are given below. Dagum writes his decomposition as

\[ G = G_w + G_{nb} + G_t \]  (2)

where \( G_w \) denotes within-group inequality, \( G_{nb} \) measures the net contribution of between-group inequality, \( G_t \) measures the intensity of the “transvariation” between subpopulations, and \( G_{gb} = G_{nb} + G_t \) measures the gross contribution of between-group
inequality. Again, more precise definitions are given later in the paper. We observe that the definitions for $G_w$ and $G_w$ are the same. That is, $G_w = G_w$. What we establish that has not been previously acknowledged in the literature is that $G = G_{nb}$. It follows that $G_R = G_i$ and hence the decompositions are identical. Thus, when Dagum (1997) refers to his work as “A New Approach to the Decomposition of the Gini Income Inequality Ratio”, it is true that he describes a new approach, but it is not true that he provides a new decomposition. Moreover, when Gertel et al (2008) describe their work as “…applying the Dagum decomposition analysis of the Gini ratio”, they could equally have referred to it as the traditional decomposition.

In Section 2 we describe the traditional decomposition. The Dagum decomposition and its equivalence with the traditional decomposition are considered in Section 3.

2. The Traditional Decomposition

Suppose for the sake of exposition that the subpopulations are countries and that there are $K$ of them which make up the total population that we call a region. Let $\mu_i$ denote mean income for the $i$-th country and $\lambda_i$ denote the population share of the $i$-th country. Then mean income for the region is $\mu = \sum_{i=1}^{K} \lambda_i \mu_i$ and the income share for the $i$-th country is $s_i = \lambda_i \mu_i / \mu$. In the traditional decomposition $G = G_w + G_b + G_R$, the contribution of within-country inequality is given by a weighted average of the Gini coefficients for each of the countries, with weights given by the products of the population and income shares. That is,

$$G_w = \sum_{i=1}^{K} \lambda_i s_i G_i$$

where $G_i$ is the Gini coefficient for the $i$-th country.

Between country inequality $G_b$ is the Gini coefficient that would be obtained if everybody in a given country was given the mean income for that country. To obtain
what will be a convenient representation for $G_B$, some more notation is needed. Let $y_{ih}$ be the income of the $h$-th income unit in country $i$, let $n_i$ be the number of income units in country $i$, and let $n = \sum_{i=1}^{K} n_i$ be the number of income units in the region. Then, the Gini coefficient for the complete region can be written as

$$G = \frac{1}{2n^2 \mu} \sum_{i=1}^{K} \sum_{j=1}^{K} \sum_{h=1}^{n_i} \sum_{k=1}^{n_j} |y_{ih} - y_{jk}|$$

Replacing $y_{ih}$ and $y_{jk}$ by their country means $\mu_i$ and $\mu_j$ yields

$$G_B = \frac{1}{2n^2 \mu} \sum_{i=1}^{K} \sum_{j=1}^{K} \sum_{h=1}^{n_i} \sum_{k=1}^{n_j} |\mu_i - \mu_j|$$

$$= \frac{1}{2n^2 \mu} \sum_{i=1}^{K} \sum_{j=1}^{K} n_i n_j |\mu_i - \mu_j|$$

$$= \frac{1}{2\mu} \sum_{i=1}^{K} \sum_{j=1}^{K} \lambda_i \lambda_j |\mu_i - \mu_j|$$

$$= \frac{1}{\mu} \sum_{i=2}^{K} \sum_{j=1}^{K} \lambda_i \lambda_j |\mu_i - \mu_j|$$

Interpretations of the residual term $G_R = G - G_W - G_B$ have been given by Silber (1989) and by Lambert and Aronson (1993). If none of the country income distributions overlap, then a ranking of income units in the whole region, ranked according to increasing income, is the same as the ranking that is obtained when countries are first ranked according to their mean incomes, and then income units within each country are ranked. Under these circumstances $G_R = 0$. If the two rankings are different, then some country distributions overlap and $G_R > 0$. Then, $G_R$ can be viewed as the contribution to inequality that occurs when income units are re-ranked from the country-based ranking to the ranking for the whole region. Lambert and Aronson (1993) show that $G_R$ is given by the area between the concentration curve from the country-based ranking and the Lorenz curve for the regional ranking.
3. The Dagum Decomposition

As mentioned in the introduction, in the Dagum decomposition within inequality is given by

\[ G_w = \sum_{i=1}^{K} \lambda_i s_i G_i = G_w \]  

(6)

To describe the other two components, Dagum assumes countries have been ordered according to increasing mean income. That is, \( \mu_1 < \mu_2 < \cdots < \mu_K \). Then,

\[ G_{nb} = \sum_{i=2}^{K} \sum_{j=1}^{i-1} \left( \lambda_i s_i + \lambda_j s_j \right) G_y D_y \]  

(7)

\[ G_t = \sum_{i=2}^{K} \sum_{j=1}^{i-1} \left( \lambda_i s_i + \lambda_j s_j \right) G_y \left( 1 - D_y \right) \]  

(8)

We will examine the components \( G_y \) and \( D_y \) and then prove that \( G_{nb} = G_y \).

The term \( G_y \) is what Dagum calls the extended Gini ratio between the \( i \)-th and \( j \)-th subpopulations

\[ G_y = \frac{\Delta_y}{\mu_i + \mu_j} = \frac{1}{(\mu_i + \mu_j) n_i n_j} \sum_{i=1}^{n_i} \sum_{j=1}^{n_j} |y_{ij} - y_{jk}| \]  

(9)

where \( \Delta_y \) is the mean difference between the \( i \)-th and \( j \)-th subpopulations.

Dagum calls \( D_y \) the relative economic affluence between subpopulations \( i \) and \( j \), when \( \mu_i > \mu_j \). It is given by

\[ D_y = \frac{d_y - p_y}{\Delta_y} \]  

(10)

where \( d_y - p_y \) is the net economic affluence between subpopulations \( i \) and \( j \), when \( \mu_i > \mu_j \), and \( \Delta_y \) is the maximum possible value of \( d_y - p_y \). The components \( d_y \) and \( p_y \) are called, respectively, the gross economic affluence, and the first-order moment of transvariation, between subpopulations \( i \) and \( j \), when \( \mu_i > \mu_j \).
The definition of gross economic affluence \( d_{ij} \) for two countries such that \( \mu_i > \mu_j \) is the weighted average of the income difference \( y_{ik} - y_{jk} \) over all pairs such that \( y_{ik} > y_{jk} \). In terms of continuous density functions \( f_i(y) \) and \( f_j(y) \) for income distributions \( i \) and \( j \)

\[
d_{ij} = \int_0^\infty \int_0^\infty (y-x) f_j(x) dx f_i(y) dy
\]

\[
= m_{ij} + m_{ji} - \mu_j
\]

where

\[
m_{ij} = \int_0^\infty y F_j(y) f_i(y) dy = E_i[y F_j(y)]
\]

A proof of the second line in (11) is given by Dagum (1997).

The definition of the first-order moment of transvariation \( p_{ij} \) for two countries such that \( \mu_i > \mu_j \) is the weighted average of the income difference \( y_{ik} - y_{jk} \) over all pairs such that \( y_{ik} > y_{jk} \). The number of such pairs will only be nonzero if the distributions overlap. It is given by

\[
p_{ij} = \int_0^\infty \int_0^\infty (y-x) f_i(x) dx f_j(y) dy
\]

\[
= m_{ij} + m_{ji} - \mu_i
\]

It can also be shown that \( \Delta_i = d_{ij} + p_{ij} \) from which it follows that \( \Delta_i \) is the maximum possible value of \( d_{ij} - p_{ij} \), the maximum occurring when \( p_{ij} = 0 \).

To prove that \( G_{ab} = G_a \), first note that \( d_{ij} - p_{ij} = \mu_i - \mu_j \) and, from (9) and (10),

\[
G_{y} D_{y} = \frac{\Delta_y}{\mu_i + \mu_j} \times \frac{d_{ij} - p_{ij}}{\Delta_y} = \frac{\mu_j - \mu_i}{\mu_i + \mu_j}
\]

for \( \mu_i > \mu_j \)

Substituting (13) into (7) yields
\[ G_{nb} = \sum_{i=1}^{K} \sum_{j=1}^{i-1} \left( \lambda_i s_i + \lambda_j s_j \right) \frac{\mu_i - \mu_j}{\mu_i + \mu_j} \quad \text{for } \mu_i > \mu_j \quad (14) \]

While the ordering \( \mu_1 < \mu_2 < \cdots < \mu_K \) is needed for Dagum’s interpretations of the components of \( G_{nb} \), it is not needed for computing (14) providing we replace \( \mu_i - \mu_j \) by \( |\mu_i - \mu_j| \). Doing so yields

\[
G_{nb} = \sum_{i=1}^{K} \sum_{j=1}^{i-1} \left( \lambda_i s_i + \lambda_j s_j \right) \frac{|\mu_i - \mu_j|}{\mu_i + \mu_j}
\]

\[
= \sum_{i=1}^{K} \sum_{j=1}^{i-1} \left( \frac{\lambda_i \mu_i + \lambda_j \mu_j}{\mu_i + \mu_j} \right) |\mu_i - \mu_j|
\]

\[
= \frac{1}{\mu} \sum_{i=2}^{K} \sum_{j=1}^{i-1} \lambda_i \lambda_j \left( \frac{\mu_i - \mu_j}{\mu_i + \mu_j} \right)
\]

\[
= \frac{1}{\mu} \sum_{i=2}^{K} \sum_{j=1}^{i-1} \lambda_i \lambda_j |\mu_i - \mu_j|
\]

This expression is identical to that in (5) from the traditional decomposition, giving the desired result. Thus, it follows that \( G_w = G_w \), \( G_{nb} = G_{nb} \) and \( G_r = G_r \).

4. Conclusion

The new approach to decomposing the Gini coefficient proposed by Dagum (1997) for measuring inequality contributions from between and within subpopulations yields a decomposition that is identical to the traditional decomposition which is commonly applied in the literature. Thus, while the “Dagum decomposition” provides a new interpretation, and new insights into the measurement of inequality, it does not lead to new expressions for the different components of the decomposition.

References


