
**11th Corden Lecture, University of Melbourne,
9th October 2013**

**Divided we Stand:
Why Inequality Keeps Rising**

John P. Martin

Former Director for Employment,
Labour and Social Affairs, OECD;
Consultant to the Bertelsmann
Foundation, Germany

Why are we concerned about inequality?

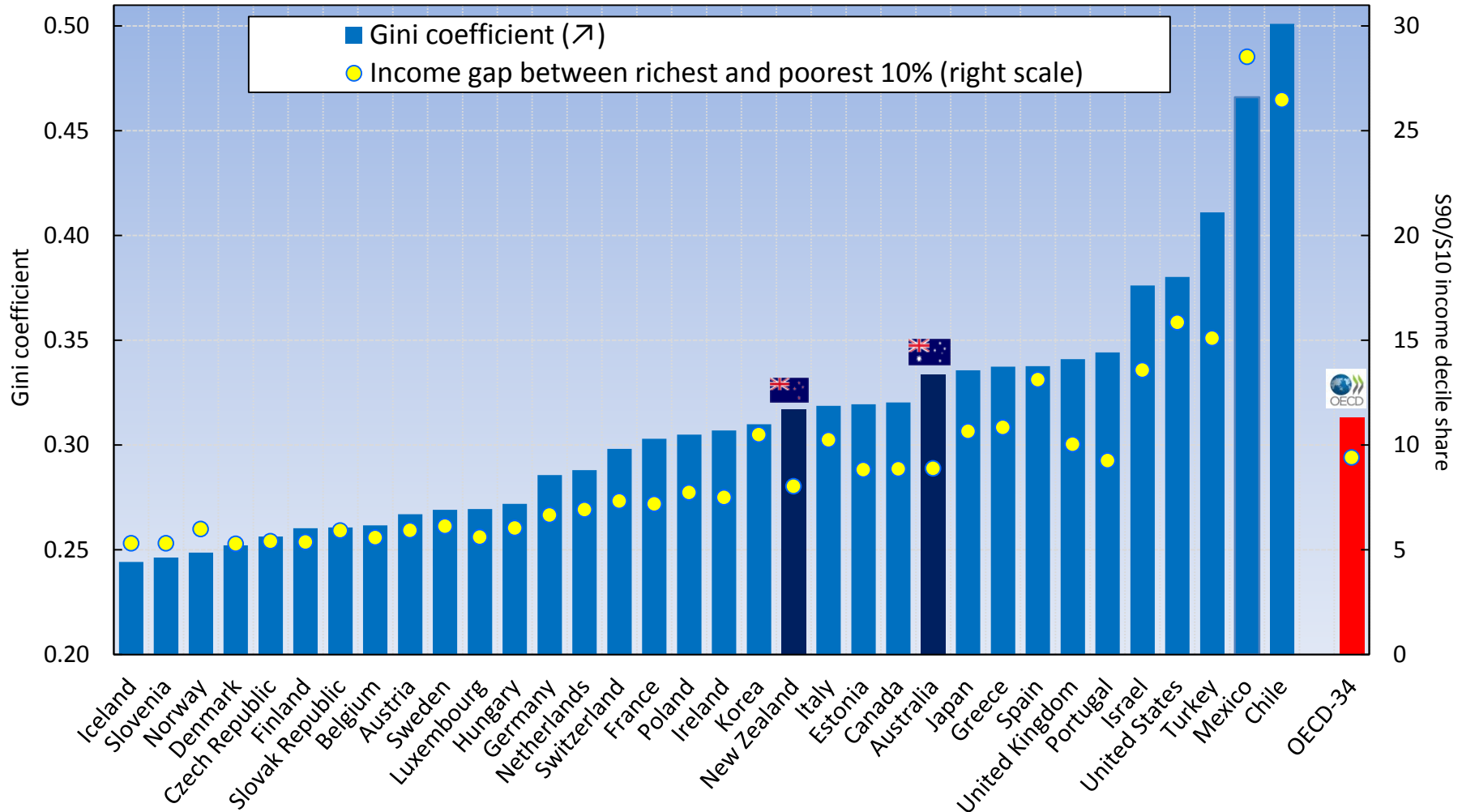


- “ Inequality is a social sin that cries out to Heaven” (Pope Francis);
- *“Addressing the question of “fairness” is a condition-sine-qua-non for the necessary restoring of confidence today” (OECD SG Angel Gurría)*
- *“What drags down our entire economy is when there is an ultra-wide chasm between the ultra-wealthy and everyone else” (President Obama)*

Outline of my presentation

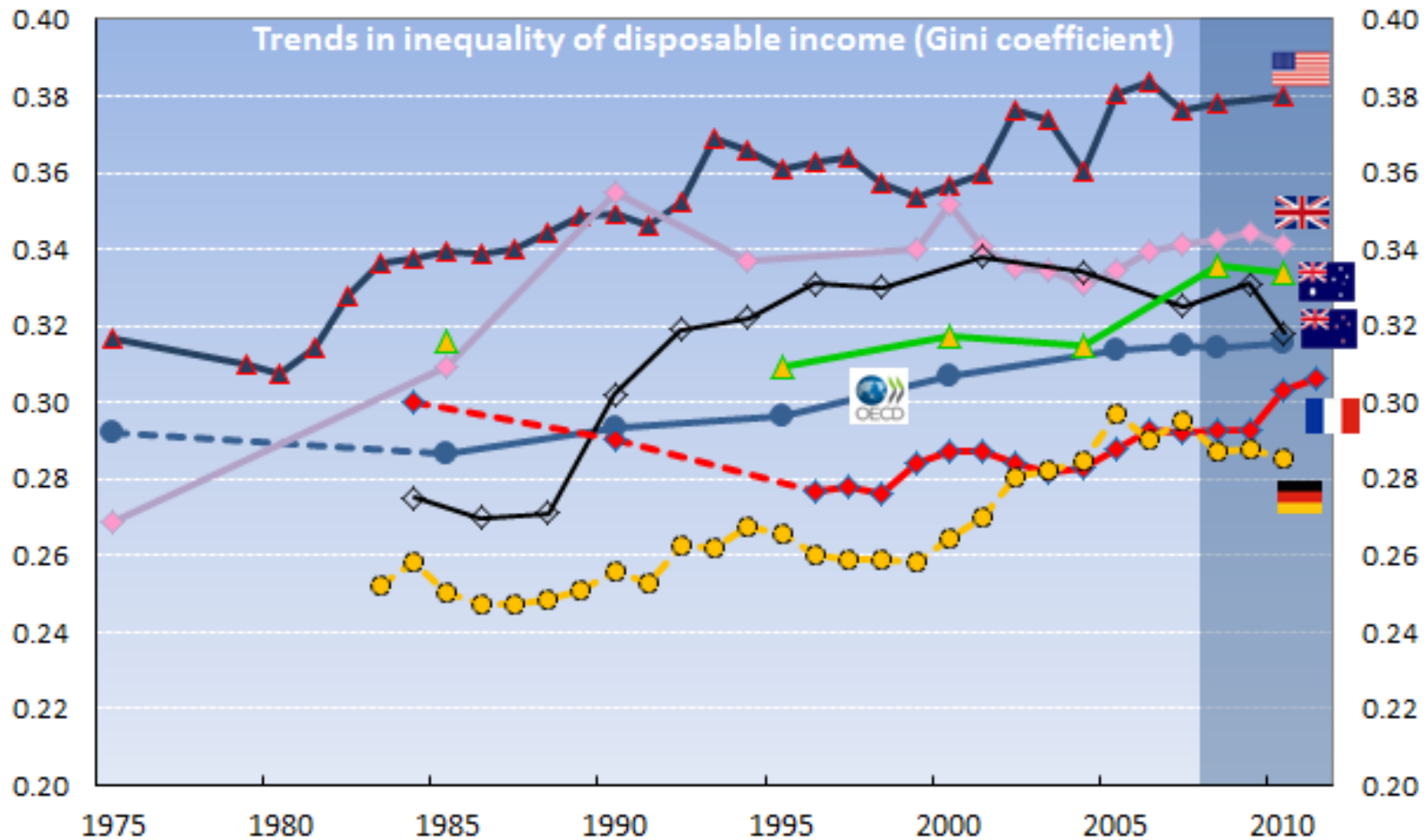
1. What are the levels and trends in income inequality across OECD countries up to the Great Recession?
2. What are the major drivers behind increases in inequality?
3. What has happened to income inequality in the Great Recession
4. Which policies are most promising to counter rising inequality?

Huge country differences in levels of income inequality



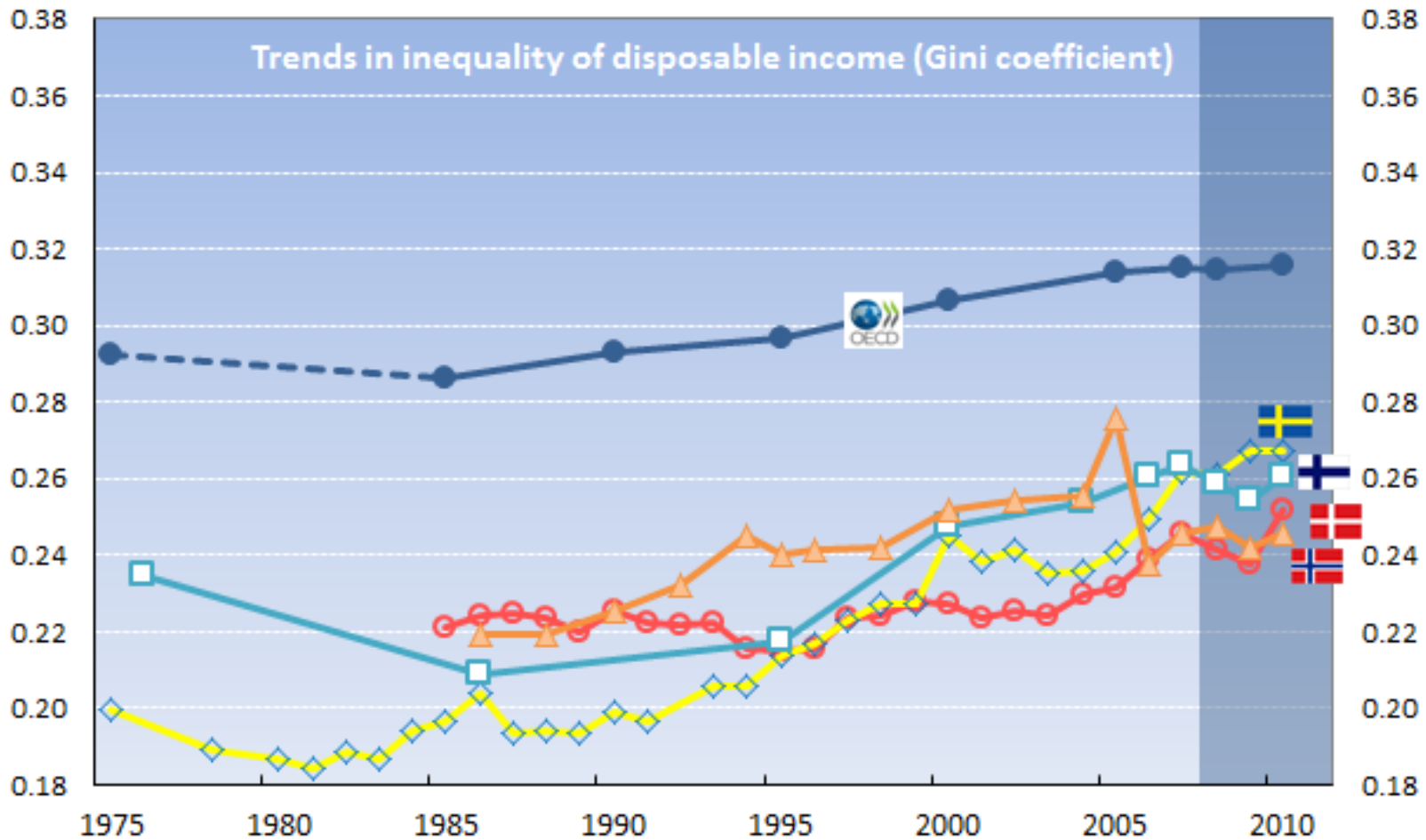
Data refer to 2010. Source: OECD 2013. *Note:* The Gini coefficient ranges from 0 (perfect equality) to 1 (perfect inequality). Gaps between poorest and richest are the ratio of average income of the bottom 10% to average income of the top 10%. Income refers to disposable income adjusted for household size.

Income inequality increased in most OECD countries over the past three decades



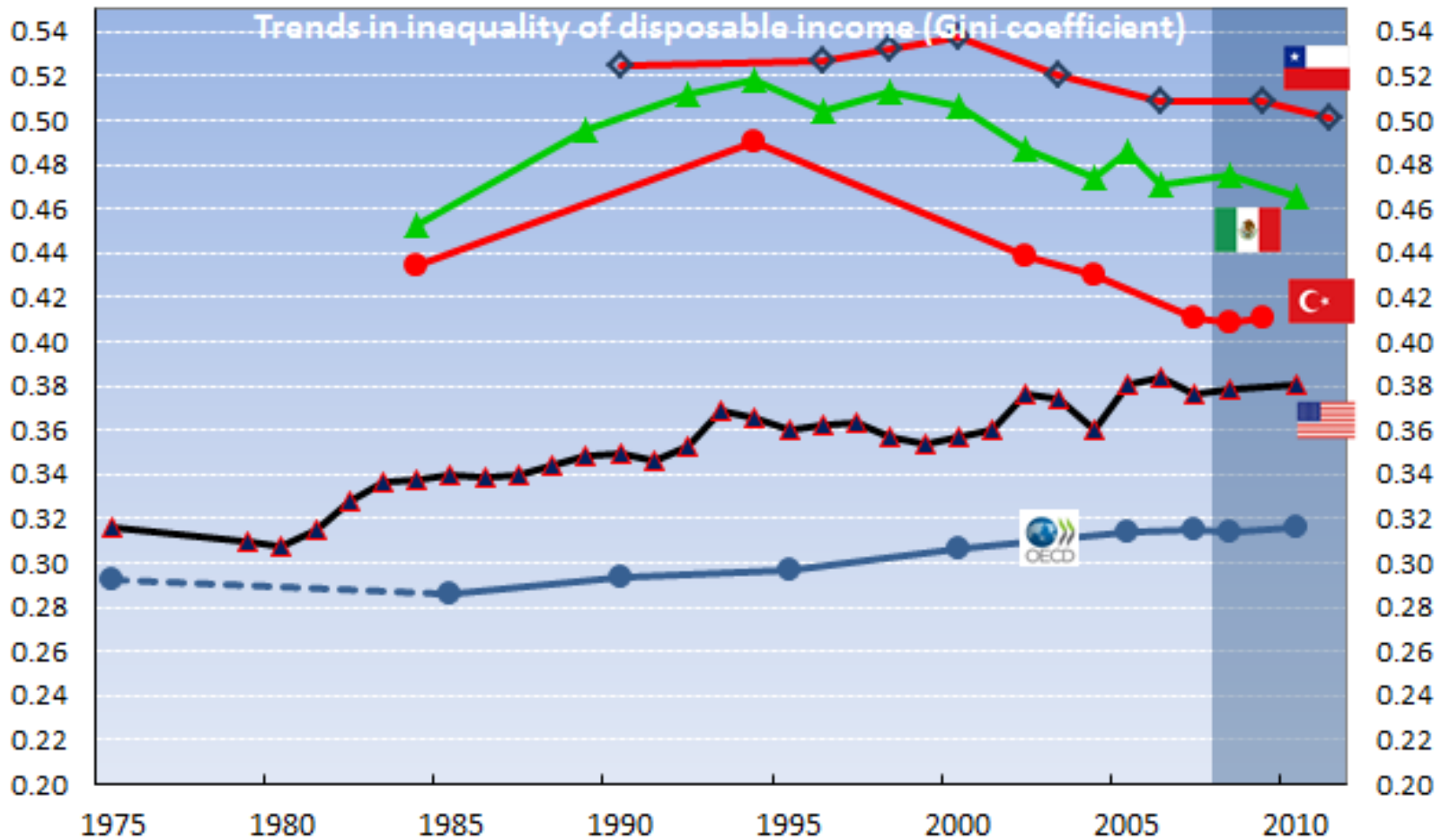
Source: OECD 2013, *Crisis squeezes incomes and puts pressure on inequality and poverty*. Note: Income refers to disposable income adjusted for household size.

.. and it increased in traditionally egalitarian countries, too



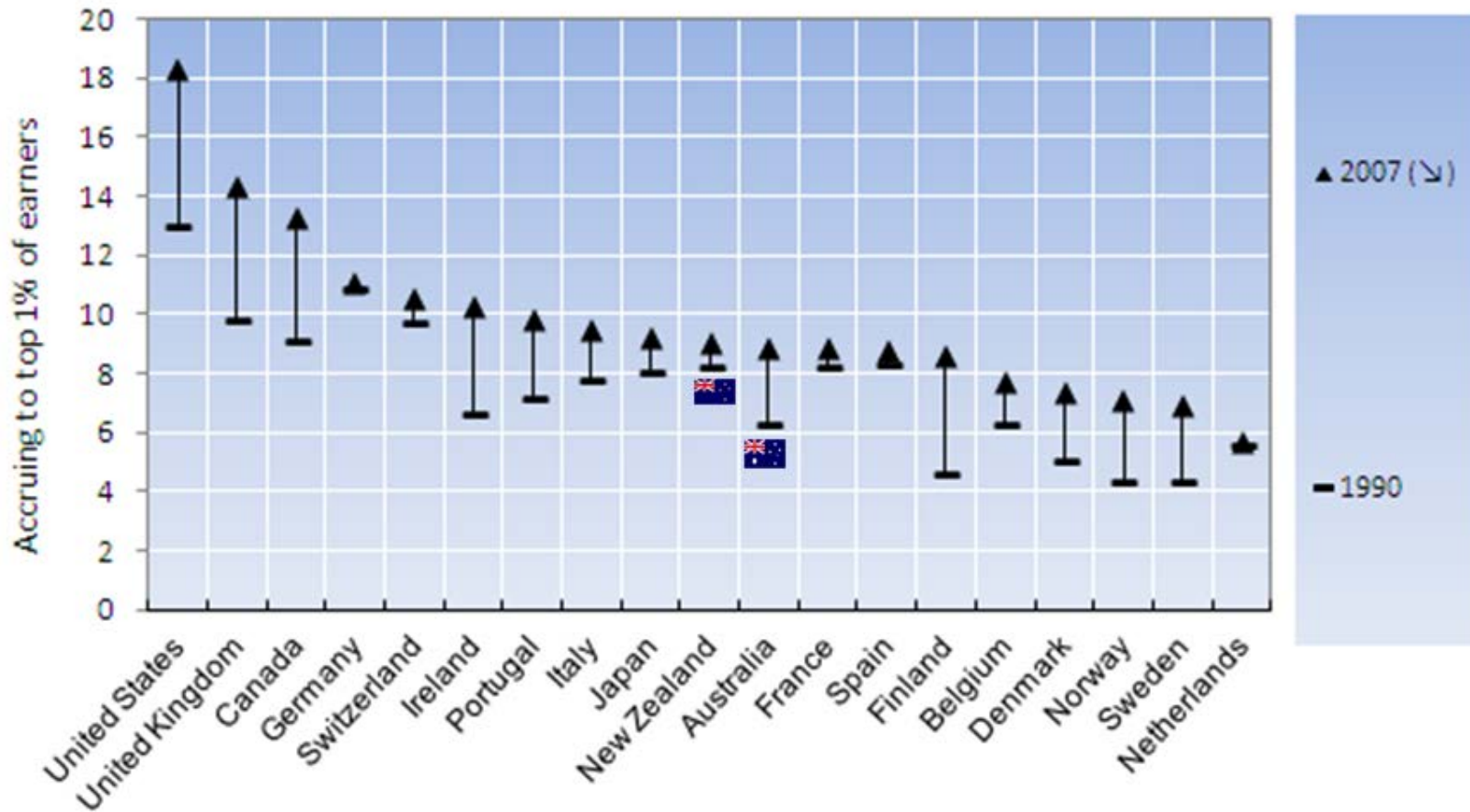
Source: OECD 2013, *Crisis squeezes incomes and puts pressure on inequality and poverty*. Note: Income refers to disposable income adjusted for household size.

.. only some very inegalitarian countries recorded drops in inequality



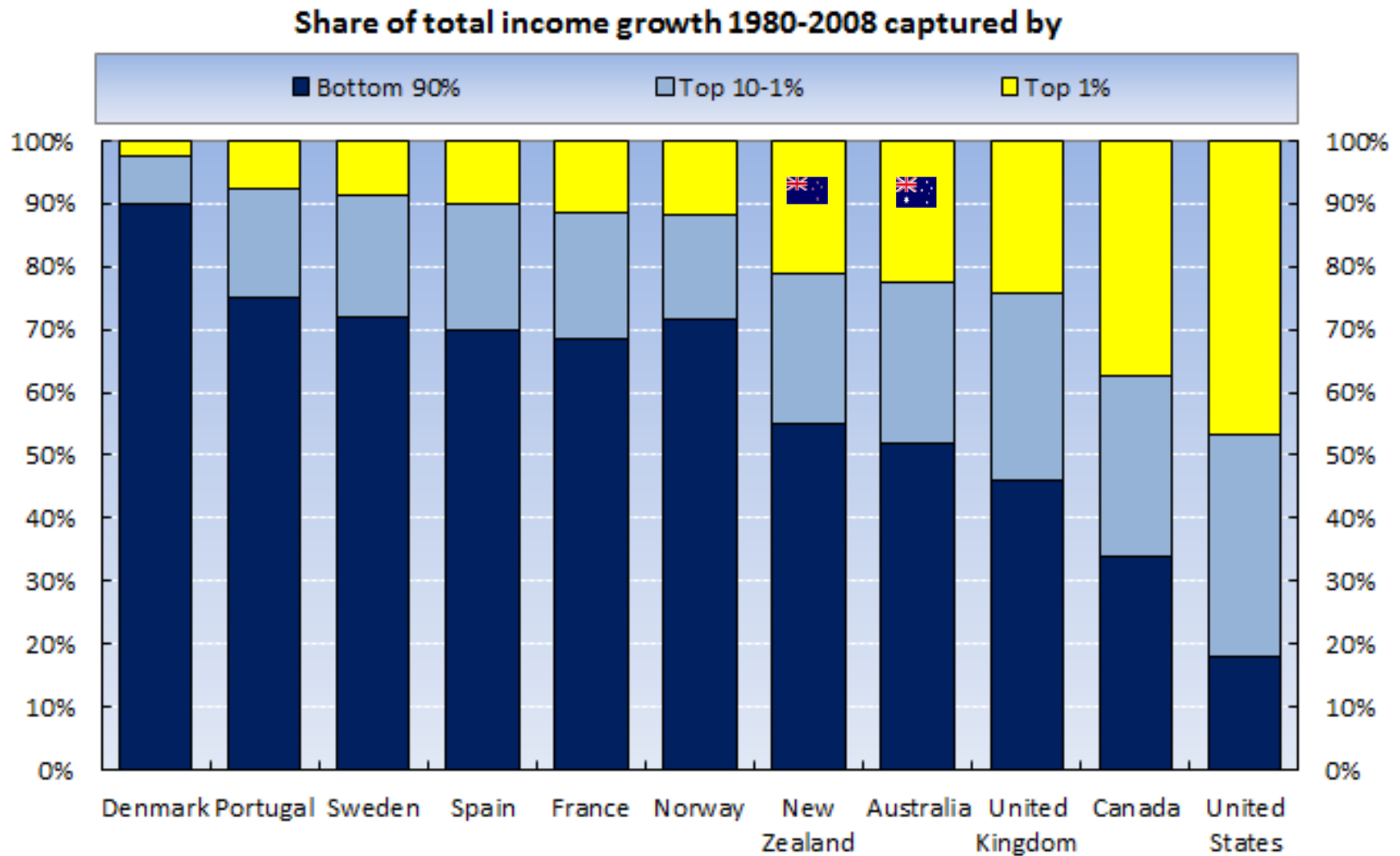
Source: OECD 2013, *Crisis squeezes incomes and puts pressure on inequality and poverty*. Note: Income refers to disposable income adjusted for household size.

At the upper end, the share of the top 1% increased



Source: OECD 2011, *Divided we Stand*

In some countries, 20% and more of long-term growth has been captured by the top 1%

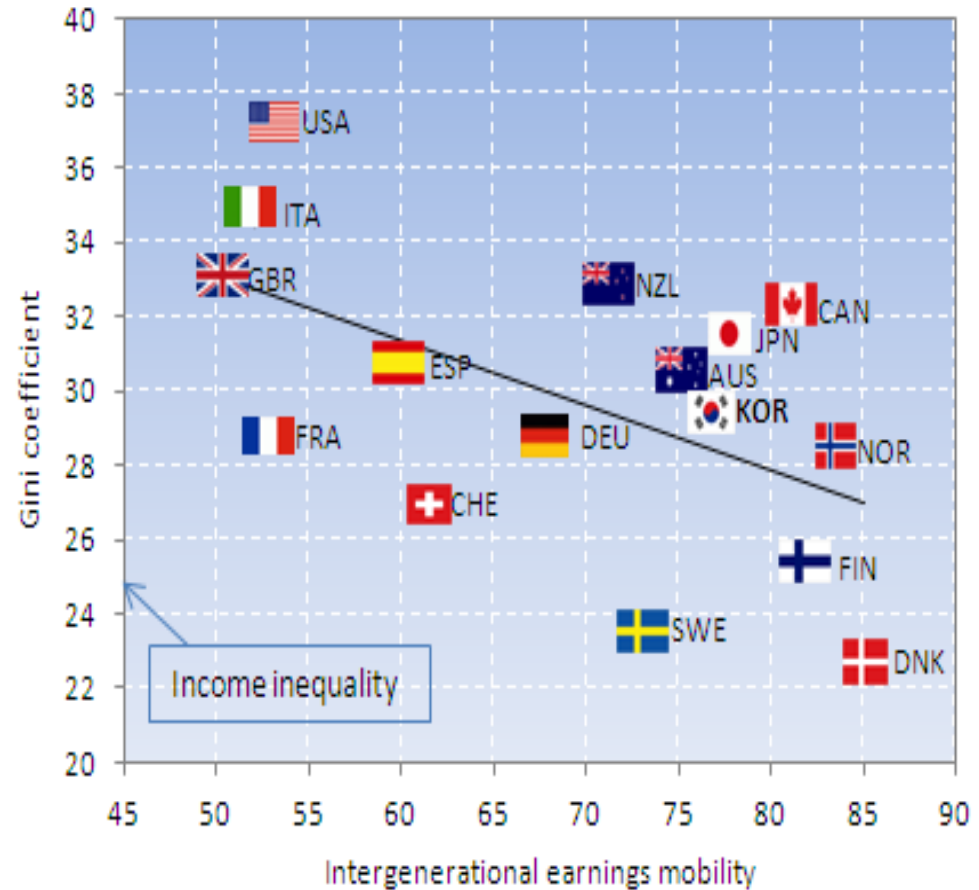


Key Stylised Facts concerning trends in income inequality

- Income inequality increased in both high- and low-inequality countries alike (and decreased only in few very-high-inequality countries) over the past 2-3 decades;
- Some convergence towards higher inequality across OECD countries
- Income inequality increased during both recession and boom periods;
- Income inequality increased, especially at the top;
- Income inequality increased despite employment growth up to the recession.

High Inequality can hinder Social Mobility

- The “Gatsby Effect” is alive and well
- Intergenerational earnings mobility is lower in high-inequality countries
- The long-term effects of widening inequality are scary: they cumulate over time and across generations



Causes of growing inequalities: The usual suspects

- Globalisation;
- Skill-biased technological changes;
- Institutional and regulatory reforms;
- Changes in employment patterns;
- Changes in family formation and household structures;
- Changes in tax and benefit systems.

OECD evidence on the main drivers of rising inequality

Main culprits:

- Skill-biased technological changes;
- Rising supply of skilled workers;
- Changes in employment patterns and working conditions;
- Changing redistribution via the tax/ben system.

Lesser culprit:

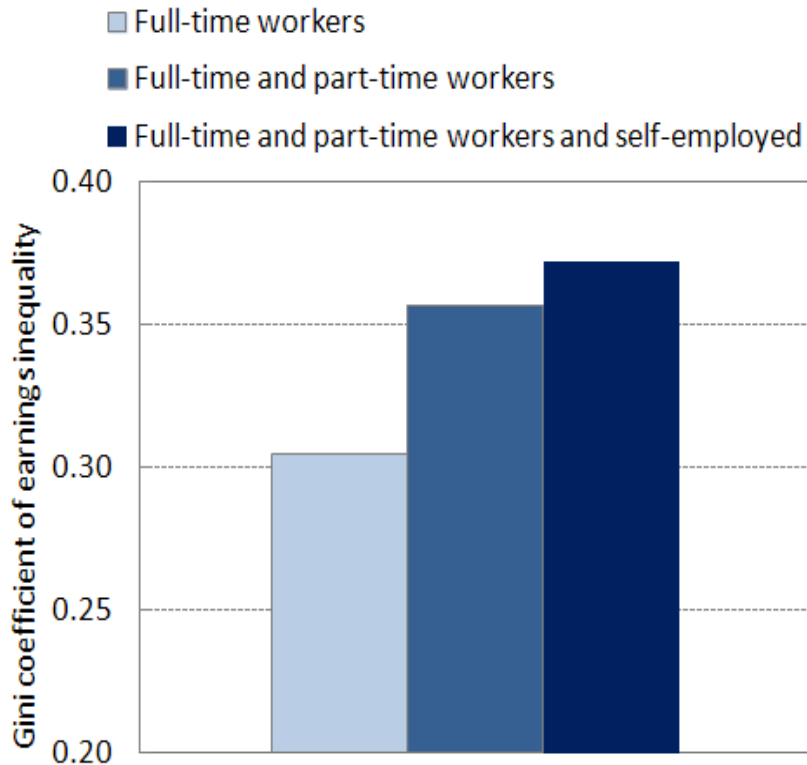
- Changing household/family structures

No direct effect:

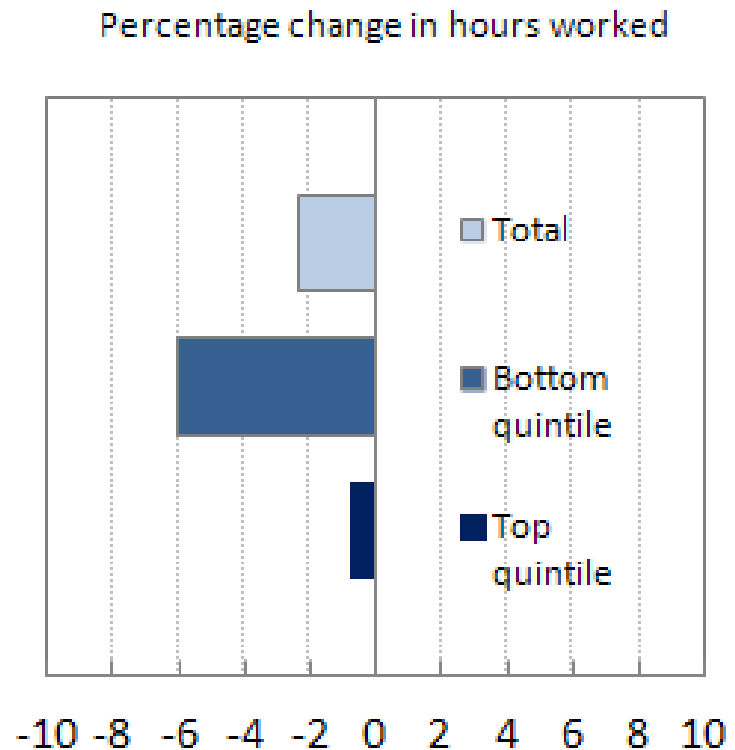
- Globalisation

Accounting for part-timers and the self-employed increases earnings inequality

A. Accounting for part-timers and self-employed increases earnings inequality



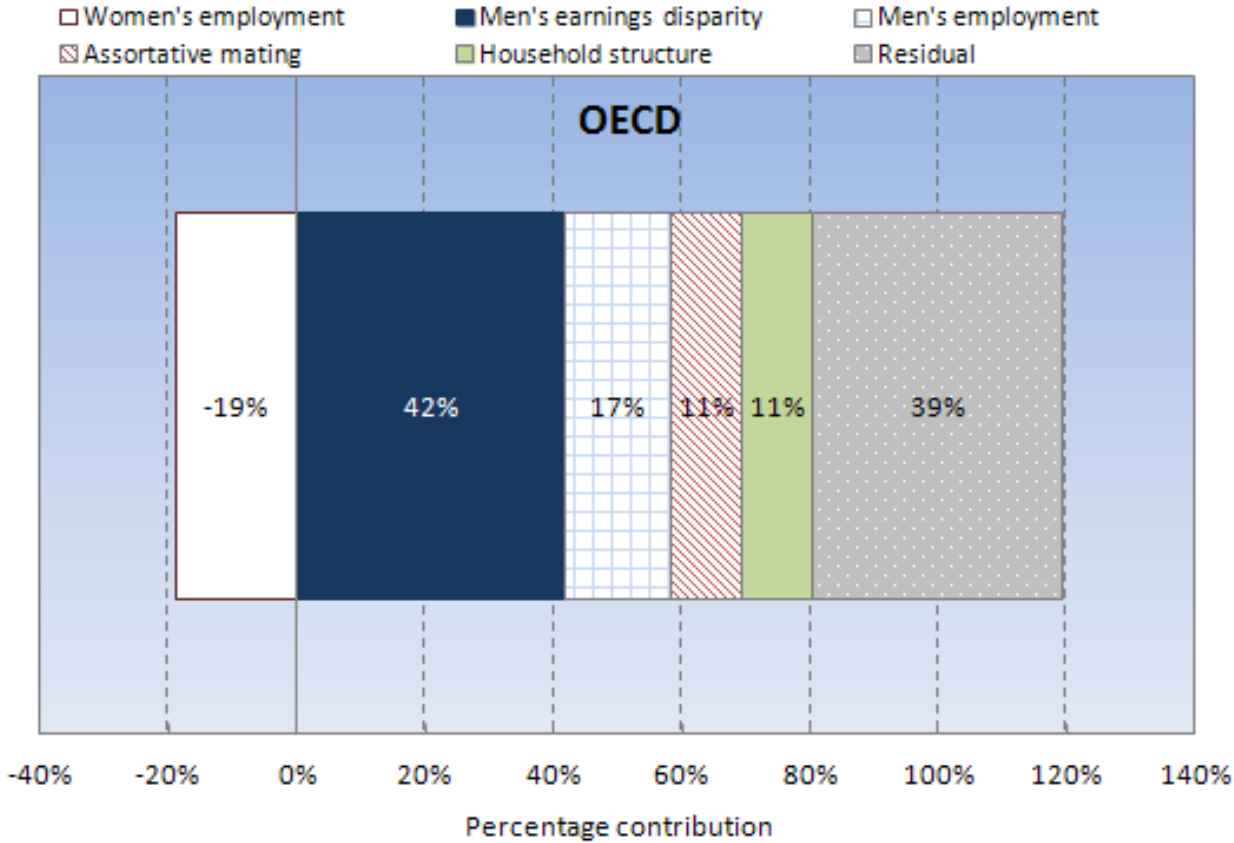
B. Hours worked decreased most among low-wage workers



Source: OECD 2011, *Divided we Stand*

Demographic/societal changes are important for inequality – but not as much as labour market trends

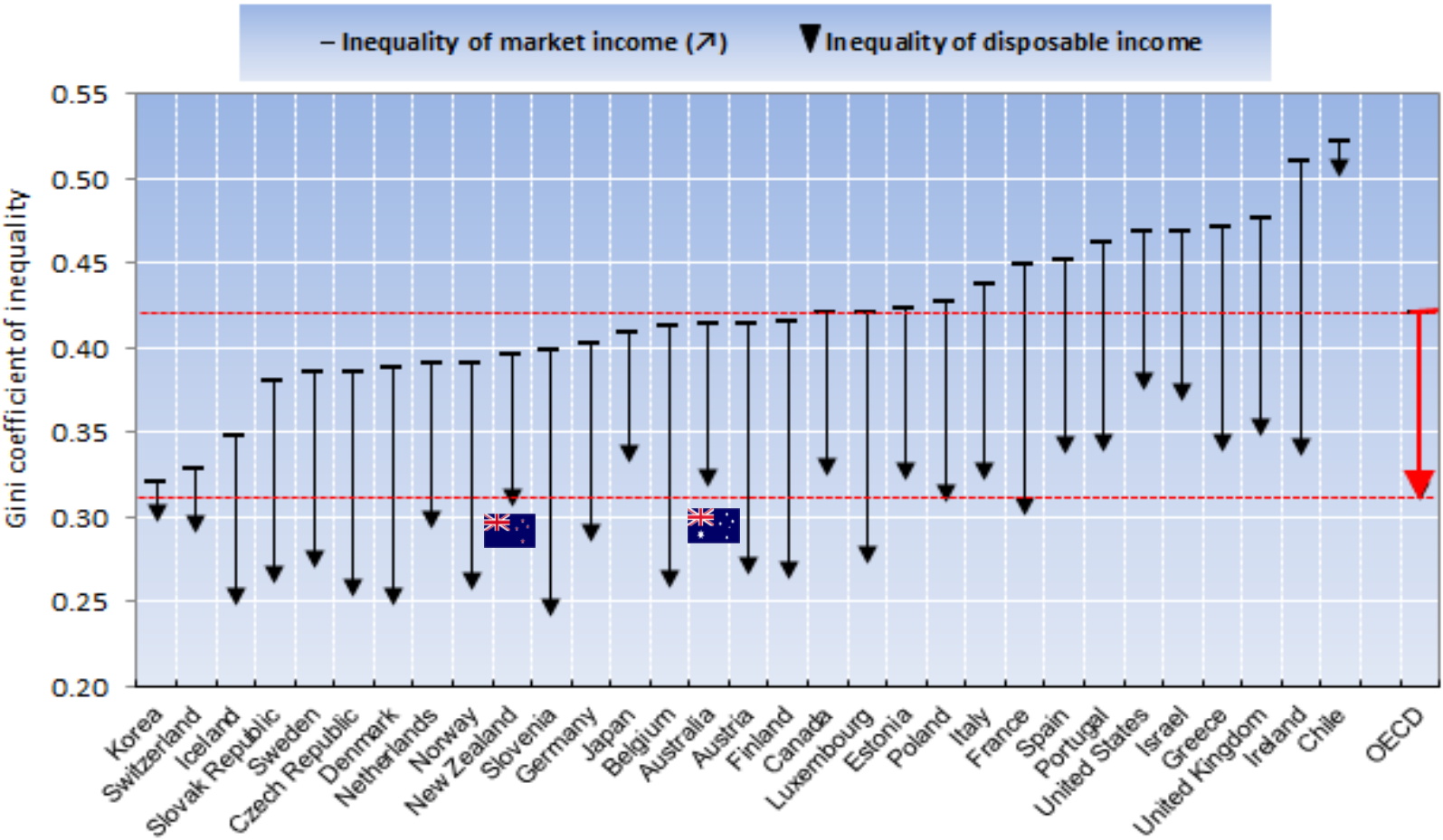
Percentage contributions to changes in household earnings inequality, OECD average



Source: OECD 2011, *Divided we Stand*.

Redistribution through taxes and benefits plays an important role ..

Inequality of market and disposable (net) income, working-age persons

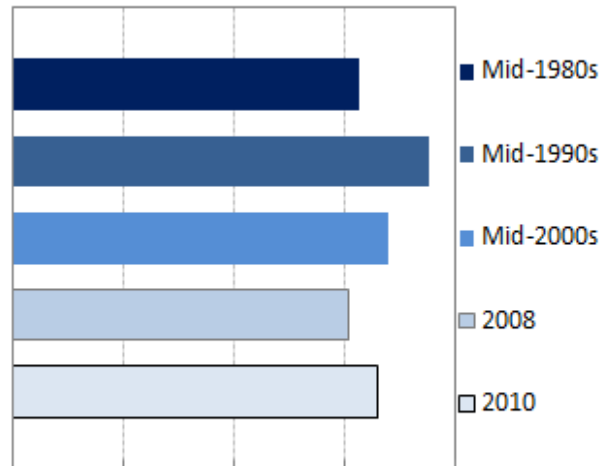


Source: OECD 2013, *Crisis squeezes incomes and puts pressure on inequality and poverty*. Note: Data refer to the **working-age population**.

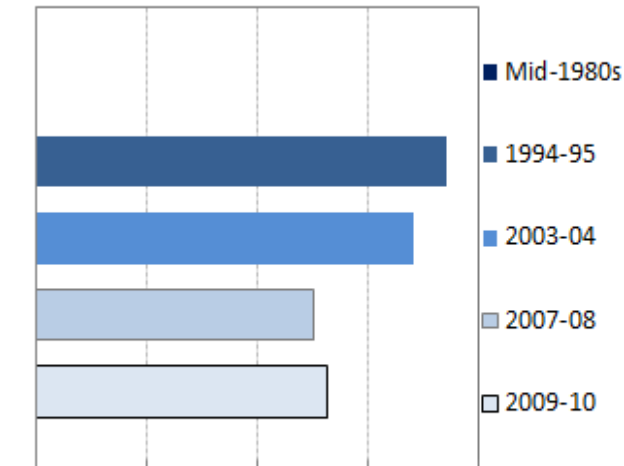
.. but redistribution became weaker in most countries

Percentage reduction of income inequality through taxes and transfers, working-age persons

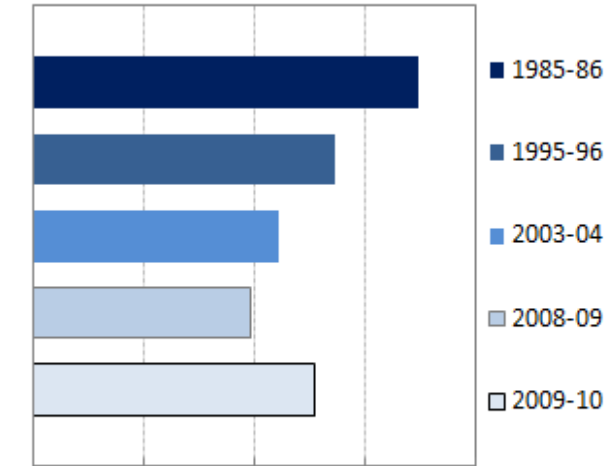
OECD average



Australia



New Zealand



Percentage reduction of market income inequality

Percentage reduction of market income inequality

Percentage reduction of market income inequality

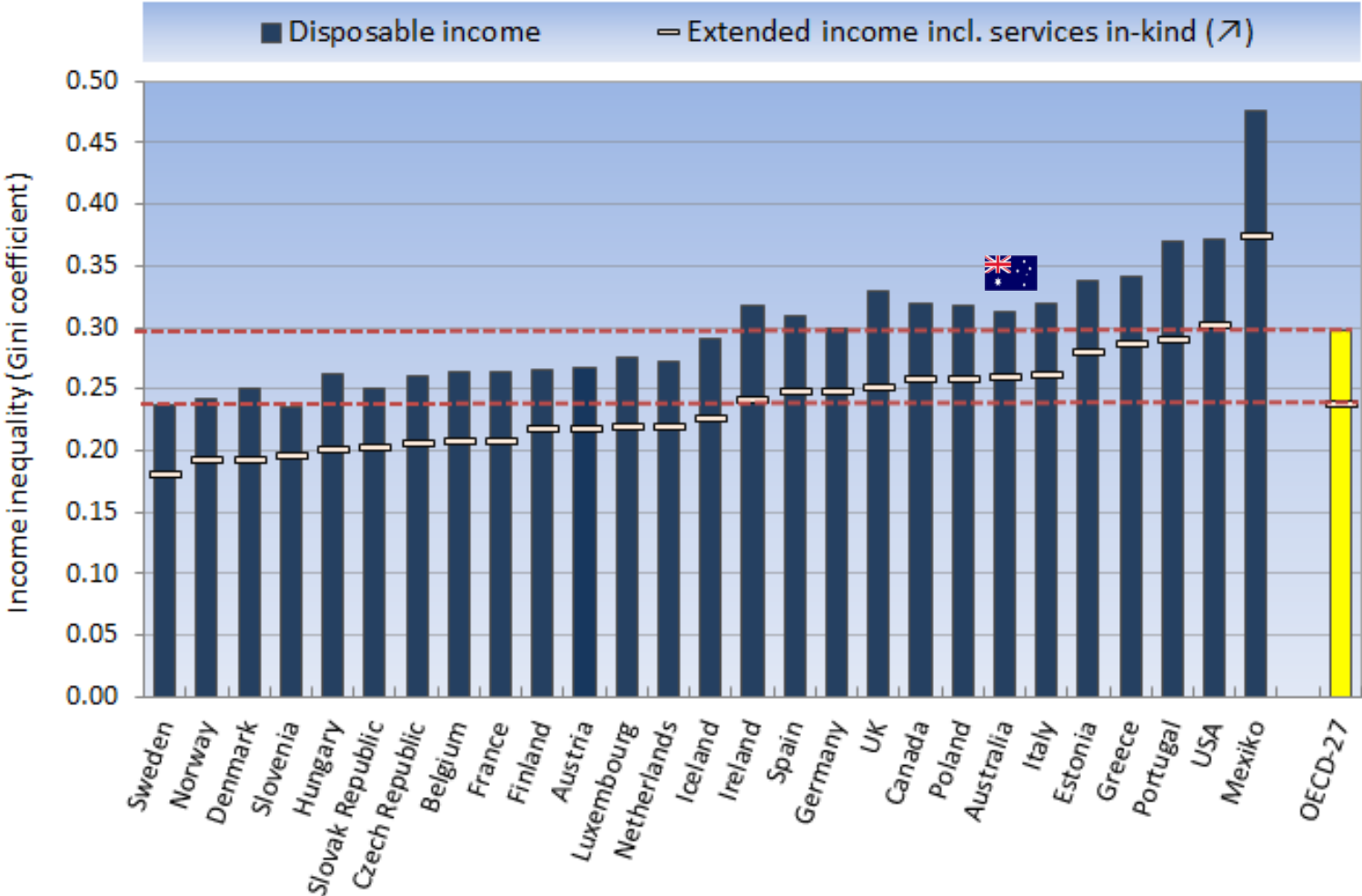
Source: OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm Note: Data refer to the working-age population.

Why have tax/benefit systems become less successful at reducing inequality?

- Changes in overall redistribution were mainly driven by benefits: taxes also played a role, but to a lesser extent;
- Spending levels have been a more important driver of these changes than tighter targeting of benefits;
- Spending shifted towards “inactive” benefits, leading to reduced activity rates and higher market-income inequality.

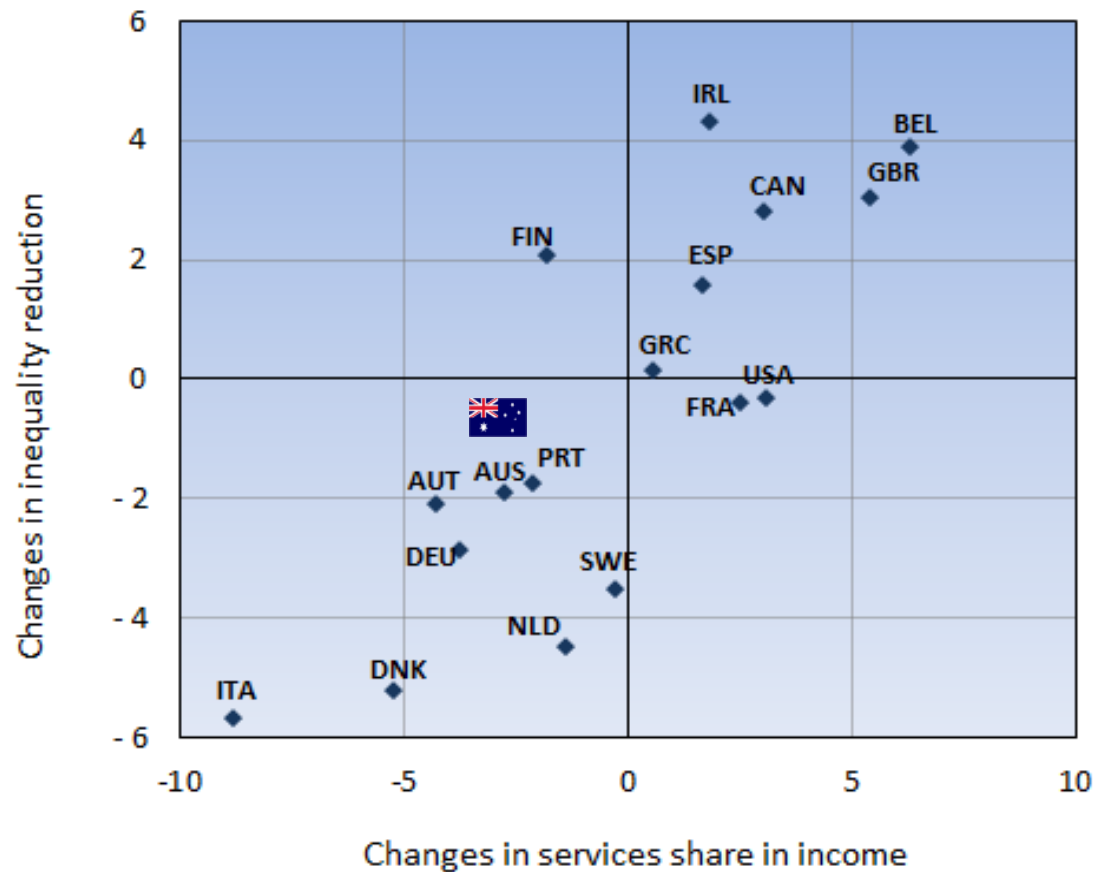
Social services also redistribute income

Education, health, care etc. reduce inequality by a fifth



Cuts in public services spending can also have considerable redistributive effects

Association between trends in size of public services and changes in inequality reduction, 2000-2007



Source: OECD 2011, *Divided we Stand*. Note: Percentage point changes in the share of in-kind benefits of services in disposable income, and of the percentage reduction in inequality (Gini coefficient), respectively.

Income inequality since the Great Recession

- What is the possible impact of the financial and economic crisis on income inequality?
- What will be possible effects of the fiscal consolidation measures? Who is likely to bear the costs of the recession and the austerity measures?
- Which tax-benefit policy mix helps best mitigating adverse distributional consequences?

Why have the initial short-term effects of the crisis on inequality been small?

- At the top end of the distribution, income shares fell due to declining stock prices and interest rates, and collapse of capital gains;
- This drop in top-earners incomes was likely *temporary* and did not undo the preceding increase in top-income shares.
- At the bottom end of the distribution, stimulus packages have cushioned falls in household income levels;
- Household coping strategies, e.g. young people returning to live with their parents, second earners increasing working hours;

...but previous recessions have increased inequality in the mid-term because of an employment divide between rich and poor ...

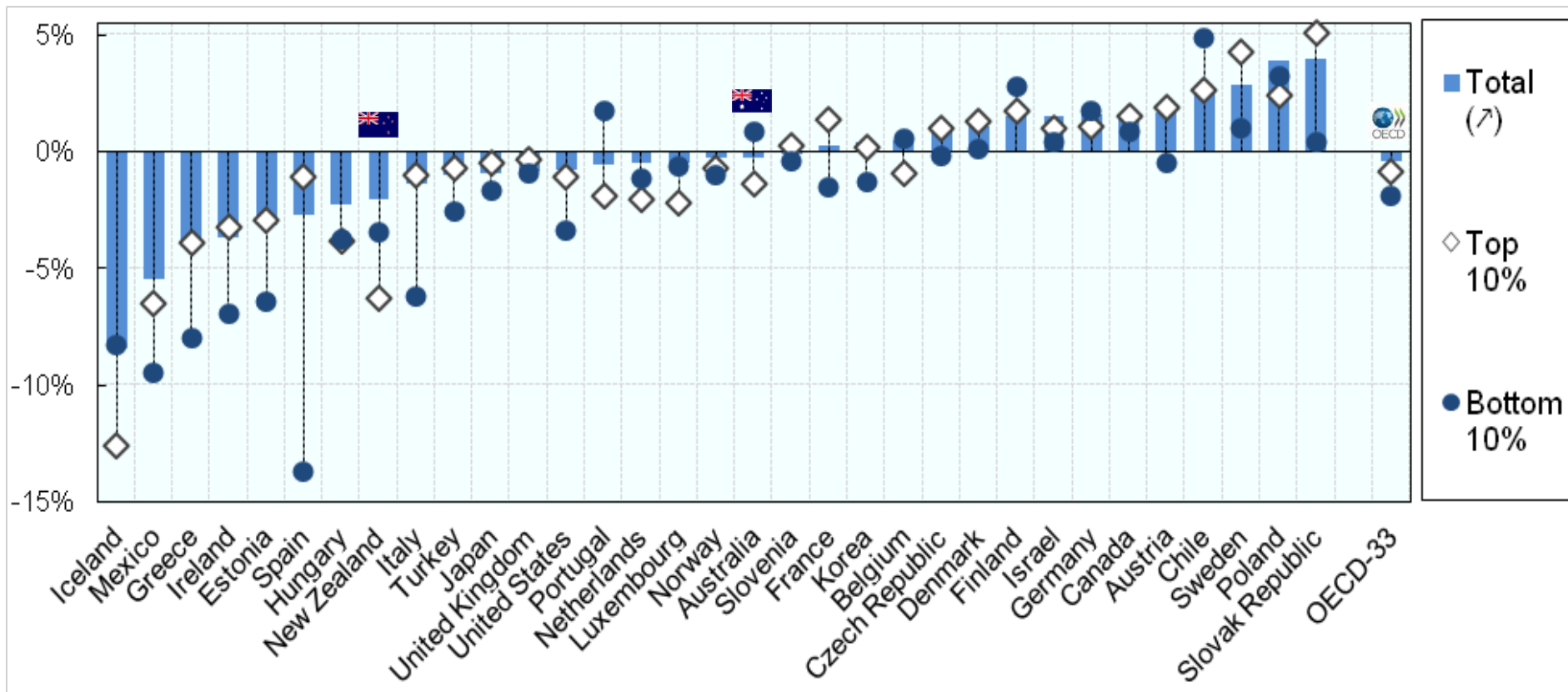
...and further tax-benefit changes could increase the cost of austerity to low-income groups

Income distribution trends during the crisis: The bottom line

- In many countries, the welfare state has prevented income inequality going from bad to worse in the first years of the Great Recession (2007 – 2010)...
- ...but as the jobs crisis persists and fiscal consolidation takes hold, there is a growing risk of further rising inequality and poverty.

But country patterns during the crisis were diverse: in many countries, poor households lost disproportionately

Annual percentage changes in disposable income between 2007 (2008) and 2010, by income group



Source: OECD 2013, *Crisis squeezes incomes and puts pressure on inequality and poverty*.

Policy implications for OECD countries seeking to cut inequality

Three pillars:

1. Tax/benefit reforms
2. Employment measures
3. Education policies

→ Both redistribution *and* inclusive employment policies matter

→ Take account of equity/efficiency trade-offs

Policy implications for OECD countries seeking to cut inequality (cont.)

- Government transfers (cash *and* in-kind) have an important role to play to safeguard low-income households;
- Guarantee access to high-quality public services;
- Scope for reviewing some existing tax provisions in light of increased “tax capacity” among top-income households;
- “*More and better jobs*”: Increasing employment may contribute to sustainable cuts in income inequality, provided employment gains occur in jobs that offer career prospects;
- Facilitate and encourage access to employment for under-represented groups: address labour market segmentation;
- Promote up-skilling of the workforce: better training and education for the low-skilled.

Thank you for your attention !



Divided We Stand
WHY INEQUALITY KEEPS RISING



New Policy Brief: *Crisis squeezes income and puts pressure on inequality and poverty:*

<http://www.oecd.org/els/soc/OECD2013-Inequality-and-Poverty-8p.pdf>

OECD work on income distribution and poverty, via:

www.oecd.org/social/inequality.htm

www.oecd.org/social/income-distribution-database.htm