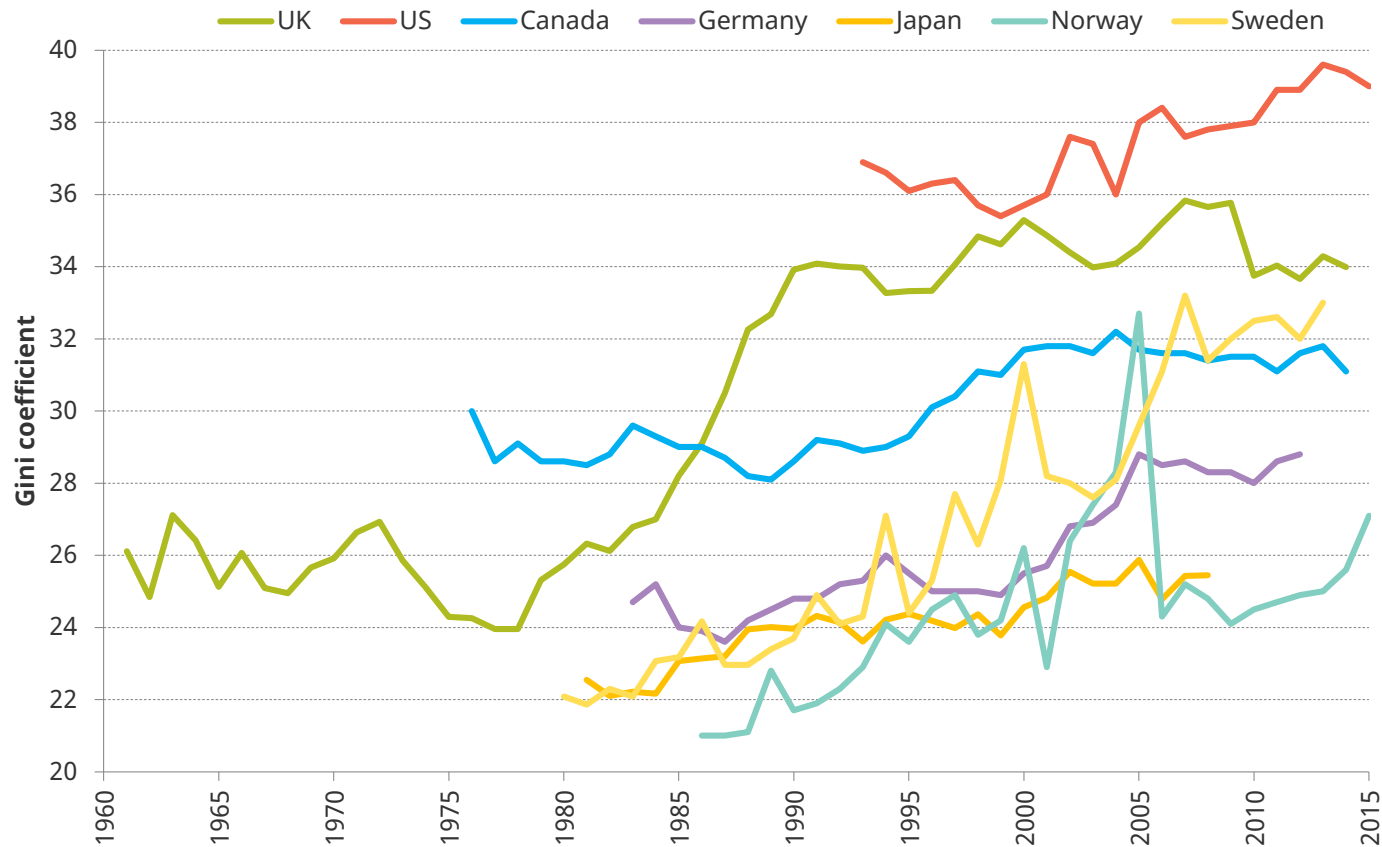


Income inequality: how has it changed, why and should governments care?

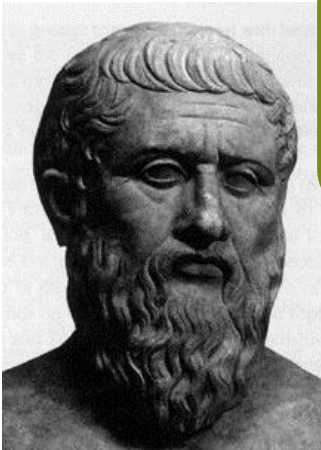
Agnes Norris Keiller

agnes_nk@ifs.org.uk

Income inequality on the up



Note: Income is measured as total household income net of taxes and benefits and is adjusted for household size.
Source: US from OECD all other countries from <https://www.chartbookofeconomicinequality.com/>



There should exist among the citizens neither extreme poverty nor again excessive wealth, for both are productive of great evil

Plato 360 BCE

I would like to be remembered as a person who is concerned about freedom and equality and justice and prosperity for all people



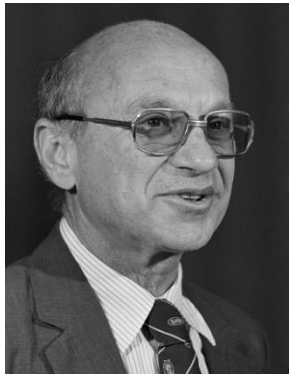
**Rosa Parks
1960s**

A society that puts equality before freedom will get neither

Milton Friedman 1980

1998: We are intensely relaxed about people getting filthy rich as long as they pay their taxes.

2012: I don't think I would say that now...we've seen that globalisation has not generated the rising incomes for all



Peter Mandelson

Should governments care about economic inequality?

If so, what policies are most appropriate?

- Several reasons why government should aim to affect inequality
- Different reasons imply different policy responses

Inequality and poverty: facts and causes

- Ineq. up in many countries, US and UK saw very large surges in 80s
- Global ineq. also up due to fast growth at the top of the world income dist.
- Different possible causes of ineq. rise have different policy implications

Inequality: cause for concern?

First Welfare Theorem

A private market equilibrium will be Pareto efficient if:

1. No externalities
2. Perfect competition (individuals and firms are price takers)
3. Perfect information
4. Agents are rational

If any of 1-4 don't hold then gov. intervention can be efficient

Even without market failures, ineq. generated by the market outcome may warrant gov. intervention

- e.g. philosophical concerns about 'fairness'

Inequality as an externality

Externalities:

- Benefits/costs that arise from behaviour of an agent and affect other agents

People unlikely to consider how their choices affect inequality

- This oversight = externalities if ineq. affects others

Several reasons why inequality is an externality

1. Preferences for equality (ineq. a negative externality)
2. Inequality incentivises effort (ineq. a positive externality)

1. implies intervention to ↓ inequality can ↑ social welfare

- Possible interventions include market intervention (e.g. maximum earnings limits) and redistribution (e.g. income tax and means-tested benefits)

2. implies intervention likely to involve equity-efficiency trade-off

Inequality and market competition

Uncompetitive markets can increase inequality

- Monopsonies suppressing wages for some types of workers
- Monopoly owners enjoying super-normal profits

Ineq. cause for concern as a symptom of underlying problem

Market intervention to tackle underlying problem better than redistribution

- Minimum wages to increase employee bargaining power
- Competition policy to try and prevent monopolies

Policies that ↓ ineq may not face equity-efficiency trade-off

Inequality and imperfect information

Imperfect info. means some risks cannot be insured privately

- e.g. job loss, negative health shocks

These risks can cause 'lower-end' inequality (a.k.a. poverty)

Government-provided 'social safety net' stands in for missing market

- Creates more equal income distribution
- Financing safety net likely to face equity-efficiency trade-off

Inequality: cause for concern?

Failures of the FWT justify policies that mitigate inequality

Externalities

1. Preferences for equality = too much ineq. in market outcome

Imperfect competition

2. Inequality due to uncompetitive markets

Imperfect information

3. (Lower-end) inequality due to uninsurable risk

Appropriate policy responses differ between reasons 1-3

Positive externalities due to inequality create a trade-off

- Some (not all) policies to ↓ ineq. may also ↓ size of economy

Inequality and poverty: stylised facts

Measuring inequality

Different measures have different benefits:

- The Gini coefficient incorporates the entire income distribution
- Percentile ratios (e.g. 90:10) are insensitive to extremes
- Income shares (e.g. top 1% share) can be calculated over many decades (à la Piketty, Saez, Zucman 2018)

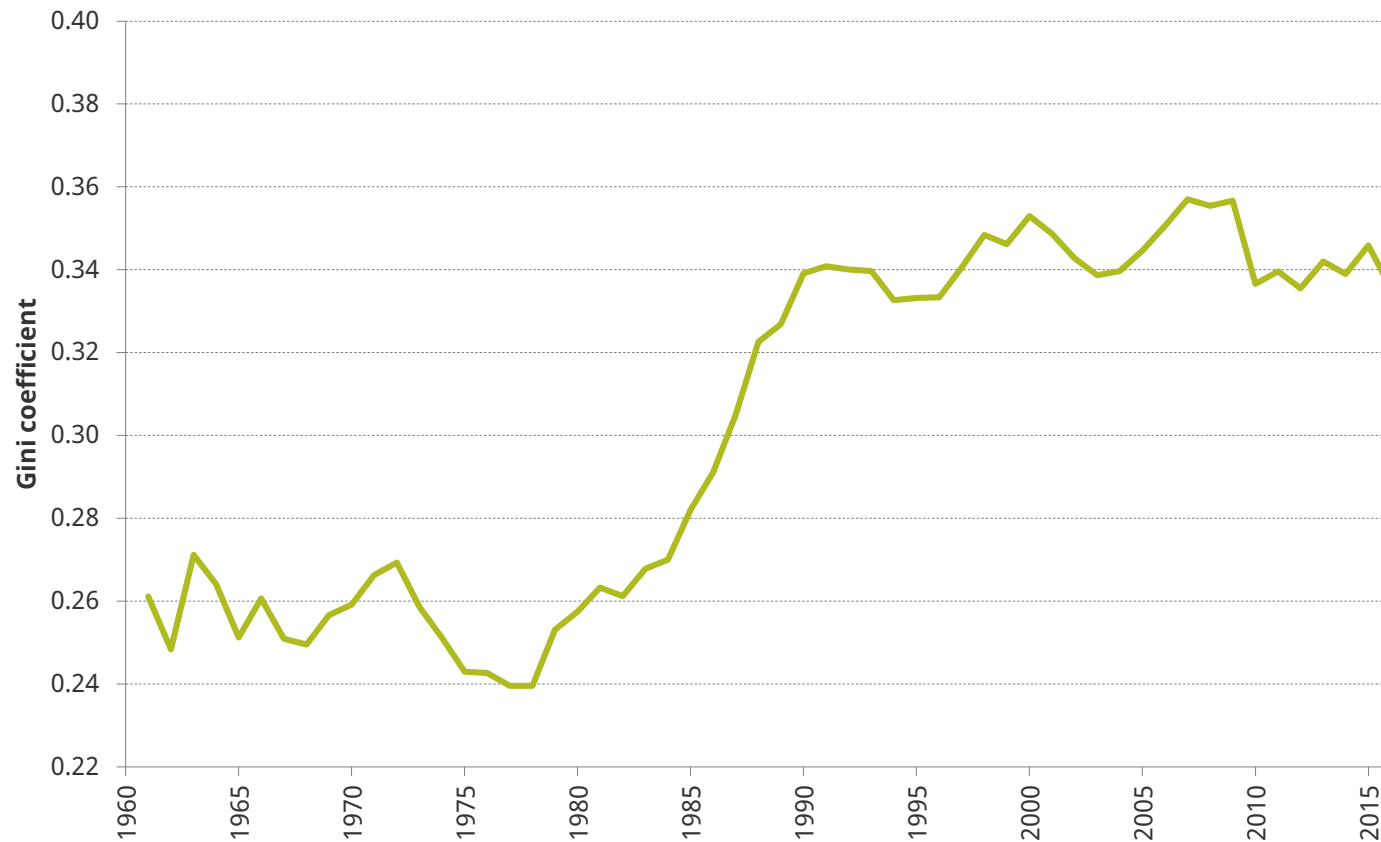
Different outcomes interesting for different reasons:

- Consumption: proxies 'lifetime income'
- Annual income: important determinant of material living standards
- Wealth: important for transmission of inequality across generations

Inequality and poverty: stylised facts

Income inequality in UK much higher than in 1960s due to large rise in the 1980s

Income inequality in the UK



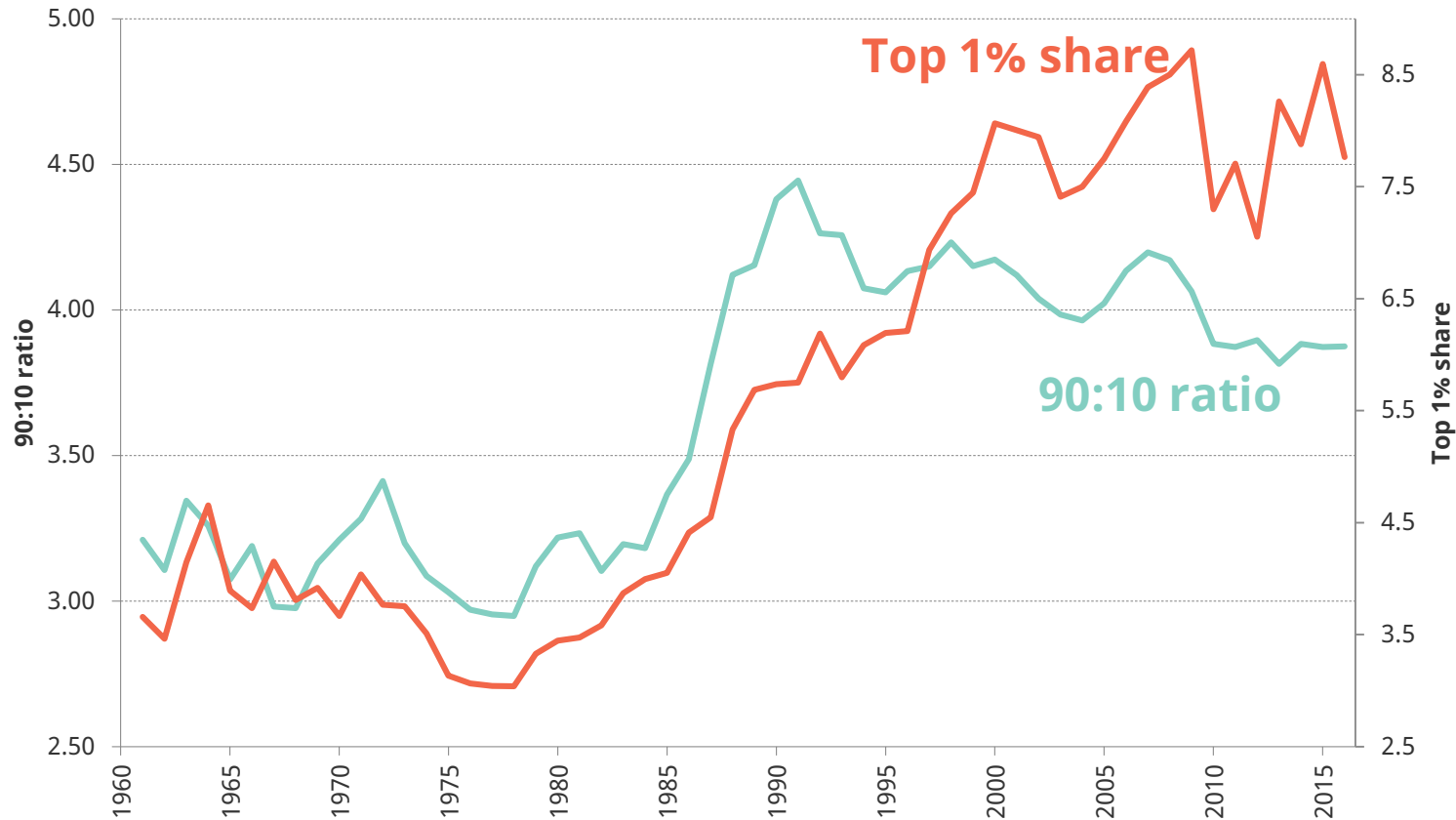
Note: Income is measured as total household income net of taxes and benefits and is adjusted for household size.
Source: Cribb et al. (2018)

Inequality and poverty: stylised facts

Income inequality in UK much higher than in 1960s due to large rise in the 1980s

- Increases also seen in other OECD countries but sharpest in US and UK
- Whole income distribution widened in the 80s
- More recent changes driven by top of the income distribution

Income inequality in the UK



Note: Income is measured as total household income net of taxes and benefits and is adjusted for household size.
Source: Cribb et al (2018)

Inequality and poverty: stylised facts

Income inequality in UK much higher than in 1960s due to large in the 1980s

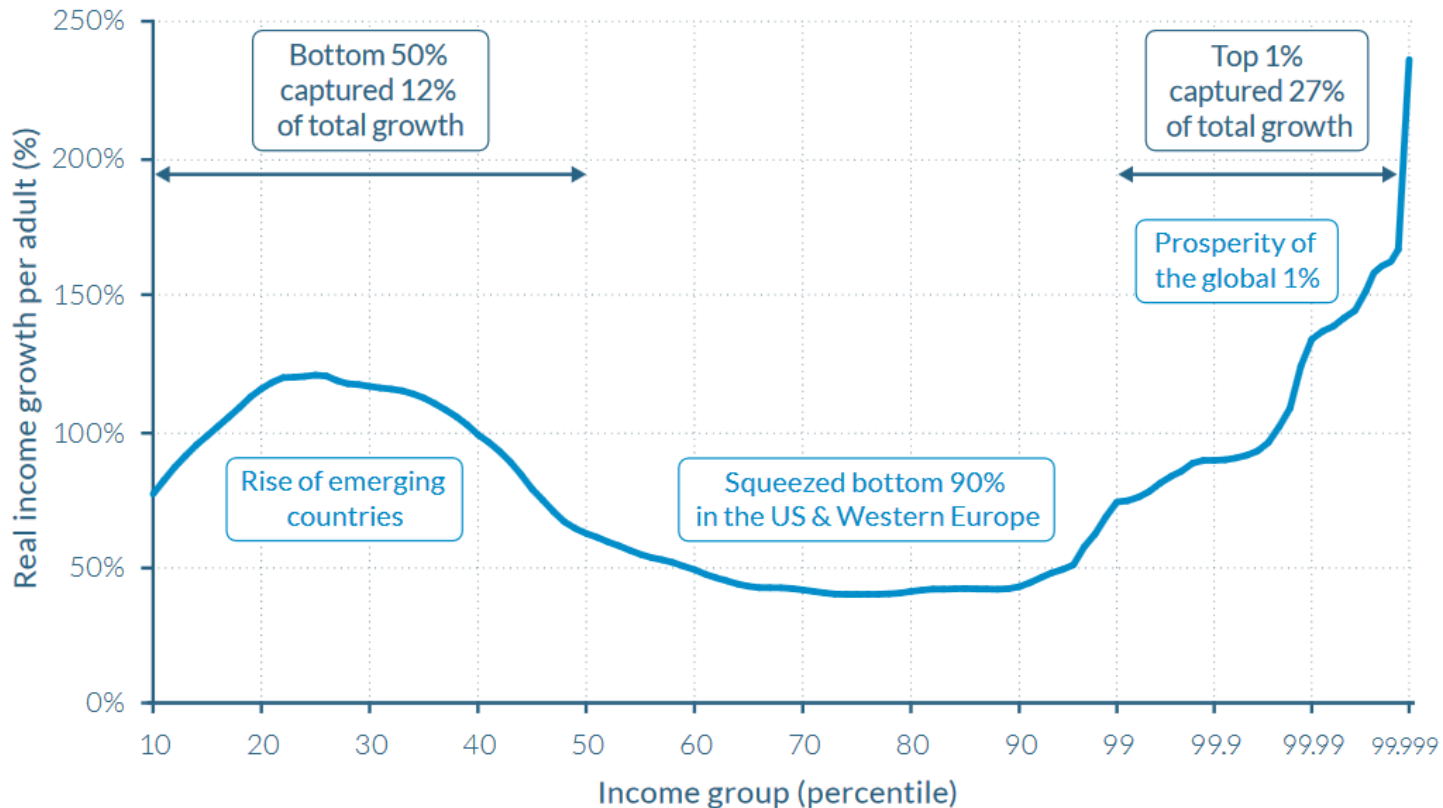
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- More recent changes driven by top of the income distribution

Pulling away of top 1% observed in most countries

Global inequality up due to top of global income distribution

The 'elephant curve'

The elephant curve of global inequality and growth, 1980–2016



Note: income refers to total pre-tax income
Source: Alvaredo et al. 2018

Inequality and poverty: stylised facts

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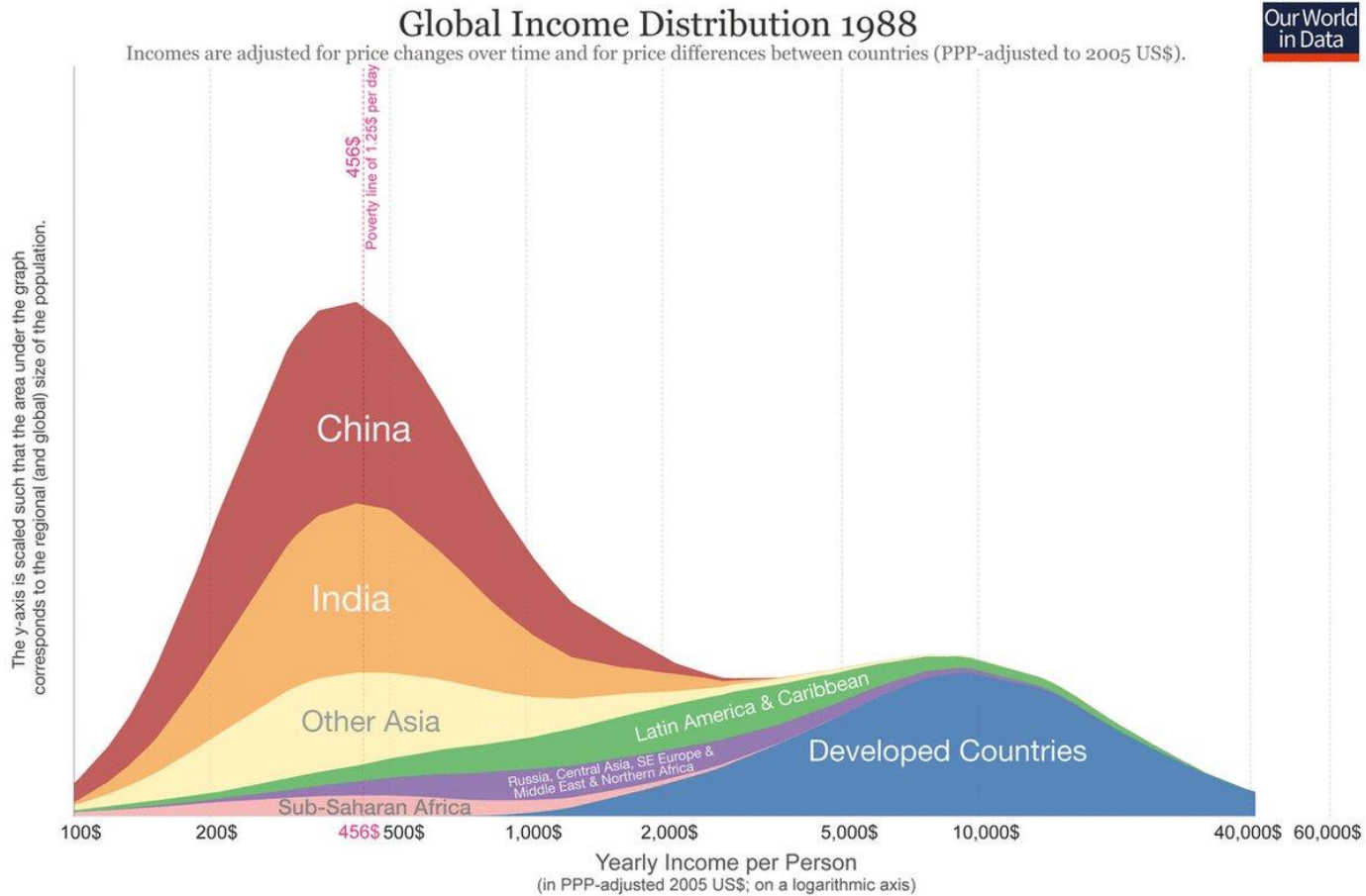
Pulling away of top 1% observed in most countries

Global inequality up due to top of global income distribution

Income growth among poor has reduced absolute poverty

- UK absolute poverty: 29% in 2000–01 → 19% in 2016–17
- Global absolute poverty: 29% in 1999 → 10% in 2015

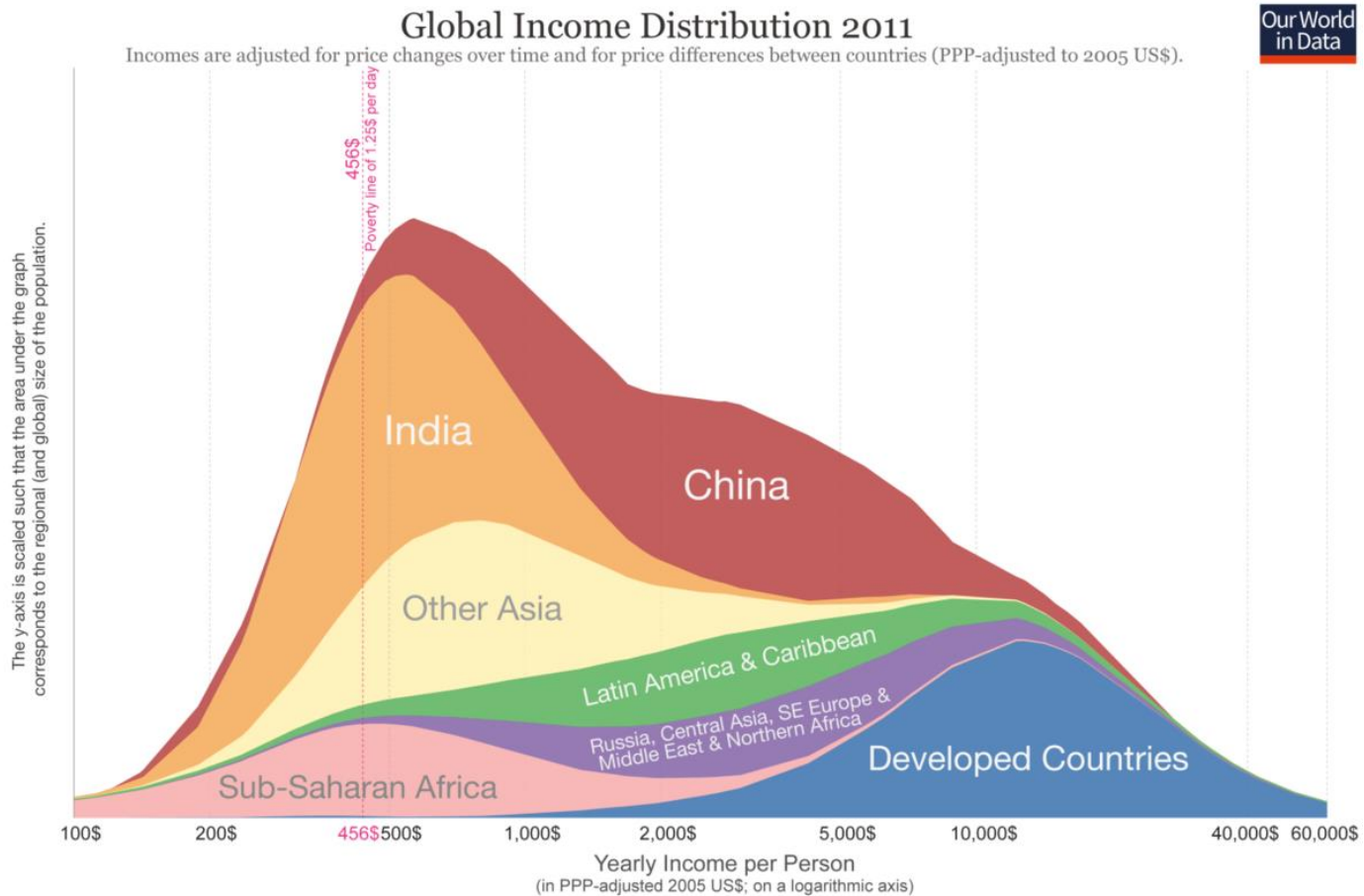
The global income distribution



OurWorld
in Data

Data source: Lakner and Milanovic (2015) – *Global Income Distribution: From the Fall of the Berlin Wall to the Great Recession*, World Bank Economic Review.
The interactive data visualization is available at OurWorldInData.org. There you find more visualizations on this topic. Licensed under CC-BY-SA by the authors Zdenek Hynek and Max Roser.

The global income distribution



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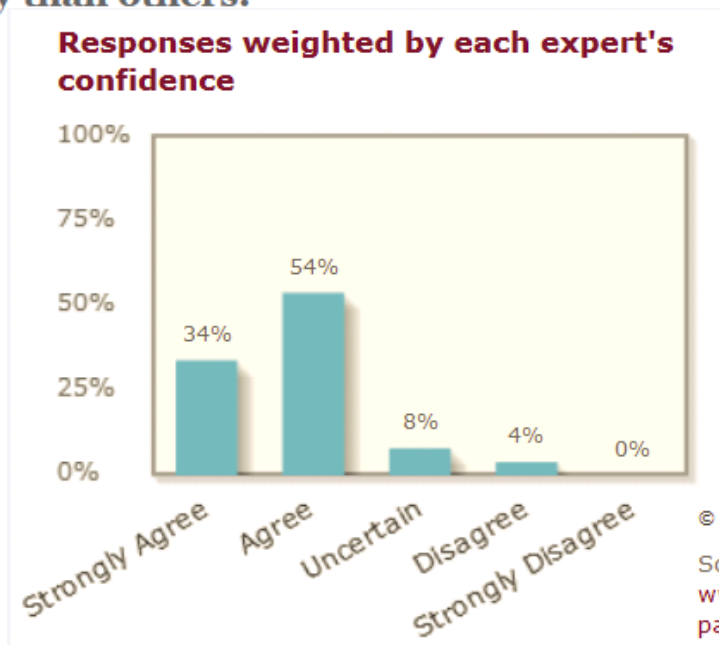
Inequality: causes and policy implications

Inequality: what's caused the increase?

Empirical work points to several causes of upward trend

- Skill/task-biased technological change (Goldin and Katz, 2009/Autor, Levy Murnane, 2003)

One of the leading reasons for rising U.S. income inequality over the past three decades is that technological change has affected workers with some skill sets differently than others.



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Source: IGM Economic Experts Panel
www.igmchicago.org/igm-economic-experts-panel

Inequality: what's caused the increase?

Empirical work points to several causes of upward trend

- Skill/task-biased technological change (Goldin and Katz, 2009/Autor, Levy Murnane, 2003)
- Trade (David Autor's Freakonomics podcast)

Both have increased productive potential of the economy

Market intervention/redistribution faces equality-efficiency trade off

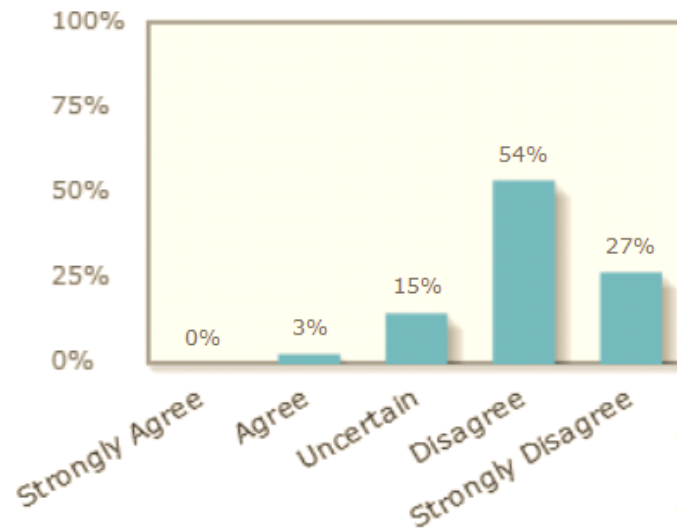
Inequality: what's caused the increase?

Several different hypotheses on why top 1% has pulled away

1. Returns to capital > economic growth rate (Piketty, 2014)

The most powerful force pushing towards greater wealth inequality in the US since the 1970s is the gap between the after-tax return on capital and the economic growth rate.

Responses weighted by each expert's confidence



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Source: IGM Economic Experts Panel
www.igmchicago.org/igm-economic-experts-panel

Inequality: what's caused the increase?

Several different hypotheses on why top 1% has pulled away

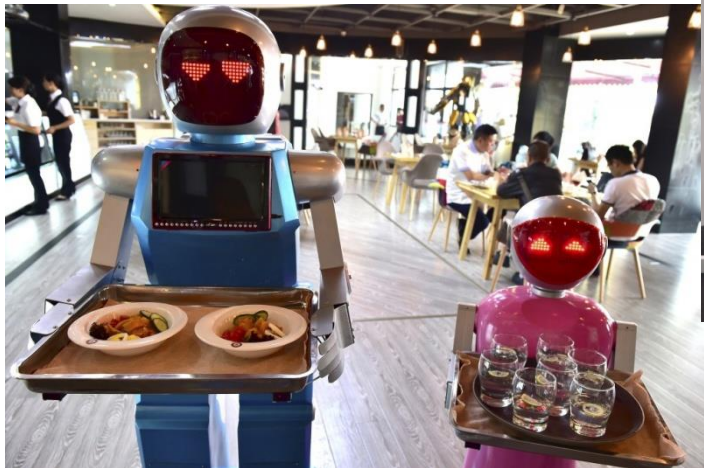
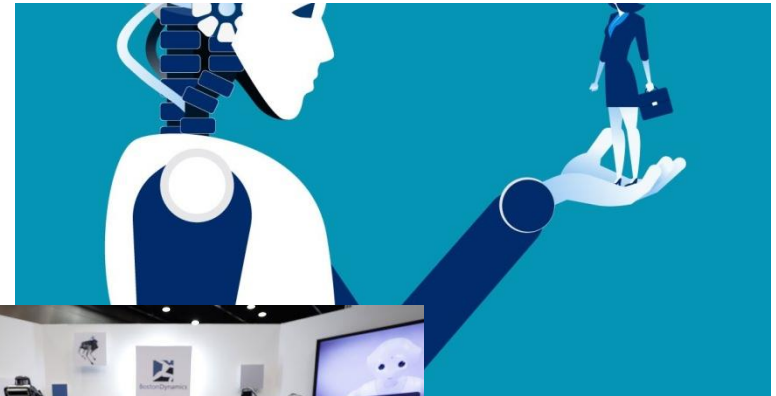
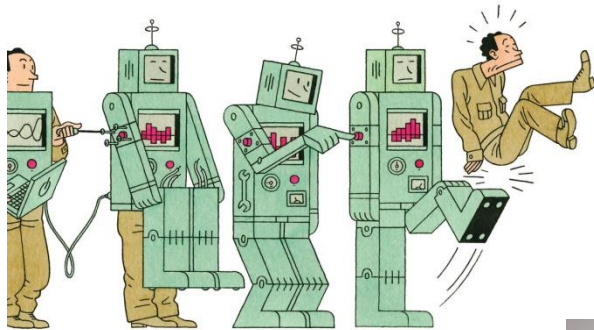
1. Returns to capital $>$ economic growth rate (Piketty, 2014)
2. 'Super-star' effects (Kaplan and Rauh, 2013)
3. Rise in market power (De Loecker and Eeckhout, 2017)

... with different policy implications

1. Emphasises asset taxation (implementation difficult)
2. Gov. intervention/redistribution faces equality-efficiency trade off
3. Competition policy could increase efficiency and equity

Research on the causes of the top 1% rise will have important policy implications

Inequality: where are we heading?



Some interesting resources

How “economic despair” affects high school graduation rates for America’s poorest students (2 mins) <https://youtu.be/wIHjPRho4A4>

David Autor – Did China eat America’s jobs? (40 mins)
<http://freakonomics.com/podcast/china-eat-americas-jobs/>

Ezra Klein and Matt Yglesias discuss US inequality and the rise in market power (50 mins) <https://www.vox.com/podcasts/2017/8/24/16189890/weeds-us-economy-inequality-trump>

Global data sources:

- Gapminder (world income distributions) <https://www.gapminder.org/>
- World Inequality Database (income shares, 90:10 ratios) <https://wid.world/>
- Chartbook of Economic Inequality (disposable income) <https://www.chartbookofeconomicinequality.com/>

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