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Income and Wealth Inequality in OECD Countries

The OECD has longstanding experience in research on income inequality, with studies dating back to the 1970s. Since 2008 the OECD has published three flagship reports on income inequality. The first one was in 2008: "Growing Unequal?", where we observed the inequality rising over the long run. In 2011 we followed up by looking at the causes and drivers of rising income inequality in the last two or three decades in a report titled: "Divided We Stand". In the third report, presented here, "In It Together, Why Less Inequality Benefits All", we look at the following issues:

- One of the main contributions of this work is new evidence about the trade-off between equality and efficiency is not as clear cut as thought before. In fact, our analysis has shown that inequality can have a negative effect on growth. This has to do with lack of opportunities, especially on the lower part of the income distribution.

- The report also looks at the effects of the Great Recession following the financial crisis of 2007-08, on income inequality. We find that inequality was increasing in good times, and in bad times it continued to increase. Whatever happens with the economy, inequality seems to be going in only one direction.

- The groups at the lower part of the income distribution are the ones that are losing the most. There has been a lot of debate about the rise of the top 1%, but inequality also concerns the most vulnerable members of society. The bottom 10% is very vulnerable, but the lower middle class has also been suffering and has not gained so much from economic growth. One of the causes has to do with the types of jobs this population holds, which are characterised by temporary contracts or part-time employment or self-employment. These jobs have created employment opportunities. In fact, most of the jobs that have been created in the last three decades have been of these types. Although one may think that some job is better than no job, low unemployment rates do not necessarily translate into low income inequality. Increasing non-standard work can create job opportunities but also have contributed to higher inequality.

- A positive finding is the rise in female labour force participation. In the last few decades, the increase in the employment of women and the reduction of the gender pay gap have partly offset the rising income inequality. Without these effects, the Gini coefficient would have been about 2 percentage points higher on average across OECD countries.

- Finally, we have looked into the distribution of wealth, which, as we will see, is much more concentrated than income.

Deriving from these findings the OECD has come up with some key main policy recommendations:

- Promote employment and good quality jobs. This is the best way to combat inequality. Not all jobs are of good quality. One must assess whether the jobs have a future, if they are paid well and if they create possibilities of a career for those who start in more vulnerable positions.

- Female participation has a great positive effect on income equality, but there is still more work to do. Policies related to fostering the labour participation of females are very important.

- Related to this is the win-win policy of investing in education and skills. It has a very positive effect both on equality and on growth.

- Finally in terms of tax and benefit systems, we have seen that redistribution is not necessarily negative for growth if policies are well designed.

Years of schooling are negatively associated with income inequality among people with low parental educational background (PEB). Figure 1 shows the number of years of education by parental educational background and

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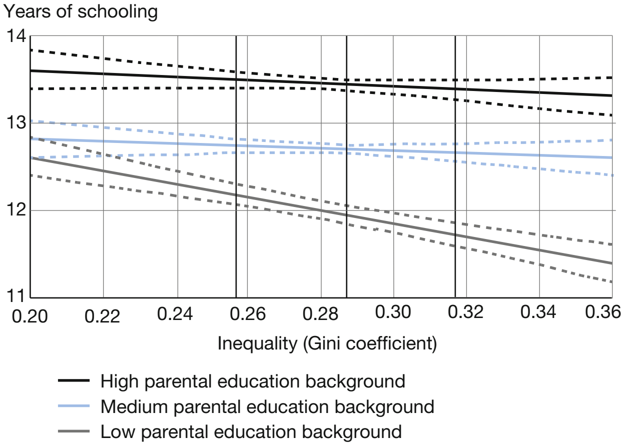
Figure 1

Inequality decreases average years of schooling, but mostly among individuals with low parental education

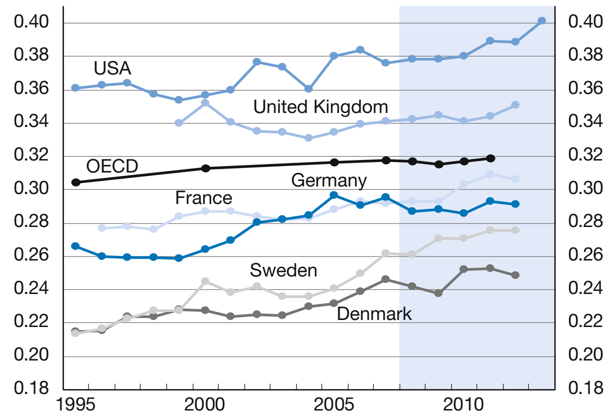


Note: The vertical lines indicate the 25th, the median and the 75th percentiles of the underlying distribution of inequality.

Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207856

Figure 2

Long-term trends in inequality of disposable income



Note: Income refers to disposable income adjusted for household size.

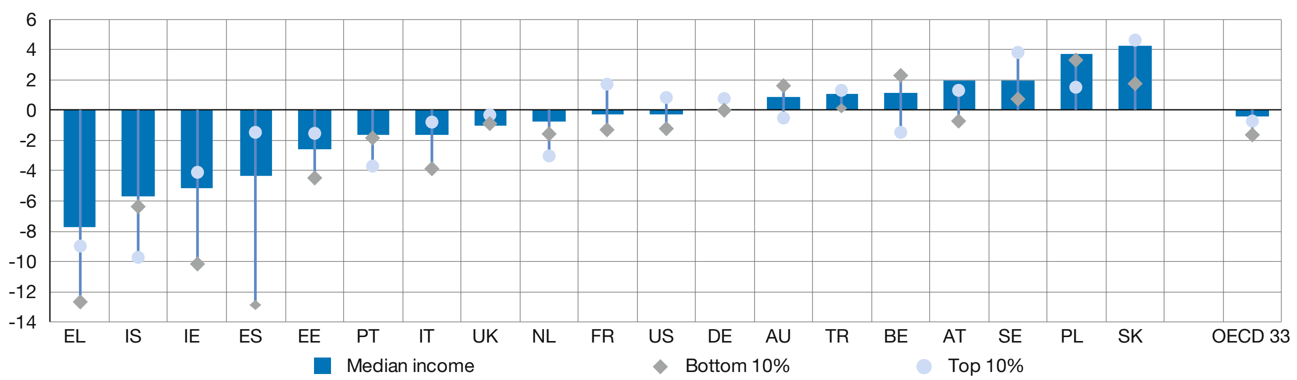
Source: OECD (2015), "In It Together", http://www.oecd.org/social/in-it-together-why-less-inequality-benefits-all-9789264235120-en.htm; OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm.

income inequality (the dotted lines show the confidence intervals). The black line represents the number of years of education of people whose PEB is high (at least one parent has attained tertiary education). The blue line is the same for people with a medium PEB, meaning that at least one parent attained upper secondary education. The grey one describes the people with a low PEB (neither parent attained upper secondary education). The x-axis shows the inequality level. For individuals with high and median PEB there is no apparent association between years of education and inequality. However, among those with low PEB, average schooling can be half a year shorter if inequality, measured by the Gini coefficient, is 5 points higher (about the current difference between Germany and United Kingdom). This indicates an underinvestment in human capital, and missing opportunities.

Now let us talk about income inequality in the OECD countries as measured by the Gini coefficient (0: perfect equality, 1: one person has all the income of the country). In Denmark the Gini coefficient is 0.25, while in Chile it is 0.5. In Denmark the top 10% are five times richer and in

Figure 3

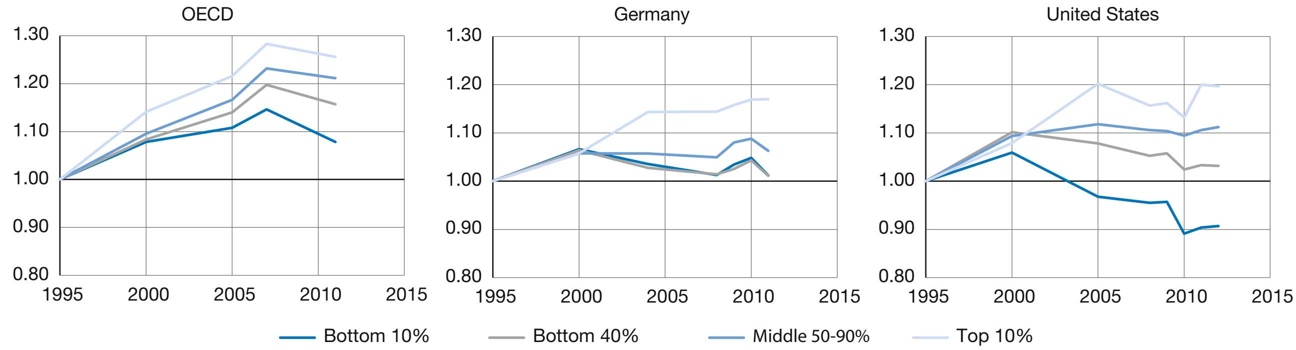
Annual percentage changes in household disposable income between 2007 and 2011



Note: Between 2008 and 2011 for France, Germany, Sweden. AT = Austria, AU = Australia, BE = Belgium, DE = Germany, EE = Estonia, EL = Greece, ES = Spain, FR = France, IE = Ireland, IS = Island, IT = Italy, NL = The Netherlands, PL = Poland, PT = Portugal, SE = Sweden, SK = Slovakia, TR = Turkey, UK = United Kingdom, US = USA.

Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207907.

Figure 4
Trends in real household incomes at the bottom, the middle and the top
OECD average, 1995 = 1



Note: Income refers to disposable household income, corrected for household size. OECD is the unweighted average of 17 countries (Canada, Germany, Denmark, Finland, France, United Kingdom, Greece, Israel, Italy, Japan, Luxembourg, Mexico, Netherlands, Norway, New Zealand, Sweden and United States).

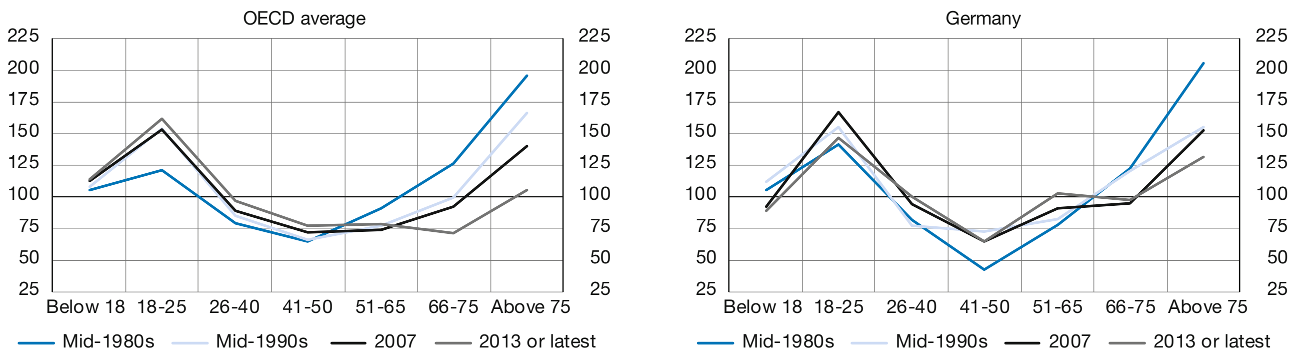
Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207920.

Chile they are about 30 times richer than the bottom 10%. On average the top 10% in OECD countries are about ten times richer. In Germany they are 6.6 times richer, and the trend is increasing.

Since the mid-1990s, income inequality has increased in good and in bad times (see Figure 2). Even though it decreased a bit in some countries in the beginning of the crisis, we can see that the rising trend continued thereafter (see the shaded blue area).

In the public debate, we often hear about the top 1%, but we should not forget about the bottom of the income distribution. Germany is a country that has not been so affected by the recent economic crisis. In contrast, in some OECD countries the income fall was very significant and particularly at the bottom 10%. Figure 3 shows the annual rate of income change between 2007 and 2011. In Greece and Spain, the bottom 10% saw their incomes fall by 12% per year in this period. This is a huge setback in a short period of time and particularly worrying as during the good times

Figure 5
Relative poverty rate by age cohort, mid-1980s to 2013 or latest available year
Total poverty rate = 100



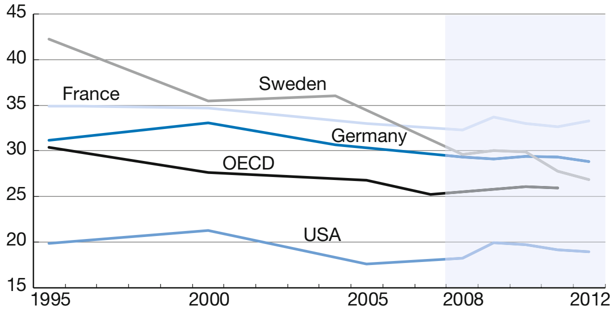
Note: OECD unweighted average for 18 OECD countries for which data are available from the mid-1980s: Canada, Denmark, Finland, France, Germany, Greece, Israel, Italy, Japan, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Sweden, Turkey, United Kingdom, United States.

Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207732.

Figure 6

Trends in market income inequality reduction, working age population

in %



Source: OECD Income Distribution Database, www.oecd.org/social/income-distribution-database.htm.

the bottom 10% were also benefitting less from economic growth.

Figure 4 shows how in the USA, even though total income was rising, the bottom 10% earned less in 2012 than in 1995. In Germany, income at the bottom 10% and even bottom 40% have barely increased after almost 20 years.

Poverty has had an interesting dynamic with respect to its age profile (see Figure 5). About 20 or 30 years ago, poverty was highly concentrated on the elderly. Over the last few decades the income position of people at pension age has been improving and elderly poverty falling. The crisis intensified this process. In general, pensions were not directly affected by the rise in unemployment and somehow less affected by austerity measures. The elderly was the age-group that lost the least during the crisis. Youth and children are now the age groups most affected by poverty in most OECD countries. In Germany, however, child poverty is still below the population average.

Redistribution via taxes and benefits considerably decreases inequality. Redistribution reduces income inequality among the working age population by about 25% on average across OECD countries (see Figure 6). However, over the long term, there has been a reduction in income redistribution. During the crisis (see the shaded area) labour and capital income fell, and unemployment increased. The unemployed started receiving unemployment and other social benefits, and that automatically increased redistribution. But, as soon as these benefits began to expire and governments implemented fiscal consolidation programmes to tackle the rising public debt, this effect receded.

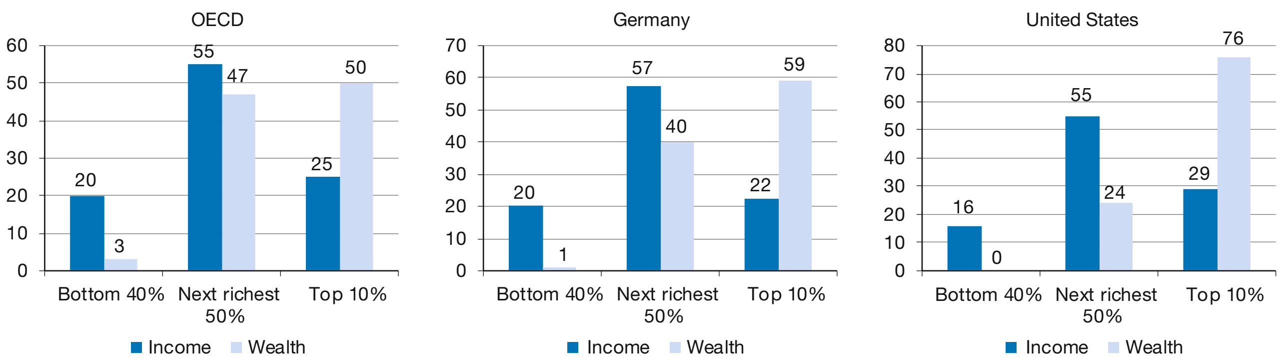
Wealth is much more concentrated than income. In Figure 7 the dark blue bars show income and the light blue bars show wealth. On average, the bottom 40% of the OECD own 20% of the income, but only 3% of the wealth. The top 10% receive on average 25% of the income and own 50% of the wealth. Germany, which is a low income inequality country, has quite pronounced inequality in terms of wealth. The USA has much higher levels of income inequality than Germany, but the two countries are much closer in terms of wealth inequality.

Figure 8 shows similar data for 17 OECD countries. The bars represent the levels of the income share of the top 10%, and the dots show the wealth share of the top 10%. Germany would be ranked 13th most unequal country in

Figure 7

Share of income and wealth going to different parts of the income and wealth distribution, around 2013

in %



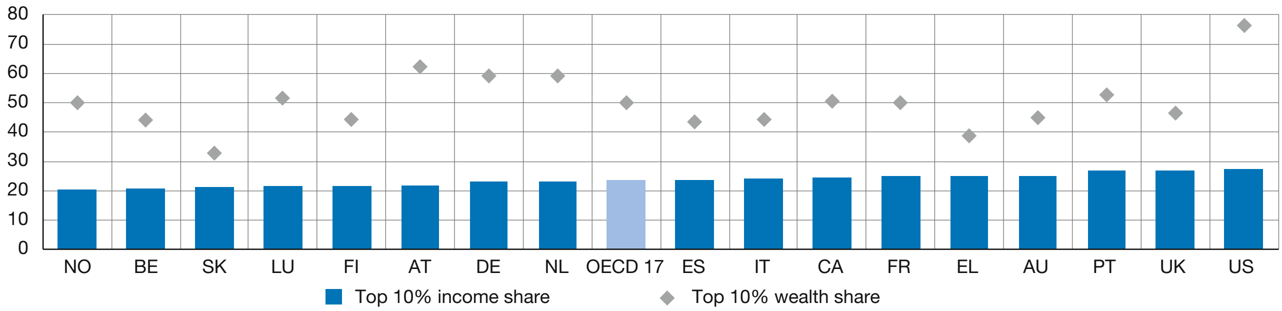
Note: Income refers to disposable household income, corrected for household size. Wealth refers to net private household wealth.

Source: OECD wealth questionnaire and ECB-HFCS survey and OECD Income Distribution Database, www.oecd.org/social/inequality.htm, OECD (2015), “In It Together”.

Figure 8

Share of household disposable income and of household net wealth held by top 10%

in %, 2012 or latest available year



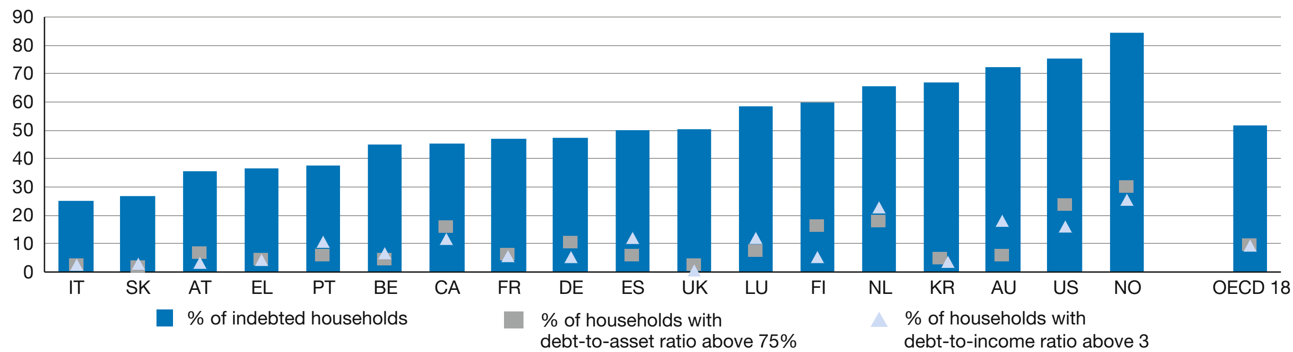
Note: Income refers to disposable household income, corrected for household size. Wealth refers to net private household wealth. Data refer to the shares of the richest 10% of income earners (bars) and of the richest 10% of wealth holders (diamonds). AT = Austria, AU = Australia, BE = Belgium, CA = Canada, DE = Germany, EL = Greece, ES = Spain, FI = Finland, FR = France, IT = Italy, LU = Luxembourg, NL = The Netherlands, NO = Norway, PT = Portugal, SK = Slovakia, UK = United Kingdom, US = USA.

Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207780.

Figure 9

Indebted and Over-indebted Households

in %, 2012 or latest available year



Note: AT = Austria, AU = Australia, BE = Belgium, CA = Canada, DE = Germany, EL = Greece, ES = Spain, FI = Finland, FR = France, IT = Italy, KR = South Korea, LU = Luxembourg, NL = The Netherlands, NO = Norway, PT = Portugal, SK = Slovakia, UK = United Kingdom, US = USA.

Source: OECD (2015), StatLink http://dx.doi.org/10.1787/888933207792.

terms of income and fourth in terms of wealth. Of course, the fact that we do not account for public pensions could bias the comparison across countries.

The other side of wealth is indebtedness. On average about half of the population of the OECD countries, including Germany is in net debt (see Figure 9). When we measure the debt-to-asset ratio in Germany, about 10% of the population is over-indebted, i.e. people owe 75% or more of their assets or more than three times their annual income. This is something to worry about, especially since it is concentrated among people with medium educational levels, i.e. people who have only finished secondary education.

Title: *Income and Wealth Inequality in OECD Countries*

Abstract: *This paper summarises some of the key findings and policy recommendations of the latest OECD report on income inequality - "In It Together: Why Less Inequality Benefits All". In particular, the paper presents new findings regarding the trade-off between inequality and growth, as well as with regard to the impact of the economic crisis and of female employment on the distribution of income and the distribution of wealth. Key policy recommendations derived from these findings are the need to promote employment and good quality jobs, to further improve female participation, to invest in education and skills, and to foster well-designed redistribution policies.*

JEL Classification: *J310, J8, D310*