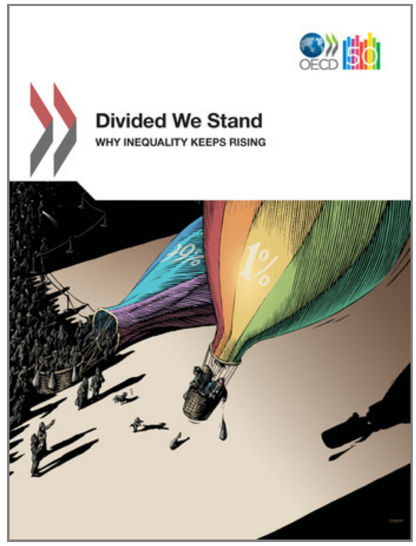
OECD *Multilingual Summaries*

Divided We Stand: Why Inequality Keeps Rising

Summary in English



- In the three decades to the recent economic downturn, wage gaps widened and household income inequality increased in a large majority of OECD countries. This occurred even when countries were going through a period of sustained economic and employment growth.
- This report analyses the major underlying forces behind these developments. It examines to which extent economic globalisation, skill-biased technological progress and institutional and regulatory reforms have had an impact on the distribution of earnings.
- The report further provides evidence of how changes in family formation and household structures have altered household earnings and income inequality. And it documents how tax and benefit systems have changed in the ways they redistribute household incomes.
- The report discusses which policies are most promising to counter increases in inequalities and how the policy mix can be adjusted when public budgets are under strain.

EDITORIAL : MIND THE GAP

The landmark 2008 OECD report *Growing Unequal?* showed that the gap between rich and poor had been growing in most OECD countries. Three years down the road, inequality has become a universal concern, among both policy makers and societies at large. Today in advanced economies, the average income of the richest 10% of the population is about nine times that of the poorest 10%.

In some countries such as Israel and the United States – inequality has increased further. But even in traditionally egalitarian countries – such as Germany, Denmark and Sweden – the income gap between rich and poor is expanding – from 1 to 5 in the 1980s to 1 to 6 today. Only a few countries have been able to buck this trend: income inequality has recently fallen in Chile and Mexico, but the richest in these two countries still have incomes more than 25 times those of the poorest.

In emerging economies, economic growth has helped to reduce sharply the prevalence of poverty. But at the same time high levels of income inequality have risen further. Among the BRICs, only Brazil managed to reduce inequality substantially, although with a ratio of 50 to 1 it is still a far more unequal country than any of the OECD countries.

The economic crisis has added urgency to deal with the policy issues related to inequality. The social compact is starting to unravel in many countries. Young people who see no future for themselves feel increasingly disenfranchised. They have now been joined by protesters who believe that they are bearing the brunt of a crisis for which they have no responsibility, while people on high incomes appear to have been spared. From Spain to Israel, from Wall Street to Syntagma Square, popular discontent is spreading rapidly. Due to the crisis, uncertainty and inequality-related issues have reached the middle classes in many societies.

The challenges are clear, but it is less obvious what has caused such inequality and what can be done about it – and what polices are needed. This report aims to untangle the complex web of factors behind the growing gap between rich and poor. The single most important driver has been greater inequality in wages and salaries. This is not surprising: earnings account for about three-quarters of total household incomes among the working-age population in OECD countries in most cases. The earnings of the richest 10% of employees have taken off rapidly, relative to the poorest 10% in most cases. The largest gains were reaped by the top 1% and in some countries by an even smaller group: the top 0.1% of earners. New data for the United States, for example, show that the share of after-tax household income for the top 1% more than doubled, from nearly 8% in 1979 to 17% 2007. Over the same period, the share of the bottom 20% of the population fell from 7% to 5%.

The labour market should therefore be the first place to act. Finding the right counterbalance to rising income inequality requires an understanding of why wages are becoming more polarised. Technological progress has been a motor for economic growth, but not all workers have been able to benefit in the same way. We have to acknowledge that better-educated, higher-earning workers have reaped higher gains while those with lower skills have been left behind. The rise of the share going to the top earners is also the result of companies operating in a global market for talent, a spectacular rise in pay of executives and bankers, and of the emergence of a winner-takes-all culture in many countries.

Labour markets have profoundly changed in OECD countries since the 1980s, marked by a series of reforms to increase their flexibility. The markets for goods and services have also been deregulated, and policies to increase competition have been pursued. These reforms have promoted productivity and economic growth and have brought more people into work. But on the "b-moll" side they have also contributed to widening earnings gaps: many of these jobs were part-time or low-paid.

More unequal wages have contributed to the fact that more people needed the help of social-protection systems to maintain their living standards. The sheer volume of redistribution through social policies increased. But with more people needing support, these systems were unable to reduce inequality by as much as they had done before. Overall, tax-benefit policies offset some of the large increases in inequality attributable to growing market-income disparities, the main driver of inequality trends between the mid-1980s and the mid-1990s. However, from the mid-1990s to 2005, the reduced redistributive capacity of tax-benefit systems was sometimes the main source of widening household-income gaps. Currently, these systems reduce inequality among the working-age population by about one-quarter on average across OECD countries, with higher redistribution in most Nordic countries and Belgium, and levels well below average in Chile, Iceland, Korea, Switzerland and the United States. The main reason for less effective redistribution over the past 15 years was on the benefit side: levels were cut and eligibility rules tightened to contain expenditures for social protection.

Tax plays a less important role than benefits in reducing income inequalities. This is especially the case over the last two decades which have seen a move away from highly progressive income tax rates and the elimination of net wealth taxes. Nevertheless, the growing share of income going to top earners means that this group now has a greater capacity to pay taxes than before and in some countries they are already paying a greater share of income taxes than in the past. It is in this context that many governments are re-examining the redistributive role of taxation to ensure that wealthier individuals contribute their fair share of the tax burden. This reassessment is not confined to a consideration of raising marginal tax rates on income, which might not be the most effective measure to raise tax revenues. It extends to include better tax compliance from tackling offshore tax evasion; eliminating tax expenditures which disproportionally benefit higher income groups; and reassessing the role of taxes on all forms of property and wealth, including the transfer of assets.

Reforming tax and benefit policies is the most direct and powerful instrument for redistribution. Yet strategies focusing only on reshuffling income would be neither effective nor financially sustainable, especially in the constrained fiscal climate that prevails today. The most promising way of tackling inequality is more than ever by the employment route. More and better jobs, enabling people to escape poverty and offering real career prospects, is the most important challenge.

This report clearly identifies *upskilling* of the workforce as one of the most powerful instruments at the disposal of governments to counter rising inequality. *Upskilling* is singled out as the only force which succeeded not only in reducing wage dispersion but also in increasing employment rates.

Investing in the workforce is therefore crucial. The investment in people must begin in early childhood and be followed through into formal education and the transition from school to work. This is vital to ensure equality of opportunity for children from disadvantaged backgrounds. At the same time, human capital investment needs to be sustained over the full course of working life. The way that training is provided needs careful assessment and both employers and individuals need the means and incentives to invest in human capital.

Many of the driving forces of income inequality are the same in both emerging and OECD economies. But the setting is not the same. Emerging economies have large informal sectors: workers who are outside of social-protection systems and generally in low-paid, low-productivity jobs. Informal employment remains stubbornly high in many emerging economies despite strong overall economic growth. In these countries, disparities between ethnic groups and regions, rural and urban populations, and migrant and non-migrant workers are also significant.

Another important instrument especially for emerging economies is the provision of freely accessible and high-quality public services, such as education, health, and family care. On average, OECD governments spend as much – some 13% of GDP – on public social services as they do on all cash benefits taken together and this spending reduces inequality by about one fifth on average. Ensuring equal access for all of the population to such services will help reduce inequality and provide equal opportunities of personal and professional development for all citizens.

There is nothing inevitable about high and growing inequalities. For economies and societies as a whole, globalisation and technological changes offer opportunities. To reap the maximum reward from these opportunities, policies must make markets more efficient while encouraging employment and reducing inequalities. This study dispels the assumption that the benefits of economic growth will automatically trickle down to the disadvantaged and that greater inequality fosters greater social mobility. Without a comprehensive strategy for inclusive growth, inequality will continue to rise. We need to put better policies for better lives at the centre of our policy efforts, while providing people with hope and equal opportunities. This report provides powerful evidence of the need to “go social!” The OECD stands ready to support its member and partner countries in achieving this objective.