What’s happening to income inequality?

Income inequality has risen in many parts of the world, including in wealthy, emerging and developing countries. In parallel, many emerging countries have seen the emergence of a middle class, which, though still fragile, could play a major role in the future development of economies and societies.
2. WHAT’S HAPPENING TO INCOME INEQUALITY?

Key themes

For much of the 20th century, the gap in incomes between the well-off and less well-off is generally thought to have narrowed in much of the world. In effect, the rich didn’t get much richer while the poor caught up a bit. According to research based on The World Top Incomes Database, this decline in inequality began in North America and much of Europe in around the 1920 and 1930s and a little later, perhaps the 1950s, in some developing countries. But then, in the 1970s and 1980s, the pattern began to reverse, and inequality began to rise again.

In very basic terms, then, the pattern of inequality in the 20th century and up to today resembles a “U” – a long decline followed by a slow rise. That shape, incidentally, is the inverse of what some economists predicted would happen (see Section 4.1).

This rise in inequality over recent decades is evident in most – but not all – rich economies. It has affected not just economies with a history of relatively high inequality, but also countries where traditionally there was less inequality, like Denmark, Germany and Sweden.

Inequality has also grown in emerging and developing economies, although not always for quite the same reasons. In recent decades, the economic rise of countries like China, Brazil and India has reshaped the global economy. Among its most striking effects has been the sharp fall in the number of people living in absolute – or dollar-a-day – poverty and the emergence of a new middle class. But poverty hasn’t gone away. Indeed, in many emerging and developing countries, relative poverty is proving stubbornly resistant and inequality, too, is widening.

2.1. Rich countries: Inequality rising since the 1980s

Since the 1980s, income inequality has risen in most OECD countries. A quarter of a century ago, disposable income of the top 10% of earners was on average around 7 times higher than that
of bottom 10%; by 2010, it was around 9½ times higher. Since the mid-1980s, average inequality in OECD countries has risen by almost 10% to just under 32 Gini points, the standard measure of inequality.

The shift was even more pronounced over roughly the same period among the top 1% of earners, especially in English-speaking countries. In the United States, for example, the share of pre-tax income going to the richest 1% more than doubled, reaching almost 20% in 2012.

**Who’s benefiting from growth?**

The rise in inequality in many countries since the 1980s (and even earlier) underlines a significant economic trend. In simple terms, the benefits of economic growth have tended increasingly to go to a smaller segment of society. In the United States, for example, between 1975 and 2012 around 47% of total growth in pre-tax incomes went to the top 1%. The share was also high in a number of other (mostly) English-speaking countries: 37% in Canada and over 20% in Australia and the United Kingdom.

But even in countries where the 1% didn’t do quite so well, the fruits of economic growth have tended to flow more towards the top 10% of earners than towards the bottom 10%. This shift has sparked increasing discussion of the need for “inclusive growth”, with the potential to ensure as many people as possible enjoy greater prosperity, have decent opportunities in areas like work and education, enjoy access to healthcare and a clean environment and are able to play a full role in society.

*More from Insights: Is the world today more unequal than it was 200 years ago?, asks the OECD Insights Blog, [http://wp.me/p2v6oD-1RQ](http://wp.me/p2v6oD-1RQ).*

**Why is inequality higher in some countries than in others?**

The variations in inequality between OECD countries are striking. Inequality is particularly high in Chile, Israel, Mexico, Turkey and the United States, and particularly low in Denmark, Norway, the Slovak Republic and Slovenia. Equally, while inequality tended to rise in most countries between the mid-1980s and
mid-2000s, there were again striking variations between countries. To be sure, it rose in most, notably the United States, New Zealand and – perhaps surprisingly – Finland and Sweden. But in some others, such as France, it barely budged.

Data: Income inequality has increased in most OECD countries since the mid-1980s.

![Gini measure of income inequality, mid-1980s and 2013](chart)

Source: OECD (2015), In It Together: Why Less Inequality Benefits All, [http://dx.doi.org/10.1787/888933207711](http://dx.doi.org/10.1787/888933207711).

What accounts for these variations? A number of factors play a role, but two are of particular importance. The first is the wage gap (or “wage dispersion”) – that’s the gap between the wages of high and low-income workers. In some countries, this gap is much wider than in others. The second is the role of the state, which takes income in the form of taxes and hands it back in the form of transfers. Taxes and transfers reduce income inequality in all OECD countries (see Section 3.5), but far more in some than in others.

These factors can be seen at work by comparing the inequality record of different countries. At the low end, the Nordic countries (Denmark, Iceland, Norway, and Sweden) and Switzerland all have below-average inequality and below-average poverty. Unemployment is low and the wage range is relatively narrow – very high wages are
relatively rare. Most people receive cash transfers from the state, and income taxes are strongly progressive – in other words, higher earners lose a bigger share of their income in tax.

More from the OECD: Inequality patterns across OECD countries are examined in “Mapping Income Inequality Across the OECD”, (Hoeller, P. et al 2012), an OECD working paper, http://dx.doi.org/10.1787/5k9h297wxbnr-en.

At the other end of the scale are a group of countries such as Chile, Israel, Mexico, Portugal, Turkey and the United States, which have relatively high income inequality. Several factors are at work – the wage range is relatively wide, with some people on very high wages, and the state often provides less in the way of cash transfers.

2.2. Developing countries: Inequality rises, but a middle class emerges

Since the late 1990s, the engine of the world economy has moved from the traditionally wealthy OECD countries to developing and emerging economies – a phenomenon sometimes called “shifting wealth”. China and India are the most famous examples, but they’re not alone: In the 1990s, only 12 developing economies saw their GDP per capita grow at more than double the rate of OECD countries; in the 2000s that number soared to 83.


Lately, economies in many emerging economies have slowed, reducing the pace of this shift in global wealth – as The Economist has noted, “its most tumultuous phase seems to have more or less reached its end”. Nevertheless, the impact of this shift has been profound. Many developing countries are seeing huge numbers of people escaping poverty and the emergence of a new middle class – even if many of its members are still on a very fragile financial footing. But, many also, are seeing widening income inequality, although the factors behind this are not always quite the same as in developed countries.
Falling poverty, rising inequality

A striking statistic: Compared to 1981, worldwide there are now around 650 million fewer people living in extreme poverty – i.e. on less than $1.25 a day – even though, over that same period, the global population rose by about 2 billion. Many factors have contributed to that decline, but the most important is the rise of China – it alone accounted for around half a billion people moving out of extreme poverty.

Data: Poverty rates in developing countries have fallen sharply since the early 1980s, although much of the decline reflects China’s economic resurgence.

Poverty rates for the developing world, 1981-2008

% below poverty line

But while $1.25-a-day poverty has been falling in much of the developing world, the same is not always true of relative poverty, which in many cases is at best stagnating. In addition, many of the countries that have made the biggest contributions to reducing poverty also have very high levels of inequality. In Brazil and much of South America, these often exceed 50 Gini points while in South Africa inequality touches 70 Gini points. It’s high, too, in India (around 34 Gini points) Indonesia (around 40 points) and China (around 45 points).
Although high, these figures are, in some cases, actually lower than they used to be, especially in parts of Latin America. On the other hand, South Africa, Indonesia and China all saw increases in inequality, although, in the case of China, it may now be stabilising.

One consequence of these trends is that most of the world’s poorest people no longer live in the world’s poorest countries. According to the British researcher Andy Sumner, about three-quarters of the world’s 1.3 billion poorest people now live in what the World Bank classes as middle-income countries (MICs), most notably India. That raises the question of whether or not growth is inclusive – is it simply enriching an educated elite or is it bringing broad benefits? The answer to that isn’t always clear. As the development expert Owen Barder has noted, “The figures suggest that the biggest causes of poverty are not lack of development in the country as a whole, but political, economic and social marginalisation of particular groups in countries that are otherwise doing quite well.”

More from Insights: “... if we focus on the poorest countries, we’ll actually miss most of the world’s poor.” OECD Insights Blog, http://wp.me/p2v6oD-Bu.

What’s driving inequality in developing countries?

In many developing countries, travelling from the bustle of a busy city to the quiet of a country village can feel like a journey through time. In some ways, it is. While cities have become increasingly plugged into the globalising economy, life in many rural areas has often changed little. These differences between urban and rural areas, or between different provinces and regions, reflect what are called spatial inequalities, and they can be a significant contributor to overall inequality in many developing countries.

Income explains only some of these regional inequalities, although in some emerging economies – notably China and India – it’s significant, with urban incomes rising faster than rural. But there are also inequalities of opportunity – notably access to healthcare, education and jobs – that are perhaps more important. For example, in some emerging economies, enrolment in secondary education is much lower in rural areas than in urban, especially for girls. Access
to basic healthcare can also vary greatly depending on where people live. In Asia, for example, infant mortality is typically much higher in the countryside than in the cities. And, in many parts of the world women still face many barriers that deprive their families and communities of valuable economic contributions.

Other factors are also at work. One, for example, is the extent to which people in many poorer countries work informally, with no written contracts and little in the way of terms and conditions of employment. In Mexico and Brazil, around half of jobs are in the informal sector, a level that rises to around 80% in India and Indonesia. Such jobs contribute to inequality in a number of ways – for one thing, they pay less than formal jobs. They also rarely offer workers opportunities for training and promotion. And they are unpredictable, meaning workers may find themselves without an income at very short notice.

More from the OECD: The role of informal work in developing countries is explored in *Is Informal Normal?* (Jütting and de Laiglesia, 2009), [http://dx.doi.org/10.1787/9789264059245­en](http://dx.doi.org/10.1787/9789264059245-en).

Finally, in developed countries, taxes and transfers do much to reduce income inequality, but in many developing countries these systems are rarely well developed. There are exceptions: In Brazil, for example, the Bolsa Familia, or family allowance programme, makes payments to more than 13.3 million families, representing nearly a quarter of the population, on condition that they enrol children in school and take part in health programmes. That has helped to reduce rates of both child poverty as well as inequality.

**Emerging middle class?**

One of the most closely watched aspects of “shifting wealth” is the emergence of a new middle class, even if in many cases its members don’t yet enjoy the prosperity and economic security that has traditionally been associated with the middle class in many wealthy countries. Nevertheless, this middle class may have the potential to play a transformative role in both the economy and society.

More from Insights: *Who are the middle classes?*, asks the OECD Insights Blog, [http://wp.me/p2v6oD-1zP](http://wp.me/p2v6oD-1zP).
By definition, “middle class” is a relative term – it’s somewhere above poor but below rich, but where? Answers vary widely. Some economists, such as Brazil’s Eduardo Giannetti da Fonseca, prefer a descriptive approach: “People who are not resigned to a life of poverty, who are prepared to make sacrifices to create a better life for themselves but who have not started with life’s material problems solved ....” Others define it numerically, but even here there are different ways of thinking. One approach is to come up with a relative figure based on income levels in each country: For example, anyone earning between 50% and 150% of the median income. Other approaches are more global, and define middle class simply as households with a certain level of income. In 2008, Goldman Sachs put that figure at between $6,000 a $30,000 a year; by contrast, experts working in development tend to use a much lower figure, such as between $10 and $100 a day.

However it’s measured, the key point is that even though this new middle class remains economically vulnerable, it has at least risen above day-to-day subsistence living and can plan for, and invest in, the future. And that, historically, has been one of the most significant attributes of the middle classes. In the words of the development expert Homi Kharas, “the middle class has been thought of as the source of entrepreneurship and innovation – the small businesses that make a modern economy thrive. Middle class values also emphasise education, hard work and thrift. Thus, the middle class is the source of all the needed inputs for growth in a neoclassical economy – new ideas, physical capital accumulation and human capital accumulation.” It’s also traditionally seen as an important political player, both as a source of stability and a force for policies like investment in education.

More from the OECD: Shifting social patterns are examined in The Emerging Middle Class in Developing Countries (Kharas, 2010), a study for the OECD Development Centre, http://dx.doi.org/10.1787/5kmmp8lncms-en.

The role of these middle classes is likely to grow: Homi Kharas projects the middle class could expand from around 1.8 billion people today to 3.2 billion by 2020 and 4.9 billion by 2030, with the bulk of this growth – about 85% – coming from Asia.