

Does inequality hamper growth?
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TRENDS IN INCOME INEQUALITY AND ITS IMPACT ON ECONOMIC GROWTH

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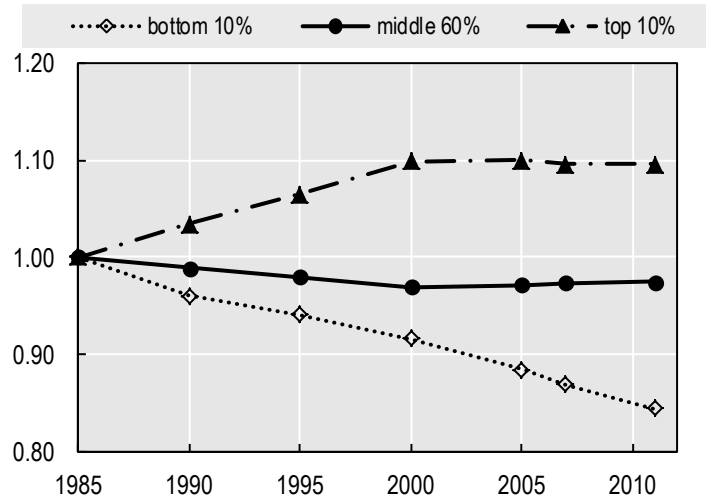


A long-term rise in income inequality

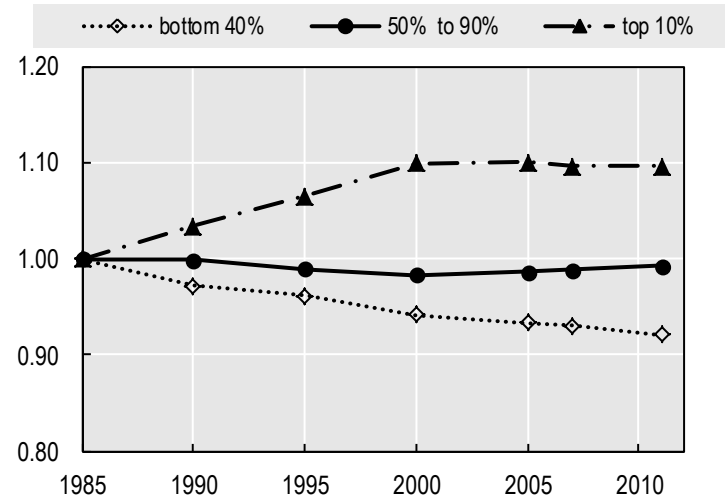
- The gap between rich and poor is at its highest level since 30 years in the OECD area.
- The richest 10% of the population earns 9.5 times more than the poorest 10% (In the 1980s the ratio stood at 7:1).

Shares of bottom, middle and top incomes in total income, OECD average 1985 to 2011/12, 1985 = 1

Traditional definition



Palma definition



Note: Income refers to disposable household income, corrected for household size. OECD average refers to 17 countries (see Annex figure A.1)

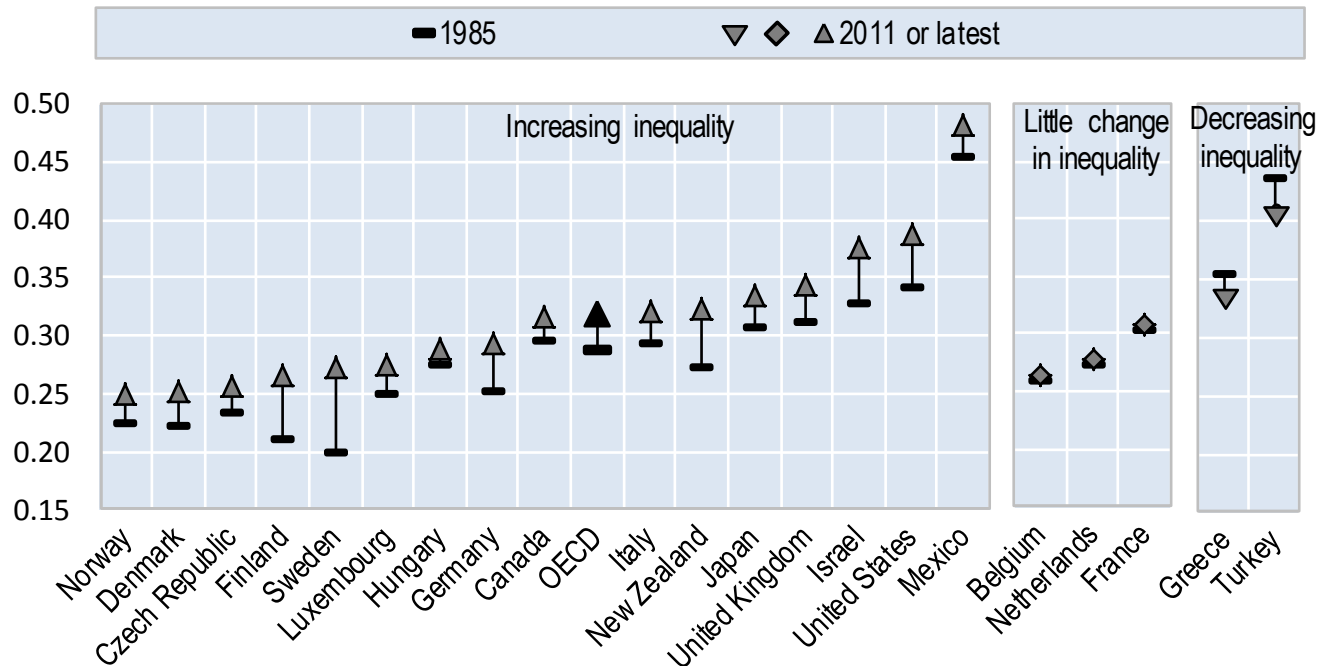
Source: [OECD Income Distribution Database \(IDD\)](#).



A long-term rise in income inequality

- A broader measure (the Gini coefficient, =0 if everybody has identical incomes, =1 if all income goes to only one person) also shows widespread increases in inequality.

Gini coefficients of income inequality, between mid-1980s and 2011/12



Note: "Little change" in inequality refers to changes of less than 1.5 percentage points.

Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

Source: OECD Income Distribution Database (IDD).



A long-term rise in income inequality

- These developments have raised concerns about their potential impact on our societies and economies.
- As countries are moving out of the Great Recession one of the central questions is whether greater income inequality is compatible with recovery and growth? Or, on the contrary, does it hold growth back?
- New OECD research shows that when income inequality rises, economic growth falls.
- One reason is that poorer members of society are less able to invest in their education.



(How) Does inequality affect economic growth?

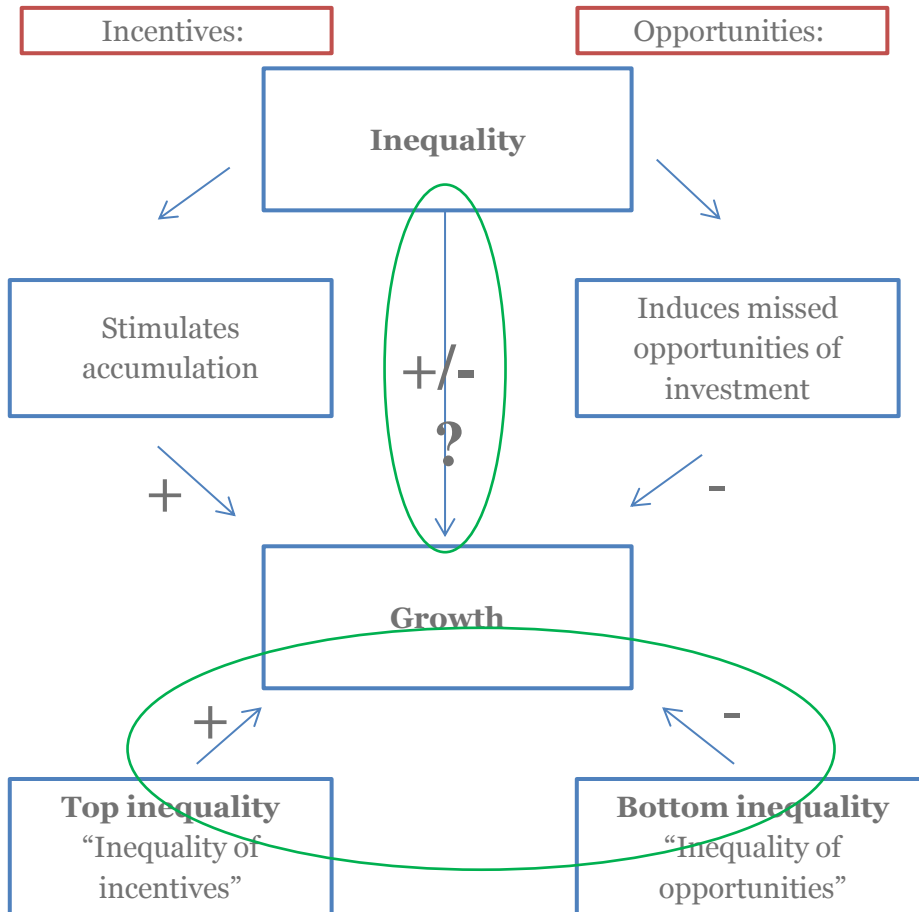
Long standing, controversial debate with two main opposing views:

- “**Incentives**” argument: Inequality might **increase** growth by providing **incentives** to work, invest and take risks
- “**Opportunities**” argument: Inequality might **decrease** growth by inducing missed **opportunities** of investment by the poor (in particular, if they can not borrow money).

Consequences of higher inequality for growth (and social mobility) will depend on which of these forces prevail.



(How) Does inequality affect economic growth? This work:

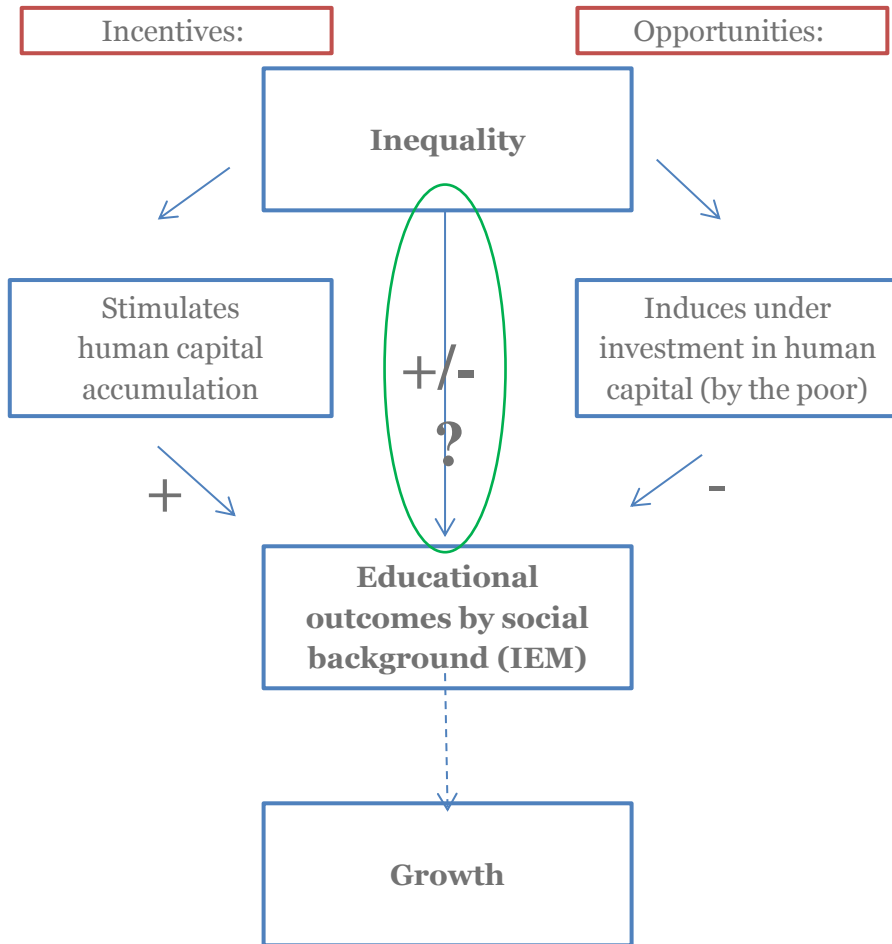


Studies the inequality-growth nexus

- Adds to a large empirical literature on the subject (which has not helped reaching a consensus)
- New look with high quality (OECD) data
 - More homogeneous set of countries
 - Broader characterization of the shape of income distribution



(How) Does inequality affect economic growth? This work:



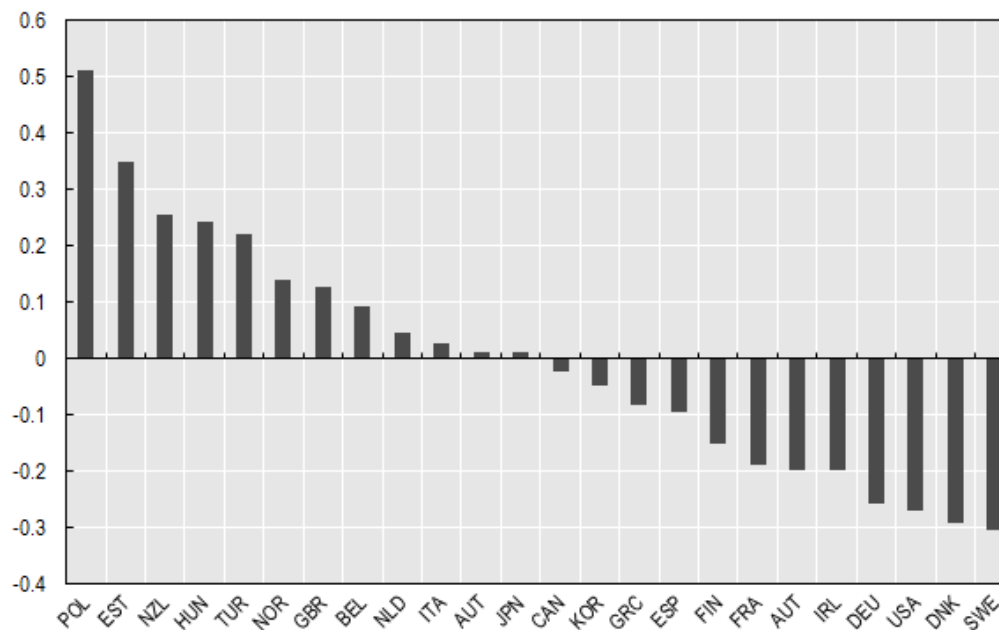
Examines the link between inequality and educational outcomes

- Is there an effect? Does it depend on social background?
 - Relevant intermediate mechanism (human capital is “the engine” of growth)
 - Relevant for the debate on inequality and social mobility



1. Inequality and Growth: main findings

- Higher inequality *lowers* economic growth
 - Increasing income inequality by 1 Gini pt. lowers GDP per capita growth by ~0.1 percentage points per year, in long run
 - Gains/losses in yearly growth using actual changes in net income inequality (2000 – 2010):





1. Inequality and Growth: main findings

- Result is driven by disparities at the *bottom* of the distribution
 - The negative effect is not just for the poorest income decile but involves the lower middle classes (the bottom 40%)
 - Top inequality is less, if any, relevant for growth
- Redistribution (through taxes and benefits) has *not* led to bad growth outcomes
 - Data allow for imperfect/partial measurement, does not imply all redistribution is equally good
 - Similar to IMF (Ostry et al 2014) looking at a broader set of countries



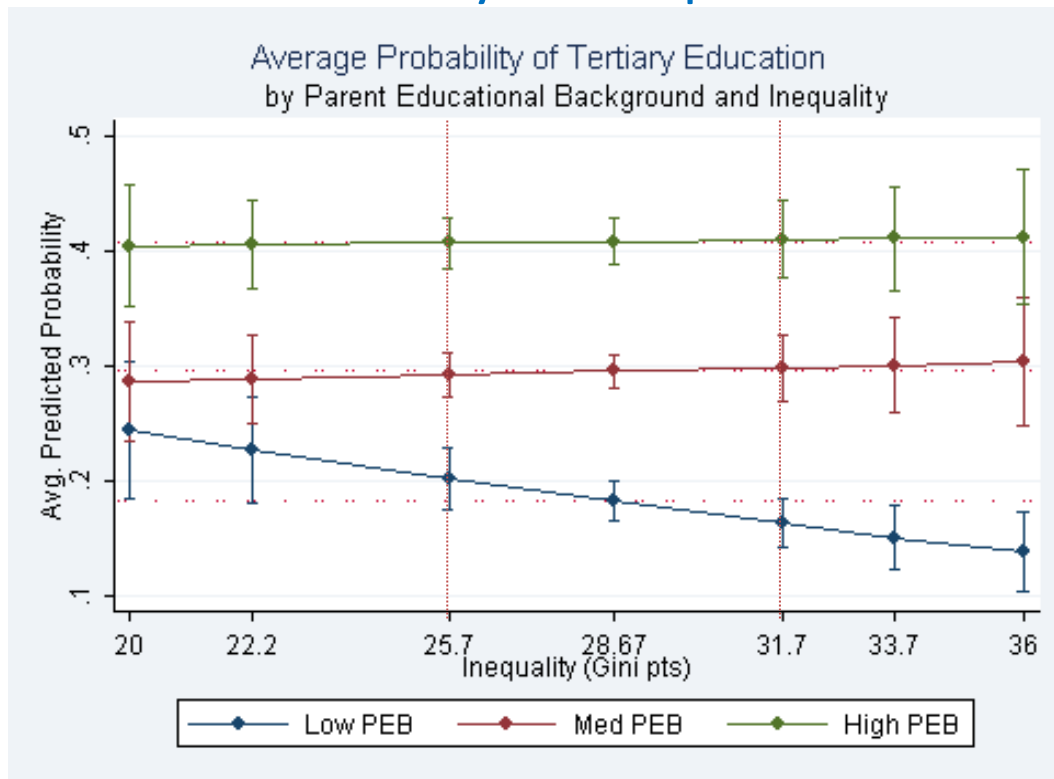
2. Inequality, human capital and growth

- Prominent mechanism: inequality narrows the set of investment opportunities by the poor
- Use PIAAC survey to test this hypothesis:
 - Distinguish individuals with “low” (*the poor*), “medium” and “high” Parental Education Background (PEB)
 - Relate their educational outcomes (formal education and skill proficiency) to inequality in their country
- Empirical question: do changes in inequality affect individuals with different PEB differently?



2. The impact of inequality on formal education

Inequality lowers the probability of Tertiary education, but only of the poor



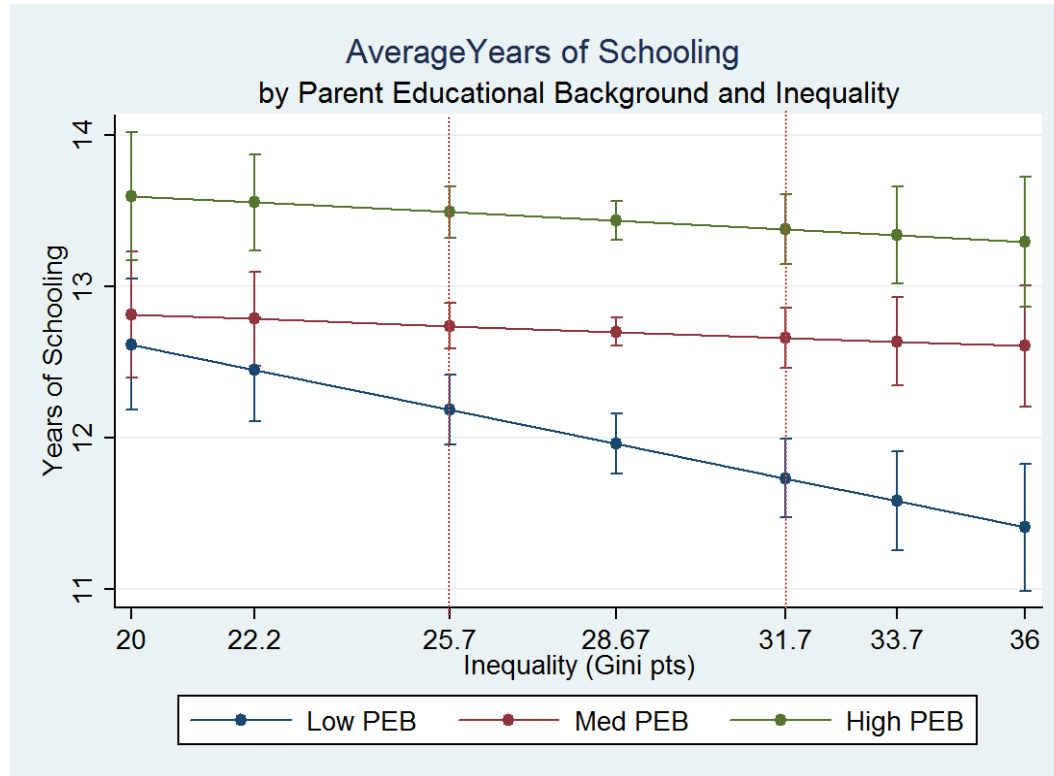
→ Increasing inequality by ~6 Gini pts. (the interquartile range) lowers AYS by ~4 percentage points (around 40% of their baseline probability differential with respect to Medium PEB individuals)

Note: Low PEB: neither parent has attained upper secondary education; Medium PEB: at least one parent has attained secondary and post-secondary, non-tertiary education; High PEB: at least one parent has attained tertiary education. The bars indicate 95% confidence intervals.



2. The impact of inequality on formal education

Inequality lowers average years of schooling of the poor



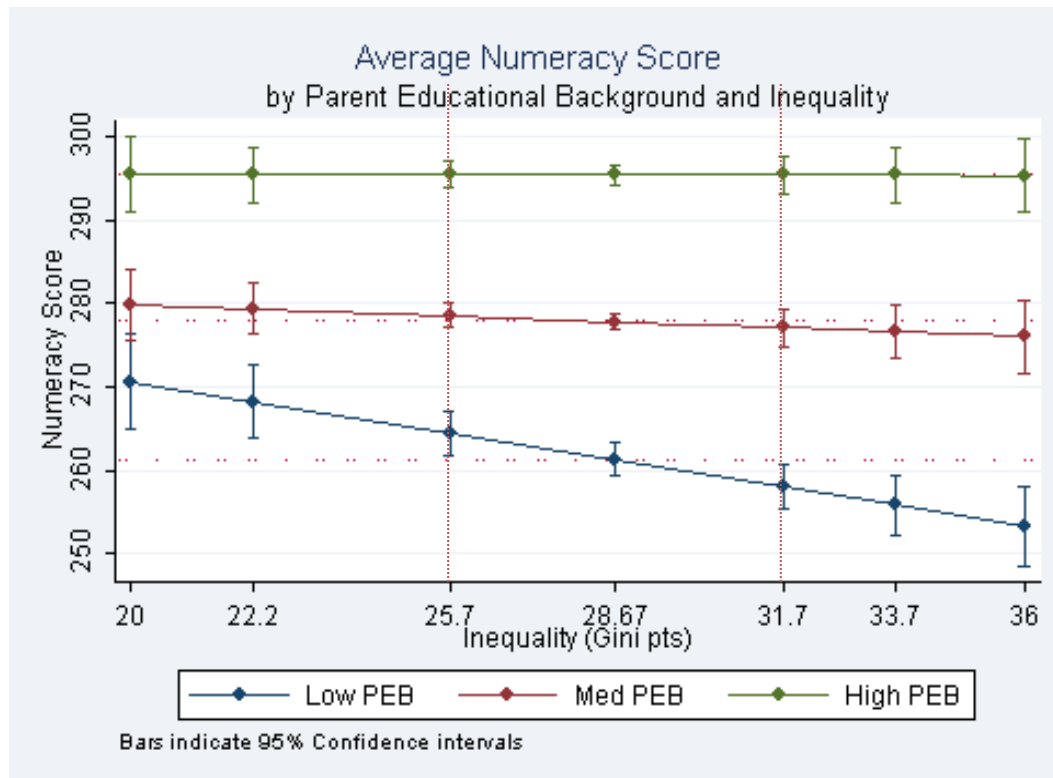
→ Increasing inequality by ~6 Gini pts. lowers AYS by almost 0.5 years (around 50% of the baseline differential in AYS between Low and Medium PEB individuals)

Note: Low PEB: neither parent has attained upper secondary education; Medium PEB: at least one parent has attained secondary and post-secondary, non-tertiary education; High PEB: at least one parent has attained tertiary education. The bars indicate 95% confidence intervals.



2. The impact of inequality on skills proficiency

Inequality lowers (literacy and numeracy) skills of the poor



Increasing inequality by ~6 Gini pts. lowers Numeracy score by ~ 6 pts (nearly 40% of the baseline differential between Low and Medium PEB individuals)



Policy implications

- The rationale for addressing the long-term rise in inequality is not only a social or political one: policies that help to limit or reverse inequality may not only make societies less unfair, but also wealthier.
- Anti-poverty programmes will not be enough. Policymakers need to be concerned about how the lower-middle classes fare more generally, as these are at risk of failing to benefit from (and contribute to) the recovery and future growth,
- Not only cash transfers but also increasing access to public services, such as high-quality education, training and healthcare, constitute long-term social investment to create greater equality of opportunities in the long run.



THANK YOU