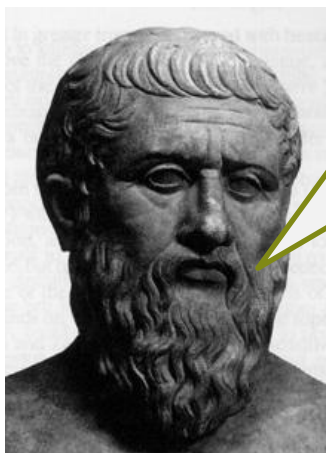


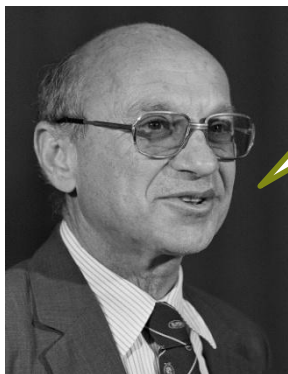
Income inequality: trends, causes and trade-offs

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

Plato 360 BCE



A society that puts equality before freedom will get neither

Milton Friedman 1980



Maybe this idea of idealizing this outcome of 'Maybe one day you too can be a billionaire and earn more than millions of families combined' is not an aspirational or good thing

Alexandria Ocasio-Cortez 2019

I do not think that equality is one of those things (like wisdom or happiness) which are good simply in themselves and for their own sakes



C.S. Lewis 1943

I believe that virtually all the problems in the world come from inequality of one kind or another

Amartya Sen 2001



Key points

1. The equity-efficiency trade-off

- More equal outcomes come at the cost of a smaller economy
- This is not always the case: it depends on the cause of inequality

2. UK inequality far higher than in 1970s owing to surge in 1980s

- Consensus that increases mainly due to impact of technology

3. Since 1980s the richest 1% have pulled away from the rest

- Causes of this trend more ambiguous

The equity-efficiency trade-off

The equity-efficiency trade-off



**Boris Johnson
2013**

Some measure of inequality is essential for the spirit of envy... that is, like greed, a valuable spur to economic activity

The equity-efficiency trade-off

Intuition: higher inequality makes people work harder

- Relative gains of 'making it' and costs of 'falling behind' are greater
- Lower inequality → people exert less effort → smaller economy
- Evidence in favour: responses to changes in top rates of income tax

Caveat 1: trade-off doesn't apply in all circumstances

- Inequality can result from market failure e.g. uncompetitive markets
- Fixing the market failure = greater efficiency and lower inequality

Caveat 2: people may be willing to bear cost of smaller economy

- Balance between greater equality and higher income a political decision

Income inequality: trends and causes

Measuring inequality

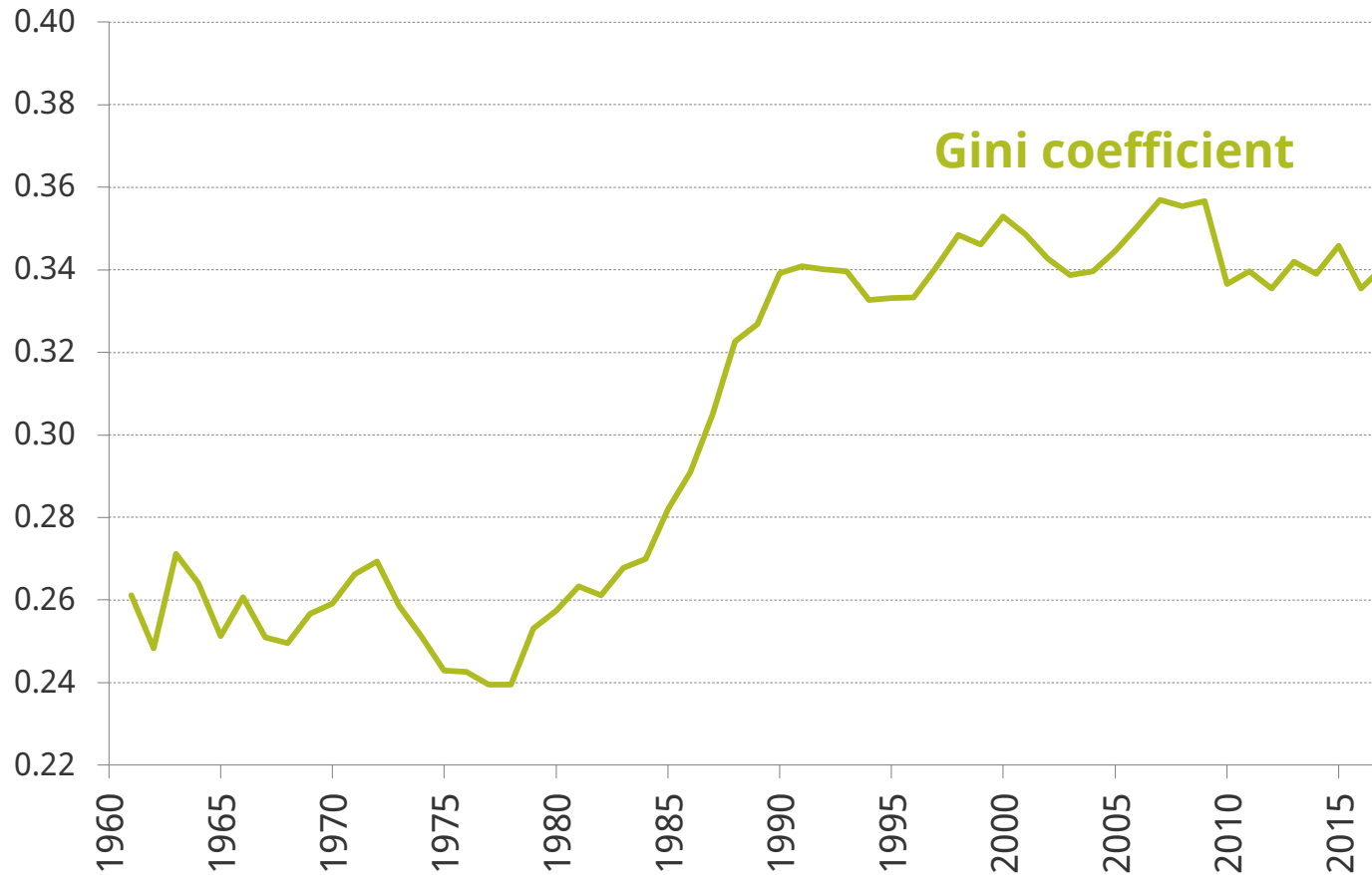
Focus on annual household income net of taxes and benefits

- An important determinant of material living standards
- Other outcomes also interesting (e.g. spending, wealth, health)

Consider two different measures of inequality

- The Gini coefficient incorporates the entire income distribution (0 = everyone has the same income, 1 = one person has all income)
- The top 1% share focuses on the very richest

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: Bourquin et al. (2019)

Income inequality in the UK

UK ineq. far higher than in 1970s owing to surge in the 1980s

- Increases also seen in other OECD countries but sharpest in US and UK

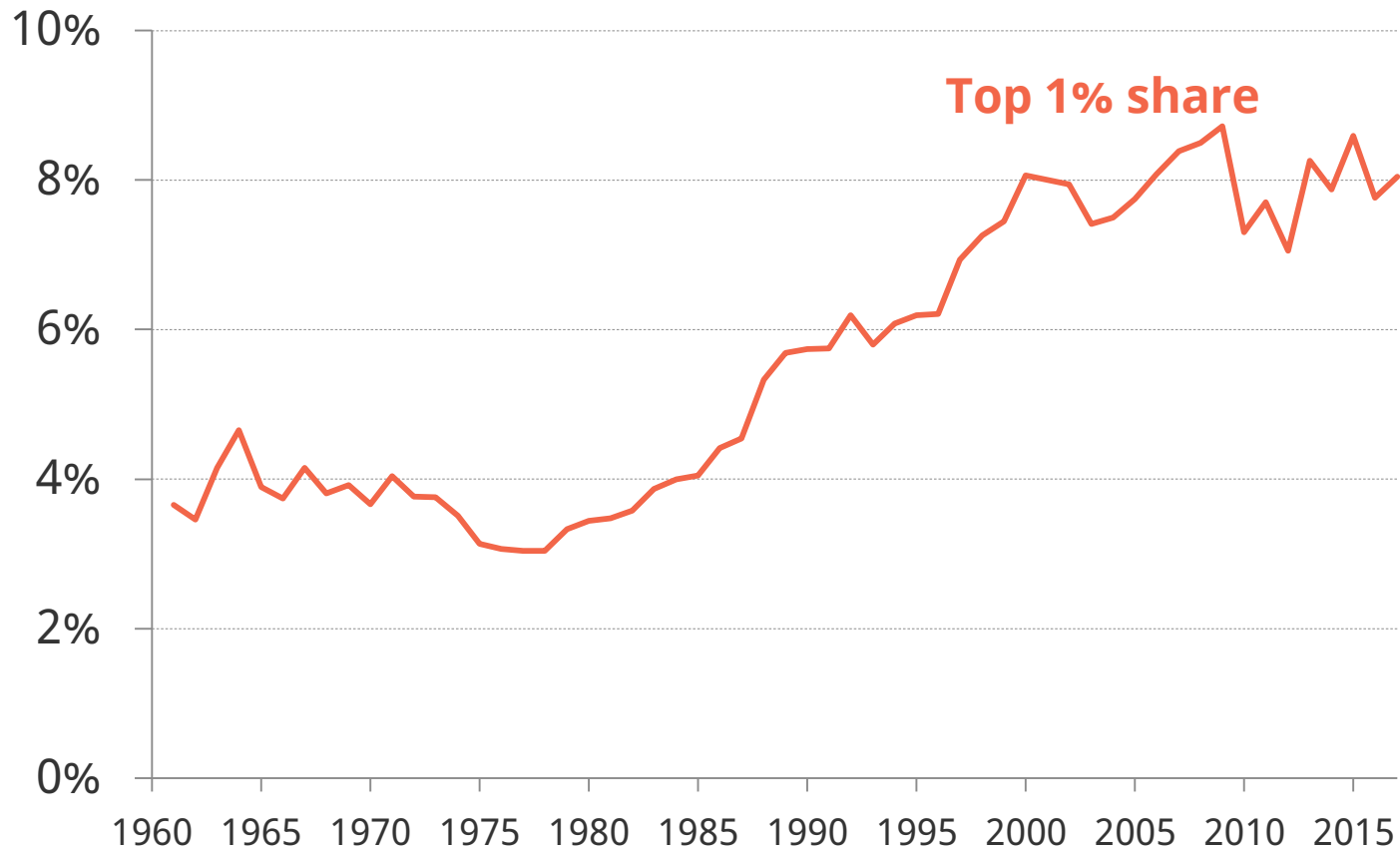
What happened in the 1980s?

- Technology = higher demand for educated workers + lower demand for skilled manual workers (Goldin & Katz 2007, Acemoglu & Autor 2011)
- Demand changes = increased pay inequality = increased income inequality
- Cuts in UK's top income tax rates also contributed (Adam & Browne 2010)

What's happened since the 1980s?

- Pulling away of the top 1% main reason inequality hasn't fallen

The rise of the top 1%



Note: Income is measured as total household income net of taxes and benefits and is adjusted for household size.
Source: Bourquin et al (2019)

The rise of the top 1%

Pulling away of top 1% observed in most countries

- Evidence supports different causes with different policy implications

Hypothesis 1: 'superstar' effects (Kaplan and Rauh, 2013)

- Technology has increased the size of markets
- Larger markets = greater incentives to secure most talented employees
- Pay of most talented increases relative to other workers

Hypothesis 2: rise in market power (De Loecker and Eeckhout, 2017)

- Product markets have become dominated by large firms
- Reduction in market competition causes firm profits to rise
- Highest-income people benefit most from higher profits

1. The equity-efficiency trade-off

- More equal outcomes come at the cost of a smaller economy
- This is not always the case: it depends on the cause of inequality

2. UK inequality far higher than in 1970s owing to surge in 1980s

- Increases also seen in other OECD countries but sharpest in US and UK
- Consensus that increases mainly due to impact of technology
- Policy changes in UK also had effect

3. Since 1980s the richest 1% have pulled away from the rest

- Pulling away of top 1% observed in most countries
- Evidence supports different causes with different policy implications

Inequalities in the 21st Century: the IFS Deaton Review



How are different kinds of inequality related, which matter most, what are the big forces that combine to create them, and what is the right mix of policies to tackle them?

- **An interdisciplinary panel of world leaders in economics, sociology, demography, philosophy, political science and epidemiology chaired by Nobel Laureate Sir Angus Deaton**
- **Initial research currently underway**
- **<https://www.ifs.org.uk/inequality/>**

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