Introduction

If you asked a typical person to list the major problems that the world faces today, the likelihood is that "inequality and poverty" would be one of the first things they mentioned. There is a widespread concern that economic growth is not being shared fairly. A poll by the BBC in February 2008 suggested that about two-third of the population in 34 countries thought that "the economic developments of the last few years" have not been shared fairly. In Korea, Portugal, Italy, Japan and Turkey, over 80% of respondents agreed with this statement.* There are many other polls and studies which suggest the same thing.

So are people right in thinking that "the rich got richer and the poor got poorer"? As is often the case with simple questions, providing simple answers is much harder. Certainly the richest countries have got richer and some of the poorest countries have done relatively badly. On the other hand, the rapid growth in incomes in China and India has dragged millions upon millions of people out of poverty. So whether you are optimistic or pessimistic about what is happening in the world to income inequality and poverty depends on whether you think a glass is half filled or half empty. Both are true.

Even if we could agree that the world was getting more unequal, it might not be because of globalisation alone. There are other plausible explanations – skill-biased technological change (so people who know how to exploit the internet gain, for example, and those who don't, lose) or changes in policy fashion (so unions are weaker and workers less protected than before) are other reasons why inequality might have been growing. All these theories have widely-respected academic champions. In all probability, all these factors play some role.

This report looks at the 30 developed countries of the OECD. It shows that there has been an increase in income inequality that has gone on since at least the mid-1980s and probably since the mid-1970s. The widening has affected most (but not all) countries, with big increases recently in Canada and Germany, for example, but decreases in Mexico, Greece and the United Kingdom.

But the increase in inequality – though widespread and significant – has not been as spectacular as most people probably think it has been. In fact, over the 20 years, the average increase has been around 2 Gini points (the Gini is the best measure of income inequality). This is the same as the current difference in inequality between Germany and Canada – a noticeable difference, but not one that would justify to talk about the breakdown of society. This difference between what the data shows and what people think no doubt partly reflects the so-called "*Hello* magazine effect" – we read about the super rich, who have been getting much richer and attracting enormous media attention as a result. The incomes of the super rich are not considered in this report, as they cannot be measured adequately through the usual data sources on income distribution. This does not mean

* See *www.worldpublicopinion.org/pipa/pdf/feb08/BBCEcon_Feb08_rpt.pdf*.

that the incomes of the super rich are unimportant – one of the main reasons why people care about inequality is fairness, and many people consider the incomes of some to be grotesquely unfair.

The moderate increase in inequality recorded over the past two decades hides a larger underlying trend. In developed countries, governments have been taxing more and spending more to offset the trend towards more inequality – they now spend more on social policies than at any time in history. Of course, they need to spend more because of the rapid ageing of population in developed countries – more health care and pensions expenditures are necessary. The redistributive effect of government expenditures dampened the rise in poverty in the decade from the mid-1980s to the mid-1990s, but amplified it in the decade that followed, as benefits became less targeted on the poor. If governments stop trying to offset the inequalities by either spending less on social benefits, or by making taxes and benefits less targeted to the poor, then the growth in inequality would be much more rapid.

The study shows that some groups in society have done better than others. Those around retirement age – 55-75 – have seen the biggest increases in incomes over the past 20 years, and pensioner poverty has fallen very rapidly indeed in many countries, so that it is now less than the average for the OECD population as a whole. In contrast, child poverty has increased, and is now above average for the population as a whole. This is despite mounting evidence that child wellbeing is a key determinant of how well someone will do as an adult – how much they will earn, how healthy they will be, and so on. The increase in child poverty deserves more policy attention than it is currently receiving in many countries. More attention is needed to issues of child development, to ensure that (as the recent American legislation puts it) no child is left behind.

Relying on taxing more and spending more as a response to inequality can only be a temporary measure. The only sustainable way to reduce inequality is to stop the underlying widening of wages and income from capital. In particular, we have to make sure that people are capable of being in employment *and* earning wages that keep them and their families out of poverty. This means that developed countries have to do much better in getting people into work, rather than relying on unemployment, disability and early retirement benefits, in keeping them in work and in offering good career prospects.

There are a number of objections that people might make in response to the previous paragraphs. They might, for example, point to the following considerations:

- What matters is not just income. Public services such as education and health can be powerful instruments in reducing inequality.
- Some people who have low incomes nevertheless have lots of assets, so they should not be considered poor.
- We should not care unduly about poverty at a point in time – only if people have low incomes for a long period are they likely to be seriously deprived.
- A better way of looking at inequality is seeing if people are deprived of key goods and services, such as having enough food to eat, or being able to afford a television or a washing machine.
- A society in which income was distributed perfectly equally would not be a desirable place either. People who work harder, or are more talented than others, should have more income. What matters, in fact, is *equality of opportunity,* not equality of outcomes.

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This study addresses all these issues directly – or, to be more accurate, it considers the empirical evidence for each of the statements, not the normative issues of what is and what is not a "good" society. In short, the comparative evidence in this report reveals a number of "stylised facts" pertaining to: *i)* the general features characterising the distribution of household income and its evolution; *ii)* the factors that have contributed to changes in income inequality and poverty; and *iii)* what can be learned by looking at broader measures of household resources.

Features characterising the distribution of household income in OECD countries

- Some countries have much more unequal income distributions than others, regardless of the way in which inequality is measured. Changes in the inequality measure used generally have little effect on country rankings.
- Countries with a wider distribution of income also have higher relative income poverty, with only a few exceptions. This holds regardless of whether relative poverty is defined as having income below 40, 50 or 60% of median income.
- Both income inequality and the poverty headcount (based on a 50% median income threshold) have risen over the past two decades. The increase is fairly widespread, affecting two-thirds of all countries. The rise is moderate but significant (averaging around 2 points for the Gini coefficient and 1.5 points for the poverty headcount). It is, however, much less dramatic than is often portrayed in the media.
- Income inequality has risen significantly since 2000 in Canada, Germany, Norway, the United States, Italy, and Finland, and declined in the United Kingdom, Mexico, Greece and Australia.
- Inequality has generally risen because rich households have done particularly well in comparison with middle-class families and those at the bottom of the income distribution.
- Income poverty among the elderly has continued to fall, while poverty among young adults and families with children has increased.
- Poor people in countries with high mean income and a wide income distribution (*e.g.* the United States) can have a lower living standard than poor people in countries with lower mean income but more narrow distributions (Sweden). Conversely, rich people in countries with low mean incomes and wide distributions (Italy) can have a higher living standard than rich people in countries where mean income is higher but the income distribution is narrower (Germany).

Factors that have driven changes in income inequality and poverty over time

- Changes in the structure of the population are one of the causes of higher inequality. However, this mainly reflects the rise in the number of single-adult households rather than population ageing *per se*.
- Earnings of full-time workers have become more unequal in most OECD countries. This is due to high earners becoming even more so. Globalisation, skill-biased technical change and labour market institutions and policies have all probably contributed to this outcome.

- The effect of wider wage disparities on income inequality has been offset by higher employment. However, employment rates among less-educated people have fallen and household joblessness remains high.
- Capital income and self-employment income are very unequally distributed, and have become even more so over the past decade. These trends are a major cause of wider income inequalities.
- Work is very effective at tackling poverty. Poverty rates among jobless families are almost six times higher than those among working families.
- However, work is not sufficient to avoid poverty. More than half of all poor people belong to households with some earnings, due to a combination of low hours worked during the year and/or low wages. Reducing in-work poverty often requires in-work benefits that supplement earnings.

Lessons learned by looking at broader measures of poverty and inequality

- Public services such as education and health are distributed more equally than income, so that including these under a wider concept of economic resources lowers inequality, though with few changes in the ranking of countries.
- Taking into account consumption taxes widens inequality, though not by as much as the narrowing due to taking into account public services.
- Household wealth is distributed much more unequally than income, with some countries with lower income inequality reporting higher wealth inequality. This conclusion depends, however, on the measure used, on survey design and the exclusion of some types of assets (whose importance varies across countries) to improve comparability.
- Across individuals, income and net worth are highly correlated. Income-poor people have fewer assets than the rest of the population, with a net worth generally about under half of that of the population as a whole.
- Material deprivation is higher in countries with high relative income poverty but also in those with low mean income. This implies that income poverty underestimates hardship in the latter countries.
- Older people have higher net worth and less material deprivation than younger people. This implies that estimates of old-age poverty based on cash income alone exaggerate the extent of hardship for this group.
- The number of people who are *persistently* poor over three consecutive years is quite small in most countries, but more people have low incomes at some point in that period. Countries with high poverty rates based on annual income fare worse on the basis of the share of people who are persistently poor or poor at some point in time.
- Entries into poverty mainly reflect family- and job-related events. Family events (*e.g.* divorce, child-birth, etc.) are very important for the temporarily poor, while a reduction in transfer income (*e.g.* due to changes in the conditions determining benefit eligibility) are more important for those who are poor in two consecutive years.
- Social mobility is generally higher in countries with lower income inequality, and *vice versa* . This implies that, in practice, achieving greater equality of opportunity goes hand-in-hand with more equitable outcomes.

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The report leaves many questions unanswered. It does not consider whether more inequality is inevitable in the future. It does not answer questions on the relative importance of various causes of the rise in inequality. It does not even answer in any detail the question as to what developed countries should do to tackle inequality. But it does show that some countries have had smaller rises – or even falls – in inequality than others. It shows that the reason for differences across countries are, at least in part, due to different government policies, either through more effective redistribution, or better investment in the capabilities of the population to support themselves. The key policy message from this report is that – regardless of whether it is globalisation or some other reason why inequality has been rising – there is no reason to feel helpless: good government policy can make a difference.

The volume is organised as follows:

Chapter 1, which constitutes the first part of this report, describes levels and trends in income inequality among people based on a measure of household cash income adjusted for differences in economic needs across households.

The second part of the report looks in more detail at some of the main drivers of these trends in income inequality, focusing on the role of population ageing and of changes in living arrangements (Chapter 2); earnings inequality among workers, and the distribution of employment opportunities among households (Chapter 3); and government redistribution through the taxes that they collect from households and the cash transfers that they provide to them (Chapter 4).

The third part of the report focuses on the conditions of people living in poverty, in particular on the features of the lower tail of the distribution of cash income (Chapter 5); on the extent to which spells of low income last over time (Chapter 6); and on measures of poverty based on people's access to the goods and amenities needed to enjoy an acceptable standard of living (Chapter 7).

The fourth part of the report assesses how OECD countries compare when looking at additional dimensions of economic inequality, namely, at how they are passed on from parents to their offspring (Chapter 8); at the extent to which differences in cash income are reduced by publicly-provided in-kind services (Chapter 9); and at whether households with low income also experience low levels of net worth (Chapter 10).

Chapter 11 provides an overview of some of the main conclusions drawn from the previous chapters, and discusses their implications for policies aimed at narrowing income inequality and poverty.

The OECD will pursue its work on these themes in the years ahead. It will continue to monitor trends in income inequality and poverty in member countries; it will work to improve data comparability and to extend country coverage to both "accession countries" (Chile, Estonia, Israel, Russia and Slovenia) and to countries that have started a process of "enhanced engagement" with the Organisation (Brazil, China, India, Indonesia and South Africa); it will deepen its understanding of the determinants of the observed trends in inequality; and, it will pursue its analysis to understand what policies can do to moderate inequality and promote greater equality of opportunity.

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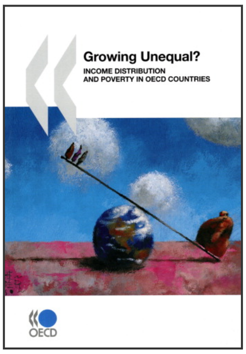

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