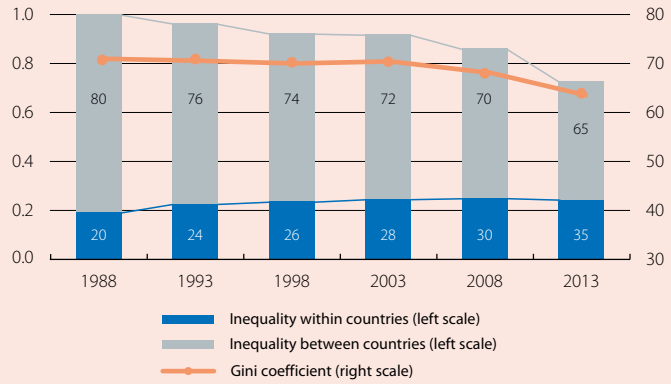
THE CONSEQUENCES OF INEQUALITY

Increasingly unequal? The recent trend in inequality

Adam Smith said that «No society can surely be flourishing and happy, of which the far greater part of the members are poor and miserable».[1] As on so many other occasions, the father of modern economics was quite right with this intuition: as confirmed by various contemporary studies, an extreme degree of inequality is not compatible with a prosperous society.[2] It is therefore crucial to determine whether the recent trend points to inequality moving in a worrying direction. Such is the aim of this article.

Global inequality (1988-2013)

(Mean log deviation) *(Gini coefficient)*



Note: *The orange line (right scale) shows the Gini coefficient of global income distribution. The height of the bars indicates the global level of inequality measured by the mean log deviation of income (left scale). The blue bars represent inequality within each country, weighted by population. The grey bars show the level of inequality between countries. The numbers correspond to the relative contribution (as a percentage) of these two sources to total global inequality.*
Source: *CaixaBank Research, based on data from the World Bank, 2016, «Taking on inequality».*

Before starting our analysis *per se*, we first need an accurate definition and measurement of inequality. In this article, and as is customary in economics literature, we will analyse the inequality of net income; i.e. the income remaining after paying taxes and receiving any social transfers.[3] Regarding measurement, the Gini coefficient will be used, which calculates the distribution of income among the whole population. This index ranges from zero (perfect income equality between individuals) to 100 (maximum inequality, when one individual has all the income), summarising the overall income distribution inequality in a single figure. This is a simple measure but suitably encapsulates a society's degree of inequality: if inequality is extreme the Gini coefficient will reflect this situation.[4]

A first level of analysis is inequality at a global level. When we analyse the inequality between all the world's inhabitants, we can see this has decreased in the last three decades: between 1988 and 2013 the global Gini coefficient fell by more than 7 pps, a drop that became sharper as from 2008.[5] This considerable reduction in inequality was mainly due to the convergence of incomes between the different countries, a process which, in turn, results largely from the fast growth seen by heavily populated emerging countries such as China, India and Indonesia. Although we certainly cannot consider the current level of global inequality to be low, it is nevertheless slightly less than the level a few decades ago and is therefore further from being extreme than in the past.

Let us now look at the situation in the more prosperous countries. One frequent comment in public debates is that inequality has become worse due to the severe economic shock of 2008-2009, the Great Recession, which, as we all know, was further aggravated by a second drop in GDP in most European countries in 2012-2013. However, the OECD's calculations of the Gini coefficient for different advanced countries show moderate growth between 2008 and 2013. Might the Gini coefficient be too general a measure of inequality in this case? Probably not, as other measurements also used by the OECD, such as the poverty rate and income shares of the top and bottom 20% of earners (see the definition in the enclosed table) also point in this direction. This is also the case of another measure which is often mentioned in the more publicised debates on this issue, obtained by calculating the percentage of a country's income that is in the hands of the top 1% of the population with the highest earnings.[6] Since these analyses suggest that the Great Recession was not an evident cause of any radical change in advanced economies, perhaps we need to broaden our timescale. However, using data since the year 2000, the essential conclusion remains the same: in the advanced countries in question, the degree of inequality measured by the Gini coefficient, and by the other indicators already

1. See Adam Smith, (1776), «The Wealth of Nations», Book I, Chapter 8: Of the wages of labour.
2. See, for example, IMF (2015), «Causes and Consequences of Income Inequality: A Global Perspective», IMF Staff Discussion Notes No. 15/13.
3. Inequality in gross income is much greater as progressive taxation and the Welfare State reduce inequality significantly, particularly in developed countries.
4. On other complementary measures of inequality, see Atkinson, A. and Brandolini, A. (2010), «On Analyzing the World Distribution of Income», The World Bank Economic Review, vol. 24, no. 1.
5. World Bank (2016), «Poverty and Shared Prosperity 2016: Taking on Inequality», Washington, D. C.
6. Estimated based on data that use information from income tax records rather than using data from household surveys, which tend to underestimate the income of the 1% of the population with the highest earnings.

Indicators of household income distribution and poverty rate by country

	Gini coefficient			S80/S20 income share ratio (%)			Poverty rate (%)		
	2000 *	2008	2013 **	2000 *	2008	2013 **	2000 *	2008	2013 **
US	35.7	37.8	38.9	6.9	7.7	8.2	23.6	24.4	24.6
UK	35.2	34.2	34.1	5.9	5.8	5.6	19.0	18.3	17.2
Spain	33.2	32.7	34.5	6.0	5.8	6.7	21.3	20.9	22.6
France	28.7	29.3	30.9	4.2	4.3	4.7	13.8	13.5	14.5
Germany	26.4	28.7	29.3	3.9	4.2	4.4	12.5	14.3	15.0

Notes: ** Data from 2000 or the latest available. ** Data from 2013 or the latest available. The S80/S20 income share ratio refers to the ratio of average income of the top 20% to the average income of the bottom 20% of the income distribution. The poverty rate corresponds to the percentage of individuals with an income below 50% of the median disposable income.*
Source: *CaixaBank Research, based on data from the OECD Income* Distribution Database.

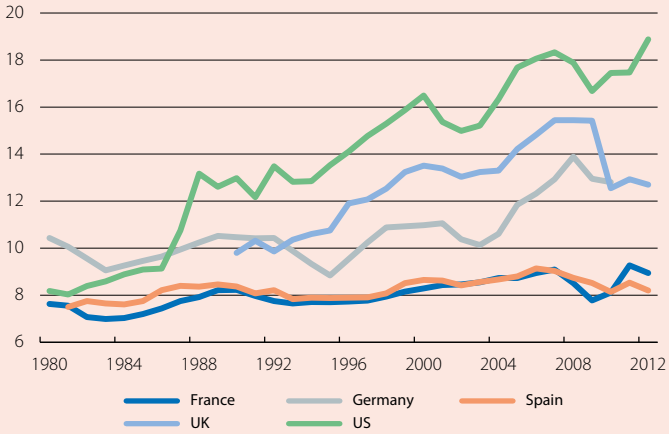
mentioned, has only increased to a moderate extent, albeit with two important exceptions: one we already know about, namely the US, while the other is perhaps more surprising, that of Germany.

In the case of Spain, and always based on the OECD figures which allow for an international comparison, the increase in inequality after the Great Recession has been somewhat more severe, as shown by the Gini coefficient, the income distribution between the 20% highest earners and the 20% bottom earners and also the poverty rate for the population.[7] A large part of this increase in inequality can be explained by the slump in employment: around 75% of the increased inequality in income from labour during the economic crisis was due to the rise in unemployment.[8] The current recovery in the labour market will therefore reduce inequality, although it is important for the Welfare State, which has played an important role in cushioning the effects of the crisis, to continue the work it has been carrying out in the recovery.

To sum up, these analyses suggest that the recent trend in inequality does not point to the overall situation getting worse in this area: at a global level inequality has tended to decrease and only in some countries is there an unquestionable trend towards greater inequality, particularly in the US, which is a case plagued with idiosyncratic aspects that would require a detailed individual analysis. Nevertheless, this does not mean we should become complacent about inequality as its impact in economic terms is potentially significant on a number of economic and political fronts: as we will see in the next articles, it can directly affect economic growth (see the article «How does inequality affect economic growth?» in this Dossier) and, indirectly, the rise in populism (see the article «Inequality and populism: myths and truths» in this Dossier) and the distribution of wealth (see the article «Can inequality cause a financial crisis?» in this Dossier).

Income of the top 1% highest earners

(% of total income)



Note: *Share of total income of the top 1% of the population with the highest earnings.*
Source: *CaixaBank Research, based on data from The World Wealth and Income Database.*

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7. OECD (2016), «Income inequality remains high in the face of weak recovery», Income inequality update (November 2016).
8. OECD (2015), «In It Together? Why Less Inequality Benefits All», OECD Publishing, Paris.