Aspects of the Economics of Inequality
Inequality is a knotty subject. There is little agreement on what ought to be equal. Should it be a measurable outcome such as income or wealth; a hazier outcome such as power or freedom; or a vague aspiration such as “equality of opportunity”?

It is often said that the world is becoming more unequal. But it is less than clear what is meant by that.

Income inequality between countries has grown over the past three centuries but it may now be narrowing between the world’s people as a whole. (FT 11-10-13)
Why has growth in many countries been unequal?

- Widening dispersion in wages and earnings in different occupations

- A growing share of profits being saved by corporations and re-distributed in the form of capital gains rather than interest or dividends

- Tax systems have become less progressive + Welfare cuts

- Fall in trade union membership and worker bargaining power in many countries

- Regressive effects of high inflation – e.g. food prices hitting poorer families

- Executive pay and bonuses rising much faster than for ordinary employees
### High and Low Pay in the UK Labour Market

<table>
<thead>
<tr>
<th>Highest paid occupations in 2014</th>
<th>£s</th>
<th>Lowest paid occupations in 2014</th>
<th>£s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aircraft pilots and flight engineers</td>
<td>1,746</td>
<td>Bar staff</td>
<td>254</td>
</tr>
<tr>
<td>Air traffic controllers</td>
<td>1,549</td>
<td>Waiters and waitresses</td>
<td>258</td>
</tr>
<tr>
<td>Chief executives and senior officials</td>
<td>1,533</td>
<td>Dry cleaners and pressers</td>
<td>259</td>
</tr>
<tr>
<td>Marketing and sales directors</td>
<td>1,298</td>
<td>Hairdressers and barbers</td>
<td>269</td>
</tr>
<tr>
<td>Advertising and public relations directors</td>
<td>1,289</td>
<td>Kitchen and catering assistants</td>
<td>268</td>
</tr>
<tr>
<td>Information technology and telecommunications directors</td>
<td>1,226</td>
<td>Leisure and theme park attendants</td>
<td>273</td>
</tr>
<tr>
<td>Legal professionals</td>
<td>1,217</td>
<td>Retail cashiers and check-out operators</td>
<td>279</td>
</tr>
<tr>
<td>Medical practitioners</td>
<td>1,167</td>
<td>Other elementary services occupations</td>
<td>280</td>
</tr>
<tr>
<td>Brokers</td>
<td>1,149</td>
<td>Nursery nurses and assistants</td>
<td>285</td>
</tr>
<tr>
<td>Financial managers and directors</td>
<td>1,143</td>
<td>Cleaners and domestics</td>
<td>286</td>
</tr>
</tbody>
</table>
The Gini Coefficient and the Lorenz Curve

The Gini Coefficient is defined as:

\[
\text{Gini Coefficient} = \frac{\text{Area } A}{\text{Area } A + \text{Area } B}
\]

The closer the Gini Coefficient is to 1, the higher the degree of inequality.
Is Rising Inequality Inevitable with Development?

The Kuznets Curve

- **Gini Coefficient (Inequality)**
- **Industrialization and urbanization**
- **Tertiary-dominated economy + development of progressive tax and welfare systems**

Per capita GNI (PPP)
Changing Inequality in the UK

Economic Inequality in the United Kingdom

- Earnings
- Overall Inequality
- Poverty
- Top Income Shares
- Wealth

Gini - after tax income of tax units
Gini - equiv household disposable income
Share of top 1 per cent in total wealth
Share living in households below 60% median
Share of top 1 per cent in gross income
Share of top 0.1 per cent in gross income

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Rising Inequality in Many Countries

Gini index in the 90s and 00s*

Source: BBVA Research, WB, OECD

*As continuous data for the Gini index is not available, averages are computed around the starting (1986-1990) and ending point (2006-2010)
Evidence on Inequality for Developing Countries

**GDP per capita (constant PPP-adjusted USD) and GINI index* (1980-today)**

*Estimations and forecasts using data from the World Bank*
The Gini Coefficient has been falling in China

Inequality of income distribution in China based on the Gini index 2004-2014

Gini index: inequality of income distribution in China from 2004 to 2014

<table>
<thead>
<tr>
<th>Year</th>
<th>Gini Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>47.3</td>
</tr>
<tr>
<td>2005</td>
<td>48.5</td>
</tr>
<tr>
<td>2006</td>
<td>48.7</td>
</tr>
<tr>
<td>2007</td>
<td>48.4</td>
</tr>
<tr>
<td>2008</td>
<td>49.1</td>
</tr>
<tr>
<td>2009</td>
<td>49</td>
</tr>
<tr>
<td>2010</td>
<td>48.1</td>
</tr>
<tr>
<td>2011</td>
<td>47.7</td>
</tr>
<tr>
<td>2012</td>
<td>47.4</td>
</tr>
<tr>
<td>2013</td>
<td>47.3</td>
</tr>
<tr>
<td>2014</td>
<td>46.9</td>
</tr>
</tbody>
</table>
Does Inequality Harm Economic Growth?

**Causes a self-perpetuating poverty cycle**
- Limited access to health care and education
- Volatile incomes, high debts + low savings

**Misallocation of scarce resources**
Capital investment in society is skewed towards the preferences of the rich
- Low collateral – limits growth of entrepreneurship

**Social and political unrest / tensions**
- Increased pressure on state welfare systems
- Rise of the informal economy + high interest rate loans (e.g. doorstep lenders)
Does Inequality Harm Economic Growth?

New OECD analysis suggests that income inequality has a negative and statistically significant impact on medium-term growth.

Rising inequality by 3 Gini points, that is the average increase recorded in the OECD over the past two decades, would drag down economic growth by 0.35 percentage point per year for 25 years: a cumulated loss in GDP at the end of the period of 8.5 per cent.

Source: OECD, December 2014
“Excessive inequality makes capitalism less inclusive. It hinders people from participating fully and developing their potential.”

“IMF research—which looked at 173 countries over the last 50 years—found that more unequal countries tend to have lower and less durable economic growth.”
Justifying a certain level of inequality

• To encourage competition and effort among workforce
• Incentivizes risk-taking behavior, incentives to invest in education
• In poor economies, inequality also helps to build up demand for certain consumer goods that require a minimum purchasing power (e.g. cars, household appliances).
Inclusive Development / Growth Policies

Human Capital Investment
- Improving school enrolment rates + quality of teaching
- Affordable early years education / childcare
- Access to higher education + vocational education

Inclusive Pro-Poor Growth Policies
- Raising basic incomes for people
- Conditional cash transfers as part of welfare
- Productivity improvements to boost real incomes / wages

Other policies designed to improve incentives & affordability
- Small scale loans, gender empowerment
- Micro-insurance to help poorest farmers
- Businesses prepared to pay the living wage and above
- Consideration of caps on executive pay
- Improved and cheaper access to infrastructure / housing
Campaign for living wage remains topical

Paying the London Living Wage is not only morally right, but makes good business sense too. There are now over 2,200 employees working for companies with contracts from the GLA who are benefitting from the London Living Wage.

Boris Johnson, Mayor of London
Campaign for living wage remains topical

National living wage compared to national minimum wage (21 years and over) in the UK from 2011 to 2014 (in £ per hour)

<table>
<thead>
<tr>
<th>Year</th>
<th>Living wage</th>
<th>Minimum wage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>7.2</td>
<td>6.08</td>
</tr>
<tr>
<td>2012</td>
<td>7.45</td>
<td>6.19</td>
</tr>
<tr>
<td>2013</td>
<td>7.65</td>
<td>6.31</td>
</tr>
<tr>
<td>2014</td>
<td>7.85</td>
<td>6.5</td>
</tr>
</tbody>
</table>
• Return to a more progressive rate structure for the personal income tax, with a top rate of 65% on the top 1% of incomes.
• Government should offer guaranteed employment at the living wage to everyone who seeks it.
• Government via National Savings should return to offering a guaranteed positive (and possibly subsidised) real rate of interest on savings, up to a maximum per person.
• Reduce market power in consumer markets
“There is probably no silver bullet, one needs to learn from experience what has worked and what has not worked, and what problem what solutions can and cannot fix.”

Esther Duflo, author of Poor Economics
The Economics of Inequality